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Paying income tax is for every entrepeneur.

Entrepreneurs may believe that under certain circumstances, they need not pay income tax.

They may say "I have not made any profit this year which means I will not pay tax!"

Another may say "How can I be expected to pay tax when my company has not made any profit?"

This is a clear misunderstanding of how income tax works.

A company is taxed on its taxable income for the tax year and not on money 'in the bank' or it's accounting profit.

Understanding how to calculate your company's income tax

In this newsletter, we provide a formula for calculating income tax and an overview of the taxable income calculation components. However, for purposes of this newsletter, we will not deal with capital gains tax.

The income tax calculation formula for a company is:

	Taxable income calculation formula
	Gross income
Deduct	Exempt income
Equals	**Income**
Deduct	Allowable deductions
	Tax allowances
Equals	**Taxable income before assessed loss**
Deduct	Assessed loss – prior year tax loss
Add/ (Deduct)	Capital gain/ (loss)
Equals	**Taxable income for the year**
Multiply	28% or SBC rate
Equals	**Tax for the year**
Less	Provisional taxes paid (Aug/Feb)
Equals	**Tax payable/ refundable**

A tax loss is carried forward to the next tax year.

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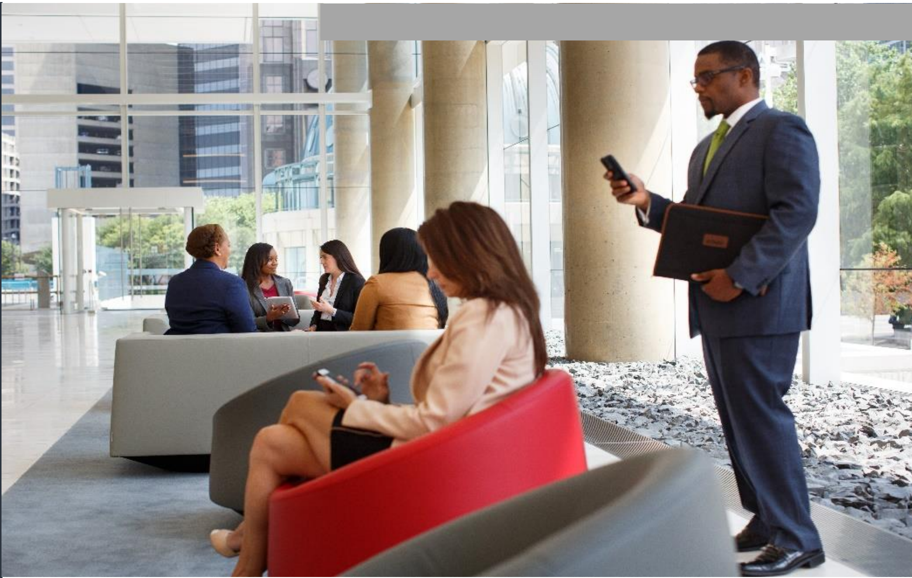

Lets break it down…

Gross income

Gross income for the tax year is:

Total amount in cash or otherwise

- All receipts whether in cash or in any other form which has an ascertainable money value are included in gross income. The money value of shares, a car, a holiday, a gold coin, etc will be included in gross income.

Received by or accrued to or in favour of the taxpayer

- The company is taxed on the value it received or the value it is entitled to receive or received by another person on its behalf.
- It must have received an amount, or it has an unconditional right to receive the amount or another person received an amount on its behalf to be taxed on it.

Excluding receipts and accruals of a capital nature

- This is best explained in the form of an example:
  - *If a company that rents out office space in its buildings sells one of its buildings, the receipt from the sale of the building will be a capital receipt and will not be included in gross income.*

    However;

  - *If a company that sells buildings receives an amount or is entitled to receive an amount from the sale of the building, the amount will be gross income and not an amount of a capital nature.*

Exempt income

These are specific receipts and accruals which are not taxed. Most of these receipts and accruals are received by natural persons. For example, the interest accrued up to R23,800.00 per annum, most dividends, life cover policy receipt, and a few others.

Companies generally do not receive exempt income. The most common exempt income that accrues to companies is dividends. Other than dividends there aren't receipts that South African companies have that are exempt.

Public benefit organization may obtain tax exemption to the receipts and accruals which are integral and specific to their principal object, for example churches, charities, Non-Governmental Organizations (NGO) etc. These companies and organizations must apply and obtain a tax exemption from SARS to benefit from the exemption provisions of the Income Tax Act (ITA).

Allowable deductions

These are expenditure and losses, actually incurred in the production of the income and not of a capital nature, in the carrying on of a trade.

These are costs like salaries, office rent, factory rent, telephone costs (airtime), printer rental costs, etc. They are expenses that are closely related to the operations necessary to undertake the trade of the company to generate income.

Expenses incurred to generate exempt income (dividends) are not allowed as a tax deduction.

It is important to note that the taxpayer **must be carrying on a trade** to claim the expenditure and losses as a tax deduction.

Tax allowances

Expenditure on computers, motor vehicles, desks, tables, printers, PABX systems, machinery and equipment, and similar items is normally expenditure of a capital nature unless the company sells these types of items to its customers as its normal trade.

An allowance for the loss in value arising from their use, in carrying on the trade to generate income, is provided as a deduction against income.

The tax allowance is normally a percentage of the cost of the expenditure allowed as a deduction over a period of a few years and is stipulated in Binding General Ruling 7 (Interpretation Note 47) from SARS.

Tax rate

The company tax rate is 28%. Small Business Corporations are taxed favourably by applying a minimum rate of 0% to a maximum rate of 28% based on the taxable income. This tax bracket provides relief for small businesses.

Provisional tax

These are prepayments of the annual income tax. They are made twice a year, every 6 months. Most companies have a February year end, as a result they make payments of provisional tax in August and February.

An optional, third top up, payment is made in September (for companies with February year ends or within 6 months of year end for all other companies) to minimize/ avoid interest charges on underpayment of provisional tax.

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Conclusion

It is not the money in the bank or the accounting profit that is taxed. It is taxable income for the tax year calculated using the above formula that determines the tax to be paid. Entrepreneurs must be aware of which receipts or accruals are gross income and which expenses are allowed as a deduction from income in the year that they were incurred. If the tax is not calculated correctly, the company will face serious negative tax implications.

Our office will gladly assist you to calculate the annual tax to ensure compliance with the ITA. You can contact us on 087 802 6376 or tshepo@amphaka.co.za.