A CRITICAL ANALYSIS OF THE SOUTH AFRICAN TURNOVER TAX SYSTEM

Submitted in (partial) fulfilment of the requirements for the degree of

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ABSTRACT

The objective of the turnover tax system is to reduce the administrative burden on micro businesses and to contribute positively to boosting these businesses and the economic growth of South Africa. The over-arching goal of this research was to analyse the South African turnover tax to investigate to what extent the turnover tax system complies with generally accepted principles of a good tax system. The research was conducted within an interpretative post-positivism paradigm, applied a qualitative research methodology, and a doctrinal research method. A detailed review of the literature was conducted to establish the nature of South African turnover tax system and the extent of its compliance with generally accepted principles of a good tax system. The literature review included an in-depth analysis of the South African turnover tax system, an in-depth analysis of generally accepted principles of a good tax system, and an investigation of the extent to which turnover tax system complies with various elements of the principles of a good tax system.

It was found in this study that the turnover tax system does not comply with certain of the elements of generally accepted principles of a good tax system and the study proposed several recommendations for the improvement of the turnover tax system. These recommendations include the establishment of training initiatives for micro business owners, reviewing the regulations pertaining to turnover tax and providing digital administration of turnover tax.

KEYWORDS: Taxation, South African turnover tax, micro businesses, generally accepted principles of a good tax system

DECLARATION

I, **Samuel John Chiromo**, declare that the work presented in this thesis is original. It has never been presented to any other University or Institution. Where other people's works have been used, references have been provided. It is in this regard that I declare this work as originally mine. It is hereby presented in partial fulfilment of the requirements for the award of the Degree of Master of Commerce (Taxation).

SIGNED……………………………………………………………..

DATE: **17th July, 2020**

DEDICATION

This dissertation is dedicated to my son, **Gregory Chiromo** and my daughter, **Florence Chiromo**. May God protect and give them a prosperous life.

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I would like to take this opportunity to express my gratitude to God for providing me with academic strength that I utilised to complete this master's degree. I would also like to convey my gratitude to the following individuals for their contribution towards the successful completion of my studies:

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- My late father, Mr John Chiromo who used to say, "Never cease in educating yourself as that is where your bright future lies." May his soul rest in peace.
- My wife, Grace, my son, Gregory and my daughter, Diana for their patience, love and support.
- My friends, for encouraging and supporting me on this academic journey.
- May the blessings and love of the good Lord be bestowed upon you All!

'Learning is a treasure that will follow its owners everywhere' – Chinese Proverb

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CHAPTER ONE: INTRODUCTION

1.1 Research context

The South African Income Tax Act, no. 58 of 1962 (the Income Tax Act), is the governing statute for taxes such as income tax, donations tax, the withholding taxes, capital gains tax, and the turnover tax. The present study will concentrate on the turnover tax which was introduced into the Income Tax Act in 2009 to reduce the administrative burden on micro businesses and to contribute positively both to boosting these businesses and to the economic growth of South Africa (South African Revenue Service (SARS), 2017:8; Labuschagne, 2018:2).

According to paragraph 2 of the Sixth Schedule to the Income Tax Act (the Sixth Schedule), a micro business is one that has not been disqualified from using the turnover tax system and whose "qualifying turnover" has not exceeded R1 million during the year of assessment. In terms of paragraph 1 of the Sixth Schedule the term "qualifying turnover" means "the total receipts derived by an individual from carrying on business activities, excluding any (a) amount of a capital nature; and (b) amount exempt from normal tax in terms of section 10(1)(zK) or 12P". This means any capital amount, for example that received from the sale of equipment used in the business, is excluded from "qualifying turnover". Also excluded are any amounts received from a small business funding entity which are exempt from income tax under section 10(1)(zK) of the Income Tax Act, or government grants which are exempt from income tax under section 12P of that Act. According to paragraph 8 of Schedule 1 to the Rates and Monetary Amounts and Amendment of Revenue Laws Act, no. 32 of 2019, turnover tax is levied at rates that vary from 0% to 3%, depending on the taxable turnover of the micro business.

Paragraph 3 of the Sixth Schedule lists a number of disqualifications from registering for the turnover tax. These disqualifications include holding any shares or any interest in the equity of another business (other than those referred to in paragraph 4), where more than 20% of the total receipts, during a specific year of assessment, consist of income from the rendering of a professional service (if the person is a natural person) or earning investment income and income from the rendering of a professional service (if the business is defined as a company). Personal service providers and labour brokers are also disqualified. In addition to the R1

million turnover limitation, there is a limit on the allowable amount of proceeds from the disposal of business assets, which may not exceed R1.5 million over the current and previous two years of assessment. It is submitted that these disqualifications exclude many small businesses from the turnover tax system.

SARS (2018:1) claims that turnover tax is characterised by its simplicity, in that it requires no dividends tax, no provisional tax, no capital gains tax (CGT), no income tax, and no expensive record-keeping. According to Stein (2016:4) and Gluckman and Turner (2018:4), these claims lack substantiation. Stein (2009:2) points out that SARS's claim that micro businesses do not pay dividends tax is a fallacy because section 64F(1)(*h*) of the Income Tax Act provides that, only to the extent to which a dividend does not exceed R200 000 per annum, no dividends tax is payable.

Olla (2016:4) and Rahim (2015:21) state that SARS has attempted to simplify the requirements to qualify as a micro business, but many small businesses still fall outside this net. Lindeque (2012:18) adds that South African turnover tax concepts may be difficult for the micro business owner to understand in that most micro business owners do not have tax expertise or tax skills. For instance, the definition of "qualifying turnover" in paragraph 1 of the Sixth Schedule refers to concepts such as "the total receipts", "from carrying on business activities", and "excluding any amount of a capital nature", none of which are defined in the Income Tax Act.

The Tax Guide for Micro Business (SARS:2017:26) states that a micro business may choose to register for Value-Added Tax (VAT) if it meets the requirements for voluntary registration under section 23(a) of the Value-Added Tax Act, no. 89 of 1991, in order to access the benefits that both turnover tax and VAT tax systems offer. Generally it may be advantageous for a micro business to register voluntarily for VAT if it supplies goods or services to customers who are registered VAT vendors and who may therefore be able to deduct the VAT charged by the micro business as input tax. A micro business, however, must be mindful of the complexity of maintaining both turnover tax and VAT systems and these may result in high compliance costs. It can be concluded, therefore, that the SARS claim that no VAT registration is required for micro business and that this represents a benefit is possibly misleading.

SARS (2009:1) also claims that record-keeping is reduced to the minimum in the turnover tax system which means that record keeping systems are rudimentary. But the reality is that,

according to paragraph 14(a)-(d), these businesses are obliged to retain records for all the amounts received during the year of assessment, the dividends declared, their assets costing more than R10 000, and their liabilities exceeding this amount. Although possibly less onerous than the record-keeping requirements of other businesses, record-keeping for micro businesses is not that simple.

Section 10(1)(zJ) of the Act exempts from normal tax all registered micro businesses carrying on business in the Republic, yet individuals who own micro businesses and earn investment income do not qualify for this exemption. Stein (2016:10) explains that, where a natural person is registered as a micro business and derives investment income and remuneration, as well as turnover which is subject to the turnover tax in a particular year of assessment, he or she is likely to be issued with two tax assessments for that year: one assessment for turnover tax and the other a normal tax assessment for investment income and remuneration. This creates another burden for natural persons registered as micro businesses as they must account both for turnover tax and normal tax for a specific year of assessment.

The claim by SARS (2009:9) that micro businesses registered for turnover tax do not pay CGT is also misleading. According to paragraph 6(a) of the Sixth Schedule, micro businesses have to include 50% of the receipts derived from the disposal of capital assets used for business purposes in their taxable turnover even if these are disposed of at a loss (Olla, 2016:61), as a result of which the turnover tax on the disposal of assets may be greater than the CGT that would otherwise be payable had the micro business not been registered for turnover tax; this is dependent on the capital gain in respect of the asset disposed of and also whether an individual or a company is trading as a micro business or not.

Stein (2016:10) explains furthermore that another misleading claim by SARS relating to the turnover tax is that micro businesses registered for turnover tax do not pay provisional tax. Paragraph 11(1) to (4) of the Sixth Schedule makes it clear that all micro businesses are liable for two interim payments per year of assessment, as is the case with provisional tax. Similar administrative sanctions apply if they are either submitted or paid late or if the estimated turnover tax has been underestimated. These payments are simply called “interim” payments. The Davis Tax Committee (2016:15) concurred: “the current Turnover Tax system allows for bi-annual payments on an elective basis . . .[t]his creates confusion and an additional administrative burden with no prospect of creating a meaningful revenue stream”, and it

recommended that "[a]ll taxation liability determined under the Turnover Tax system should be discharged by way of an annual declaration made on or before 31 May each year."

Willemse (2015:1) concludes that, although micro businesses are instrumental in the growth of the South African economy as a source of job creation and a counter to poverty, these businesses face many obstacles such as relatively high tax compliance costs relative to their turnover as a result of the generally high fixed costs associated with the systems that are necessary for compliance with the requirements of the tax system for micro businesses.

Possibly due to the difficulties recounted above there has been a low uptake and a small increase in businesses registered for turnover tax. Lindeque (2012:24) records that in September 2008 there were 400 000 businesses with a turnover of R1 million or less, but that, surprisingly, only 4 209 businesses were registered for turnover tax by the end of April 2009. According to the Davis Tax Committee Report (2016:13), there were 7 827 businesses registered for turnover tax, as of July 2013, 139 with addresses unknown, 59 dormant, 74 in estates, 345 inactive, and 49 suspended.

Although criticism has been levelled at the Sixth Schedule, in particular that it may result in a small tax liability when the taxpayer is in a loss position (Olla, 2016:61), the Davis Tax Committee Report (2016:14) is insistent that "it is important to emphasise that registration in terms of the Sixth Schedule is a voluntary election by the taxpayer. There is nothing to prohibit a taxpayer from registering as a sole trader and being subject to taxation at personal income tax rates."

It is such criticisms of the turnover tax system that prompt the need for a study that analyses the South African turnover tax system in order to determine whether this system complies with generally accepted principles of a good tax system. Kabinga, Alt and Kiprotich (2016:5) define generally accepted principles of a good tax system as those formal guidelines on taxation which are widely accepted and/or discussed and should be considered whenever specific tax laws are proposed, discussed, and implemented.

As early as in the 18th century, Adam Smith, in his *Wealth of Nations* (1776), formulated four tax principles or canons: equality, certainty, convenience, and economy. In the Davis Tax Committee Report (2016:14) Adam Smith's original tax principles were revised and expanded

into five principles: 1) efficiency: the tax system must produce sufficient income for the state; 2) equity: all residents must contribute to the fiscus in proportion to their ability to do so; 3) simplicity: taxes should be simple to understand and should be collected in a timely and convenient manner; 4) transparency and certainty: tax rules and procedures should be transparent and applied consistently, and 5) tax buoyancy: the tax system should raise sufficient revenue during all phases of the business cycle.

The present study is guided by the following research question: Does the South African turnover tax system comply with generally accepted principles of a good tax system?

1.2 Goals of the research

The over-arching goal of the present research is to analyse the South African turnover tax to investigate the extent to which the turnover tax system complies with generally accepted principles of a good tax system. In order to achieve the main goal, the study is guided by the following sub-goals:

- to analyse the South African turnover tax system;
- to describe the generally accepted principles of a good tax system;
- to determine the extent to which the South African turnover tax system complies with the generally accepted principles of a good tax system; and
- to recommend possible improvements to the South African turnover tax system.

It is likely that, by reviewing the literature on the South African turnover tax system together with the generally accepted principles of a good tax system, the study will make a contribution to the field by providing recommendations for improving the South African turnover tax system.

1.3 Methods, procedures, techniques and ethical considerations

This study falls within the post-positivist research paradigm, which proposes that reality can never be fully known and that efforts to understand reality are restricted owing to the sensory and intellectual limitations of human beings (Bryman, Bell, Hirschson, Do Santos, Du Toit, Masenge, Van Aardt, and Wagner, 2015:14). This study has striven to be as objective, detached, and neutral as possible, and has adopted the interpretive methodology whereby

reality is interpreted through a "sense-making" process (Bryman et al, 2015:14). The method consists of reviewing the relevant literature to draw up a framework of the principles of a good tax system, and for this purpose, the study adopted a qualitative systematic literature review. De Vos, Strydom, Fouche, and Delport (2016:383) confirm that a qualitative systematic literature review can be deployed as a research methodology in a scientific study.

Secondly, a doctrinal method was used to analyse the Sixth Schedule and other legal sources pertaining to the turnover tax system. According to Ali, Yusoff and Ayub (2017:493), a doctrinal method involves the analysis of case law, arranging, ordering, and systematising legal propositions and the study of legal institutions through legal reasoning or rational deduction. McKerchar (2008:18) describes the doctrinal method as a library-based undertaking that focuses on reading and performing intensive scholarly analysis on statutes, judicial decisions, and commentaries. By using the doctrinal method, an in-depth understanding of the legal perspective of the turnover tax system was achieved. This enabled an analysis of the elements of turnover tax from the perspective of the generally accepted principles of a good tax system. Finally, the framework of principles of a good tax system was applied using thematic analysis in which a researcher identifies, analyses, and reports identifiable patterns or themes within the data analysed (Du Plooy-Cilliers, Davis & Bezuidenhout, 2016:241) to determine to what extent the turnover tax system complies with the principles of a good tax system. The present study is based entirely on documentary data. The documentary data used in the study consists of the following:

- legislation, namely the Income Tax Act 58 of 1962 and the Value-Added Tax Act, 89 of 1991;
- South African Revenue Service (SARS) guides and reports;
- international and local guides and reports on generally accepted principles of a good tax system;
- articles in accredited journals; and
- textbooks and other writings.

An ethical clearance certificate was not required to conduct the study as no human beings were involved in the study. The data used for the purpose of the research was in written form and was publicly available.

1.4 Overview of the thesis

Chapter two provides an overview of the South African turnover tax system by discussing its nature, the concept of "receipts", "from carrying on business activities," and "excluding any amount of a capital nature," as applicable to "qualifying turnover" for the purpose of determining the turnover tax. It also discusses the anti-avoidance provisions for qualifying turnover, the criteria for disqualifying businesses from registering for turnover tax, the application of CGT, dividends tax for micro business, and the administration of turnover tax.

Chapter three focuses on describing the generally accepted principles of a good tax system by discussing their historical perspective, their elements, and their overlapping features. It also indicates the specific tax principles that form part of the current study, namely equity, certainty, convenience of payment, economy in collection, and flexibility, and the rationale behind their choice.

Chapter four provides an analysis of the extent to which the South African turnover tax system complies with the generally accepted principles of a good tax system.

Chapter five provides the conclusion by establishing the extent to which the research goal and sub-goals have been achieved. In doing so, the findings emerging from this study are presented. The chapter also provides recommendations for improvement of the turnover tax system and concludes the study.

CHAPTER 2: AN OVERVIEW OF TURNOVER TAX IN SOUTH AFRICA

2.1 Introduction

Chapter 2 provides an overview of the South African turnover tax system by discussing its nature, the concept of "receipts", "from carrying on business activities," and "excluding any amount of a capital nature," as applicable to "qualifying turnover", for the purpose of determining the turnover tax. Also discussed is the anti-avoidance provisions for qualifying turnover, the criteria for disqualifying businesses from registering for turnover tax, the taxation of capital gains, dividends tax for micro business, and the administration of turnover tax.

2.2 Nature of the South African turnover tax

The turnover tax was enacted in terms of section 71 of the Revenue Laws Amendment Act, no. 60 of 2008. It is a stand-alone tax set out in the Sixth Schedule to the Income Tax Act (SARS, 2009:5). As the name implies, turnover tax is calculated according to the turnover of a business, as opposed to the taxable income of a business (i.e. income less allowable expenses). According to paragraph 2(1)(a) and (b) of the Sixth Schedule, a micro business is a natural person or a company whose "qualifying turnover" has not exceeded R1 million during the year of assessment. This implies that persons carrying on their business activities as proprietors, partnerships, close corporations, co-operatives, or private companies may choose to register for turnover tax if they are natural persons (or the deceased or insolvent estate of a natural person who was a registered micro business at the time of death or insolvency), or if they are companies. Rahim (2015:19) defines a natural person as someone capable of representing himself or herself. Generally, a natural person for tax purposes can be defined as a living human being. Businesses that are registered as trusts do not qualify as micro businesses, hence they cannot register for turnover tax.

The "qualifying turnover" for a micro business should not exceed R1 million (paragraph 2(1) of the Sixth Schedule). The R1 million qualifying turnover threshold applies to a year of assessment (12 months) running from 1 March to the last day of February (paragraph 2(1) of the Sixth Schedule). If a person carries on business activities for less than 12 months, paragraph 2(2) of the Sixth Schedule requires that the qualifying threshold of R1 million must be pro-rated based on the number of full months in that particular year of assessment that the person

carried on business. According to paragraph 8(1) of the Sixth Schedule, a person that meets all the requirements as stipulated in Part II of the Sixth Schedule may elect to register as micro business either before the commencement of a year of assessment or during a year of assessment, within two months from the date of commencement of business activities.

In addition to excluding capital receipts from taxable turnover, paragraph 5 of the Sixth Schedule includes amounts received from carrying on business activities in the Republic, and amounts as set out in paragraph 6, and excludes amounts as set out in paragraph 7, and provides that any amounts refunded by the micro business to its customers must be excluded for the purpose of determining the turnover tax.

Paragraph 6 of the Sixth Schedule includes in taxable turnover, (a) 50 per cent of all receipts of a capital nature from the disposal of immovable property mainly used for business purposes, other than trading stock and any other asset used mainly for business purposes, other than any financial instrument, and (b) in the case of a company, investment income (other than dividends and foreign dividends). In terms of the definition of "investment income", this includes income in the form of annuities, interest, rental income in respect of immovable property, royalties, or income of a similar nature, as well as proceeds from the disposal of financial instruments (held for trading purposes).

Paragraph 7 of the Sixth Schedule excludes from taxable turnover, (a) in the case of a natural person, investment income; (b) amounts exempt from normal tax in terms of section 10(1)(zK) or 12P (amounts received from a small business funding entity, and amounts received in respect of government grants); (c) amounts received that accrued prior to registration which were subject to tax; and (d) a refund from a supplier of goods and services.

Lindeque (2012:19) argues that if a taxpayer is either a sole proprietor or partnership and has elected to register as micro business and uses the turnover tax system, this might cause complications for the micro business owner who has to take account of both income tax (with regard to other sources of taxable income) and turnover tax. In such a situation, according to SARS (2009:15), the Commissioner will tax the taxpayer under multiple tax systems which are usually for the salaries and investment income received by the taxpayer, and the turnover tax system for the income of the micro business. Hence, tax compliance costs are increased for these micro businesses.

According to Lindeque (2012:16) it is important that the distinction between "qualifying turnover" and "taxable turnover" is drawn since these terms have different meanings and applications. The micro business must ascertain its “qualifying turnover” in order to elect whether to register for turnover tax and determines the R1 million threshold to qualify as a micro business, but turnover tax is calculated on “taxable turnover”. Paragraph 1 of the Sixth Schedule defines “qualifying turnover” as the total of the receipts derived from business activities, but excluding any amounts of a capital nature received from business activities (for example, an amount received from the sale of equipment used in the business) and any amounts received by a micro business from a small business funding entity which is exempt from income tax under section 10(1)(zK) of the Income Tax Act, or from government grants which are exempt from income tax under section 12P of the Income Tax Act. “Taxable turnover” is determined in terms of paragraph 5, with paragraph 6 including certain amounts in taxable turnover and paragraph 7 excluding certain amounts. This can be confusing for micro business owners, demonstrating that turnover tax is not as simple as had been assumed both by SARS and the National Treasury. Silke (2018:862) suggests that when determining a person’s qualifying turnover, whether a receipt constitutes gross income or is in fact taxable is irrelevant.

The definition of qualifying turnover in paragraph 1 of the Sixth Schedule refers to concepts such as “the total receipts”, “from carrying on business activities,” and “excluding any amount of a capital nature” which are not defined in the Sixth Schedule or anywhere else in the Income Tax Act. These concepts may be difficult for the micro business owner to understand because most micro business owners do not have advanced tax skills.

2.3 The receipts

Paragraph 5 of the Sixth Schedule states that “the taxable turnover of a registered micro business, in relation to any year of assessment, consists of all amounts not of a capital nature received by that registered micro business during that year of assessment from carrying on business activities in the Republic…”. By contrast, the definition of “gross income” in section 1 of the Act includes “the total amount, in cash or otherwise, received by or accrued to or in favour of” residents and non-residents. The term “accrued to” is used in paragraph 7(c) of the Sixth Schedule to exclude amounts “received” during a year of assessment that “accrued” and

were subject to tax prior to registration as a micro business. As the terms "total receipts", accrued to or in favour of", and "excluding any amount of a capital nature" are dealt with in case law relating to the definition of "gross income", and the expression "from carrying on business activities" is dealt with in case law relating to the preamble to section 11 of the Act, case law that assists in determining the meanings of these concepts is discussed.

An amount is received by a taxpayer only if it is received by him or her on his or her own behalf and for his or her own benefit (*Geldenhuys v CIR,* 1947 (3) SA 256 (C)). The case of *Mooi v Secretary for Inland Revenue,* 1972 (1) SA 675 (A), established the concept of "unconditionally entitled to" and stated that accrual occurred at the time the taxpayer became unconditionally entitled to an amount. Thus, amounts that are received by a micro business on its own behalf and for its own benefit are included in taxable turnover, but amounts that accrue but are not received during the year of assessment are not taken into account when determining the qualifying turnover of micro businesses.

Stein (2009:54) comments that the "cash" basis is the main advantage of the South African turnover tax system. Lindeque (2012:20) argues that the concept of "accrual" can be a problem for a micro business owner who, if he or she had not consulted a tax practitioner, would not be able to identify which amounts had accrued and were included in the taxable income for the previous year of assessment. The owner therefore would have to seek advice, again thereby increasing the compliance cost for the business.

There are various circumstances that have the effect of amounts that are received being included or excluded from taxable turnover, for example:

- theft and fraud;
- amounts by which a customer is overcharged;
- amounts that are borrowed; and
- deposits.

In a Supreme Court of Appeal case, *MP Finance Group CC (in liquidation) v C:SARS* (69 SATC 141), which involved a fraudulent pyramid scheme, it was held that even if the scheme was legally obliged to repay an investor immediately on receipt, that was because of the legal

principles applicable to the parties to an illegal contract as between themselves. The present case was about the relationship between the scheme and the *fiscus*. Furthermore, an illegal contract is not without all legal consequences and can have fiscal consequences. The amounts paid to the scheme were accepted by the operators of the scheme with the intention of retaining them for their own benefit and notwithstanding that in law they were immediately repayable, they constituted receipts within the meaning of the Income Tax Act. Amounts received by a micro business as a result of theft or fraud are therefore included in taxable turnover.

In a special court case (ITC 1624 (1996) 59 SATC 373), the issue was whether or not an amount which the appellant had overcharged a customer constituted an amount received. Wunsh J stated (at page 378) the following:

> None of these cases [referred to by the appellant] is in my view authority for the proposition that where a trader receives a payment of money in the course of carrying on its trade which it obtains by making a fraudulent or, for that matter, negligent, misrepresentation to a customer, it does not receive that money or that it has not intended to receive it as part of its business income and in the course of its business.

The amount received by a micro business as a result of overcharging customers (whether inadvertently or fraudulently) will be regarded as a receipt for the purpose of determining turnover tax.

The question of loan monies as a receipt by micro businesses is not dealt with in the Sixth Schedule, therefore it is important to refer to case law to distinguish between a receipt by micro businesses for tax purposes and receipts on loan account, traditionally regarded as capital. In *CIR v Genn & Co* (*Pty*) *Ltd,* 1955 3 SA 293 (A), the court held (at page 388) that:

> ….it certainly is not every obtaining of physical control over money or money's worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income. At the same moment that the borrower is given possession he falls under an obligation to repay. What is borrowed does not become his, except in the sense, irrelevant for present purposes, that if what is borrowed is consumable there is in law a change of ownership in the actual things borrowed.

In instances where a micro business owner obtains a loan from a financial institution, or even from a relative, which is then used in the operations of the micro business, the amounts will be received within the meaning of the term "received", but would constitute receipts of a capital nature (refer to the discussion below regarding capital receipts.).

Unicus Tax Specialists (2018:1) comment, regarding the receipt of deposits, that as taxpayers who receive deposits are typically required to repay the deposits under certain circumstances it would appear that this is enough to show that a deposit is not received by the taxpayer for his or her own benefit. However, in the cases of *Brookes Lemos Ltd v CIR,* 1947 (2) SA 976 (A), 14 SATC 295; *Greases (SA) Ltd v CIR,* 1951 (3) SA 518 (A), 17 SATC 358 and *Pyott Ltd v CIR,* 1945 AD 128, 13 SATC 121, it was held that even if a taxpayer has an obligation to return a deposit to a customer as indicated in the contract, the deposit amount can still be received by the taxpayer for his or her own benefit if the taxpayer receives and deals with the money as his or her own. These "deposit" cases, however, all involved deposits on returnable containers. Following the case of *CIR v Genn & Co (Pty) Ltd*, Haupt (2019:21) is of the view that, upon receiving money, if a micro business owner comes under an obligation to repay it, whether then or in the future, the amount is not a receipt for turnover tax purposes. Building maintenance or garden service businesses may require their clients to pay deposits or prepayments before rendering their services to those clients. Upon the receipt of such deposits or prepayments, if the micro business owners use such deposits or prepayments as their own, despite the obligation to pay back deposits or the prepayments received if they fail to render their services to the clients, it is submitted that such deposits or prepayments would be receipts that form part of the micro businesses' taxable turnover. Where, for example, a micro business letting property receives deposits that are refundable when a tenant vacates the property, these amounts will not be received for the purposes of turnover tax.

While the case law dealing with the meaning of "received" is clear, its application is often difficult in practice for micro businesses. In terms of section 102 of the Tax Administration Act, no. 28 of 2011 (referred to as the Tax Administration Act), micro business owners bear the onus of proving that an amount has been received (or not received) for their own benefit.

A micro business owner may receive an amount in a form other than cash, and the value would have to be ascertained. In the case of *CIR v Butcher Bros (Pty) Ltd,* 13 SATC 21 (A) 1944, the

Court held that the initial onus is upon the Commissioner to determine an amount. Haupt (2019:19) confirms that "[t]he general principle . . . is that in situations where an amount is received . . . in a form other than money . . . the amount . . . is established by ascertaining the market value . . . at the date the taxpayer becomes entitled to the asset" The micro business must therefore recognise the value of an amount in a form other than cash as a receipt for the purpose of determining the taxable turnover.

2.4 Carrying on of business activities

Paragraph 1 of the Sixth Schedule explains that "qualifying turnover means the total receipts from carrying on business activities ...". Although the phrase "carrying on business activities" is not defined in the Act, the court, in the case of *Cape Town Municipality v Clarensville (Pty) Ltd,* (1974) 2 All SA 346 (C), provides useful guidelines as to its meaning. A business activity constitutes either an act of selling or supplying goods or services and an intention to continue selling or supplying such goods or services as and when the opportunity arises for as long as it is thought desirable; or a series of acts of selling or supplying goods or services in circumstances from which this intention can be inferred. The case of *COT v Glass*, 24 SATC 499, 1962 (1) SA 872 (FC), confirms that a business owner is regarded as carrying on business activities if there is continuity in the selling or supplying of goods or services.

Paragraph 5 of the Sixth Schedule indicates that taxable turnover relates to receipts from business activities "in the Republic" of South Africa, implying the importance of the location of business activities. SARS (2016:15) explains that if the business activities or services earning income are performed in South Africa, the receipt would derive from South Africa. If the micro business delivers goods to customers outside South Africa, foreign receipts will be regarded as receipts for the purpose of determining its turnover.

2.5 Excluding any amount of a capital nature

The definition of "qualifying turnover" in paragraph 1 of the Sixth Schedule excludes all amounts of a capital nature in the determination of turnover tax. Because neither the Sixth Schedule, nor the Eighth Schedule (which deals with capital gains tax), nor the Act itself, define the meaning of "receipts of capital nature", case law is referred to, to determine the meaning of receipts of a capital nature.

The case of *CIR v Visser* 1937 TPD 77, 8 SATC 271, introduced the principle of the "tree and fruit"; the tree is capital in nature and the fruit is revenue in nature. The court found that the amount in dispute had accrued to the taxpayer as the product of his wits, energy, and influence and as such was not a receipt of a capital nature but was income in nature.

In the case of *Vaculug (Pvt) Ltd v COT* 25 SATC 201, 1963(2) SA 694 (SR), it was stated that amounts received for the use of assets, without any change in ownership, are generally of a revenue nature as, for example, interest, rent, or royalties, but that where there is a transfer of ownership of an asset difficulties could arise. A receipt may be of a capital nature in the hands of one taxpayer as in the sale of a private home, but of an income nature in the hands of another as when a taxpayer's business is to buy and sell houses.

In the case of amounts received for services rendered, such amounts constitute revenue received in respect of the application of the recipient's wits and labour (*Millin v CIR* 1928 AD 207, 3 SATC 170). Hence, amounts received for services rendered usually constitute receipts of a revenue nature.

Thus, when a micro business provides services or sells trading stock, the amounts will be of a revenue nature. The sale of assets held as investments, either to earn income or to manufacture products, will give rise to receipts of a capital nature. Except in the case of the sale of assets used mainly for business purposes (paragraph 6(a) of the Sixth Schedule), the proceeds from the disposal of capital assets are excluded from taxable turnover. In terms of section 102 of the Tax Administration Act, the onus is on the taxpayer to prove that a receipt is of a capital nature and therefore excluded from "qualifying turnover". The taxpayer must be able to discharge the onus "on a balance of probabilities" as opposed to "beyond a reasonable doubt".

The courts have also used both objective and subjective tests to determine whether a receipt is capital or revenue in nature.

2.5.1 Objective tests

Wessels J, in the case of *COT v Rezende Gold and Silver Mines (Pvt) Ltd*, 37 SATC 39, 1975(1) SA 968 (RAD), held that where capital is productively employed in deriving income, and without a change in ownership of the asset, it is income; payments received in this case were regarded as rentals and therefore revenue in nature. Rental payments were also identified as revenue in nature in the case of *Modderfontein B Gold Mining Co Ltd v CIR* 32 SATC 202, 1923 AD 34.

Where a taxpayer continuously sells the same kind of asset, this indicates that the taxpayer uses such assets as stock-in-trade to sell at a profit, and therefore the disposal of such assets is revenue in nature. This is evident in the case of *COT v Glass*, in which the Court held that where the receipt was from a business combining the activities of landjobber, builder and land developer, the activity the respondent was involved with was revenue in nature as he had continuously carried on such activities for many years.

In some instances, capital assets can change their nature to that of revenue if disposed of in the ordinary course of business (*CIR v Strathmore Exploration Ltd*, 20 SATC 375, 1956(1) SA 591(A).)

One of the objective tests relating to the capital or revenue nature of a receipt is the length of time for which an asset is held (*C: SARS v Capstone 556 (Pty) Ltd*, (2016) 78 SATC 231 (SCA).)

2.5.2 Subjective tests: intention

In ITC 1462 (1988) 51 SATC 168, the court stated (at page 172) that: "The most important 'test' employed by the courts in deciding whether the proceeds arising upon the disposal of an asset are in the nature of income or capital is the test of 'intention': with what intention did the taxpayer acquire and hold the asset?"

In the case of *CIR v Paul 1956* (3) SA 335 (A), 21 SATC 1, the taxpayer, who was a land surveyor, persuaded his brother-in-law to purchase the full 167 acres with him as co-owner, their intention being to retain the piece of land originally sought and to sell the remainder to

their best advantage. The taxpayer then sub-divided the surplus and sold the surplus off over several years at a profit. Profit was made on three lots which the Commissioner sought to include in the taxpayer's taxable income. The court held that the taxpayer did not purchase the property for speculative purposes but rather as a capital investment. The dominant purpose in acquiring the land was to obtain a smallholding, not to make a profit. The fact that he intended to sell the surplus land at the best possible price was expected and did not render his purpose speculative. The fact that the taxpayer sub-divided the land and sold it off in plots could not *per se* render the proceeds of a revenue nature. A similar situation occurred in the case of *CIR v Stott* 1928 AD 252, SATC 253, where the Special Court considered the intention of the taxpayer in acquiring an asset as the important factor and it was held that the amounts realised constituted accruals of a capital nature in the hands of the appellant.

Where the taxpayer changes his or her intention regarding an asset, the nature of the asset may also change. For instance, in the case of *Natal Estates Ltd v SIR,* 1975 (4) SA 177 (A), it was stated that the taxpayer had originally acquired the assets in question as capital assets. It had thereafter changed its intention vis-à-vis those assets and made the selling of assets part of its business, thereby changing the nature of the assets from capital to revenue in nature.

To summarise: case law provides an understanding of what constitutes receipts of capital or of a revenue nature which can be applied for the purpose of determining the turnover tax. Receipts with the following characteristics may be regarded as a receipt of capital or of a revenue nature, and included in or excluded from qualifying turnover for turnover tax purposes:

- Receipts which are the product of the property that the micro business owner worked/used are usually receipts of a revenue nature and are included for the purpose of determining the qualifying turnover (*CIR v Visser*).
- The amount received by a micro business owner for the use of assets, without any change in ownership, is generally of a revenue nature, such as, for example, interest, rent, or royalties. Where there is a transfer of ownership of an asset, the receipt may be of a capital nature in the hands of a micro business owner, as in the case of *Vaculug (Pvt) Ltd v COT* and *COT v Rezende Gold and Silver Mines (Pvt) Ltd*, and excluded for the purpose of determining the turnover tax.
- The amount that a micro business owner receives for services rendered normally constitutes revenue because it is earned as a result of the application of the micro business

owner's wits and labour and included for the purpose of determining taxable turnover (*Millin v CIR*).

- Amounts that a micro business owner receives from the sale of his or her product or services constitutes ordinary trading in the commodity or service; therefore the receipts are of a revenue nature and included for the purpose of determining the taxable turnover of the micro business (*COT v Glass*).
- Where the micro business owner purchases a product or service with the intention of selling it at a profit, the receipts are regarded as being of a revenue nature and therefore such receipts should be included for the purpose of determining the turnover tax.

2.6 Anti-avoidance rule for qualifying turnover

Paragraph 13(a) and (b) of the Sixth Schedule states that:

> the total amount received from carrying on business activities by a connected person in relation to a person described in paragraph 2 (1) (a) or (b) must be included in the qualifying turnover of that person for purposes of applying paragraph 2, where the connected person carries on business activities that should properly be regarded as forming part of the business activities carried on by that person; and the main reason or one of the main reasons for the connected person carrying on business activities in the way that the connected person does is to ensure that the qualifying turnover of that person does not exceed the amount as described in that paragraph.

This implies that paragraph 13 of the Sixth Schedule provides an anti-avoidance rule to guard against income splitting by a micro business owner. These rules apply when a micro business is split between connected persons in order to ensure that the total qualifying turnover of a micro business remains within the R1 million qualifying turnover threshold. Lindeque (2012:16) argues that although the concept of a "connected person" is defined in the Income Tax Act and some SARS tax guides, it remains a complex concept to be understood by the micro business owner.

The definition of a connected person in section 1(d)(i) of the Income Tax Act states that a relative of a micro business owner is a connected person in relation to that micro business owner. The term "relative" is defined in section 1(1) of the Income Tax Act as follows:

> "[R]elative" in relation to any person, means the spouse of that person or anybody related to that person or that person's spouse within the third degree of consanguinity, or any spouse of anybody so related, and for the purpose of determining the relationship between any child referred to in the definition of "child" in this section and any other person, that child shall be deemed to be related to the adoptive parent of that child within the first degree of consanguinity.

Similarly, where micro business "B" is a connected person in relation to micro business "A", micro business "A" is simultaneously a connected person in relation to micro business "B". Thus, micro business "A" and micro business "B" are mutually connected persons. Where a micro business operates as a partnership, all members of the partnership are connected persons in relation to one another and a member and his or her partner's connected persons are simultaneously connected persons as well. Thus, if "X" and "Y" are partners in a micro business, they are connected persons. In addition, relatives of "X" are connected persons in relation to "Y" and relatives of "Y" are connected persons in relation to "X". Nevertheless, an individual partner in a micro business partnership is not a connected person in relation to the micro business partnership, as a partnership is not a separate legal *persona*, distinct from its members (SARS, 2020c:12).

According to Haupt (2019:829), for the purposes of determining the qualifying turnover of any person, the Commissioner is of the view that the total amount received by a connected person from carrying on business activities must be included in the qualifying turnover of the person seeking to be registered as a micro business; this applies only if the Commissioner is satisfied that the connected person carries on business activities that should properly be regarded as forming part of the business activities carried on by that person and that the main reason or one of the main reasons for "splitting" the business activities is to ensure that the qualifying turnover of that person does not exceed the turnover limit. Thus, according to SARS (2016:7), the qualifying turnover of a person seeking registration as a micro business should be combined with the business receipts of connected persons in relation to that person. If the combined qualifying turnover exceeds R1 million, none of the connected parties will qualify as a micro business.

2.7 Persons who do not qualify as micro businesses

The Sixth Schedule provides for circumstances where persons will not qualify to register as micro businesses.

2.7.1 Prohibition and limitation of interests in other companies

Paragraph 3(a) of the Sixth Schedule states that a person, whether a natural person, partner in a partnership, or a company, does not qualify as a micro business for any particular year of assessment if, at any time during that year of assessment, that person or company holds any shares or has any interest in the equity of a company.

Paragraph 4 of the Sixth Schedule provides for certain permissible shareholdings or interests that the person or company may hold and still be allowed to register as a micro business. These are shares or interests in companies listed on the South African Stock Exchange, collective investment schemes, bodies corporate, share block companies, associations of persons managing collective common interests of members, and a venture capital company as defined in section 12J of the Income Tax Act. Paragraph 4(e), (f) and (g) of the Sixth Schedule provides additional permissible investments for companies and natural persons: a company or a person is not disqualified from registering as a micro business whose interest constitutes less than 5 percent of the interest in a social co-operative such as a burial society; or whose interest constitutes 5 percent of the interest in a primary saving co-operative bank; or who has an interest in any friendly society.

2.7.2 Limitation on investment and professional service income

Paragraph 3(b)(ii) of the Sixth Schedule imposes limitations on the registration as a micro business of persons and companies that derive an income from investment and professional services. This paragraph states that a company is disqualified from registering as a micro business if the aggregate income derived by the company from "investment income" and "professional services" exceeds 20% of the total receipts of the business. In the case of a natural person such as a sole proprietor or a partner, paragraph 3(b)(i) explains that the 20% limitation only applies to income from the rendering of a professional service.

The term "investment income" is defined in paragraph 1 of the Sixth Schedule as any income

derived from annuities, dividends, interest, and/or rental derived from immovable property, royalties, or income of a similar nature, and any proceeds derived from the disposal of financial instruments. According to paragraph 7(a) of the Sixth Schedule, investment income derived by a natural person is excluded from the taxable turnover for the purpose of determining turnover tax. SARS (2016:10) states that there are some types of income derived by natural persons that must be included for the purpose of determining turnover tax. Such income includes income derived from providing accommodation on a short-term basis, for example, a guesthouse, a lodge, a bed and breakfast establishment, or an hotel. If a person has the exclusive use of a property or a portion of a property on a long-term basis, for example periods exceeding one month, whether under one or more contracts, a portion of the income earned may be regarded potentially as rental in respect of immovable property and is hence excluded from the taxable turnover.

SARS (2009:8) explains that the exclusion of investment income from the taxable turnover arises because the Commissioner is endeavouring to cater for the common law principle that the individual and the business are not distinct or separate entities and that the investment income is taxable under normal income tax rules, subject to applicable annual exemptions.

2.7.3 Professional services

The term "professional service" is defined in paragraph 1 of the Sixth Schedule as follows:

> Professional service "means a service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation or veterinary science.

While the term "professional service" is widely defined, SARS (2016:11) lists some of the activities that would not, in general, be considered to be professional services. These include retail sales, repairing, installing, altering, decorating, cleaning, constructing, or improving the movable, immovable, or personal property of customers, and the provision of services of a personal or social nature to the public.

The definition of the term "professional service" has various exclusions and, as a result, has faced public criticism, and, in turn, has created confusion among micro business owners (Lindeque,2012:20). In order to comment on this confusion regarding the rationale for excluding professional services from taxable turnover, SARS (2016:11) responded that the turnover tax system is mainly aimed at benefiting micro businesses that actively engage in labour-intensive entrepreneurial business activities. SARS (2016:11) further states that professional services are generally rendered by knowledge-intensive, high-income earning taxpayers, with profit margins that are significantly higher than those envisaged in the design of the turnover tax system, in the light of which reality and in order to protect the tax base and ensure a more "level playing field" for various types of businesses under the turnover tax system, professional services are excluded from taxable turnover for the purposes of determining turnover tax.

2.7.4 Limitation on capital disposals

Paragraph 3(e) of the Sixth Schedule explains that a person will not qualify as a micro business owner in a given year of assessment if the proceeds from the sale of capital assets (whether immovable or movable but excluding any financial instruments) and used *mainly for business purposes* exceed an amount of R1,5 million over a three-year period. The three-year period consists of the current and immediately preceding two years of assessment.

According to SARS (2016:13) immovable property disposed of is regarded as having been used "mainly" for business purposes if more than 50% of its floor area is used for that purpose. In respect of all other assets (movable assets excluding any financial instrument), the asset is regarded as having been used "mainly" for business if it is used for more than 50% of the time for business purposes. Such assets may include motor vehicles, furniture, computers, and all other movable assets purchased for use in the activities of the micro business. SARS has not recognised that the term *"more than 50% of its floor area"* might well be irrelevant for a technologically oriented micro business, which uses a virtual, rather than a physical, office.

SARS (2016:13) also noted that the R1,5 million threshold applies to the total proceeds from capital assets disposed of in the relevant years of assessment and not to each individual asset disposed of. This implies that a micro business owner must calculate the aggregate amount for all assets (both movable and immovable) disposed of during the recent three years of

assessment including the current year. If the aggregate amount exceeds R1.5 million the business does not qualify as a micro business and, hence, it will have to be deregistered as a micro business.

2.8 Prohibition of personal service providers and certain labour brokers

According to paragraph 3(c) of the Sixth Schedule, personal service providers and labour brokers without a tax exemption certificate granted in terms of paragraph 2(5) of the Fourth Schedule to the Income Tax Act (the Fourth Schedule) do not qualify to register as micro businesses.

2.8.1 Labour broker

Paragraph 1 of the Fourth Schedule to the Income Tax Act defines a labour broker as a natural person who, for reward, provides a client with the services of other persons to render a required service and pays the other persons for rendering that service. In practice it is not easy to determine whether a company, close corporation or trust, is a "labour broker". SARS (2020a:5) has therefore developed the following criteria for determining whether the person or an organisation is a "labour broker":

- More than 80% of the gross income of the labour broker during the year of assessment consists of, or is likely to consist of, amounts received from any one client of the labour broker or from an associated institution of the client, unless the labour broker employs three or more full-time employees who are involved in the business of that labour broker on a full-time basis and who are not connected persons in relation to the labour broker. The rule relating to the three or more employees does not apply to persons engaged in other activities of the labour broker; the employees must be directly involved in the labour broking activities of the labour broker in order to provide or procure persons for clients of that labour broker; or
- The labour broker offers to any of its clients the services of another labour broker. This prerequisite does, however, not prevent a labour broker from obtaining an employee from another labour broker for the purposes of offering the employee to a client. For instance, if labour broker A is requested by a client to offer a particular type of employee whom it does not employ, and labour broker A obtains this employee from

labour broker B so that he/she becomes an employee of labour broker A, then providing the employee to the client in the standard way, labour broker A would not be penalised by this prerequisite because the employee is provided to the client as an employee of labour broker A. This prerequisite is applicable when, for example, a client is permitted to hire an employee of labour broker B through labour broker A; or

- The labour broker is contractually obliged to offer the services of a specified employee to the client. This prerequisite is relevant when, for example, the client proposed or required employee A to render a service. This prerequisite, on the other hand, is not relevant if an employee of the labour broker was selected as a result of a *bona fide* selection process based on the requirements of the client and specified as such in the final contractual agreement.

In terms of the proviso to paragraph 2(5)(a) of the Fourth Schedule, the person or organisation that meets these criteria may not be granted a certificate of exemption, except if that person or organisation carries on an independent trade and is registered as a provisional taxpayer under paragraph 17 of the Fourth Schedule, or is registered as an employer under paragraph 15 of the Fourth Schedule, and, subject to any extension granted by the Commissioner, submitted all the returns as required by the Income Tax Act.

2.8.2 Personal service provider

Paragraph 1 of the Fourth Schedule to the Income Tax Act defines a personal service provider as a company or trust whose services are rendered to clients by a connected person (usually the owner, relative, or beneficiary). The connected person in this instance, according to SARS (2020c:11), would be regarded typically as an employee of the client, and when it is necessary for the services to be performed mainly at the premises of the client, the connected person is controlled or supervised by the client according to the manner in which the services are required. A company or trust is also a personal service provider if more than 80% of the income is received from one client during the year of assessment. A company or trust that employs three or more full-time employees who are engaged in the business of the company or trust on a full-time basis and throughout the year of assessment, however, is not regarded as a personal service provider.

2.9 Exclusion of public benefit organisations, recreational clubs, associations, and small business funding entities

Paragraphs 3(f)(iv), (v), (vi), and (vii) of the Sixth Schedule state that institutions, including a public benefit organisation approved by SARS under section 30 of the Act, a recreational club approved by SARS under section 30A of the Act, an association approved by SARS under section 30B of the Act, and a small business funding entity approved by SARS under section 30C of the Act, do not qualify to register as micro businesses. These organisations are normally exempted from tax. The main purpose of introducing the turnover tax is to reduce the tax burden for micro business. Public benefit organisations can apply to SARS to be exempted from tax altogether and there is no need for such institutions to register as micro businesses.

2.10 Special rules relating to partnerships

Paragraph 3(g) of the Sixth Schedule states the factors that would disqualify all the partners in a partnership from registering as a micro business, and the factors that would disqualify only a specific partner without this applying to the rest of the partners. According to paragraph 3(g), all partners will be disqualified from being subject to turnover tax if any one of them is not a natural person or if the qualifying turnover of the partnership, as a whole, exceeds R1 million. A specific partner will be disqualified if that partner holds shares in a company or is a member of another partnership. This disqualification will not affect the remaining partners.

According to SARS (2016:14) partnerships are taxed on a flow-through basis, thus the taxable turnover of a partnership is taxed in the hands of each partner according to the profit-sharing ratio specified in the partnership agreement. The partners are individually registered as micro businesses for turnover tax purposes and each partner is separately liable for turnover tax based on that partner's taxable turnover as determined in the partnership agreement and under the partnership profit-sharing ratio.

Unlike a natural person, paragraph 3(g)(iii) explains that the R1 million qualifying turnover threshold is applied to the collective turnover of the partnership, thus for each individual partner to qualify as a micro business for turnover tax purposes, the collective qualifying turnover of the partnership must not exceed R1 million. SARS (2016:15) explains that the income of any disqualified partner of a micro business is subject to normal tax based on that

partner's profit-sharing ratio. Nevertheless, the aggregate qualifying turnover of the partnership must still be determined by considering the collective qualifying turnover of all the partners, including any individual partners who may have been disqualified.

2.11 Capital gains tax for micro business

Paragraph 57A of the Eighth Schedule to the Income Tax Act (the Eighth Schedule) states that a registered micro business must disregard any capital gain or loss for CGT purposes upon disposal of any asset used mainly for business purposes. According to the *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008*, specific measures are in place to avoid abuse. As a substitute for CGT, paragraph 6(a) of the Sixth Schedule explains that the qualifying micro business must include 50% of all receipts of a capital nature in its taxable turnover. This inclusion does not apply to proceeds derived from the disposal of an asset not used mainly for business purposes by the micro business. According to SARS (2016:13) immovable property disposed of by a micro business will be regarded as having been used "mainly" for business purposes if more than 50% of its floor area was used for business purposes. For any other asset (rather than the immovable assets) disposed of the proceeds from the sale of the asset will be taken into account when the asset is used more than 50% of the time for business purposes. In addition, paragraph 3(e) of the Sixth Schedule indicates that a person will not qualify as a micro business if the total receipts from the disposal of assets used mainly for business purposes exceeds R1,5 million during the current and preceding two years of assessment.

Stein (2009:1) comments that the inclusion of 50% of the proceeds in the taxable turnover of micro business proves that the indication by SARS, that micro businesses do not pay CGT is inaccurate. Stein (2009:1), furthermore, argues that the practice of having the capital amount included in the taxable turnover, even where a capital loss has been incurred, is contrary to the practice of the normal tax system where a capital loss is offset against a capital gain.

2.12 Dividends tax for micro business

Section 64E(1)(a)(i) of the Income Tax Act stipulates that the dividends tax is currently levied at 20% on any dividends paid by a company. According to SARS (2016:20) companies that are registered as micro businesses may also pay dividends tax. Section 64F(1)(h) of the Income

Tax Act provides a specific exemption for holders of shares in micro businesses for cash dividends paid to a holder of shares in a registered micro business to the extent that the aggregate amount of all dividends (cash or *in specie*) paid by that micro business to holders of shares in that micro business, during the year of assessment in which that dividend is paid, does not exceed R200 000. All dividends paid in a year of assessment by a micro business in excess of R200 000 will therefore be subject to dividends tax. Stein (2009:2) therefore argues that SARS's claim that micro businesses do not pay dividends tax is a fallacy.

Although the R200 000 exemption is granted on dividends paid during a year of assessment by a micro business, the Income Tax Act is silent on what steps should be taken if the shareholder fails to claim the dividend during the year of assessment of the micro business in which such dividends are due. SARS (2016:20) does state, however, that in such a situation the exemption or a part of it is forfeited. If a registered micro business has previously declared, for example, dividends of R150 000 but the holders of shares for whatever reason fail to claim the available exemption, only additional dividends not exceeding R50 000 paid during that year of assessment may be exempted, provided the qualifying holders make the necessary declarations and undertakings.

Furthermore, the Income Tax Act does not prescribe how the dividend exemption is to be applied if there are multiple holders of shares in a micro business. SARS (2019:20) considers that in such circumstances a fair and reasonable approach would be to apportion the exempt amount in accordance with the entitlements of the holders to the dividends.

In terms of the procedure for applying for the exemption, section 64G(2)(i) provides that the holders of shares in the micro business who qualify for exemptions should declare this to SARS by completing the prescribed claim form for exemption. The completed claim form is then submitted to the micro business at a specified date for submission to SARS.

Unlike a cash dividend, a dividend *in specie* involves the distribution of an asset other than in the form of cash by a company. Section 64EA(b) states that a micro business that declares and pays a dividend consisting of a distribution of an asset *in specie*, is liable for the dividends tax. There is, however, a condition imposed by section 64FA(A)(i), in which it is stated that the micro business is not liable for dividends tax on a dividend *in specie* to the extent that the holders of its shares would have qualified for the exemption in section 64F(1)(h) had the

dividend hypothetically not been the distribution of an asset *in specie*.

For the micro business to qualify for the exemption, section 64FA(1)(a) states that the holder of shares to whom the dividend *in specie* was paid must submit to the micro business, by the date of payment of the dividend, a declaration in the form prescribed by SARS that the dividend or a portion of it would have been exempt under section 64F had it not been a dividend *in specie*; and a written undertaking in a form prescribed by SARS to inform the micro business in writing that should the circumstances affecting the exemption applicable to the beneficial owner change or should the beneficial owner cease to be a beneficial owner, the exemption may be revoked.

As in the case of cash dividends, in terms of section 64FA(1)(a), read with section 64F(1)(h), the exemption stipulated applies to the aggregate amount of all dividends (cash and *in specie*) paid by a registered micro business in a year of assessment to all holders of shares.

2.13 Turnover tax administration

While the Tax Administration Act deals with matters such as the submission of returns, assessments, audits, penalties, dispute resolution and other matters, the Sixth Schedule provides for the registration and deregistration of a micro business.

2.13.1 Registration of micro businesses

Paragraph 8(a) and (b) of the Sixth Schedule states that a person qualifying as a micro business may apply to register as a micro business with SARS before the beginning of the year of assessment or before the date during the year of assessment prescribed by the Commissioner in the *Government Gazette*. If that micro business commences business activities during the course of the year of assessment, the person must register as a micro business within two months from the date of commencement of its business activities.

Paragraph 8(2) of the Sixth Schedule explains that should a person qualify as a micro business and elect to be registered as such, the registration would be effective from the beginning of the year of assessment. That is, a person cannot be registered as a micro business for only part of the year of assessment unless the business commences during the year. Paragraph 8(3) of the

Sixth Schedule explains that a micro business that deregisters either on a voluntary or a compulsory basis will not be able to register again as a micro business.

Stein (2009:1) criticises the registration process for turnover tax as being difficult to understand for a micro business owner and that the rules are complex.

2.13.2 Deregistration of micro businesses

Paragraph 10 of the Sixth Schedule provides two conditions in terms of which a registered micro business may be deregistered from turnover tax by SARS, namely, compulsory or voluntary.

Paragraph 10(1)(a) and (b) of the Sixth Schedule states that compulsory deregistration will take place if a registered micro business no longer qualifies to be registered as such. Three factors may necessitate a compulsory deregistration, namely: 1) if the qualifying turnover derived by the micro business from carrying on business activities during a year of assessment exceeds or is likely to exceed the R1 million threshold; 2) if the person is disqualified under paragraph (3) of the Sixth Schedule.

According to paragraph 10(3) of the Sixth Schedule, in a situation where a micro business is required to be deregistered because it has exceeded, or there are reasonable grounds to believe that it will exceed, the qualifying turnover threshold of R1 million for the year of assessment, but that the excess is nominal and of a temporary nature, the micro business must apply to SARS for a decision as to whether the micro business must remain registered as a micro business or not. SARS (2016:24) has provided some guidance in that regard, and explains that if the total receipts in excess of R1 million are within a 2% to 3% range of qualifying turnover, that amount would generally be considered nominal for purposes of paragraph 10(3). SARS (2016:24) states further that the facts and circumstances of each case will be considered by the Commissioner in determining whether the business may remain registered as a micro business. In such circumstances the Commissioner may consider the particular event identified by the taxpayer as reason for exceeding the threshold by a “nominal” amount, and whether that event is of a “temporary” nature.

SARS (2016:25) requires that a registered micro business, which is subject to compulsory

deregistration, must notify the Commissioner within 21 days from the date on which it no longer qualifies as a micro business. Penalties may be levied on the micro business if the Commissioner is not notified about the intended deregistration (SARS, 2016:25). Upon receipt of the intended deregistration, the Commissioner will deregister the micro business from the turnover tax system with effect from the first day of the month following the month during which the business no longer qualifies to be a registered micro business (SARS, 2016:25). If the micro business ceases to qualify as such during a year of assessment, the taxpayer's turnover tax assessment for the particular year will contain an amount payable in respect of turnover tax (up to the date of deregistration) and a separate assessment for normal tax.

Furthermore, according to section 1 of the VAT Act the business will also have to register for VAT if the total value of taxable supplies in a 12-month period exceeds, or is likely to exceed, the R1 million taxable supply threshold at which registration for VAT is compulsory, as indicated in section 23(1) of the VAT Act.

According to paragraph 9(1) and (2) of the Sixth Schedule a micro business may choose to deregister voluntarily, but the choice to deregister must be made before the beginning of the year of assessment or at a later date during that year of assessment prescribed by the Commissioner in the *Government Gazette*. Voluntary deregistration, according to SARS (2016:20), occurs when the owner of a registered micro business prefers to be taxed under the normal tax system and elects to deregister from the turnover tax system. Section 72 of the Taxation Laws Amendment Act no. 43 of 2014 indicated that as from 1 January 2016 the three-year lock-in period would not apply, and that a micro business would be able to deregister voluntarily at any time.

SARS (2016:26) states that deregistration will be effective from the beginning of the following year of assessment. For example, a registered micro business that chooses to deregister for turnover tax by submitting a notification to the Commissioner on 15 January 2020, will be deregistered with effect from 1 March 2020.

2.13.3 Voluntary VAT registration of micro business

According to section 100(1) of the Taxation Laws Amendment Act no. 24 of 2011, the prohibition against micro businesses from registering for both turnover tax as well as VAT was lifted as from 1 March 2012. A micro business may therefore choose to register for VAT if it meets the requirements for voluntary registration under the VAT Act and registration is in its best interests. For a micro business which is registered for VAT, total receipts for qualifying turnover and taxable turnover purposes include any VAT amounts received by the micro business (SARS, 2016:26). A person that elects to be registered simultaneously under both tax systems does so on a voluntary basis in order to access the benefits that these systems offer. Under these circumstances it is worthwhile for the micro business to consider the potential advantages and disadvantages of being registered as a VAT vendor in relation to the particular trade in which it is involved.

According to SARS (2016:26) it may be advantageous for a micro business to register voluntarily for VAT if it supplies goods or services to customers who are registered VAT vendors and who therefore may be able to deduct the VAT charged by the micro business as input tax. Should a micro business opt to register for VAT it must be cognisant of the complexity of having to maintain two tax systems, namely VAT and turnover tax. A micro business that elects also to register for VAT will have to perform certain duties and take on certain responsibilities. For example, vendors are required to ensure that VAT is levied on taxable supplies made by them, that tax invoices are issued, that VAT is deemed to be included in all prices advertised or quoted, that returns must be submitted, and that payments are required to be made to SARS on time.

2.13.4 Payment of turnover tax for micro business

Paragraph 11(1) to (4) of the Sixth Schedule states that micro businesses must make two interim payments and possibly one final payment on assessment. To process the first interim payment the micro business must, within six calendar months of the commencement of the year of assessment, estimate its taxable turnover for the entire year of assessment, compute the turnover tax payable on that estimated taxable turnover, and pay 50% of the turnover tax to the Commissioner. The interim payment for the micro business is due on or before 31 August of each year (SARS, 2016:27).The fact that a micro business owner must estimate an accurate

taxable turnover for the purpose of its first interim payment also places the micro business owner in a difficult position as it is not easy to predict to what extent the products or services offered by the micro businesses will respond to the dynamic market environment.

Paragraph 11(4)(a) to (c) of the Sixth Schedule states that the micro business must also compute the estimated taxable turnover at the last day of the year of assessment in preparation for the second interim payment. The second interim payment is computed by subtracting the first interim payment previously paid from the total turnover tax payable on the estimated taxable turnover for the full year of assessment. SARS (2016:27) requires that the second interim payment must be paid on or before the last day of the year of assessment, that is, 28 or 29 February. Paragraph 11(6) of the Sixth Schedule states that incorrect final estimates of taxable turnover for the year of assessment may result in penalties and interest imposed in Chapter 15 of the Tax Administration Act, no. 28 of 2011 (hereafter referred to as the Tax Administration Act) being levied against a taxpayer.

Stein (2009:2) argues that the micro business owner has to pay two interim payments during the year, despite SARS's enthusiastic promotion of the turnover system, claiming that no provisional tax will be payable. The interim payment structure mirrors the provisional tax system as it is subject to the same penalty provisions as the normal provisional tax system. Stein (2009:2) also argues that the claim is specious in that SARS has merely re-named provisional payments in the normal tax systems as "interim payments" in the turnover tax system, but that there is no other difference. Consequently, Lindeque (2012: 21) comments that the micro business owner will continue to incur the compliance costs associated with provisional tax payments even if the business is registered for turnover tax.

2.13.5 Interest and penalties

Paragraph 11(3) of the Sixth Schedule states that should a micro business fail to pay the interim payment of turnover tax when it is due, interest at the prescribed rate is payable on the amount of turnover tax that is due. It is also important that a micro business owner should provide an accurate estimation of taxable turnover for the second interim payment, as paragraph 11(6) makes it clear that a penalty will be imposed if an estimate of the taxable turnover for the second interim payment is less than 80% of the actual taxable turnover for the year of assessment. The penalty to be charged is computed at 20% of the difference between the tax

payable on 80% of the taxable turnover and the tax payable on the estimate that was initially computed.

Paragraph 11(8) of the Sixth Schedule provides that a penalty will not be imposed if the Commissioner has issued an assessment for a payment due at the end of the year of assessment. In addition, and according to paragraph 11(7) of the Sixth Schedule, the penalty will be waived in full or in part if the Commissioner is satisfied or partly satisfied that an understatement of the estimate was not deliberate or negligent, and that the estimate was based on the information available. In this instance, in terms of section 102 of the Tax Administration Act, the onus rests on the micro business owner to prove that the understatement was not deliberate or negligent. Nonetheless, according to Chapter 16 of the Tax Administration Act, as the understatement penalty is deemed to be a percentage-based penalty, each understatement is investigated to determine whether it was merely bona fide error. Then the reasonable amount of penalty is calculated as a percentage of the shortfall based on each circumstance.

2.14 Payments of other taxes by micro businesses

Paragraph 11(4A) of the Sixth Schedule explains that a micro business which is subject to the turnover tax system remains liable for the payment of employees' tax (PAYE), the skills development levy (SDL), and unemployment insurance fund (UIF) contributions. In order to align with the simplified tax system available to micro businesses, however, paragraph 11(4A) of the Sixth Schedule, as amended by the Tax Administration Laws Amendment Act no. 39 of 2013, makes provision for micro businesses to elect to make twice-yearly payments of employees' tax, SDL and UIF. These payments must be made within seven days after the end of the relevant six-monthly period (paragraph 2(1) of the Fourth Schedule, section 6 of the Skills Development Levies Act, no. 9 of 1999, and section 8 of the Unemployment Insurance Contributions Act, no. 4 of 2002).

Paragraph 11(4B) of the Sixth Schedule states that if a micro business chooses to make twice-yearly payments of tax liabilities, this choice should apply to all tax types. Thus, the micro business cannot choose to adopt the special dispensation in relation to only one or two types of tax. This is also consistent with section 27(4)(b) of the VAT Act in which it is stated that micro businesses that have made written applications will fall into Category D, and therefore make twice-yearly payments.

According to Lindeque (2012:22) the fact that micro businesses are still liable for employees' tax, SDL and UIF, demonstrates clearly that the normal provisions of the Income Tax Act associated with employees' tax also apply to micro businesses, and that therefore, from the perspective of compliance costs, the turnover tax system brings little relief to the micro business owner.

2.15 Record-keeping for micro businesses

Contrary to the provisions of Part A of Chapter 4 of the Tax Administration Act, paragraph 14 of the Sixth Schedule states that a registered micro business is required to retain a record only of the amounts received during a year of assessment, of any dividends declared during that year of assessment, of each asset at the end of the year of assessment with a cost price of more than R10 000 and for each liability at the end of the year of assessment exceeding R10 000. This requirement includes documentation relating to amounts specifically excluded from taxable turnover, such as investment income, government grants, amounts derived from a small business funding entity, accruals, and refunds made in favour of the micro business, all of which are excluded from taxable turnover in terms of paragraph 7 of the Sixth Schedule. According to section 29(3) of the Tax Administration Act, a micro business is required to retain these records for a period of five years from the date of submission of the return. SARS (2016:29) added that such records should not be submitted with the Turnover Tax Return (TT03) and that instead these records must be kept and made available for audit purposes if requested.

SARS (2009:1) claims that record-keeping for micro business is reduced to the minimum in the turnover tax system by providing a simple means of record keeping for micro business owners to maintain. An analysis of paragraphs 14(a) to (d) of the Sixth Schedule, reveals that these businesses are obliged to retain certain records and this is an indication that, although possibly less onerous than the record-keeping requirements of other businesses, record-keeping for micro businesses is not that simple.

2.16 General administrative and transitional provisions

According to SARS (2016:29), although the turnover tax system has its own set of administrative provisions within the Sixth Schedule, the general administrative provisions relating to, for example, returns, assessments, dispute resolution, and refunds in the Tax Administration Act also apply to micro businesses subject to the turnover tax system. Yet SARS (2016:1) claims that the turnover tax system was introduced into the South African Income Tax Act to reduce the administrative burden for micro businesses.

There are also complications in respect of persons who registered for turnover tax, then deregistered, and are currently registered under the normal tax system or *vice versa*. Paragraph 7(c) of the Sixth Schedule and section 48C of the Income Tax Act provide that a person who moves from the normal tax system to the turnover tax system may have been taxed on the accrual of an amount under normal tax which is subsequently received by the micro business and now falling under the turnover tax system. This amount must be excluded from taxable turnover. Section 48C(1) of the Income Tax Act states that if the person received the amount during the year of assessment when registered as a micro business, that amount was included in that person's taxable turnover, and the amount accrues to that person when he or she is no longer registered as a micro business, such amount must not be taken into account when determining the taxable income of that person. SARS (2016:29) explains that this normally takes place when a person received payments in advance for goods or services supplied to customers of which the full acquisition expenditure was incurred in the previous year of assessment, and such amounts were taxed under the turnover tax system.

2.17 Conclusion

Chapter 2 has focused on the South African turnover tax system by discussing in detail the provisions of the Sixth Schedule, and the concepts of “receipts”, “from carrying on business activities,” and “excluding any amount of a capital nature,” as applicable to “qualifying turnover” for the purpose of determining turnover tax. The chapter also discusses the anti-avoidance rule for qualifying turnover, the criteria for disqualifying businesses from registering for turnover tax, the taxation of capital gains, and dividends tax for micro business, as well as the turnover tax administration. It was found that many aspects of the turnover tax system may

be too complex to be understood and managed by micro business owners, very few of whom have the necessary tax expertise and skills.

It was noted that claims made by SARS, such as that turnover tax is characterised by its simplicity, by requiring no dividends tax, no provisional tax, no tax on a capital, no income tax, and no expensive record-keeping, are misleading and lack substantiation.

Possibly due to the complexities explained above, there has been a low uptake of businesses registered for turnover tax. According to Lindeque (2012:24) in September 2008 there were 400 000 businesses with a turnover of R1 million or less, and surprisingly, only 4 209 businesses had registered for turnover tax by the end of April 2009. According to the Davis Tax Committee Report (2016:13), as of July 2013, there were 7 827 businesses registered for turnover tax, 139 with addresses unknown, 59 dormant, 74 in estates, 345 inactive, and 49 suspended.

Lindeque (2012:24) concluded that the definitions and concepts associated with turnover tax still require interpretation, and a normal business owner would require the assistance of a tax practitioner. Lindeque (2012:24) points out that an understanding of the legislation is imperative if a micro business owner is to decide whether the simplified tax system is, in fact, the most appropriate route for him to take.

In the next chapter the focus will be on the generally accepted principles of a good tax system with the aim of establishing the extent to which the South African turnover tax system complies, or does not comply, with all the principles of a good tax system.

CHAPTER 3: THE NATURE AND DEVELOPMENT OF THE GENERALLY ACCEPTED PRINCIPLES OF A GOOD TAX SYSTEM

3.1 Introduction

Chapter 3 addresses the second sub-goal of the study: to describe the generally accepted principles of a good tax system. The chapter discusses the development of the generally accepted principles of a good tax system by focusing on its historical perspective, overlapping features, and various categories of the principles of a good tax system. After analysing various categories of these principles, chapter 3 also identifies the principles that are suitable for the current study and explains the rationale for their suitability. Thereafter, the present chapter discusses in detail the elements of each principle identified.

3.2 The development of the generally accepted principles of a good tax system

Governments around the world endeavour to find ways of raising revenue and increasing government expenditure sometimes results in fiscal constraints. Raising revenue remains the main reason for taxation, which is the primary means of finance for public goods such as the maintenance of law and order and the viability of public infrastructure (OECD, 2014:30). Tax is a means, furthermore, by which income is redistributed from the rich to the poor to perform a critical role in the achievement of social policy, thereby aiming to ensure that citizens never fall below a level of income that would deprive them of access to basic food, clothing, housing, and education (Alley & Bentley, 2005:585).

There are broad tax policy considerations that traditionally have guided the development of tax systems (OECD, 2014:30) and which, according to Mokry (2006:17), fulfil a critical role in the generation and subsequent use of state revenue for the implementation of national economic policies. Thus, far from being marginal issues, the tax systems and taxes are, to a great extent, key in sustaining the economy. The policy considerations that guide a tax system are described in different terms, which include a good tax system, the canons of taxation, and concepts of taxation (OECD, 2014:30; Emslie & Davis, 2011:1; Alley & Bentley, 2005:585, and Jarczok-Guzy, 2017:73; Frecknall-Hughes, 2014:88). Kabinga, Alt and Kiprotich (2016:5) describe the principles of taxation as the formal guidelines which are widely accepted and should be taken into consideration whenever specific tax laws are proposed, amended, discussed, and implemented. Ebimobowei and Ebiringa (2012:15) consider that these specific principles of

taxation are the appropriate criteria to be applied when developing and evaluating tax structures. Derived from concepts formulated by welfare economists, they are designed to achieve the broad objective of a country's tax system that are, ideally, based on the principles of social justice.

3.3 Historical perspective of principles of taxation

There are scholars (such as Adam Smith, 1776, Newmarch, 1861, Jackson, 1994 and the Organisation for Economic Co-operation and Development (OECD:1998)) who developed a number of generally accepted principles for a good tax system. An early categorisation of these principles stems from Adam Smith's *Wealth of Nations* (1776). Jarczok-Guzy (2017:72) endorses Adam Smith as one of the most important authors of generally accepted principles of a good tax system. As early as the 18th century, Smith formulated four principles or canons: equality, certainty, convenience and the economy of taxation.

Although Adam Smith's principles of taxation are seminal, in the light of modern business practices, Du Preez and Stiglingh (2018: 141) emphasise the need for them to be modernised because, with the revolution of technology, business practices have been modernised. Alley and Bentley (2005:585) argue that, with the increasing globalisation of business having resulted in the mobility of capital and the blurring of jurisdictional boundaries, the setting of domestic tax policy has taken on an increasingly international application. Alley and Bentley (2005:624) assert furthermore that the generally accepted principles of a good tax system are not consistent. The value judgments of those applying a tax system will determine which principles are preferred. This does not make one principle more or less worthwhile than another; in deciding which principle should take priority, both should be considered, and the process should be transparent.

According to Frecknall-Hughes (2014:87) attempts to revise the principles of a good tax system are not new, but the principles of taxation have been intensively debated for over 200 years. Du Preez and Stiglingh (2018:141) indicate that many contributors have reformulated these principles and that many countries do not agree about what they should constitute, as is reflected in many tax reviews and committees that have existed over the past 60 years, with each formulating its own list of taxation principles.

An extract from the history of contributors who have participated in the quest to formulate the principles of taxation is provided in Table 3.1 below:

Table 3.1: An extract from the history of the guiding principles of taxation

Author	Criteria	Title of publication
Adam Smith 1776	• Equality • Certainty • Convenience of Payment • Economy in Collection	Canons of Taxation
Carter Report – Canada 1966	• Equity • Neutrality • Transparency and Accountability • Certainty • Simplicity • Flexibility	The Use of the Tax System to Achieve Economic and Social Objectives
Asprey Report – Australia 1975	• Fairness • Efficiency • Simplicity • Growth • Stabilisation	Criteria for Tax Systems
Meade Report – United Kingdom 1978	• Incentives and Economic Efficiency • Distributional Effects • International Aspects • Simplicity and Costs of Administration and Compliance • Flexibility and Stability • Transitional Problems	Characteristics of a Good Tax Structure
HMSO Green Paper Report – United Kingdom 1981	• Practicality • Fairness • Accountability • Cost of Administration • Fiscal Dimensions • Financial Control	Requirements of a Local Tax System
O’Brien Report – Ireland 1982	• Equity • Efficiency • Simplicity	Criteria for a Tax System

	• Low Administrative and Compliance Costs	
Ridge and Smith – United Kingdom 1991	• Administrative Feasibility • Economic Efficiency • Equity and Accountability	Criteria for Local Tax
Jackson 1994	• Equity or Fairness • Certainty • Convenience of Payment • Economy in Collection and Compliance • Transparency	Characteristics of an Efficient Tax System
OECD (Ottawa) 1998	• Neutrality • Efficiency • Certainty and Simplicity • Effectiveness and Fairness • Flexibility	Taxation Framework Conditions (for electronic commerce)
James and Nobes 1997	• Efficiency • Incentives • Equity • Macroeconomic Considerations	Principles of Taxation
ICAEW Tax Faculty 1999	• Statutory Certainty • Simplicity • Easy to Collect and Calculate • Properly Targeted • Constant Consultation • Regular Review • Fair and Reasonable • Competitive	Principles for a Better Tax System
American Institute of Certified Public Accountants 2001	• Equity and Fairness • Certainty • Convenience of Payment • Economy in Collection • Simplicity • Neutrality • Economic Growth and Efficiency	Guiding Principles of Good Tax Policy

	• Transparency and Visibility • Minimum Tax Gap • Appropriate Government Revenues	
Alley and Bentley – Australia 2005	• Equity and Fairness • Certainty and Simplicity • Efficiency • Effectiveness • Neutrality	A re-modelling of Adam Smith's Tax Design Principles
President's Advisory Panel on Federal Tax Reform – USA 2005	• Simplicity • Fairness • Economic growth	Report of the President's Advisory Panel on Federal Tax Reform
Henry Review – Australia 2010	• Equity • Efficiency • Simplicity • Sustainability • Policy Consistency	Australia's Future Tax System
The President's Economic Recovery Advisory Board – USA 2010	• Simplicity • Compliance	The President's Economic Recovery Advisory Board
Mirrlees Review – UK 2011	• Equity • Certainty • Convenience of Payment • Economy in Collection • Minimize Negative Effect on Welfare and Economic Efficiency • Minimize Administration and Compliance Cost • Fairness in more than a Distributional Sense • Transparency	Tax by Design
Davis Tax Committee – South Africa 2015	• Equity • Simplicity • Efficiency • Transparency and Certainty • Tax Buoyancy	First Interim Report on Macro Analysis

American Institute of Certified Public Accountants (AICPA) – USA 2017	*Two additional principles were included:* • Information Security • Accountability to Taxpayers	Update of the 2001 document

***Source**: Alley and Bentley (2005:587) and Du Preez and Stiglingh, (2018:141)*

3.4 Overlapping features of principles of taxation

Table 3.1 indicates that, although there are various generally accepted principles of a good tax system developed by scholars and institutions these overlap. Table 3.1 also indicates that all scholars and institutions use Adam Smith's principles as a point of reference and thus do not deviate much from the elements Smith devised. Taking globalisation and enhanced technological developments into account, the OECD, at the conference of Ottawa in 1998, remodelled Smith's principles by designing a taxation framework for electronic commerce. The focus of the OECD was to develop principles consistent with those taxpayers conducting businesses in a globalised and electronic business environment.

Table 3.1 indicates that the Davis Tax Committee (2015) of South Africa is the only body in the developing countries that has remodelled Adam Smith's principles of taxation. The Davis Tax Committee's tax principles were designed to be consistent with the economic environment of South Africa, taking into consideration that South Africa is not an isolated state, and that it operates in a globalised environment.

3.5 Principles of taxation used in the study

To ensure that this study covers a wide scope of the principles of taxation, elements of those principles are employed as determinants of the extent to which South Africa's turnover tax complies with principles of good taxation.

3.5.1 Adam Smith's tax principles

Adam Smith's principles consist of four elements, namely, equity, certainty, convenience of payment, and economy in collection. As these principles are the point of reference for all other tax principles designed by various scholars and institutions, they are adopted for this study.

3.5.2 The OECD (Ottawa)'s principles of taxation

The OEDC (Ottawa)'s principles of taxation consist of five elements, namely, neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility. As some South African micro businesses use electronic commerce, it is necessary that the present study adopts the OEDC (Ottawa)'s principles of taxation in its endeavour to determine the extent to which the turnover tax for micro businesses complies with the generally accepted principles of a good tax system.

3.5.3 The Davis Tax Committee's tax principles

The Davis Tax Committee's tax principles also consist of five elements, namely, equity, simplicity, efficiency, transparency and certainty, and tax buoyancy. The rationale for adopting these principles for this study is that they are the only ones designed for and in developing countries. In addition, these principles were designed to be consistent with the economic environment of South Africa. It is therefore important to make extensive use of the Davis Tax Committee's tax principles to determine the extent to which South African turnover tax complies with the generally accepted principles of a good tax system.

There is an overlap of the generally accepted principles of a good tax system as outlined in Adam Smith's tax principles, the OECD (Ottawa)'s principles of taxation, and the Davis Tax Committee's tax principles. Similar elements are grouped into one element for the purposes of this study. Table 3.2 below indicates the grouping of various elements of tax principles on which the present study focuses:

Table 3.2: Grouping of elements of tax principles

Elements utilised in the present study	**Name of the element in Adam Smith's principles of taxation**	**Name of the element in the OECD (Ottawa)'s principles of taxation**	**Name of the element in the Davis Tax Committee's tax principles**
Equity	Equity	Neutrality	Equity
Certainty	Certainty	Certainty and simplicity	Transparency and certainty
Transparency	Not applicable	Not applicable	Transparency and certainty

Convenience of payment	Convenience of payment	Efficiency	Efficiency
Economy in collection	Economy in collection	Effectiveness and fairness	Tax buoyancy/efficiency
Flexibility	Not applicable	Flexibility	Simplicity

Source: *Own compilation, based on principles formulated by Adam Smith, the OECD (Ottawa) and the Davis Tax Committee.*

Table 3.2 indicates that, after grouping similar elements of the generally accepted principles of a good tax system, the present study focuses on five elements, namely, equity, certainty, convenience of payment, economy in collection, and flexibility.

3.5.4 The principle of equity

Smith's (1776) first maxim is the concept of equity or equality, which means that people should pay taxes in proportion to their "ability to pay". A progressive income tax system is a typical example of the application of equity principle which ensures that those who earn higher incomes pay more taxes than those who earn a lesser income (Olivier, 2017:35). Kabinga, Alt and Kiprotich (2016:7) argue that equity in taxation expresses the idea of fairness in taxation as being one of the principles that guide tax policy. Similarly, Wilson-Roger and Pinto (2009:76) emphasise that most people would agree that a tax should be equitable and should be perceived to be equitable, thereby promoting voluntary compliance. On the contrary, if taxpayers in general believe that the tax is inequitable it is likely that they would resort to tax evasion or avoidance.

For Smith (1776), the expenses of government are similar to those of a mutual private property or an estate. From this perspective he proposes that payment of tax should be in accordance with each individual owner's interest in that property (Drenkard, 2015:5). In Adam Smith's (1776:1433) words:

> The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate.

According to Smith (1776), cited by Olivier (2017:35), the introduction of consumption taxes on luxuries is another typical example of the equity principle of taxation in that it discourages people from lower income groups from consuming goods they can little afford, but it might be a lucrative means of collecting taxes from the more affluent members of society. Toll fees, or user taxes, would be perceived by Smith (1776) to be an equitable tax, because the cost of goods or services supplied by the government is aligned with the advantage enjoyed by the user of those goods or services (Drenkard, 2015:8).

Equity can be either vertical or horizontal. According to Kabinga, Alt and Kiprotich (2016:7), horizontal equity determines whether a tax system makes arbitrary distinctions among taxpayers, or whether distinctions are based on irrelevant criteria. According to the concept of horizontal equity, those who are equal, that is, similarly situated persons, ought to be treated equally, which implies that those who have similar levels of income should pay similar levels of tax, and that there should be no discrimination between them. For example, it is against the principle of horizontal equity if one person purchases goods in a local store and pays sales tax, while another person purchases similar goods via the internet and does not pay sales tax. Vertical equity determines how people at different income levels should be taxed, taking into consideration their relative abilities to pay. With vertical equity it is expected that high income earners pay a larger percentage of their income in taxes than do lower income earners. Modern economists interpret equality or the ability to pay differently from Adam Smith's (1776) eighteenth-century perspective: the concept of vertical equity is concerned with how people with different abilities to pay should be treated, what levies should be imposed on those with different levels of income, for the purposes of the division of the tax burden. A good tax system should be designed in such a way that it ensures horizontal as well as vertical equity.

Based on the assumption of the diminishing marginal utility of money, Jarczok-Guzy (2017:35) argues that the principle of the ability to pay calls for a progressive system of income tax, that is, that the rate of tax should increase with a rise in income. As early as 1880, Adolph Wagner, as cited by Jarczok-Guzy (2017:73), put forward the thesis that proportional taxes negatively affect the lives of taxpayers because the same tax rate places unequal tax burdens on taxpayers of diverse incomes, and that therefore the only fair taxation is progressive taxation. A progressive tax is a tax in which the tax rate increases as the taxable amount increases (Jarczok-Guzy, 2017:76); whereas for the proportional tax, the percentage tax rate remains the same as taxable amount increases (Soyode & Oyedokun, 2019:18). In most countries in the

world, a progressive system of income and of other direct taxes has been adopted to ensure equality in the tax system (Olivier, 2017:35). It becomes clear that if all taxpayers are required to pay taxes according to their ability, the sacrifices of all taxpayers are rendered equal, according to each individual's capacity. The canon of equality and the canon of equity are two sides of the same coin.

In the recent case of *C: SARS v Pretoria East Motors (Pty) Ltd,* (291/12) [2014] ZASCA 91, the Supreme Court of Appeal considered administrative equity in a tax dispute. The Supreme Court of Appeal emphasised the fact that, for the sake of fairness (equity) and proper court procedure, SARS must state the grounds on which it bases its assessments and make clear to the taxpayer what it is disputing, so that the taxpayer knows what is required in order to discharge the burden of proof.

In summary, the principle of equity requires that each individual taxpayer contributes towards the fiscus based on his or her ability to pay. The principle of equity is a key concept in taxation that seeks to promote fairness and equitability in the levying of taxes. Where a tax system complies with this concept, taxpayers are likely to contribute willingly towards government activities.

3.5.5 The principle of certainty

Another important principle of a good tax system is certainty. To quote Adam Smith (1776:1434): "The tax which each individual is bound to pay ought to be certain and not arbitrary". The time of payment, the method of payment, and the amount to be paid ought to be clear to the taxpayer and to other stakeholders. The OECD (2014:30) comments that tax policies which are clear and simple assist taxpayers to know where they stand; a simple tax system therefore makes it easy for individual taxpayers and businesses to understand their obligations and entitlements. As Muller (2010:51) argues, certainty involves simplicity, and this means that taxes should be simple in concept, administration, and collection. Certainty in a tax system enables taxpayers to respond to policy choices to ascertain their tax liabilities.

In 2011, the British House of Commons (2011:15) identified two elements of tax certainty: the clarity of the tax system, and the assurance that the tax system will be understood and consistently applied. Clear and certain tax policies have the potential to contribute to

fundamental principles of fairness and to economic growth. In support of this contention, Muller (2010:51) expresses the view that certainty in a tax system is necessary for the economy because its absence would demoralise assurance in the markets, which in turn could obstruct economic growth. Kabinga, Alt and Kiprotich (2016: 8) assert that certainty encourages the tax system to be predictive, which then significantly enhances the capacity for businesses to plan their investments, costs, and tax liabilities; all of this renders certainty in taxation systems important for all commercial activities.

Wilson-Rogers and Pinto (2009:81) point out that certainty in tax systems is not only an economic concept but is also a legal concept, and that certainty reinforces the rule of law which requires taxpayers and their advisors to ascertain their rights and obligations in respect of tax from the legislation. To do this, the tax system must be certain. Wilson-Rogers and Pinto (2009:81) further assert that "absence of clarity is destructive of the rule of law; it is unfair to those who wish to preserve the rule of law; it encourages those who wish to undermine it". This assertion is also supported in the 2014 Report of the OECD (2014:30) on addressing the tax challenges of the digital economy. In this report it is stated that the tax rules that are easily understood make it easier for taxpayers to anticipate the tax consequences of transactions in advance, and for the revenue authority to evaluate compliance. This implies that businesses are likely to make optimal decisions and respond to intended tax policy signals, thereby minimising the potential for tax disputes. The report further indicates that a tax system which is certain is likely to reduce compliance costs incurred by taxpayers, resulting in an efficient tax system.

Despite the significance of certainty in optimising the efficiency of a tax system, Drenkard (2015:10) argues that certainty of taxes can be difficult to achieve because tax laws can be open to interpretation and citizens may find it difficult to understand complex tax laws which are inherently subject to change, sometimes retrospectively. Drenkard (2015:10) also states that in the United States, for instance, state taxes are sometimes changed retrospectively, causing considerable uncertainty about the amount of tax actually required. Olivier (2017:35) contends that the inconvenience of the payment of taxes is one of the factors that negatively affects certainty in a tax system because the exact amount to be paid is not always known at the time of payment, as for example, when unearned income might be taxable at some future date.

In consolidating all the opinions and arguments in respect of the certainty principle of a good tax system, the Davis Tax Committee (2014:5) analysed certainty from a South African

perspective and concluded that a tax system underpinned by the principle of certainty should be characterised by clarity in the following circumstances: the calculation of tax and the time and manner of its collection; transparency during the consultative process while tax reform is being undertaken; it should be understood easily by citizens and characterised by administrative convenience; minimal resources should be deployed throughout the economy in the management of tax affairs; and there should be a fair fee for advice on tax for those taxpayers who are less well off than others.

3.5.6 The principle of transparency

According to the Minnesota Center for Fiscal Excellence (MCFE, 2016:3) a transparent tax system informs taxpayers that a tax exists, the reason why it is levied, who is responsible for its existence, and the manner in which it is calculated. A transparent tax system also enables the taxpayer to make informed judgements about the relationship between the tax burden and the types and levels of government services provided. Thus, according to Campuzano (2015:1), tax transparency enables taxpayers to develop realistic expectations regarding what government can and cannot do and helps them to monitor the effective performance of government in respect of revenue collection.

Tran-Nam, Taylor and Slemrod (2013:296) state that the principle of tax transparency is consistent with the economists' "incidence" principle which acknowledges that the final responsibility for the tax burden falls on taxpayers through higher prices, lower wages, or lower returns on investment. MCFE (2016:3) considers a transparent tax system to be one which has characteristics such as making taxpayers aware of linkages to spending, avoiding automatic tax increases, and reporting on tax incidence, especially on taxes finally paid by taxpayers who are not directly levied. Thus, tax transparency means that information about the tax systems and how taxes are used is readily available to both taxpayers and administrators; it enables taxpayers to know who is being taxed, how much they are paying, and what is being done with their money. Taxpayers can also find out who, in broad terms, pays the tax and who benefits from tax exemptions, deductions, and credits.

Nevertheless, a quote from Campuzano (2015:2) states that:

> …taxation processes are characterized by information asymmetries that stand in the way of furthering fair, effective and efficient tax systems. Such imbalances are inevitable because government tax agencies always have exclusive access to some information and practices and always have compelling reasons to keep much of it confidential. But, such asymmetries are not only related to information accessibility, they may exist too in the aims of disclosers and users of such information. This is, in our opinion, an essential premise to take into account in the formulation of fair transparency measures.

Akinboade (2015:395) demonstrates that tax laws in many developing countries such as South Africa change rapidly producing instability and limited transparency in tax systems. Complicated tax legislation results in ongoing changes in the tax laws which confuse tax administrators and taxpayers alike, all of which triggers increasing opportunities for simple error and, in particular, tax avoidance.

Tax transparency, as a principle for a good tax system, plays a critical role in the effectiveness and efficiency of the tax system. Tax transparency is acknowledged in the tax system if taxpayers can obtain knowledge about the existence of the tax, the underlying reason for its implementation, authorities who are in charge of the tax, and the approach to be used when computing such tax. Tax transparency in a tax system includes fairness in the tax process, that the voice of taxpayers is included in the tax process, mechanisms for appeal, and explanation of procedures to the taxpayers by the authorities.

3.5.7 The principle of convenience of payment

The convenience of the payment principle states that the amount, time, and manner of payment of a tax should not only be certain, but the time and manner of its payment should be convenient for the taxpayer. If, for example, tax is collected at the time of harvest, this would be a convenient time because with crops newly reaped farmers have the income for payment. Similarly, the requirement that taxes be paid in the middle of the month is not convenient because funds may be scarce at this time. If tax schedules provide convenient times for payment, individuals and businesses would be in a position to meet these costs, and evasion would be reduced (Gluckman, 2012:18). According to Alley and Bentley (2005:610) convenience helps to ensure compliance with tax systems. Simply put, the more difficult and inconvenient a tax is to pay the more likely it is that it will not be paid. Meer (2013:1) comments

that if the time and manner of tax payment is not convenient, tax evasion and corruption may follow.

Muller (2010:51) puts forward the suggestion that it is preferable that taxes be levied on a cash basis rather than in kind; also, taxes should be levied in a manner that takes into account a taxpayer's liquidity. In the matter of taxing assets, unrealised assets need to be valued in order to be assessed for taxation, but discretionary valuations can result in inconsistencies and this could invite tax avoidance because of the uncertainty of value. The Davis Tax Committee Report (2018:36) commented that generally taxes on wealth and wealth transfers are more inconvenient for taxpayers to pay compared with other types of taxation. In some cases, especially with annual taxes, tax liability can demand that an asset be sold in order to provide for the necessary funding to cover the payment of the tax. Selling assets, however, is difficult when demand for the asset is low, or the economy is in recession. In such circumstances, the taxpayer would have to sell assets in a depressed market just to finance a tax liability, which is an unhappy situation because it may result in an unintended loss for the taxpayer.

Alley and Bentley (2005:610) explain that the typical payment mechanisms for promoting the convenience principle include withholding (such as the withholding of income taxes from employee remuneration) and periodic payments of an estimated tax liability (such as provisional tax). The withholding and periodic payments of tax should be conducted in such a manner that compliance costs are not increased, as Alley and Bentley (2005:610) point out that compliance costs such as collecting information, obtaining advice from tax experts, and the preparation of returns can reduce the convenience of the tax system. Mueller (2016:4), however, argues that the tax withholding process allows tax authorities to tax people more than they should be taxed. It is therefore paramount that a tax system be designed in such a way that tax falls due at a time or in a manner most likely to be convenient to the taxpayer and that there should be no increase in compliance costs.

Nevertheless, the appropriate tax payment mechanism depends on the amount of the liability, and how easy (or difficult) is its collection process. For instance, as Alley and Bentley (2005:610) demonstrate, the self-assessment regime implemented in the New Zealand tax system mandates taxpayers to determine their own tax liability; some taxes are also collected at source. The convenience of collection varies depending on the type of tax and the circumstances of the taxpayer.

The principle of convenience was analysed by Meer (2013:1) who found that it is an extension of the principle of certainty. Where the principle of certainty states that the taxpayer should be aware of the amount, manner, and mode of paying taxes, the principle of convenience states that this should be easy, convenient, and taxpayer friendly. That is to say, the time and manner of payment should be convenient for the taxpayer and that generous time limits should be set for the completion of tax returns, to enable the taxpayer to meet his or her tax obligations in a reasonable time. Piontkivska (2020:2) added that, in some countries, paying taxes entails filling in numerous tax forms and reports to comply with national legislation, but that this violates the principle of simplicity and convenience.

It can be concluded, therefore, that a tax system that is convenient has characteristics such as designing the time and methods of tax collection to accommodate the circumstances of taxpayers, to increase revenue collection, reduce tax evasion and corruption, to lower compliance costs, and generally to promote a basis of cash and not "in kind" payment. To promote such principles in the tax system, payment mechanisms such as the withholding of income taxes and periodic payments can be used in such a way as to not increase compliance costs. Convenience of collection varies depending on the type of tax to be paid. In general, tax systems that involve filling in numerous tax forms and reports to comply with national legislation violate the principle of simplicity and convenience.

3.5.8 The principle of economy in collection

In the words of Adam Smith (1776:1436): "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state". Collection involves the government in the inevitable expense of tax collection. As these costs reduce the national income, they should be minimised as far as possible. If the expenses of administration incurred in the collection of taxes yield less than its collection, or even consume a major portion of the tax revenue collected, it is a worthless levy and should not be included in a good tax system (Olalekan & Oyedokun, 2019:22). This principle, on the one hand, deals with a revenue integrity that guarantees a tax system that diminishes opportunities for tax avoidance and arbitrage and provides a sustainable revenue base for the government. On the other hand, it deals with fiscal

adequacy enabling the government to raise sufficient revenue to meet its requirements (Murry, Oliver & Wyatt, 2014:19).

According to National Economics and Statistics (2018:14) one of the indicators of a good tax system is efficiency: the administrative costs for tax authorities and compliance costs for taxpayers should be kept to a minimum as far as possible. Due to the reduction of the tax authorities' administrative costs and the taxpayers' compliance costs, revenue collection can improve, Alley and Bentley (2005:596) argue that these should be the prime focus for tax authorities in their endeavour to increase revenue collection.

Mohamud and Isak (2019:127) suggest that in situations in which government experiences low tax collection, it is advisable that it persists in transforming the tax administration and other systems in order to promote the timely collection of sufficient revenue through the enforcement of tax law. Michael and Ascenzo (2015:82) argue that improvement in tax collection cannot be achieved only by transforming the tax system, but by aligning tax collection to the values, vision, and strategic direction of the government, as well as by applying a new thought paradigm in respect of the relationship between the revenue authority and the taxpayer. The vision and values of the government are the driving forces behind the major cultural changes found among both the tax agencies and the taxpayers, and which inform the effectiveness and responsiveness of the tax authority. Michael and Ascenzo (2015:82) further argue that good tax administration originates in the philosophy that reinforces the thinking and actions of the tax agencies, which include their willingness to work with the community, their ability to build trust in tax collection systems by embracing a fair and professional approach, the agencies' integrity and transparency, as well as their empathy with and vigilance in the tax collection process. Michael and Ascenzo (2015:82) indicate that administration powers are also critically important from the perspective of tax collection; and that to improve tax collection the government must make sure that tax agencies have the necessary powers to carry out their tax collection responsibilities.

Mohamud and Isak (2019:133) demonstrate that for the tax system to generate adequate revenue it has to be simplified in three ways: tax collection should not only be done on a cash basis, but on the basis of modern forms of payment such as mobile money payments; instead of tax revenues being handled by revenue cashiers, they should be deposited to licensed private banks in the country. Tax assessment should not be based on *ad hoc* judgments of tax

authorities only but should involve a joint responsibility between taxpayers and tax authorities. As Mohamud and Isak (2019:134) point out, automating the tax administration's processes increases the speed of its operations and facilitates revenue collection. But South Africa may, in some instances, be dependent upon the old-fashioned manual tax administration system characterised by human dependent, time-consuming processes, physical documentation, poor information capturing capabilities, unreliable reporting mechanisms, and high administrative costs.

The principle of economy in collection, therefore, has the following characteristics: government expenditure on tax collection remaining as low as possible; the tax system should be set up in such a way as to minimise opportunities for tax avoidance and arbitrage and provide a sustainable revenue base for the government without compromising the government's ability to raise sufficient revenue to meet its requirements. The principle of collection in an economy deals with the promotion of efficiency in the tax collection process, which focuses on minimising both administrative and compliance costs, which in turn increase tax revenue collection. Furthermore, in order to improve tax revenue collection, the tax system should be simplified by the adoption of modern forms of payment such as mobile money payments, promoting electronic tax payment, promoting the joint responsibility of taxpayer and tax authority in respect of tax assessment, and automating tax administration processes.

3.5.9 The principle of flexibility

The principle of flexibility involves taxpayers operating in global economic, social, and technological conditions, and the tax system should be sufficiently flexible to be responsive to change. Thus, as taxpayers operate in a digital age, the tax system should strive to find an appropriate balance between flexibility and stability thereby enabling the government to respond to changes while also creating a system that allows both predictability and certainty (Fiscal Commission Working Group, 2013:58). The OECD Report (2001:9) and National Economics Statistics (2018:8) concur that the tax system should be flexible and dynamic enough to ensure that it keeps pace with technological and commercial developments. The flexibility and dynamism of the tax system, according to the OECD Report (2014:31), means that the tax system should have durable structures that can easily adapt to the changing policy environment without compromising the government's ability to use technology in the tax

collection process. According to Alley and Bentley (2005:603), flexibility is integral to the efficiency of the tax system.

Hodzic (2019:777) is of the view that the principle of flexibility involves the creation of a tax system that has flexibility and automation and requires as little documentation and form filling as possible, while, at the same time, ensuring a high level of security. This allows the tax system to be secure, flexible, and compatible with other tax systems around the world. To promote the principle of flexibility in the tax system, Bentley (2019:695) suggests that the government should establish and develop the technology system that facilitates changes in use, content, organisation, ownership, and infrastructure. A flexible source of revenue is one that can be changed easily to meet changing governmental needs.

Migai, De Jong and Owens (2019:424) also indicate that a flexible tax system can help transform the informal sector into a formal sector, securing additional sources of revenue for the government. By contrast, a non-flexible tax system is characterised by deficient tax compliance processes because its payment methods (usually in cash) allow for the circumvention of the official reporting processes that underpin the formation of the taxable base. According to Hodzic (2019:777), the principle of flexibility promotes a digital administration which brings changes in the employment structures of the tax system by increasing flexibility in its processes. A digital administration also reduces the need for its staff having to deal with paper-based tasks, they are retrained and redeployed to provide services to taxpayers and manage compliance functions such as crosschecking assets. To increase the flexibility of tax administration, Hodzic (2019:777) points out that there is a need for the harmonisation of the digital business model and the tax control model.

In conclusion, the principle of flexibility requires tax systems which are flexible and sufficiently responsive to change. The flexibility of a tax system is attributed to its durable structures that are easily adaptable to a changing policy environment without compromising the government's ability to use technology in their tax collection processes. As a result, flexible tax systems promote digital administration and help to efficiently combat corruption and tax evasion.

3.6 Conclusion

Chapter 3 has focused on describing the generally accepted principles of a good tax system by discussing their development, historical perspective, their elements, and their overlapping features. The chapter also indicates the specific tax principles that form part of the current study and the rationale behind their choice, namely equity, certainty, convenience of payment, economy in collection, and flexibility.

In respect of the equity principle of taxation, this chapter concludes that equity means that each individual taxpayer should contribute towards government support based on his or her ability to pay. In addition, the principle of equity implies that taxpayers should pay taxes in proportion to their earnings, as in progressive taxation. The principle of equity is a key concept in taxation that also seeks to promote fairness and equitability in the administration of taxes. In safeguarding this concept taxpayers are more likely to contribute willingly towards government funds.

Chapter 3 also concludes that a tax system that promotes the principle of certainty is characterised by clarity in the calculation of tax and the time and manner of its collection, by transparent consultative processes when a tax is being amended, a tax system that is easily understood by citizens, by administrative convenience, and by its ability to minimise those resources used to handle tax affairs.

A tax system that is convenient has characteristics such as time and methods of tax collection that are suitable for taxpayers, an increase in revenue collection, a reduction in tax evasion and corruption, and low compliance cost. Chapter 3 argues that, to promote the principles of convenience in the tax system, payment mechanisms such as the withholding of income taxes and periodic payments can be deployed. These mechanisms should be used in such a way that they do not increase the costs of compliance. The convenience of collection varies depending on the type of tax to be paid, and, generally, those tax systems that involve filling in numerous tax forms and reports in compliance with national legislation violate the principle of simplicity and convenience.

Regarding the principle of economy in collection, to improve its systems of revenue collection, modern forms of payment should be adopted, such as mobile money payment, promoting

electronic tax payment, promoting joint responsibility of taxpayer and tax authority in respect of tax assessment, and automating the tax administration processes.

Finally, flexibility is discussed as one of the principles of taxation which indicates that flexibility implies a tax system which is durable, but flexible and sufficiently responsive to change.

The next chapter will discuss the extent to which the South African turnover tax system complies, or does not comply, with all the principles of a good tax system.

CHAPTER 4: COMPLIANCE OF THE TURNOVER TAX SYSTEM WITH GENERALLY ACCEPTED PRINCIPLES OF A GOOD TAX SYSTEM

4.1 Introduction

Chapter 4 addresses the third sub-goal of the study: to determine the extent to which the South African turnover tax system complies with generally accepted principles of a good tax system. The principles of a good tax system include the principles of equity, certainty, transparency, convenience of payment, flexibility, and economy in collection. In this chapter the turnover tax system is analysed against each element of each principle; this is followed by a consideration of the extent to which the turnover tax system is compliant with generally accepted principles of good tax systems.

4.2 Turnover tax and the principle of equity

The principle of equity requires that every taxpayer contribute according to his or her ability towards the revenue of the government. The principle of equity requires that tax is paid in proportion to earnings, as in a progressive tax system. By safeguarding equity, taxpayers willingly contribute to government activities in such a way that satisfies them (Olivier, 2017:35; Drenkard, 2015:8; Gluckman, 2018:3).

In order to determine the extent to which the turnover tax system complies with the principle of equity this study considers four major facets of the turnover tax in relation to the principle of equity:

- the reason (philosophy) for the introduction of the tax
- turnover tax is paid on a proportional basis and is a progressive tax;
- the affordability of turnover tax;
- turnover tax is levied based on receipts (revenue).

To promote the potential for small businesses to grow the economy and minimise their compliance cost, it was proposed in the 2008 budget review that an elective presumptive turnover tax system be implemented for small businesses with a turnover up to R1 million per annum (subject to specific inclusions and exclusions). This instrument replaced income tax, CGT, dividends tax, and VAT for small businesses (The Revenue Laws Amendment Bill,

2008:14). Nonetheless, Willemse (2015:1) argues that the micro businesses registered for turnover tax still face tax compliance costs due to the generally high costs associated with processes necessary to comply with the requirements of the turnover tax system. This implies that compliance costs for micro businesses are proportionately higher than for larger businesses and therefore the principle of equity is not satisfied.

Olla (2016:4) and Rahim (2015:21) state that many small businesses still fall outside of the net as their annual turnover exceeds the threshold of R1 million. This further illustrates a lack of equity because a micro business with a turnover of R1 million is permitted to register for the turnover tax, while a micro business with a turnover of, for example, R1 100 00 may not register.

According to paragraph 8 of Schedule 1 to the Rates and Monetary Amounts and Amendment of Revenue Laws Act, no. 32 of 2019, turnover tax is levied at rates that vary from 0% to 3%, depending on the taxable turnover of the micro business. This does not take into consideration the expenses that may be incurred, and no deductions are permitted to compensate for these expenses. For example, a micro cleaning business that provides services to industrial companies may incur higher expenses than a micro cleaning business that provides cleaning services to private individual residences. Because micro businesses operating in different sectors might not incur the same expenses, taxation across all sectors at the same rate contradicts “the ability to pay” element of the equity principle.

A progressive tax requires that higher-income individuals should pay a greater share of their income in taxes than those less able to pay, thereby providing the means for a large proportion of public services (The Inland Revenue Department and the New Zealand Treasury, 2018:5). Similarly, because turnover tax is progressive, micro businesses with higher taxable turnovers pay higher amounts of turnover tax than those with lower taxable turnovers. This relates to the principle of vertical equity. Because of the design of the turnover tax, however, progressiveness of the tax rate does not guarantee equity. As expenditure is ignored, a business operating with low costs and a lower turnover and a business operating with high costs and a higher turnover, but both with the same profits, would pay different amounts in turnover tax. From the perspective of horizontal equity, the profit of two businesses with the same turnover, but different cost structures, would differ, but they would pay the same amount in tax. The design of the turnover tax therefore does not guarantee either vertical or horizontal equity as

expenditure is not taken into account. Turnover tax being levied on taxable turnover means that micro businesses are required to pay tax even if they make a loss, which also contradicts the principle of equity.

Paragraph 3 of the Sixth Schedule states that if a taxpayer forms part of a certain profession listed under professional services and more than twenty percent of his or her income is earned from this profession, he or she is prohibited from registering for turnover tax even if his or her qualifying turnover is less than R1 million. Gluckman (2012:29) is of the view that this provision goes against the principle of equity in that, just because a micro business forms part of a certain profession, this excludes the business from registration for turnover tax. Hence, automatic prohibition is not equitable.

According to paragraph 3(g)(iii) of the Sixth Schedule and the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2008, in order to ensure that only micro businesses have access to the turnover tax system, the R1 million qualifying turnover threshold is applied to the collective turnover of a partnership. The "ability to pay" principle is violated again because partnership income is split between partners and each partner could otherwise have qualified separately for the turnover tax.

It is clear that, in certain respects, the South African turnover tax does not comply with the principle of equity.

4.3 The turnover tax and the principle of certainty

A tax system which complies with the principle of certainty is characterised by clarity in the calculation of tax and the time and manner of its collection, a transparent consultative process during the process of tax reform, one that is easily understood by citizens, administrative convenience, its ability to minimise resources used in the economy to handle tax affairs, and levels of fairness perceived by taxpayers who are unable to afford expensive tax advisors (Davis Tax Committee, 2014:5).

The turnover tax system has few complicated exemptions and SARS (2018:1) claims that turnover tax is characterised by its simplicity and its certainty in that it requires no dividends tax, no provisional tax, no CGT, no income tax, and no expensive record-keeping. This

perception is shared by Soyode and Oyedokun (2018:33) who observe that a multiplicity of taxes invites uncertainty and is harmful to businesses by unlocking the channel for revenue leakages; any tax system that promotes uncertainty negates the principle of certainty.

Although the turnover tax system seems to offer simplicity and certainty, it is only so if the micro business owner has some level of understanding of the turnover tax system. Gluckman (2012:32) points out that, in reality, there is often a lack of insight among business owners as to whether turnover tax is a feasible solution for those wishing to register for the tax. It is inevitable that, if there is insufficient training provided for individuals registering for turnover tax, their potential tax liability is unpredictable and uncertain. Because in many cases understanding of the tax is lacking and dealing with procedural matters may also be difficult for most micro business owners, the result is they become victims of SARS's penalties for non-compliance with the procedures of the system.

Since the turnover tax was implemented in 2009, it has undergone various amendments. Almost every financial bill proposed by the Minister of Finance has introduced new changes to turnover tax, each of which may increase its underlying uncertainty for micro business owners already in the system. The lack of a stable turnover tax system may lead to complications in formulating long-term plans for micro businesses and impose increasing compliance costs. These concerns are reflected in the observation made by Olivier (2017:57) who argues that constantly changing tax systems may cause difficulties in designing long-term goals for businesses reluctant to take on the expense and risk of the likely compliance costs for taxpayers. SARS (2012:6) makes the following statement:

> Several reforms of the turnover tax for micro businesses (with annual turnover below R1 million) were announced in 2011. Building on these reforms, micro businesses will be given the option of making payments for turnover tax, VAT and employees' tax at twice-yearly intervals from 1 March 2012. It is further envisaged that a single combined return will be filed on a twice-yearly basis from 1 March 2013. The number of returns required for these taxes will fall from about 18 per year to only two a year in 2013. The build-up of tax liability will require such taxpayers to ensure that funds are available when payment is due.

This represents a substantial simplification of the compliance duties of micro businesses and should result in more certainty and a reduction of compliance costs.

All tax systems are subject to change due to the dynamic nature of their environment, but the implementation of change and improvement must be executed with proper consideration (Lombard, 2018:33). Similarly, the extent of benefits due to change in a turnover tax system can be substantial if change is responsibly instituted and carried out. Constant amendments to turnover tax, however, may lead to uncertainty in the timing and manner of tax payment.

In summary, the turnover tax system complies with certain aspects of the principle of certainty, as is evident in its ability to replace various taxes with a single system thereby reducing compliance costs. On the other hand, the system may not comply with other aspects of the principle of certainty. For example, many micro business owners, due to a lack of training and information, may not understand the calculation and underlying procedures of the turnover tax.

4.4 Turnover tax and the principle of transparency

Transparency as a principle for a good tax system plays a critical role in the effectiveness and efficiency of the tax system. Transparency in tax matters includes an open and transparent system of consultation with all stakeholders when new legislation is introduced and changes to existing legislation are made, clear mechanisms for appeal, and clear explanations to taxpayers by the tax authorities of the effect of new legislation or changes to existing legislation and the related procedures. If they have the necessary information about the tax, taxpayers should also be able to come to conclusions about the tax revenue collections and the concomitant government services provided to them (Campuzano, 2015:13; Arvidsson, 2019:83; Tran-Nam, Taylor & Slemrod, 2013:296). The principle of transparency overlaps with principles such as certainty, simplicity, and neutrality (Marcus, 2007:20), and goes hand in hand with accountability because a transparent process ensures that all parties involved in the implementation and administration of a tax system can be held accountable (Lombard, 2018:33).

Turnover tax was introduced into the South African Income Tax Act in 2009 to reduce the administrative burden on micro businesses and to contribute positively to assisting these businesses to survive financially and to the economic growth of South Africa (SARS, 2017:8; Labuschagne, 2018:2). Campuzano (2015:13) comments that a transparent tax system should reflect aspects of information justice, for example, the rule of justification that requires tax authorities to explain decision-making procedures and results in a comprehensive and

reasonable way to taxpayers; furthermore, the rule of truthfulness requires that communications between tax authorities and taxpayers should be honest and sincere. In a transparent tax system, the voice of the taxpayer about tax procedures is important for the maintenance of their trust in the tax system. Political processes give taxpayers an opportunity to influence how and to what extent they are taxed. It appears that the underlying reasons for the introduction of turnover tax and its workings were not clearly communicated to micro business owners, most of whom have a limited or no knowledge about turnover tax. This view is supported by the study conducted by Schutte, Labuschagne, Georgescu and Pop (2019:67) indicating that there were no consultations scheduled between SARS and micro business owners before the turnover tax was adopted, even though such consultations could have contributed to the government's understanding of the potential flaws of the system.

Such consultations regarding turnover tax processes should be held, not only during the initial implementation of the system, but all future amendments to the existing tax legislation should be made only after appropriate consultation has taken place with micro business owners. These consultations should be undertaken in a formal and timely manner to ensure that all issues raised by micro business owners are taken into consideration before the implementation of the amendments. Lombard (2018:33) warned, however, that although the approval of a tax system or any of its amendments is adopted as an inclusive and transparent process, tax systems should be regularly reviewed to ensure that they continue to attain the goals for which they were developed. If regular reviews of the tax system are conducted to determine whether the tax system is still relevant and justifiable, the system should be scrapped, or altered, if the review shows that the tax system no longer attains its goals. The consultation process should be conducted in such a way that it imposes no constraints on its regular review processes.

SARS has issued a publication: *Tax Guide for Micro Businesses* (SARS: 2016) to assist with the understanding of the turnover tax. The level of tax literacy of most micro business owners, however, is low, so they may have difficulty in understanding the tax guide issued by SARS. Thus, transparency regarding the turnover tax system may not be achieved.

The turnover tax system complies with some aspects of the principle of transparency, for example, the tax authority indicated the underlying reasons for its implementation, but this reason was not clearly communicated to micro business owners. There also seems to have been no consultation of micro business owners in the implementation and amendments to turnover

tax legislation. SARS has issued a guide for micro business owners, but for business owners with a low level of tax literacy, this may not be of much assistance.

4.5 Turnover tax and the principle of convenience of payment

A tax system which can be described as convenient has characteristics such as the time and method of tax collection that are convenient for taxpayers, an increase in the convenience of revenue collection, a substantial reduction in tax evasion and corruption, and low compliance costs. To promote the convenience principles in the tax system, payment mechanisms such as the withholding of taxes and periodic payments can be used, and in such a way that they do not increase compliance costs. The reality of the convenience of collection varies depending on the type of tax to be paid, and tax systems violate the principle of simplicity and convenience when they require the filling in of numerous forms and reports to comply with national legislation (Piontkivska, 2020:2; Mueller, 2016:4; Muller, 2010:51; Alley & Bentley, 2005:610).

Although the fact that turnover tax is calculated on a receipts basis is thought by SARS to be a convenience for micro business owners, it is the manner of payment of turnover tax that might be inconvenient for micro business owners. Firstly the owner must complete a Payment Advice for Turnover Tax form (TT01) and make the first interim payment on the last business day of the month of August, or six months after the end of the year of assessment; in the case of a company, then a second payment must be made at the end of the tax year on the last business day of February or the end of the year of assessment, by completing TT02; the final payment must then be made between 1 July and 31 January of the following assessment year, or within six months after the end of the year of assessment, and a TT03 form completed. The first two interim payments are based on the estimated taxable turnover of the micro business for that assessment year. At the end of the assessment year a turnover tax return (TT03) that reflects the actual taxable turnover of the micro business must be completed. Any shortfalls or overpayments then become payable or refundable. Although payment of the tax in three instalments may be convenient from a cash-flow perspective, one final payment on assessment could be more convenient for micro business owners, as it would reduce the compliance cost. Gluckman (2012:51), however, argues that it contradicts the principle of convenience because some micro business owners may not have access to the amounts required to pay the interim tax due and could suffer potential cash flow problems. A further concern is that an eFiling

option is not yet available for the submission of the Turnover Tax returns (SARS, 2020b:25), which would involve the inconvenience of manual submissions.

Gluckman (2012:12) observes that, to date, the turnover tax system has not been a success because it is inconvenient and leads micro business owners to elect for a normal income tax system or to avoid registering for tax purposes altogether. Tax evasion and the lack of new taxpayers defeat the purpose of implementing turnover tax and the original intention, which was to encourage the growth of micro businesses and promote compliance.

Regarding the matter of time that a micro business spends on compliance, as Naicker and Rajaram (2019:130) point out, the aggregate time spent by micro businesses on complying with tax is slightly less than two thirds of the time taken by a business that is not registered for turnover tax. This adds to the convenience of the turnover tax system and demonstrates that turnover tax meets one of its objectives, which is to reduce the cost of tax compliance by reducing the time spent on compliance.

In summary, the turnover tax system partially complies with the principle of convenience. On the one hand, it is compliant because the aggregate time spent by micro businesses on administering turnover tax is slightly less than two thirds of the time taken by a business not registered for turnover tax. On the other hand, the turnover tax system is non-compliant as three tax payments, together with the required forms, are required in respect of a year of assessment, involve substantial effort and may cause cash flow problems and relatively high compliance costs.

4.6 Turnover tax and the principle of flexibility

One of the elements of flexibility is that the tax system should be amended when the need arises. The turnover tax system has been amended regularly since its introduction and several amendments have been made. This indicates that the turnover tax system is flexible and allows amendments to be made when required.

The principle of flexibility is possible only if a tax system has durable structures that allow government to use technology in the tax collection process. According to The Institute of

Chartered Accountants in England and Wales (ICAEW, 2019:3) such structures are characterised by pre-population of returns, strong relationships with third-party information suppliers and software vendors, understandable and reliable digital tax systems, consideration of taxpayers who cannot or will not use digital methods, establishment of proper legal support for tax digitalisation, pre-existing universal filing and high levels of tax morale. Because the turnover tax system does not have the option of eFiling, it cannot be said to be flexible in that regard.

In summary, the compliance of the turnover tax system with the principle of flexibility is apparent in areas such as mechanisms for amendments to the tax, but non-compliance with the principle of flexibility is observed by the lack of eFiling for turnover tax collection.

4.7 Turnover tax and the principle of economy in collection

The principle of economy in collection has the following characteristics: government spending on tax collection should be kept to the minimum; the tax system should be designed in such a way that it should minimise opportunities for tax avoidance and arbitrage; and it should provide a sustainable revenue base for the government without compromising government's ability to raise sufficient revenue to meet its requirements. The principle of economy in collection deals with the promotion of efficiency in the tax collection process in which the focus is to minimise both administrative and compliance costs thereby increasing tax revenue collection (Olalekan & Oyedokun, 2019:22; Murry, Oliver, & Wyatt, 2014:19; National Economics and Statistics, 2018:14).

Turnover tax was introduced into the South African Income Tax Act, in 2009 to contribute positively to assisting in the growth of micro businesses and the economic growth of South Africa (SARS, 2017:8; Labuschagne, 2018:2). It appears that there is an alignment between turnover tax and the values, vision, and strategic direction of the government that reflects a new thought paradigm in respect of the relationship between the revenue authority and the micro business owners.

Since its implementation, data on the turnover tax cost has not been readily available. Boonzaaier, Harj u, Matikka, and Pirttila (2016:6) indicate that revenue collected from turnover

tax during the 2014-15 financial year amounted to only R17.5 million, or 0.2 percent of the total tax revenue collected. The current study therefore assumes that the turnover tax system generates insufficient revenue to justify the cost that the government incurs in operating the system itself and obviously does not comply with the principle of economy in collection.

4.8 Conclusion

Chapter 4 has analysed the extent to which the South African turnover tax system complies with the generally accepted principles of a good tax system. These principles include the principles of equity, certainty, transparency, convenience of payment, flexibility, and economy in collection. Table 4.1 below summarises the extent to which the turnover tax system complies or does not comply with various elements of the generally accepted principles of a good tax system.

Table 4.1: The turnover tax system's compliance with generally accepted principles of a good tax system

Tax principle	Elements of tax principle	Compliant
Equity	Vertical and horizontal equity	**Partly** – from the point of view of its progressive nature, but differences in cost structures imply a lack of equity.
	Progressivity and proportionality	**Yes** – micro businesses with higher taxable turnovers pay higher amounts of turnover tax than those with lower taxable turnovers.
	Ability of taxpayer to pay	**Partly** – low rates, but as expenses are not taken into account, profits may be low (or losses may be made).
	Charged based on net income	**No** – levied on taxable turnover.
Certainty	Ability to consolidate various taxes	**Partly** – turnover tax replaces dividends tax (to a certain extent), and income tax.
	Knowledge of underlying tax procedures	**No** – understanding of the tax may be lacking and dealing with procedural matters is difficult for most micro business owners.
	Time and manner of collection	**Yes** – it follows the same time and manner of collection as the normal income tax.
	Transparent consultative process	**No** – micro business owners are not specifically consulted in respect of tax amendments.
	Administrative convenience	**Yes** – records -keeping is relatively easy.

Transparency	Knowledge about the existence of the turnover tax	**Uncertain**.
	Knowledge about the underlying reason for its implementation	**Uncertain**.
	Knowledge about the approach to calculate tax	**Uncertain.**
	Voice of taxpayers in the tax process	**No** – **t**here is no consultation with micro business owners.
	Mechanisms for appeal	**Yes** – the mechanisms in the Tax Administration Act are available.
	Explanation of procedures by the authority to the taxpayers	**Partly** – by way of a SARS Guide, but this may not be understood by micro business owners.
	Knowledge about the use of turnover tax revenue	**Uncertain.**
Convenience of payment	Time and methods of tax collection	**Yes** – two interim and a final payment; the aggregate time spent by micro businesses on complying with tax is slightly less than the time taken by a business that is not registered for turnover tax.
	Increase in revenue collection by the government	**No** – a low rate of tax and few businesses are registered for turnover tax.
	Reduction in tax evasion and corruption	**Uncertain**
	Low compliance cost	**No** – high compliance cost.
	Cash flow available	**Partly** – interim tax payments may cause potential cash flow problems.
Flexibility	Ability to respond to change	**Yes** – can be amended when the need arises.
	Durable structures that can easily adapt to the changing policy environment	**Yes** – it can be amended to adapt to the changing policy environment.
	Compatible with other tax systems around the world	**No** – it is a stand-alone tax.
	Digital tax administration	**No** – lack of eFiling option.
Economy in collection	Aligned to the values, vision and strategic direction of the government	**Yes** – its aim is to contribute positively to assisting in the growth of micro businesses and the economic growth of South Africa.
	Cost efficiency	**No** – collection costs are high in relation to the revenue collected.

Source*: Own compilation*

The study therefore found that turnover tax system complies only to a certain extent with generally accepted principles of a good tax system. This indicates that it only partly meets the

objectives with which it was introduced and may explain the relatively low uptake of the turnover tax system by micro business owners. There are no statistics available of the number of and reasons for de-registration of micro business from the turnover tax. The turnover of some micro businesses may have increased above R1 million, while others may have de-registered for other reasons. A further point of concern is that the R1 million threshold was promulgated in 2008 and has not been increased since. If an average inflation rate of 4% per annum is assumed over the period 2008 to 2020, this would be the equivalent of R1,6 million in today's terms. A final criticism may be that the same penalty system applies to micro businesses for non-compliance as for any taxpayer, while the amounts in question would be low due to the low rate of turnover tax.

The next chapter will summarise the achievement of the study objectives, provide recommendations for the improvement of the turnover tax system and a final conclusion.

CHAPTER 5: SUMMARY, RECOMMENDATIONS AND CONCLUSION

5.1 Introduction

Chapter 5 summarises the achievement of the study objectives, provides recommendations for the improvement of the turnover tax system and states the conclusion of the study.

5.2 Achieving the objectives of the study

The over-arching goal of the research was to analyse the South African turnover tax to investigate to what extent the turnover tax system complies with generally accepted principles of a good tax system. In order to achieve the main goal, this study was guided by the following sub-goals:

- to analyse the South African turnover tax system;
- to discuss the generally accepted principles of a good tax system;
- to determine the extent to which the South African turnover tax system complies with the generally accepted principles of a good tax system; and
- to recommend possible improvements to South African turnover tax system.

5.2.1 Research objective 1: To analyse the South African turnover tax system

The overview of the South African turnover tax system was provided in chapter 2, discussing the paragraphs of the Sixth Schedule and certain concepts relating to the understanding of the terms "qualifying turnover": "receipts", "from carrying on business activities," and "excluding any amount of a capital nature", for the purpose of determining turnover tax. The chapter also discussed the anti-avoidance rule for qualifying turnover, the criteria for disqualifying businesses from registering for turnover tax, the taxation of certain capital gains, dividends tax for micro business, as well as the turnover tax administration.

The analysis of the turnover tax system established that claims made by SARS that turnover tax is characterised by its simplicity by requiring no dividends tax, no provisional tax, no capital gains tax, no income tax, and no expensive record-keeping, are misleading. Dividends tax is payable on dividends declared in excess of R200 000 per year of assessment, three interim

payments similar to provisional tax payments are due and record-keeping for a micro business owner is relatively complex. It was suggested that the concepts underlying the South African turnover tax system may be too complex to be understood and managed by micro business owners few of whom may have the necessary tax expertise and skills and that, as the definitions and concepts associated with turnover tax still require interpretation, a business owner may require the assistance of a tax practitioner. Understanding of the legislation is imperative if the micro business owner is to decide whether the simplified tax system is, in fact, the most appropriate business tax model to adopt. Possibly due to these difficulties, there has been a low uptake of businesses registered for turnover tax.

5.2.2 Research objective 2: To discuss the generally accepted principles of a good tax system

Chapter 3 provided a description of the generally accepted principles of a good tax system by discussing their historical perspective and development, their elements, and their overlapping features. The chapter also indicated the specific tax principles that may apply to the current study and the rationale behind their choice, namely equity, certainty, convenience of payment, economy in collection, and flexibility.

In respect of equity principle of taxation, this chapter established that vertical equity means that each individual taxpayer should contribute towards government support based on his or her ability to pay. Hence, it is recommended that micro businesses should pay Turnover Tax in proportion to their earnings to ensure vertical equity. The principle of equity is a key concept in taxation that seeks to promote fairness and equity in the administration of taxes. In complying with this concept, taxpayers are likely to contribute willingly towards government activities.

Chapter 3 also arrived at the conclusion that a tax system that promotes the principle of certainty is characterised by clarity in the calculation of tax and the time and manner of its collection, by transparent consultative processes when the tax is amended, is easily understood by taxpayers, by its administrative convenience, by its ability to minimise those resources used in the economy to handle tax affairs, and by a level of understanding of taxpayers who are unable to afford expensive tax advisors.

It was established that the tax system that is convenient has characteristics such as time and methods of tax collection that are suitable for taxpayers, an increase in revenue collection, a reduction in tax evasion and corruption and low compliance costs. Chapter 3 argued that, to promote the principles of convenience in the tax system, payment mechanisms such as the withholding of income taxes and periodic payments can be deployed. These mechanisms should be used in such a way that they do not increase the costs of compliance. The convenience of collection varies depending on the type of tax to be paid, and, generally, those tax systems that involve filling in numerous tax forms and reports in compliance with national legislation violate the principle of simplicity and convenience.

Regarding economy in collection principles, the chapter established that, in order to improve tax revenue collection, the government should persist in transforming tax administration systems by aligning tax collection to the values, vision, and strategic direction of the government, as well as by applying a new thought paradigm to the relationship between the revenue authority and the taxpayer. To improve its systems of tax revenue collection, modern forms of payment should be adopted such as mobile money payment, promoting electronic tax payment, promoting joint responsibility of the taxpayer and tax authority in respect of tax assessment, and automating the tax administration processes.

Finally, flexibility was discussed as one of the principles of taxation and it was ascertained that flexibility allows taxpayers to operate in global economic, social, and technological conditions, and a tax system which is flexible and sufficiently responsive to change.

5.2.3 Research objective 3: To determine the extent to which the South African turnover tax system complies with the generally accepted principles of a good tax system

Chapter 4 analysed the extent to which the South African turnover tax system complies with the generally accepted principles of a good tax system. These principles include the principles of equity, certainty, transparency, convenience of payment, flexibility, and economy in collection. In this chapter the turnover tax system was analysed against each element of each principle. Thereafter, the extent to which the turnover tax system is compliant with generally accepted principles of a good tax system was discussed.

The chapter established that turnover tax partially complies with the principle of equity as, although it is a progressive tax and that its rates are low, differences in cost structures among micro business and the fact that the expenses are not considered, imply a lack of equity. Turnover tax replaces dividends tax (to a certain extent), capital gains tax (CGT) and income tax, it follows the same time and manner of collection as the normal income tax and record-keeping is relatively easy. Micro business owners are, however, not specifically consulted in respect of tax amendments, understanding of the tax by micro business owners may be lacking and dealing with procedural matters is difficult for most micro business owners, thus implying a partial compliance with the principle of certainty.

The chapter also established that many micro business owners may be uncertain about the existence of the turnover tax, the underlying reason for its implementation, the approach to calculate turnover tax and the use of turnover tax revenue. The SARS tax guides may not be understood by many micro business owners. Hence, turnover tax is partially compliant with the principle of transparency. Although turnover tax seems to be convenient to micro business owners by allowing two interim and a final payment, it generates low tax revenue due to the low rate of tax and the limited number of businesses registered for turnover tax. Micro businesses also incur high compliance cost and have potential cash flow problems which compromises the compliance of the turnover tax system with the principle of convenience of payment.

The chapter further established that the characteristics of turnover tax, such as its ability to respond to change and adapt to the changing policy environment, and its alignment to the values, vision and strategic direction of the government, seem to indicate that turnover tax is compliant with the principle of flexibility. Nonetheless, there is no eFiling option for turnover tax and its collection costs are high in relation to the revenue collected. The chapter concluded that turnover tax is also partially compliant with principles of flexibility and economy in collection.

The next section will provide the recommendations for possible improvement of the South African turnover system.

5.3 Recommendations of the study and areas for further study

The objective of the turnover tax system is to reduce the administrative burden on micro businesses and to contribute positively to encouraging these businesses and promoting the economic growth of South Africa. The turnover tax system is therefore important as it can contribute to the solution of economic and social challenges that South African government is currently facing. Based on the research, the following recommendations are made:

- Effective training should be provided on the turnover tax system for micro business owners and those intending to register as micro businesses and awareness campaigns should be introduced. A special unit that provides support to the micro businesses registered for turnover tax could be established.
- The exclusion of certain businesses (such as businesses offering services in accounting actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education and engineering), from registering as micro businesses should be reconsidered as this promotes an unfair tax system. Disqualification criteria need to be revised as they are too complex to be understood by many micro business owners.
- The threshold amount of R1.5 million for capital disposals that disqualifies micro businesses for turnover tax, and the R1 million qualifying turnover threshold should be increased in order to keep pace with inflation, increase the number of businesses that adopt the turnover tax system and reduce the number of micro businesses that leave.
- The current threshold of R335 000 at which the 1% rate of tax commences could be increased to further reduce the tax burden. Micro businesses that make a loss should be exempted from paying turnover tax and be allowed to set off their losses against their future tax liability. This may attract and retain micro businesses, thereby increasing the number of micro businesses registered for turnover tax.
- The amendment process of the turnover tax system should be preceded by a transparent consultative process in which the micro business owners form part of the process. This process could be coordinated by the Department of Small Business.
- The rules relating to the interim payments of turnover tax should be relaxed by allowing the micro businesses to choose whether to make interim payments of the turnover tax or pay one amount six months after the end of the assessment year. This may reduce liquidity problems faced by micro businesses and the need to submit multiple returns.
- To improve the flexibility of the turnover tax system, digital administration in the form of eFiling should be introduced.

- A separate and less draconian penalty system for micro businesses should be considered.

The methods used in the present study consist of a review of the relevant literature to develop a framework of principles of a good tax system and an application of the doctrinal method to analyse the Sixth Schedule and other legal sources pertaining to the turnover tax system. The study utilised a qualitative methodology and an empirical study that utilises a quantitative methodology could be conducted to ascertain the perspective of micro business owners regarding the turnover tax system. A study that benchmarks the South African turnover tax with a similar tax applied in other countries could also be conducted in order to identify ways of improving South African turnover tax.

5.4 Conclusion

The aim of the research was to analyse the South African turnover tax to investigate to what extent the turnover tax system complies with generally accepted principles of a good tax system and make recommendations for possible improvements. It was found in this study that turnover tax does not comply with all the elements of generally accepted principles of a good tax system and recommendations were made for the possible improvement of turnover tax system.

It is respectfully submitted that the comment by the Davis Tax Committee (2016) that the turnover tax should be retained in its present form because taxpayers can always elect to pay tax according to the normal procedures in the Income Tax Act, ignores the reason why the turnover tax was introduced, instead of recommending changes to improve the system so that it meets the objectives for its introduction.

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