

Tax efficiency for sole proprietors

Thinking of starting a business in your own name or leaving full-time employment to start your own consulting practice? Along with formulating a viable business and marketing plan it is important to also ensure that you will be able to meet your ensuing income tax obligations efficiently and timeously.

Jeremy Burman of Private Client Holdings advises that one of the first steps is to set up a proper record keeping system for your business.

Set up a record keeping system

"There is no prescribed format or system, so this will depend on the nature of the business and the number and complexity of the transactions. This can be as simple as a basic system on excel that records the relevant details i.e. date, description and amount of all business inflows and outflows for each tax year, or alternatively, an accounting packages that allows you to manage invoicing and debtors as well your suppliers and payments. Either system can be used by your tax consultant to prepare your annual income statement and tax return."

According to Burman, files (electronic or hard copy) should be kept of all invoices for a period of five years. This is especially important in the case of cash expenses as this will serve as the only proof of the expenditure incurred. Although you are not required to provide supporting documents when you submit your annual tax return these may be requested by SARS in the event of your return being selected for review or audit.

"Remember: the burden of proof rests with the taxpayer, so inadequate record of an expense could mean that SARS will disallow the related claim, resulting in a larger tax bill for your business," warns Burman.

"It is important to note that your business taxable income must be calculated on the accrual basis and not the cash basis. This means that you can claim expenses that have been incurred but not yet paid by the tax year end. The flip side of this, however, is that all invoices raised by you during the year must be included in your taxable income regardless of whether or not these have been settled by the end of the tax year. SARS provides some relief in the form of doubtful and bad debt allowances where all or part of an invoice is not expected to be recovered."

What expenses can you claim against your business income for tax purposes?

Burman advises that the short answer is: any expenditure that is incurred in earning this business income - excluding amounts of a capital nature.

"Amounts of a capital nature would include expenditure that results in a long-term benefit for the business, for example, the acquisition of assets such as computers to be used in your business. Although the cost cannot be claimed in full in the year incurred, the Income Tax Act does however provide for certain capital allowances that allow for the write off of the cost of an asset over a set period of years."

"Common claimable non-capital business expenses would include bank charges, telephone and internet costs, advertising, client entertainment, staff costs, stationery, professional subscriptions, office rental and travel expenses. Specifically disallowed by SARS is expenditure of a private or domestic nature, therefore personal expenditure that does not relate to your business e.g. holidays, school fees, childcare etc. may not be claimed," says Burman.

Business premises and tax claims

Burman further explains that if you lease a business premises you are entitled to claim the monthly rental payments on this property. Where, however, you operate your business from your home your 'office rental' claim will be limited to a percentage of your home expenses.

"This percentage is equal to the size (in meters squared) of your home office divided by the size of your entire house. Home expenses include rent paid (where the property is leased), municipal bills, security, cleaning, insurance and repairs and maintenance. Bond interest may also be included where the property is owned by the taxpayer, however, taxpayers should be aware that this can have a capital gains tax effect when the property is sold."

Claiming off your motor vehicle

If you wish to claim motor vehicle expenditure it is a requirement of SARS that a log book be kept by you detailing your business travel for the tax year. You will be entitled to claim the percentage of the total expenditure that relates to your

business travel. Motor vehicle expenditure includes: fuel, insurance, licenses, repairs and maintenance and either:

- wear and tear (depreciation) plus interest on a vehicle loan; or
- repayments against vehicle finance agreements.

Business start-ups and registering for provisional tax

“As a sole proprietor you are required to register as a provisional taxpayer with SARS in the tax year in which you start your business,” advises Burman. “This means that you will be required to submit provisional (estimated) returns by 31 August and 28 February of each tax year. Although these returns will be based on estimated taxable income and do not need to be exact, you must take care not to underestimate this income as under-payment of provisional tax could lead to the application of penalties by SARS.”

“August, September and October are frequently challenging for provisional taxpayers from a cash flow perspective as they are required to make two tax payments within a couple of months of each other: the first by 31 August relating to tax due on the estimated taxable income of the business for the first 6 months of the current tax year and the second being the final tax payment for the previous tax year.”

Before starting a sole proprietorship, it is worth engaging an experienced tax consultant who will offer guidance, particularly in the following areas:

- The correct business structure (confirming that registration of a company or registration for turnover tax would not be more appropriate);
- Obligations in terms of registering for VAT or as an employer;
- Obligations in terms of the Tax Act with a focus on estimating the magnitude of and the timing of upcoming tax payments.

This assistance will, in the long run, save your business from any costly errors and allow you to focus your time and attention where it belongs, on running a profitable business.

For more information contact Private Client Holdings on (021) 671 1220.

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