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Dear Mr Nkosi, Mr Godongwana, Ms Ndabeni-Abrahams and Mr Momoniat

## CHANGES TO SMME LEGISLATION TO REDUCE COSTLY RED TAPE

1. In the 2022 State of the Nation Address, President Ramaphosa stated that the government is taking far-reaching measures to unleash the potential of small businesses, micro-businesses and informal settlements. One of these measures is a review of the Business Act, No. 71 of 1991 – alongside a broader review of legislation that affects small, medium, and micro enterprises (SMMEs) – to reduce the regulatory burden on informal businesses.
2. The President admitted that there are too many regulations in South Africa that are unduly complicated, costly, and difficult to comply with and this prevents companies from growing and creating jobs.
3. The South African Institute of Chartered Accountants (SAICA) fully supports the President's intentions to assist SMMEs to thrive as well as the appointment of Mr Nkosi to



head up a team in the Presidency mandated to implement and coordinate the cutting of red tape across government.

4. SAICA also supports the National Integrated Small Enterprise Development Masterplan (NISED Plan) that was released in June 2022 for comment. SAICA made certain [recommendations](#) in this regard. We acknowledge that the development and support of small businesses is not the domain of one department but the collective action of many public and private actors that implement coordinated interventions.
5. In this regard, SAICA sets out below two specific areas that are currently complicated, costly, and difficult to comply with for SMMEs and, if changed, could be quick wins for SMMEs and the President in his SMME compliance burden reduction endeavours.
6. The **first area** requiring simplification is the definition of a “SMME”, which is also recognised in the NISED Plan as requiring attention – that is, that a uniform definition for SMMEs is needed.
7. The **second area** that could be simplified is the requirements that enable Public Benefit Organisations (PBOs) to grant loans to SMMEs. Each of these areas are discussed further below.

#### Definition of a SMME

8. The [National Small Enterprise Act](#), 102 of 1996 (previously called the National Small Business Act) was established, among other things, to “*provide guidelines for organs of state in order to promote small business in the Republic*”. This Act defines a small enterprise in section 1 and this definition was amended by [Government Notice No. 399](#), published 15 March 2019 as follows:

*A separate and distinct business entity, together with its branches or subsidiaries, if any, including co-operative enterprises, managed by one owner or more predominantly carried on in any sector or subsector of the economy mentioned in column 1 of the Schedule and classified as a micro-, a small or a medium enterprise by satisfying the criteria mentioned in columns 3 and 4 of the Schedule.*

9. The criteria (in columns 3 and 4 of Schedule 1) used to classify an enterprise as micro, small or medium are the enterprise’s number of employees and total annual turnover – see the details of Schedule 1 below.

### SCHEDULE 1

*The new National Small Enterprise Act thresholds for defining enterprise size classes by sector, using two proxies*

Column 1	Column 2	Column 3	Column 4
Sectors or sub-sectors in accordance with the Standard Industrial Classification	Size or class of enterprise	Total full-time equivalent of paid employees	Total annual turnover
Agriculture	Medium	51 - 250	≤ 35,0 million
	Small	11- 50	≤ 17,0 million
	Micro	0 - 10	≤ 7,0 million
Mining and Quarrying	Medium	51 - 250	≤ 210,0 million
	Small	11- 50	≤ 50,0 million
	Micro	0 - 10	≤ 15,0 million
Manufacturing	Medium	51 - 250	≤ 170,0 million
	Small	11- 50	≤ 50,0 million
	Micro	0 - 10	≤ 10,0 million
Electricity, Gas and Water	Medium	51 - 250	≤ 180,0 million
	Small	11- 50	≤ 60,0 million
	Micro	0- 10	≤ 10,0 million
Construction	Medium	51 - 250	≤ 170,0 million
	Small	11- 50	≤ 75,0 million
	Micro	0- 10	≤ 10,0 million
Retail, motor trade and repair services.	Medium	51 - 250	≤ 80,0 million
	Small	11- 50	≤ 25,0 million
	Micro	0 - 10	≤ 7,5 million
Wholesale	Medium	51 - 250	≤ 220,0 million
	Small	11- 50	≤ 80,0 million
	Micro	0 - 10	≤ 20,0 million
Catering, Accommodation and other Trade	Medium	51 - 250	≤ 40,0 million
	Small	11- 50	≤ 15,0 million
	Micro	0 - 10	≤ 5,0 million
Transport, Storage and Communications	Medium	51 - 250	≤ 140,0 million
	Small	11- 50	≤ 45,0 million
	Micro	0 - 10	≤ 7,5 million
Finance and Business Services	Medium	51 - 250	≤ 85,0 million
	Small	11- 50	≤ 35,0 million
	Micro	0- 10	≤ 7,5 million
Community, Social and Personal Services	Medium	51 - 250	≤ 70,0 million
	Small	11- 50	≤ 22,0 million
	Micro	0 - 10	≤ 5,0 million

10. These categories are further defined per sector or subsector of the economy in which an enterprise operates (column 1 of Schedule 1). For example, an enterprise in the agriculture sector qualifies as a medium enterprise if it employs 51 to 250 employees and has a turnover of between R17 million and R35 million. If the enterprise operates in the wholesale trade sector, the thresholds are between 51 and 250 employees, and a turnover between R80 million and R220 million.
11. If one had to take the minimum and maximum thresholds in each of these columns into account, the all-inclusive definition for an SMME in terms of this Act is an enterprise managed by one owner or more, with fewer than 250 employees and an annual turnover of no more than R220 million.



12. These categorisations are then used to, inter alia, determine whether a business is an SMME that is entitled to the financial and non-financial support that this Act envisages.
13. In taxation, various approaches are utilised depending on the intent of the legislation whether it is to provide direct income tax relief or provide relief to those that support a defined group of SMME's.
14. For example, a "small, medium or micro-sized enterprise" is defined in section 1 of the Income Tax Act (ITA) as any—
  - (a) *person that qualifies as a micro business as defined in paragraph 1 of the Sixth Schedule; or*
  - (b) *any person that is a small business corporation as defined in section 12E(4).*
15. A micro business and a small business corporation (SBC) have various qualifying criteria. If one were to *only* consider the turnover/gross income requirements, the turnover tax is only applicable to entities with a 'qualifying turnover' (separately defined) of R1 million or less, whereas an SBC is required to have 'gross income' of R20 million or less.
16. If one were to consider the Small Business Funding Entities (SBFE) definition in section 30C of the ITA, it is evident that SBFE can only provide funding to SMMEs as defined in the ITA (being micro businesses and SBCs). If this is read with the National Small Enterprise Act, SBFE can basically only provide funding to micro and small enterprises in the "Agriculture" and "Catering, Accommodation and other Trade" sectors as the other sectors' "small" category has a turnover limit that ranges (mostly) above the R20 million limit that is set for a SBC as mentioned in the section 1 definition of a SMME in the Income Tax Act.
17. When it comes to support, including funding loan support by Public Benefit Organisation, the Ninth Schedule Part I 1(p) of the ITA limits support to micro enterprises.
18. We acknowledge that targeted fairness (i.e. complexity) and simplicity are at opposite ends of the spectrum. However, it is submitted that the current policy framework to determine how targeted financial and non-financial support will be determined for various SMME's is too complex to coordinate and properly implement by government.
19. What is even more problematic, is that this complexity excludes the same targeted SMME's from accessing the support as there are just too many technicalities and hurdles. It is important that government and Parliament, craft a policy and legislation that views this from a SMME's perspective who have limited resources to unpack all of this complexity.
20. For example, if an SMME has to:
  - a. Determine its BEE status and reporting requirements in this regard, then it must determine:
    - i. Is it an exempt micro enterprise (turnover <R10m, with different requirements for certain sectors); or a
    - ii. Qualifying small enterprise (turnover >R10m<R50m)?

- b. Determine its tax status:
  - i. Is it a micro business ('qualifying turnover'  $\leq$  R1m); or
  - ii. Is it a Small Business Corporation (gross income  $\leq$  R20m)?
- c. Determine if it can access tax support from third parties:
  - i. Is section 30C applicable then is the SMME an SMME as defined in the ITA?
  - ii. Is the nature of the funding PBO loan funding, then is the business a micro business as defined in the ITA ('qualifying turnover'  $\leq$  R1m)?
- d. Access SEDA (non-financial support) and SEFA (financial support) support:
  - i. Is it a SMME as defined under the National Small Enterprise Act (see turnover per the extract of this Act provided above)?

21. Submission: The lack of a uniform SMME definition means that a significant amount of red tape, complexity and exclusion to access is created for the target market, namely SMME's. A SMME would have to navigate its financing, capital structure, labour, tax matters and incentives all based on different requirements as to both access compliance and reporting. This is a literal mind field. This directly results in SMMEs not being able to access or just abandoning any such prospect to especially incentives and support, to the detriment of the economy and government economic policy for SMME's. It also significantly increases the cost for SMME's to access, comply and report.
22. It appears that the tax legislation in particular does not align with entities/funds that are created/available for supporting SMMEs and job creation and excludes the majority of the SMME's that the National Small Enterprise Act intends to support. The above concerns highlight the disconnect between the country's investment objectives and the existing tax legislation that effectively prohibits SARS from supporting the national objective.
23. Furthermore, the need for changes in the legislation to support PBO's is especially important in this post-COVID world where discretionary funding is in short supply to fund SMME by PBOs using private resources.
24. SAICA therefore strongly supports a uniform definition for SMMEs across government as priority to all other projects. The lack of such definition across government not only increases complexity and compliance costs but prohibits entities wishing to assist SMMEs from doing so in the most economical manner resulting in less funds being available to provide the support SMMEs so desperately need.
25. We are also of the view that it prevents government from coordinating activities and undermines effectiveness of policy implementation. We recommend that a single SMME definition should be contained in the National Small Enterprise Act and that all other legislation should refer to such single definition.
26. In such way a balance between complex fairness and simplicity (access) could be achieved as one definition would be contained in a single Act and it would apply for all Acts once determined.



27. We understand that the Department of Small Business Development was, a few years back, tasked with revising the definition of SMMEs (which is now also included in the NISED Plan) and reviewing the National Small Enterprise Act. However, in May 2021 the Department said that it is cautious to provide timelines because it will be doing a lot of consultations as it wants to bring everyone on board and only once the Department has a product that is acceptable to most people will it start taking it through the government processes and then take it to Parliament<sup>1</sup>. No timeline is provided in the NISED Plan either. In this regard the Presidency should be enforcing a timeline to ensure long outstanding implementation.
28. Although we understand the complexities involved in this process, we do believe that there is already a lot of research on this topic and SAICA is more than willing to continue providing support to this initiative and advises that reviewing the National Small Enterprise Act should be expedited due to its critical importance to SMMEs, as is indicated in the next area of concern discussed below.

### **Granting of loans by PBOs to micro businesses**

29. Non-profit organisations play a significant role in society as they undertake a shared responsibility for the social and development needs of the country thereby relieving the financial burden, which otherwise falls on the State<sup>2</sup>.
30. Tax benefits are designed to assist non-profit organisations by augmenting their financial resources and providing them with an enabling environment in which to achieve their objectives. The organisation will, however, only be exempt from income and related taxes if it is specially approved for this purpose by the Commissioner (as a PBO) and if it complies with the requirements and conditions (public benefit activities) as set out in the Income Tax Act (the Act), particularly the Ninth Schedule of the Act.
31. Thus approved PBOs have the privilege and responsibility of spending public funds, which they derive from donations or grants, in the public interest on a tax-free basis.
32. A taxpayer making a *bona fide* donation in cash or of property in kind to a section 18A-approved organization (Ninth Schedule – Part II), is entitled to a deduction from taxable income if the donation is supported by the necessary section 18A receipt issued by the organization.
33. SARS is, however, becoming very strict in the interpretation of the Ninth Schedule requirements, particularly in respect of paragraph 1(p)(iii) of Part I of the Ninth Schedule. This paragraph states that an entity can apply for PBO tax exempt status if it intends to provide training, support/assistance to emerging micro enterprises to improve capacity to start and manage businesses, which may include the granting of loans on such conditions as may be prescribed by the Minister of Finance by way of regulation.

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<sup>1</sup> <https://pmg.org.za/committee-meeting/32933/>

<sup>2</sup> Tax Exemption Guide for Public Benefit Organisations in South Africa  
<http://www.samemonfoundation.co.za/SARSTax.pdf>



34. Despite this section being enacted in 2003, these regulations have, **almost 20 years later**, not yet been published.
35. The effect of this is that the SARS Tax Exemption Unit (TEU) states that it does not have the discretion to consider an application under para 1(p)(iii) insofar the regulations have not been published.
36. Thus, the TEU cannot grant PBO and section 18A status under para 1(p)(iii) of the Ninth Schedule insofar as it relates to the provision of loans to micro enterprises, until such time as the Minister of Finance has issued the regulations as stated in paragraph 1(p)(iii) of Part I and II of the Ninth Schedule.
37. According to the TEU, section 30C dealing with SBFES was inserted into the Act to deal specifically with the provision of funding.
38. Section 30C was introduced because tax relief was previously only afforded to funders of SMMEs if monies were invested through a venture capital company (VCC) or if approved by the Commissioner as a PBO. Any activity provided to SMMEs that did not fall under the VCC regime or PBO legislation therefore did not qualify for relief under the Income Tax Act<sup>3</sup>.
39. Section 30C contains the prescribed requirements an entity must comply with to qualify for and retain approval as a SBFES so as to enjoy partial exemption under section 10(1)(cQ) of the Act.
40. The result of the above is that any taxpayer that wishes to provide public benefit activities and funding to SMMEs on the most economic basis, will have to set up two separate legal entities, each holding different exemption statuses – one exempt in terms of the Ninth Schedule (for all activities other than funding provided to micro enterprises), and one in terms of section 30C (for funding to SMMEs).
41. The TEU is also unwilling to provide dual registration (both in terms of the Ninth Schedule and section 30C) within one entity, despite the undertaking by an entity to ringfence the various activities and to keep separate accounting records. Furthermore, these entities will be restricted in relation to what SMME they can support as it is all dependent on the size (and industry) of the SMME as defined in the Income Tax Act as explained in paragraph 14 above.
42. Taking the above into account, the tax incentives for PBOs appear to be out of alignment with how businesses want to operate, that is, in an efficient and cost-effective manner. We even have come across an example where the Competition Commission has ruled that a Fund needs to be established by one of the companies to provide training, assistance as well as loan funding to SMMEs.
43. Yet, due to the requirements in the income tax legislation, two different entities will need to be established to achieve this requirement, resulting in less money being available for loan funding to the SMMEs.

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<sup>3</sup> <https://www.sars.gov.za/wp-content/uploads/Legal/Drafts/LPrep-Draft-2021-76-Draft-Tax-Exemption-Guide-for-Small-Business-Funding-Entities-16-September-2021.pdf>

44. Submission: We urge the Presidency to ensure that the Minister of Finance urgently issues the regulations as stipulated in paragraph 1(p)(iii) of the Ninth Schedule (Part I and II).
45. We, however, request that the paragraph 1(p)(iii) of Part I and II of the Ninth Schedule be expanded to provide for loans to SMMEs not just micro businesses as currently provided for in the legislation (see comments regarding the definitional concerns on the first few pages of this document).
46. The reason for this is because a major challenge in the growth of SMMEs (and not just micro enterprises) is access to funding due to their inherent risk and lack of collateral together with the fact that they often lack the necessary training and commercial skills to manage and develop the business.
47. Without this change, entities will only be able to assist 'micro businesses' as defined in the Income Tax Act (being those with, *inter alia*, a qualifying turnover of R1 million or less).

48. SAICA is available to engage further on this and as it continues to believe that a collaborative approach is best suited in seeking solutions to complex challenges. SAICA is also committed to assist in any way possible to ensure that SMMEs have an enabling environment to thrive and so ensure sustainable economic development for our country.

Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely



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