

More effective employee share schemes on the cards

A number of changes are being introduced to more effectively utilise broad-based employee share schemes.

To date, these schemes have not been well implemented due to a low monetary threshold of R9 000 over three years, the inability of employers to apply any penalty to "bad leavers" as well as the fact that 90% of employees had to be entitled to participate.

As a result, the following adjustments have been made:

- The previous ceiling of R9 000 over a three-year period has been increased to R50 000 over a five-year period. Effectively, the employer will receive an income tax deduction for the value of the shares placed in the hands of the employee up to the cap of R50 000 in five years and the employee will not be taxable on such accrual.
- Employers will be permitted to reacquire the shares at the lower of market value (either as of the date of the initial grant of the share or market value as at the date of reacquisition by the employer) where the employee's services are terminated by virtue of employee misconduct or poor performance.

- The percentage of employees entitled to participate in the scheme has been dropped from 90% to 80% of employees.

The above relaxations are welcomed as it is anticipated they will result in more meaningful acquisition of equity by workers.



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Where the trade in question falls within the list of suspect trades (excluding farming), and losses have been incurred in six years out of ten, then the reasonable prospect rule cannot apply to the benefit of the taxpayer.

However, it is important to note that a business in which there is a reasonable prospect of making a profit within a reasonable time period must take into account and show proof of factors such as proportion of gross income derived from that trade, level of activities carried on, expenses incurred in promotion, whether trade is carried on in a

commercial manner taking into account the location of the business, and business plans.

So, should you wish to invoke the reasonable prospect safety net, a taxpayer would need to have at their disposal significant information in order to motivate their case. Such information might include but not be limited to the following: business plans, details of employees, unexpected events giving rise to losses, nature of the business, details of advertising, promotion and/or selling expenses.



Ring fencing of assessed losses

Ring fencing provisions were introduced into the Income Tax Act due to on-going concerns about the erosion of the tax base owing to certain trades, such as part-time farming at a loss.

These provisions, effective from the 2005 tax year, only apply to natural persons who, but for the loss, would pay tax at the maximum marginal rate.

Effectively, the losses from certain trades may be ring fenced and may only be set off against taxable income from those trades.

Where a person has, in the circumstances described above, incurred an assessed loss in at least three out of the five years ending with the year of assessment in question, or the trade in respect of which the loss was incurred falls within a list of "suspect" trades, the loss will be ring fenced (subject to the "reasonable prospect" provisions dealt with below in more detail).

The suspect trades include:

- Any sport practised by that person or any relative
- Any dealing in collectibles by that person or any relative
- The rental of residential accommodation (unless at least 80% of the residential accommodation is used by

persons who are not relatives of that person for at least half of the year of assessment)

- The rental of vehicles, aircraft or boats as defined in the Eighth Schedule (unless at least 80% of the vehicles, aircraft or boats are used by persons who are not relatives of that person for at least half of the year of assessment)
- Animal showing by that person or any relative
- Farming or animal breeding (unless that person carries on farming, animal breeding or activities of a similar nature on a full-time basis)
- Any form of performing or creative arts practised by that person or any relative
- Any form of gambling or betting practised by that person or any relative.

As it is now approaching the end of the five-year period since the provision became effective, it is appropriate to consider the effect of the application of the rule and how the reasonable prospect provision may come to the assistance of a taxpayer.

Where the trade constitutes a business in respect of which there is a reasonable prospect of making a profit within a reasonable time period, the ring fencing provisions will, subject to the following, not apply.

Micro businesses: think before you switch

Turnover tax may not be the best option for all micro businesses

In an effort to make tax requirements more straightforward and to lessen costs, micro businesses have been given an opportunity to switch to turnover tax. But micro businesses should think carefully before making this switch.

A natural person, a company or close corporation held entirely by natural persons may qualify for registration as a micro business and pay tax based on turnover.

The turnover-based tax regime for micro businesses with a turnover of up to R1 million per year will effectively replace income tax, capital gains tax (CGT), secondary tax on companies (STC) and value-added tax (VAT). A micro business may not be registered as a VAT vendor. Payroll taxes, however, will not be affected.

While the turnover tax system will reduce compliance costs for micro businesses, those with annual turnovers in the upper bracket of R750 000 to R1 million should do their homework before switching to the new system. At a certain point in this bracket, it may become more cost effective to remain in the normal tax regime.

"Businesses in the upper turnover bracket could find they're paying more tax than they would in the normal system," says Bernard Sacks, Tax Partner at Mazars Moores Rowland.

"The tax burden on micro businesses at the higher-end of the turnover range (R750 001 to R1 million) could be increased beyond the liability in the current tax system, which encourages such businesses to contemplate maintaining sufficient records to migrate to the normal income tax regime," says Sacks.

This is illustrated by the table set out below, which is based on the following assumed facts:

Turnover	R 950 000
Expenses	R 750 000
Total taxable income	R 200 000

The example below illustrates that turnover tax could in fact result in the highest liability amongst the three entities evaluated.

Once a decision has been made to register as a micro business, voluntary deregistration is not possible for three years and re-entry to the system is not possible for three years after voluntary deregistration.

"So if you find you've made a mistake in going the route of turnover tax, it's a mistake that will stay with you for three years," warns Sacks.

The system excludes professional service businesses such as accounting, broking, consulting, engineering, law, management, real estate, surveying and veterinary science businesses. These services are supposedly rendered by more sophisticated, high income-earning taxpayers with the ability to deal with the administrative requirements of the normal tax regime.

Partners in partnerships comprised only of natural persons are eligible, but the turnover tax regime excludes people who are partners in more than one partnership, and people with interests in other close corporations and companies except listed company shares and unit trusts.

"The intention of the turnover tax regime is to simplify requirements and reduce administration costs. It's not to reduce tax liability. But businesses with a turnover range of R750 001 and above should think carefully before they switch to the turnover-based system," concludes Sacks.

Micro Businesses	Small Business Corporations ¹	Natural Persons
Tax payable based on turnover R34 500	Tax payable based on taxable income R15 400	Tax payable based on taxable income R33 430
	(First R46 000 is exempt from tax and balance of the taxable income attracts tax at 10%) If the after tax profit is declared as a dividend, STC of R17 782 will become payable, bringing the total tax payable to R32 182.	(The tax payable is based on the standard tax tables applicable to natural persons)

¹ A Small Business Corporation is a company or close corporation (excluding certain corporations engaged in service businesses and investment corporations) whose shares or members interests are held entirely by natural persons where the shareholders or members own no other shares other than listed shares or unit trusts and where the turnover does not exceed R14 million per year.

REMEMBER, REMEMBER... THE 31ST OF DECEMBER

Earlier this year, we highlighted a pending change to the Secondary Tax on Companies (STC) legislation.

Presently, dividends declared in the course of, or in anticipation of, the liquidation or deregistration of a company out of the following are exempt from STC provided the steps listed in Section 41(4) of the Income Tax Act (as below) are timeously implemented:

- Reserves in existence prior to the introduction of STC in March 1993 (except for reserves arising from a revaluation of trading stock)
- Profits arising from the realisation of capital assets during the period immediately following the last year of assessment ending before 31 March 1993 to 30 September 2001
- That portion of profits arising from the realisation of capital assets held at 1 October 2001 as relates to the period from date of acquisition to 30 September 2001 (determined by market valuation method)

NOTE:

the above exemption only applies to dividends declared by 31 December 2008

Following the declaration of such dividends, the company needs to take the following steps within 18 months of declaration of the dividends in order for the exemption to remain intact:

- Submit a written statement to the Registrar of Companies (or Close Corporations as the case may be) confirming that the company has no assets or liabilities and has ceased trading
- Submit a copy of the written statement to SARS
- Submit all required returns or information to SARS or make arrangements for submission.

It should be noted that a dividend that is exempt from STC is known as a capital distribution and will have a Capital Gains Tax effect for the shareholder.



Bernard Sacks