CHAPTER 1: INTRODUCTION TO THE STUDY

1.1 INTRODUCTION AND BACKGROUND TO THE STUDY

Albert Einstein, as cited in Slemrod and Bakija (1996:xv), once said that the hardest thing in the world to understand is income tax. Nevertheless, it is vital that income tax is understood as it forms a critical element of how a government affects the lives of its citizens.

Lamont (1992:83) states that of all the powers of government, other than its authority to declare war, none bears so incisively upon the welfare of citizens, both privately and in their economic enterprise, as does its power to tax. The effect of taxation is that subjects are forced to give up hard earned earnings or possessions, or, in the early days, also payments in kind, without receiving visible benefits in return (Coetzee, 1993:5; Theron, 1994:16).

Taxes have been levied in South Africa since 1914. Every year the Minister of Finance presents the annual budget, in which the total intended government expenditure for the following year is detailed. During this process, the manner of funding the expenditure is also indicated. Government expenditure in South Africa is predominantly funded by means of revenue generated from tax levies (Mohr, Van der Merwe, Botha & Inggs, 1988:79-91; Venter, Hamel & Stiglingh, 2004:4). Table 1 provides a summary of government income for the 2005/2006 fiscal year as well as the estimated figures for 2006/2007.

Table 1: Sources of government income

Type of Tax	**2005/2006 Outcome R Million**	**Percentage**	**2006/2007 Estimate R Million**	**Percentage**
Taxes on income and profits	**230 804**	**55.30%**	**274 300**	**56.02%**
Personal income tax	125 645	30.11%	139 000	28.39%
Company tax	86 161	20.65%	114 771	23.44%
Secondary tax on companies	12 278	2.94%	15 700	3.21%
Tax on retirement funds	4 783	1.14%	2 750	0.56%
Other	1 937	0.46%	2 079	0.42%
Taxes on payroll and workforce	**4 872**	**1.17%**	**5 850**	**1.20%**
Taxes on property	**11 138**	**2.67%**	**10 345**	**2.11%**

Domestic taxes on goods and services	**151 362**	**36.27%**	**174 667**	**35.67%**
Value-added tax	114 352	27.40%	134 562	27.48%
Specific excise duties	14 547	3.49%	16 100	3.29%
Levies on fuel	20 507	4.91%	21 750	4.44%
Other	1 956	0.47%	2 255	0.46%
Taxes on international trade & transactions	**18 202**	**4.36%**	**23 900**	**4.88%**
Stamp duties and fees	**793**	**0.19%**	**600**	**0.12%**
State miscellaneous revenue	**163**	**0.04%**	**-**	**-**
Total tax revenue	**417 334**	**100%**	**489 662**	**100%**

Source: Department of Finance: National Treasury. 2007. *Estimate of National Revenue*. [Online] Available from: http://www.treasury.gov.za/documents/budget/2007/review/chap4.pdf [Accessed: 2007-08-08].

The South African Revenue Service (SARS) was established by legislation to collect revenue and ensure compliance with tax law. Its vision has been, and still is, to become an innovative revenue and customs agency that enhances economic growth and social development and supports South Africa’s integration into the global economy in a way that benefits all citizens (SARS, 2004a). In ten years of democracy, SARS has striven continuously to broaden the tax base, improve its service levels to taxpayers, and pursue enforcement initiatives that contribute directly to increased revenue yield which will finance government’s developmental agenda (SARS, 2004b).

The present Minister of Finance in South Africa, Trevor Manuel, stated that the obligation to pay one’s fair share of taxes, as and when they fall due, is part of the new morality which democratic governance must inculcate in every South African. He accepted that tax evasion and fraud are among the most insidious forms of criminality that plague the South African society and that millions of Rand are diverted on a daily basis from the fiscus by tax criminals. The government has no option but to support the energetic and innovative drive by SARS to improve compliance by thoroughly investigating any fraudulent scheme that comes to its attention. The government, therefore, commended the efforts of SARS to stamp out tax evasion and fraud and continues in its intention to show zero tolerance to any form of tax evasion and fraud (Manuel, 1999:58).

According to Adams (1921:536,556), a government’s success or failure with the levying (collecting) of income tax rests primarily upon the honesty of taxpayers. The author further states that one of the factors that contributes to the dishonesty of taxpayers is the complexity of the tax system, as it may lead to administrative failures. From the taxpayers' perspective, it is deduced that the most common complaint about taxes is straightforward – they are too high (Slemrod & Bakija, 1996:1).

Lewis (1982:39) supports this statement. He mentions that if you go into almost any English country pub, order some drinks, settle by the bar and work the subject of taxation into the conversation by asking the locals what their opinion of income tax is – a Clean Air Act version would be likely to include statements such as: "We pay too much tax", "It's the government that is to blame", "It's not worth working so hard anymore because anything you earn is taken away again". Lewis (1982:41) states that taxes are always unpopular and only an idiosyncratic minority is likely to say that it pays too little tax. In addition, Sommer (1984:275) highlights that one thing is certain, namely, that everywhere in the world taxpayers want more value for their money collected in the form of taxes.

By distinguishing statutory taxes from effective payments, tax evasion defines a specific revenue deficiency, known as the "tax gap". The tax gap merely portrays the wedge between economic reality and a purely legal construct called statutory taxes (Franzoni, 1998:3).

Both the Margo Commission (1986:§27) and the Katz Commission (1994:§5.1) dealt with tax morality and the tax gap in South Africa. The Katz Commission defines the tax gap as: "…the difference between the taxes that the law seeks to collect and those in fact collected". The Margo Commission points out that this happens by means of both tax avoidance and tax evasion. Both of these studies quote estimates by the International Monetary Fund. These estimates showed that the tax gap in industrialised countries was in the order of 10% and that for the developing world, the average was 33%. The Katz Commission (1994:§5.5) went so far as to estimate that in South Africa the tax gap was 20%, which represented at that time an amount of R21 billion.

Both studies alluded to the effect of a declining level of tax morality in the country and ascribe this to various factors. These include:

- resentment over what is regarded as unfair, burdensome or excessive taxation;

- deficiencies in administration, including poor collection;
- problems relating to recognition of income and expenditure;
- ineffective countering of avoidance; and
- a high level of evasion.

There is, by definition, no reliable way of determining the size of South Africa's tax gap. In developing countries, however, it is common cause that the gap is large and growing. A widening tax gap has adverse consequences. The failure of the collection agency to maintain effective administration of those areas of the tax system that require special assessment and auditing skills results in greater reliance being placed on revenue sources that are relatively easy to administer (for example, employees' tax) (Stewart, 1994:24).

Edwards (1997:64) remarked that the recommendations received from both the Margo and the Katz Commission were not implemented. According to *Finansies en Tegniek* [Finance Week] (1997:66), the tax morale in South Africa was, at that time, at its lowest level ever. In an article written by Ngwenya (1999:10), it is stated that: "South Africans have lost respect for the law to such an extent that our new heroes are big time criminals. We don't pay taxes and we happily buy stolen goods". This author blamed the lawlessness of South Africans on the fact that the majority of South Africans are angry because those who had wealth are losing it and those who never had wealth still do not have it. Pravin Gordhan, the present SARS Commissioner, disclosed that about R20 billion in taxes was lost to fraud and poor tax morality (Sawyer, 1998:6). Of the 44.4 million people living in South Africa in February 2001, 11.8 million were economically active, but only 6.7 million were registered taxpayers (Kemp, 2002).

In the pre-1994 South Africa, ramshackle tax legislation and ineffective tax collection allowed people to divert large amounts of income tax to tax shelters and tax havens. Some of the tactics employed were legal and some were not, but in both cases, the taxman was frustrated and relatively powerless. The shortfall was made up by lower-income taxpayers who were not in a position to make smart tax arrangements (Hazelhurst, 2003:64).

Hazelhurst (2003:64) notes that in the post-1994 South Africa, a series of legislative changes and the creation of a new revenue-collection system have created a tax dispensation in which there is better compliance and improved enforcement. He contends that, using state-of-the-art technology and 113 qualified forensic investigators at the Woodmead office in Sandton, Pravin Gordhan (the present SARS Commissioner) is closing the tax gap. However, this author notes that the gap still exists. It was estimated by Croome, a partner at Edward Nathan and Friedland (who was also the Chairman of the South African Institute of Chartered Accountants (SAICA)'s tax committee at that time), that five million economically active people are not registered for tax purposes (as cited by Hazelhurst, 2003:64).

Naidoo (2005:13) confirmed the view of Hazelhurst by stating that SARS has undoubtedly made significant strides in improving the administration of taxes. It has become more efficient and has increased its staff numbers and staff quality. SARS is now a far more effective tax-gathering machine than ten years ago. Laws have been tightened and, in fact, over the last decade there have been such a significant number of changes to the tax laws that they are now so complex that only a handful of tax experts can understand them. This, clearly, creates additional problems for compliance by taxpayers who do not have access to sophisticated tax specialists.

Naidoo (2005:13) continued by stating that despite all the efforts of SARS, there is still the perception that there is a significant tax gap in South Africa. A figure of R30 billion is bandied about in the press as the extent of the gap (Cokayne, 2002:6; Kemp, 2002; Leuvennink, 2003:1; Mabanga, 2004:11; Temkin, 2002:3; Temkin, 2003:1). Kemp (2002) is of the opinion that individual taxpayers make up the vast majority of the "tax gap".

The tax gap is made up of two parts - those who fail to register as taxpayers, as well as registered taxpayers who do not declare their full income (Hazelhurst, 2003:64; Delport, 2000:15). According to Trevor Manuel, the present Minister of Finance, as cited by Loxton (2002:3), the tax gap in South Africa is occasionally due to ignorance, but is generally attributed to aggressive tax planning to reduce liabilities and to certain people who simply do not pay tax. Mabanga (2004:11) reported on an interview where Pravin Gordhan, the present

SARS Commissioner, remarked that every society has a tax gap and that in South Africa we had a tax system that excluded the majority for a long time.

Due to the fact that government expenditure is predominantly funded by means of revenue generated from tax levies, it is of utmost importance to protect the country's tax base. The present research is thus important as it concerns income tax compliance (that is, people's willingness to pay tax) as well as the obverse, tax resistance.

Tax resistance takes two major forms, namely, tax avoidance and tax evasion, both of which diminish the government's tax receipts. Smith and Kinsey (1987:642) stated that taxpayers' opportunities for both compliance and non-compliance vary substantially and opportunity factors must, therefore, be included in any analysis of tax behaviour. Therefore, the significance of the current study is emphasised as it attempted to build upon previous research. This study also utilised insights from several disciplines and various theoretical perspectives.

The country of focus for this study was South Africa. South Africa is a country that comprises a diverse collection of cultures, languages, beliefs and backgrounds. It is conceivable that these different population groups may have differing perceptions of taxation resulting from their cultural backgrounds or even their political and social histories. These perceptions may, in turn, influence their attitudes towards tax compliance. This study, therefore, attempted without any pre-conceived ideas or expectations, to assess the perceptions about taxation amongst the different population groups in South Africa.

Taking the above into consideration, the problem statement and research objectives formulated for this study are presented below.

1.2 PROBLEM STATEMENT

There appears to be a substantial tax gap between the tax that is theoretically collectable from economically active persons in South Africa and the tax that is actually collected. One of the main reasons for the tax gap is non-compliance by taxpayers and potential taxpayers with tax legislation. One of the causes of non-compliance has been demonstrated to be the attitudes and perceptions of people and it is possible that, in South Africa, the perceptions about taxation of different population groups may also differ. In order to change taxpaying behaviour, perceptions must first be identified, and then influenced in a positive way towards tax compliance.

1.3 OBJECTIVES OF THE STUDY

The primary objective for this study was to determine the perceptions of South African taxpayers about various aspects with regard to taxation. South African taxpayers, for the purpose of this study, included natural persons from the four major South African population groups who were twenty-one years and older. This study made use of the term *taxpayers* despite the fact that some natural persons might not have been liable for income tax, as their income was below the tax threshold. All natural persons, however, pay tax when purchasing goods and services and, therefore, contribute towards government income.

The following secondary objectives were set for this study to assist in achieving the primary objective:

- To determine perceptions about general tax-related issues amongst South African taxpayers.
- To determine the various demographic, economic or other factors that might influence a taxpayer’s attitude with regard to general tax-related issues.
- To determine perceptions about tax evasion and tax compliance statements amongst South African taxpayers.

- To investigate the relationship between taxpayers' views with regard to a specific tax-related statement and their attitudes towards tax evasion and tax compliance.
- To investigate the relationship between taxpayers' views concerning a specific tax evasion statement and their attitudes towards tax compliance.
- To determine whether taxpayers' perceptions about tax penalties are related to their attitudes regarding tax evasion.
- To determine whether the perceptions about taxation of the various population groups differ.
- To assess whether the findings from the current research substantiates earlier research.

This study aimed to establish the likelihood that taxpayers' perceptions with regard to taxation would influence their attitudes towards tax compliance. This study then assumed that if taxpayers have negative perceptions about taxation, they will also have negative attitudes towards tax compliance and *vice versa*.

If it was found that taxpayers' perceptions influenced their attitudes towards tax compliance, it could be inferred that it is important to concentrate on changing taxpayers' perceptions with regard to taxation in order to achieve a more positive attitude towards tax compliance.

1.4 IMPORTANCE AND BENEFITS OF THE STUDY

Despite all the efforts of SARS, there still appears to be a significant tax gap in South Africa (Naidoo, 2005:13). It is of utmost importance to protect the country's tax base. This research is thus important as it revolves around tax compliance (that is, people's willingness to pay tax) as well as the obverse, tax resistance.

It is imperative to determine taxpayers' perceptions with regard to taxation in order to not only influence government policy regarding taxation, but also to enable government to market itself and its services more effectively to the general public. This study is also important as it focuses on the perceptions of taxpayers.

The significance of this research is further emphasised by the fact that only limited research on taxpayers' perceptions has been conducted within a South African context. To the writer's knowledge only one accredited study (Oberholzer, 2005:249-275) has investigated taxpayers' perceptions in South Africa. A limitation of the study undertaken by Oberholzer (2005:249-275) is that it focused on previously disadvantaged South Africans and disregarded other population groups of the country. Hence, this study is important as it attempted to build upon this previous research by including a broader segment of individuals in South Africa. In doing so, it is hoped that this study will also open further fields of research regarding taxation in South Africa.

1.5 DEFINING THE KEY TERMS

This research revolved around a number of key concepts, namely, *taxation*, *tax evasion*, *tax compliance*, *South African taxpayers*, *perceptions*, as well as *population groups*. The manner in which these key terms have been defined for the purpose of this study is considered below.

Taxation: *Taxation*, for this study, is defined as: "…a compulsory unrequited payment to the government" (Organisation for Economic Cooperation (OECD), 2004).

Tax evasion: *Tax evasion*, for the purpose of this study, refers to illegal activities deliberately undertaken by a taxpayer to free him or herself from a tax burden, for example, where a taxpayer omits income from the annual tax return (Lewis, 1982:123; OECD, 2004; Stiglingh, Venter & Hamel, 2005:389; Webley, Robben, Elffers & Hessing, 1991:2).

Tax compliance: For this study, *tax compliance*, typically means: "…true reporting of the tax base; correct computation of the liability; timely filing of the return; and timely payment of the amounts due" (Franzoni, 1998:5).

South African taxpayers: South African taxpayers, for the purpose of this study, included natural persons from the four major South African population groups who were twenty-one years and older. As mentioned previously, this study made use of the term *taxpayers* despite the fact that some natural persons might not have been liable for income tax, as their income might have been below the tax threshold. All natural persons do, however, pay tax when purchasing goods and services and thereby contribute towards government income.

Perception: For this study *perception* is defined as: "The process by which people sense, select, and interpret stimuli" (Lumsden & Lumsden, 2000:382).

Population groups: The *population groups* for this study consisted of the four major South African population groups (that is, White, Coloured, Indian and Black/African) as defined by Statistics South Africa (Statistics South Africa, 2004:1).

1.6 RESEARCH DESIGN AND METHODOLOGY

In order to establish the theoretical basis for the research, an extensive literature review was conducted and prior research conducted on various aspects relating to tax evasion was analysed.

This was an exploratory study and an interrogation/communication approach was followed as the data was collected from respondents by means of interviews using a questionnaire as the measuring instrument. Previous research and models (as discussed in the literature review) were taken into account when formulating the questions in the questionnaire.

As trained fieldworkers merely recorded the responses as indicated by the respondents without any manipulation of variables taking place, an *ex post facto* design was followed. The study was descriptive as it revolved around determining the likelihood (how much) that taxpayers' (who) perceptions with regard to taxation would influence their attitudes towards tax compliance (what) in Tshwane (where) during February 2006 (when) (Cooper & Schindler, 2003:146-149).

As data was only collected on one occasion, this was a cross-sectional study. The study was also a statistical study and was designed for breadth rather than depth. It attempted to highlight a sample of South African taxpayers' perceptions with regard to taxation and made numeric inferences based on the data obtained. The research was also performed under field conditions as it was conducted under actual environmental conditions (Cooper & Schindler, 2003:149-150).

The universe for the sample included residents from the four major South African population groups (that is, White, Coloured, Indian and Black/African) in the Tshwane metropolitan area (which includes Pretoria, the capital city of South Africa), who were twenty-one years and older. A sample size of 260 South African taxpayers from this area was considered to be appropriate for the study.

1.7 DEMARCATION OF STUDY

This study focused on taxpayers who were natural persons. Hence, corporate taxpayers were excluded.

It is important to note that the research was performed within the Tshwane metropolitan area only. This study is classified as baseline research. It was not the purpose of the study to generalise the conclusions reached to the whole of the South African population. This study only highlights the various perceptions amongst the major population groups within South Africa.

1.8 STRUCTURE OF THE THESIS

Chapter 1: Introduction to the study

The first chapter provides an introduction and background to the study and presents the problem statement and objectives. The importance and benefits of the study are highlighted, the key terms are defined and the research design and methodology are briefly summarised. Next, the study is demarcated. The chapter concludes by providing an outline of the structure of the thesis.

Chapter 2: Literature review

The second chapter highlights the important findings from the literature review. This discussion primarily revolves around why people evade taxes from both an economist's and a social psychological viewpoint. Previous empirical research performed relating to tax evasion and previous research performed relating to taxpayers in South Africa is explored. A brief discussion is provided concerning tax ethics and the history of taxes. The manner, in which the term *perception* is applied, for the purpose of this study, is also considered.

Chapter 3: Research design and methodology

The third chapter discusses the research design and methodology applied for this study. This chapter provides details of the research design, the sampling method, as well as the manner in which the data was collected and analysed for this study. In addition, the link between the theoretical framework (discussed in chapter 2) and the design of the questionnaire is discussed. The techniques used to enhance the validity and reliability of the research outcome are also described and the ethical considerations are addressed.

Chapter 4: Demographic and other factors

This chapter discusses the representativity of the sample and considers the demographic profile of the respondents, their economic circumstances, risk profile, relationship with SARS and fiscal attitudes.

Chapter 5: Analysis of relationships

The fifth chapter presents the findings related to the main themes of the study. This chapter considers respondents' perceptions with regard to general tax-related issues, tax evasion issues, tax compliance issues, and perceptions concerning penalties related to tax evasion. Where similar past research has been performed, this is highlighted together with the findings.

Chapter 6: Conclusions and implications

The final chapter brings the study to a close. It considers strategies for government to address tax evasion, highlights respondents' comments regarding taxation in South Africa, provides a review of recently published literature and summarises the findings and conclusions of the research. Limitations to the study as well as recommendations for future research are also considered.

1.9 SUMMARY

This chapter introduced the focus of this study. It provided an introduction and background to the study and presented the problem statement and objectives. The importance and benefits of the study were highlighted. The key terms were defined, the research design and methodology were summarised and the field of research was demarcated. This chapter also presented an outline of the structure of the rest of the dissertation.

The following chapter highlights the findings from the literature, the focus being on the reasons why people evade taxes examined from both an economist's and social psychological viewpoint.

CHAPTER 2: LITERATURE REVIEW

2.1 INTRODUCTION

The literature review provides a contextual understanding of the incidence of and factors influencing tax evasion and tax avoidance. This discussion revolves primarily around why people evade taxes from both an economist's and a social psychological viewpoint. Previous empirical research performed in relation to tax evasion and previous research performed in relation to taxpayers in South Africa is examined. A brief discussion is provided concerning tax ethics and the history of taxes. The manner in which the term *perception* is applied, for the purpose of this study, is also considered.

2.2 TAX EVASION AND TAX AVOIDANCE

Hessing, Elffers, Robben and Webley (1992:304) propose that there are probably three groups of taxpayers - taxpayers who never evade taxes, taxpayers who will try to evade every now and then and taxpayers who will try to evade on a regular basis.

It is essential to note that, in legal terms, there is an important distinction between tax evasion and tax avoidance. *Tax evasion* refers to illegal activities deliberately undertaken by a taxpayer to free him or herself from a tax burden (for example, where a taxpayer omits income from the annual tax return). *Tax avoidance*, on the other hand, usually denotes a situation in which the taxpayer has arranged his or her affairs in a perfectly legal manner with the result that he or she has either reduced the taxable income or has no income on which tax is payable. No obligation rests upon the taxpayer to pay a greater amount of tax than is legally due under the taxing Act. A taxpayer is also not debarred from entering into a *bona fide* transaction, which when carried out has the effect of avoiding or reducing liability to pay tax, provided that there is no provision in the law designed to prevent the avoidance or reduction of tax (Lewis, 1982:123; OECD, 2004; Stiglingh *et al*., 2005:389; Webley *et al*., 1991:2).

This principle was clearly explained by the United Kingdom judgement in Inland Revenue Commissioners v The Duke of Westminster (1936), 19, where Lord Tomlin established that:

> "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax".

Perhaps it is with this ingenuity in mind that Lewis (1982:123) emphasises that the dividing line between tax evasion and tax avoidance is blurred (as with many differentiations).

Taxation and evasion is a pervasive phenomenon in all societies (Bird & Oldman, 1990:453; Slemrod, 1992:v). Tax evasion is a complex and generally hidden behaviour that can have significant social and economic consequences (Webley *et al*., 1991:128; Lewis, 1982:159). Taxation and evasion have always gone hand in hand. In fact, during William Pitt's speech introducing income tax in Britain in 1799, the problem of evasion occupied the centre stage: "It was to prevent all evasion and fraud that a general tax shall be imposed on all the leading branches of income" (as cited by Webley *et al*., 1991:1).

Ironically, even though tax rates in Victorian England were set at levels that now seem unbelievably low (income tax was set at 2.90%), there were complaints about evasion from the outset. In 1868, it was estimated that the average taxable income declared was less than half of what it should have been. In Exeter, where there was a special report in 1871, only 20% of those liable for income tax made returns that were satisfactory to the Revenue Service (Sabine, 1966:105-106). One can, therefore, without fear of contradiction, assert that income tax evasion *per se* is most certainly not a modern problem. Tax evasion is ubiquitous and as citizens from around the world have taken part, it is a behaviour that can be found in a wide variety of cultural and legal settings (Webley *et al*., 1991:23).

The reasons for evading taxes have been explored by both economists and psychologists. This is considered in the subsequent two sections.

2.3 WHY DO PEOPLE EVADE TAXES? – AN ECONOMIST'S VIEWPOINT

According to Webley *et al*. (1991:8), if one was to stop a person in the street and ask him or her why people evade tax, the answer would almost certainly be "greed". The assumption is that people will commit an offence, any offence, if by doing so they maximise their utility. Becker (1968:207) argues that people become criminals not because their motivations are different from others, but rather because their evaluations of cost and benefits differ. Applied to the tax situation, people are treated as rational, amoral decision makers whose aim, in this as in all other areas, is simply to maximise utility (Becker, 1968:207).

Allingham and Sandmo's (1972:338) classical model of tax evasion assumes that behaviour is influenced by factors such as the tax rate (which determines the benefits of evasion), the penalties for fraud, as well as the probability of detection (which determine the cost). For example, in Great Britain only 400 serious tax fraud investigations take place a year compared with 30 million taxpayers, resulting in only 60 successful prosecutions a year (Accountancy, 2004:103).

Taxpayers contemplating tax fraud may well calculate that the chance of being caught is very remote. Allingham and Sandmo (1972:324) mention that given the low probability of being audited in many countries and the comparatively low penalties for those being caught evading, rational and selfish taxpayers would decide to evade or underreport taxable income. The classical model, therefore, predicts that both the probability of detection as well as the severity of penalties will affect evasion. It would be logical to infer that if detection is likely and penalties severe, then people will be more compliant.

Over the years a number of extensions have been made to the classical model. One of these extensions defined the interactive (game-playing) models (Benjamini & Maital, 1985:245-264;

Corchon (1984, in Webley *et al*. 1991:10)). Further models incorporate the idea of limited rationality (Jackson & Milliron, 1986:125-165; Kahneman & Tversky, 1979:263-291; Kahneman & Tversky, 1984:341-350; Schadewald, 1989:68-84).

The interactive models stem from the recognition that a taxpayer is not taking decisions in isolation and that there are other "players" in the "game". The revenue authorities can clearly alter the probability of detection and the penalty rate. The behaviour of other taxpayers may also be relevant. A taxpayer's reputation may suffer if he is caught evading in a population largely comprised of non-evaders. On the other hand, a taxpayers' reputation may be unaffected or even rise if the majority of people evade taxes (Webley *et al*., 1991:10).

In the Corchon model (described by Cowell 1990:122), the tax situation is treated as a two-person game involving the taxpayer and the authorities. The taxpayer has two choices - either to comply or not to comply. The authorities also have two choices - they can investigate the taxpayer or not. Clearly there is no simple equilibrium in this model. If the taxpayer is complying, it is best for the authorities not to waste money investigating. On the other hand, if taxpayers are aware that the authorities are not investigating, it is best for the taxpayer not to comply. Equilibrium exists if both parties use mixed strategies. In this situation, the probability of evasion increases with the marginal cost of investigation and decreases with the size of the penalty for evasion.

An extension to the Corchon model takes into account the behaviour of other taxpayers, including certain social psychological variables such as stigma, reputation and social norms. The details of this model developed by Benjamini and Maital (1985:245-264) are somewhat technical but it is sufficient to say that it has multiple stable equilibria. In a homogeneous population everybody either evades or is completely honest. More realistically, in a heterogeneous population, members of certain groups will generally evade whilst members of other groups will generally be honest. Vogel (1974:512) also confirms that group support appears to be important in the formation of attitudes towards tax evasion. Taking this into account, Cowell (1990:113) suggests that this implies that the decision about evasion is a process where a person first decides whether to be honest or not, and then proceeds to the finer calculations of how much to evade.

Treating decisions as a two-stage process is also found in approaches that hypothesise limitations to rationality. The best known of these approaches is Kahneman and Tversky's (1979:263-291; 1984:341-350) prospect theory. People who observe that the tax rate is lower than their reference tax rate derive utility from this. Kahneman and Tversky (1979:263; 1984:343) argue that people make choices in two stages.

In the first stage, the *problem-editing phase*, the individual reformulates options so that the subsequent choice is simplified. This editing consists of operations that transform the probabilities and outcomes, such as simplification (for example, rounding a probability of 0,49 to 0,50) and segregation (decomposing a choice into a more or less risky option). An important part of this process is the framing of outcomes (prospects) as gains or losses relative to some reference point, rather than as final states of wealth or utility.

In the second phase, the *evaluation phase*, the individual evaluates each of the edited prospects and chooses the prospect with the highest value. In this stage the individual will use a utility function that is convex for losses, concave for gains, and steeper for losses than for gains. This implies that when sure gains are involved individuals will tend to avoid risks, whereas they will be willing to take risks to avoid sure losses. It also implies that individuals will take different decisions depending on how problems are framed.

Tversky and Kahneman (1981:453) provide a common example of prospect theory. In this example subjects are asked to imagine that the United States is threatened with an unusual disease that is expected to kill 600 people. A choice has to be made between two interventions. The first of these gives a certain outcome - 200 people will live and 400 will die. The second is risky - there is a one in three chance that 600 people will live (no people will die) and a two in three chance that no people will live (that is, 600 will die). The option that most people choose depends on how the problem is framed. If the situation is presented as a gain (for example, 200 people will be saved versus a one in three chance of 600 being saved) the majority of respondents chose the certain option. Conversely, if it is presented as a loss (that is, 400 people will die) the risky choice is more popular.

The relevance of this to tax evasion has been noted by a number of researchers (Jackson & Milliron, 1986:152; Schadewald, 1989:69) and is discussed in greater depth by Smith and Kinsey (1987:648). There are several factors that implicate framing in tax decisions. For instance, tax that has to be paid has greater utility than tax that is already withheld. It is also noted that the majority of taxpayers in the United States seem to prefer having more withheld than is strictly necessary. This implies that in a system where tax is withheld by the authorities, individuals who expect a refund and perceive this as a gain would avoid the risks associated with evasion. On the other hand, those expecting to pay yet more tax (a certain loss) would be more likely to take the risky alternative and evade tax.

2.4 WHY DO PEOPLE EVADE TAXES? – A SOCIAL PSYCHOLOGICAL VIEWPOINT

Two kinds of theories exist to explain why people evade paying tax. The first of the two groups are integrative models of the taxpaying process, based on a wide knowledge of the literature and designed to introduce some new ideas. These are sometimes referred to as theories but are rather regarded as frameworks (and are sometimes so named by their authors) within which data about taxpaying and evasion can be organised. Some of the best examples would include the models of Lewis (1982:160,226), Groenland and Van Veldhoven (1983, in Webley *et al*., 1991:13) and Smith and Kinsey (1987:651-657).

At best these models give one a feel for the crucial variables involved in evasion and how they might be interrelated. At the very least, these models are reminiscent of the information-processing models of consumer behaviour found in marketing texts, with a multitude of little boxes connected by arrows that are solid and dotted. The second kind is a rather straightforward application of a social psychological theory to tax evasion (Kaplan, Reckers & Reynolds, 1986:461-467).

In his book, “The psychology of taxation”, Lewis (1982:vii) reviewed the entire scope of research into taxation and drew insights from a variety of disciplines. He was particularly concerned to fuse psychology and economics. Lewis (1982:160,226) suggests two models - one which brings together the concerns of the individual and the concerns of the authorities, and the other which focuses on the relationship between tax attitudes and tax behaviour. Webley *et al*. (1991:14) summarise Lewis’s two models, the first as a conceptual map. As far as the authorities are concerned, three factors are regarded as important in this model:

- government’s fiscal policy;
- tax enforcement policy; and
- policy makers’ assumptions about taxpayers.

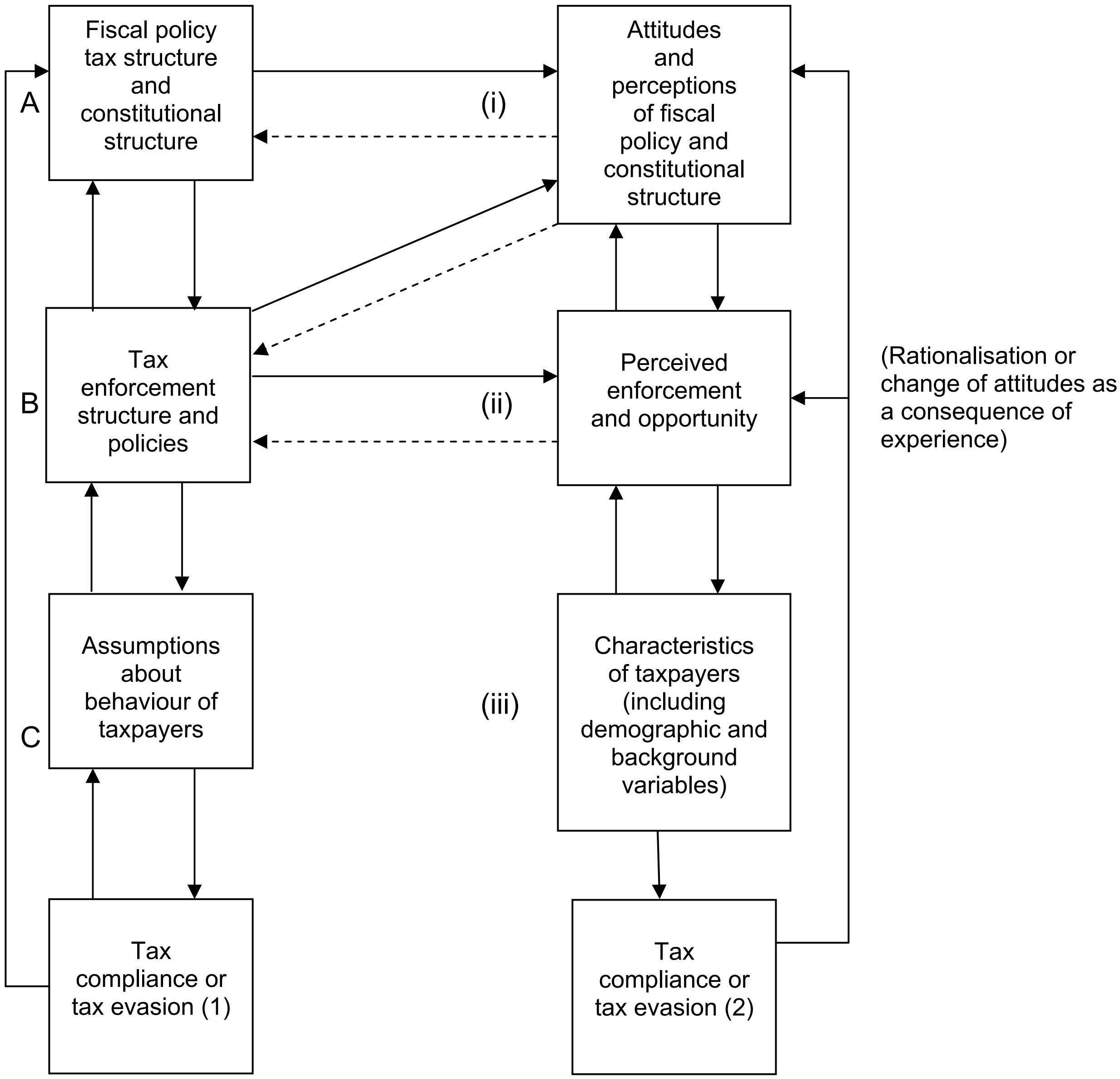
The tax enforcement structure partly determines the level of evasion, which itself affects fiscal policy makers’ assumptions. On the individual side, another three factors are described. These are *fiscal attitudes and perceptions* (which include the individual’s support for government policies, perceptions of the tax system and burden, feelings of alienation and inequity), *perceptions of enforcement and opportunity*, and *characteristics of the taxpayers* (demographics and personality traits). These all interact to affect the decision as to whether to evade tax or not.

The two sides (governmental and individual) also affect each other. Fiscal attitudes and perceptions are partly a result of actual government policy, and actual enforcement structure also affects perceived opportunities for evasion. Conversely, the attitudes and perceptions of taxpayers feed into fiscal and enforcement policy. Tax enforcement structures will, therefore, be linked in some way with people’s views as to whether they can evade taxes and get away with it. Vogel (1974:501) mentions that taxpayers’ attitudes are no doubt closely connected with perceptions about the degree of distributive justice codified in a particular tax system.

Lewis’s second model, concerning the relationship between tax attitudes and tax behaviour, provides more detail on how decisions (whether governmental or individual) are reached. Lewis (1982:172) suggests that demographic variables, attitudes towards the government and tax inspectors, as well as personality traits, influence a person’s attitude to tax behaviour.

Lewis does, however, point out the difficulty of actually testing this model as it relates to a behaviour that is private and illegal. Figure 1 below is a diagrammatic representation of Lewis's view on tax evasion.

Figure 1: A revised model of tax evasion



Source: Lewis, A. 1982. *The psychology of taxation*. Oxford: Martin Robertson, p. 172.

This diagrammatic representation can be divided down the centre to give two descriptions of tax compliance. The first (1) describes a structure that incorporates elements of the theoretical approaches of economists and political economists, and the second (2), psychological and sociological perspectives.

According to Lewis (1982:172) these two approaches are not completely separate and may indeed be considered to exist in parallel to one another with points of overlap - points that must be strengthened if our understanding of tax compliance is to be improved. Lewis (1982:156) describes the two representations of tax compliance independently and then follows with a discussion of the interaction between them. A brief exposition of this diagrammatic representation follows.

Box A refers to the constitutional structure of government (for example, in terms of corporate-technocratic linkages), a country's tax structure (for example, the proportion of direct to indirect taxes and marginal income tax rates) and government fiscal policy. All of these factors can affect tax enforcement policies contained in box B. The government constitution and government policy determine which tax enforcement procedures are legal and desirable and, in turn, different tax structures may make one type or style of tax enforcement more appropriate than another.

Continuing down to box C, assumptions about the behaviour of taxpayers as optimising and risk aversive come next. This is followed by box D and the dependent measure of tax evasion or tax compliance. Arrows linking boxes flow in both directions. Not only does fiscal policy determine tax enforcement policies - fiscal policies themselves may also be amended by the success or failures of tax enforcement procedures. Fiscal policy and tax enforcement may, in turn, be affected by changing assumptions about taxpayers and the degree of tax evasion. However, as the diagram reveals, a more direct feedback loop is far more common in that increases in tax evasion may have effects on fiscal policy and tax enforcement procedures, while the tax policymaker's view of taxpayers and their motivations remains unedited and of little or no interest.

The second half of the model (labelled 2) comprises boxes (i), (ii), (iii). This approach to tax evasion and tax compliance places emphasis on the attitudes and perceptions of taxpayers and thus constitutes an analysis of tax evasion behaviour “with a human face”. Box (i) contains a host of considerations raised in social surveys under the heading of attitudes towards and perceptions about constitutional structure, as well as government and fiscal policy. More specifically, it includes taxpayers’ support for government and fiscal policy, feelings of coercion, impotence, alienation and the perceived accountability of the relevant fiscal authorities.

Taxpayers’ perceptions of the uses, purposes and fairness of taxation (perhaps in terms of equity); perceptions of tax burdens and exchange; moral and normative (in the social psychological sense) as well as other rationalisations incorporated in tax ethics, are also included.

Interacting with this bundle of factors (hence the arrows indicating a two-way flow) are taxpayers’ perceptions of the probability of detection and the size of the fine. Questions concerning the perceived equity of opportunity for tax evasion are also considered here. In particular, there is the perception that the tax system may appear unfair, in the sense that people with higher incomes are perceived as having greater opportunities in the legal sense to avoid paying tax.

Boxes (i) and (ii) interact, as some taxpayers may have a better understanding of the working of fiscal policy than others, and, in the reverse direction, tax authorities perceived as rigorous invaders of personal liberty may, in turn, engender more antipathetic tax attitudes. Interacting with boxes (i) and (ii) are the characteristics of taxpayers in terms of their individual, group and demographic differences. Surveys have identified a host of these variables. Principal amongst these are education factors and fiscal knowledge, social class, socioeconomic groupings, occupational role relationships and union membership, age, income (including perceived economic well-being and anticipated future economic well-being), sex and marital status, political preferences, risk aversion and familiarity with evasion and evaders. Also included in this are considerations of compliance costs.

It has been shown that different groups in society have varying tax attitudes and different perceptions of tax enforcement. There is also a less obvious flow in the opposite direction – individual differences in risk aversion, compliance costs and perceived economic well-being are also influenced by perceptions of tax authorities and attitudes towards tax. While this second approach to tax compliance implies that tax attitudes, perceptions and individual differences between taxpayers constitute antecedents of tax evasion, this need not always be so; hence the feedback from tax compliance (2). Perceived enforcement and opportunity may be partly the consequence of tax evasion practice. Similarly, tax attitudes may be taxpayers' own rationalisations of their behaviour after the event.

The crucial and most productive aspect of this revised model is present in the interaction between its two seemingly disparate halves. The solid arrow between box (A) and box (i) is in recognition of the fact that tax attitudes must in part be the result of actual, as well as perceived, fiscal policies, government intentions and the constitutional structures underpinning them. Similarly, actual as well as perceived tax enforcement procedures affect both tax attitudes and perceptions of tax enforcement.

The main thrust of the argument is that effective tax policies must take account of these links and be responsive to these tax attitudes and perceptions, as indicated by the dotted arrows. The dotted arrows indicate the comparative weakness of these links in present-day tax policy-making and implementation (with the notable exceptions of the fiscal referenda in California and elsewhere, as well as the influence of informed elites such as pressure groups). These arrows are also dotted as they may represent only what even the more enlightened of tax policy-makers, administrators and theoretical political economists *think taxpayers think* without having adequately investigated their implicit assumptions. The case is thus presented that an adequate model of tax compliance must take into account both halves of this revised analysis.

Groenland and Van Veldhoven (1983, in Webley *et al*., 1991:17) put forward a tentative framework that fused *ad hoc* approaches with attitude-behaviour models. Individual differences and situational characteristics interact to affect attitude towards (and knowledge of) the tax system, which, in turn, affects the disposition to evade. These dispositions and situational characteristics then have direct effects on actual behaviour. Three different kinds of situational characteristics are discussed, namely, *opportunity, socio-economic factors* and the *tax system*. These are all seen as having the potential, directly and indirectly, to affect evasion. Thus, the particular configuration of the tax system will provide opportunities for evasion for certain tax groups and influences attitudes towards it.

In outlining their approach Smith and Kinsey (1987:642) make a number of valid points. They argue that it is equally important to understand what factors motivate compliance as well as which factors motivate evasion. Secondly, many analyses of evasion focus on the preferences and intentions of taxpayers and largely ignore the social context. Thirdly and finally, they highlight that all past research has assumed that non-compliance is the result of a conscious and deliberate decision by taxpayers. Their model, therefore, highlights that in many situations non-compliance may simply be the result of inertia and that people probably do not take a single decision to evade. It is more likely that through a series of actions, such as keeping good records or “guesstimating” expenses, they end up complying (or not complying).

Smith and Kinsey (1987:645) present a flow chart, which shows what factors shift people from their habitual behaviour to consciously taking a decision and forming intentions. In general, aspects of the social context such as tax reform, changes in the economy, and changes in salary will make taxes more salient. People will then move through three stages, namely, *diagnostic* (in which the situation is defined), *action* (in which intentions are formed) and *implementation* (in which they decide how to carry out intentions).

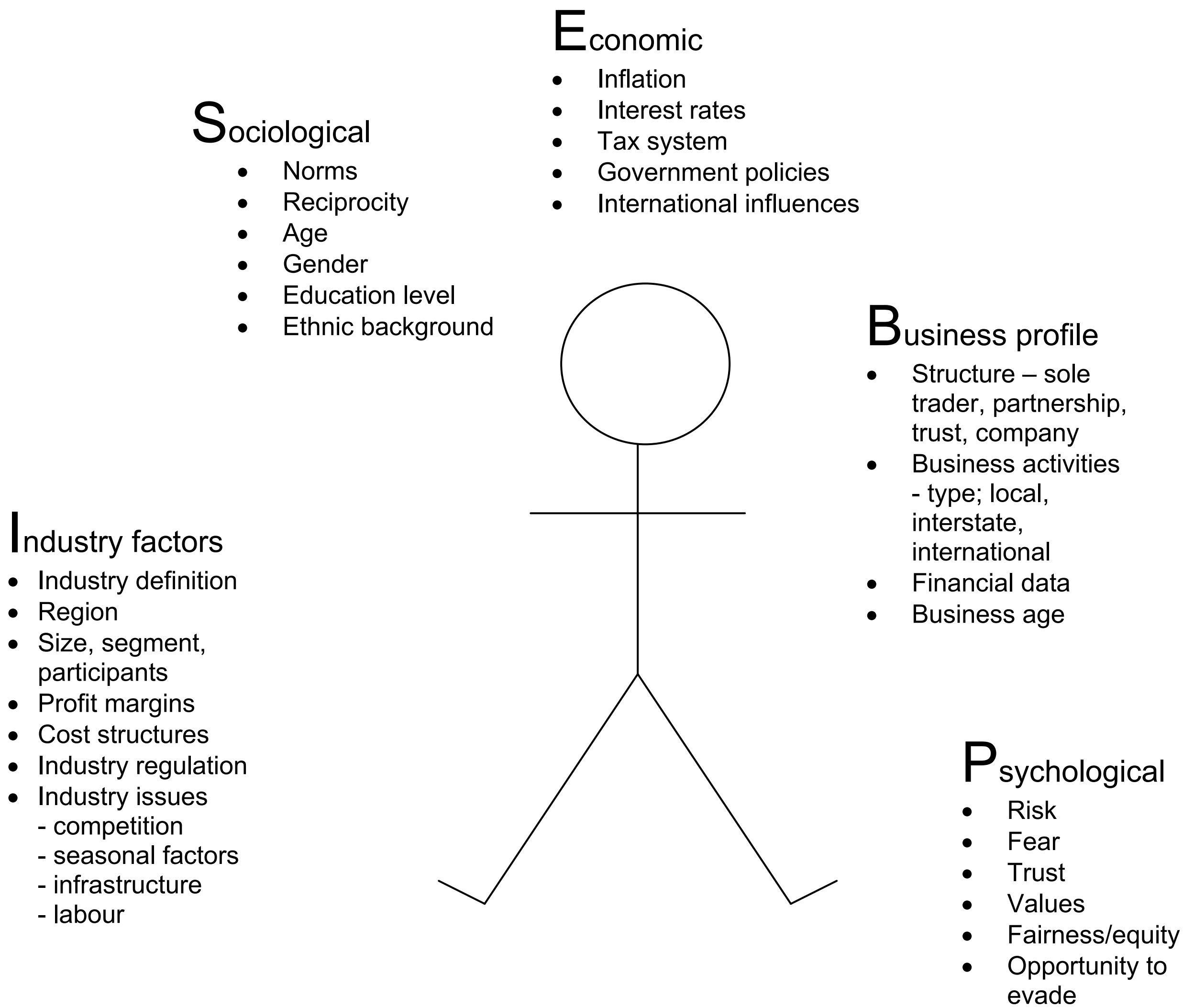
Smith and Kinsey (1987:652) continue by emphasising that people are seen as weighing four clusters of factors in forming intentions: *material consequences, normative expectations, socio-legal attitudes* and *expressive factors*. This is done in prospect theory terms (that is, decisions are framed in terms of gains and losses from some initial reference point). These authors consider two kinds of opinions - these include opinions about the goals that are dependent on taxes (that is, government spending), and those that concern the tax system itself. They believe that attitudes towards goals have indirect effects that work through attitudes towards the system itself. Expressive factors or "psychic costs" have a direct effect on intentions. These are simply the subjective costs and benefits involved with taxpaying, such as the frustration involved in completing tax forms.

Finally Kaplan *et al.* (1986:461-476) base their respective theories on attribution theory. *Attribution theory* is concerned with how people make sense of their social world by attributing causes to one thing or another. These authors substantiate their viewpoint by mentioning that people do things either because they *have to* (environmental cause) or because they *want to* (internal cause). They additionally claim that several principles in attribution theory may be useful in formulating hypotheses concerning tax evasion.

Their research indicated that certain socio-psychological processes influence the perception of tax evasion behaviour of others and the stated propensity to engage in evasion behaviour. For example, if many people evade tax, the fact that a particular individual is noncompliant tells you little about that person. The individual would be seen as less responsible and, therefore, a lesser punishment is appropriate. Similarly, if individuals cheated only on their taxes and in no other context, this would lead to an attribution to the tax situation (based on its "distinctiveness"). In addition, it is pointed out that increased trust in government results in higher tax morale and thus lessens the likelihood of non-compliance.

The Australian Cash Economy Task Force (1998:18) conducted an extensive review of compliance literature whilst compiling its second report to the Australian Tax Office. The research to date has revealed that taxpayer compliance decisions can be affected by factors that can broadly be categorised as psychological, sociological, economic and industrial. Figure 2 is a schematic presentation of these variant factors.

Figure 2: Factors influencing a taxpayer's compliance decision



Source: Australian Cash Economy Task Force. 1998. *Improving tax compliance in the cash economy*. [Online] Available from: http://ctsi.anu.edu.au/publications/ATOpubs/improving%20tax%20compliance.pdf [Accessed: 2005-03-31]. p.18.

The Australian Cash Economy Task Force (1998:19) considers that none of these factors stand alone as the sole reason for a taxpayer's behaviour, and equally, it is not possible to identify which factors in combination may influence the behaviour of any one particular person. This makes it difficult to study a taxpayer's attitude towards taxation (Fallan, 1999:173-184).

2.5 PREVIOUS EMPIRICAL RESEARCH PERFORMED ON TAX-RELATED MATTERS

Although not specifically related to South Africa, this section highlights a number of previous studies and some specific findings that deal with tax-related matters.

In a survey by Friedland, Maital and Rutenberg (1978:113), it was found that females evaded tax more than men. By contrast, three of four studies conducted by Webley *et al*. (1991:110), found that men evaded more often than women.

Groenland and Van Veldhoven (1983, in Webley *et al*., 1991:59) substantiate their theory that people with an internal locus of control (those who see their environment as largely under their personal control) will succeed in evading taxes more often than those with an external locus of control. These authors found that people with higher levels of education evaded tax more than those with lower education levels. Vogel (1974:511) confirms this as he states that the tax system in Sweden creates unequal tax minimisation opportunities since education is a necessary precondition to the successful practice of either tax minimisation or tax evasion. Another study performed by Fallan (1999:173-184) indicated that increased tax knowledge has meant that people consider their own tax evasion more seriously.

Webley *et al*. (1991:68-77) found that people use the unfairness of the tax system as a justification for evasion. They also note that people who are not society oriented, young, and employed are most likely to be associated with tax evasion behaviour.

Another survey undertaken by Webley *et al*. (1991:85) indicated that the percentage of the total tax liability voluntarily reported was considerably higher for wage earners (95%) than for individuals whose primary source of income was business related (77%). The same author also found strong support for the proposition that greater opportunity leads to greater tax evasion (Webley *et al*., 1991:102).

After all their experimental studies into tax evasion, Webley *et al*. (1991:122) contend that for some participants the task of calculating their tax liability was too difficult. Some comments received from respondents included: "I was not quite sure what I was doing", "I do not know a lot about tax forms, to be honest I was just guessing a lot of it", and "I am afraid".

Previous research found that normative commitment to compliance could be positively reinforced by the effective detection and punishment of non-compliance, particularly for tax laws not rooted in values based on the relationships among individuals (Slemrod, 1992:6; Smith, 1992:223-250).

In a Scottish study conducted by Dean, Keenan and Kenney (1980:39-40), it was shown that tax evasion may increase if people believe that they will not be detected. In present circumstances, about 26% of respondents agreed that almost all taxpayers could easily evade small amounts without being detected. In addition, 66% agreed that almost all taxpayers would evade small amounts if they thought that they would not get caught evading. Thus, the difference between 26% and 66% could be viewed as the difference between opportunity and the potential exploitation of relaxed tax enforcement. It is important to note that the number of perceived likely evaders lessened (even with no fear of prosecution) as the amount evaded increased. This implies that even if tax authorities were comparatively impotent, the evasion of larger amounts would be considered to be ethically unacceptable, while the evasion of small amounts would not be.

Other possible reasons for the cause of tax evasion as established by Dean *et al*. (1980:42) include greed and financial hardship, government wastage, low chance of detection and the desire to break the system.

In a study conducted in North Carolina by Song and Yarbrough (1978:450), respondents were asked to compare and rank each of the five commonly discussed shortcomings of income tax. The results were:

- the tax rate is too high;
- there are too many loopholes;
- the regulations are too complicated;
- the middle-class bears the biggest burden; and

- it penalises the honest and law-abiding.

Mueller (1963:233) found that younger people are more favourably inclined towards increased services (therefore, higher tax rates). Conversely, those over 55 years of age are more fiscally conservative, favouring both tax and expenditure cuts. It appears as if attitudes and life experience might have an impact on taxpayers' actions.

A study investigating political attitudes and democracy in five nations by Almond and Verba (1963:379-387), revealed that education is an important factor in determining a citizen's orientation towards government, authority and his or her beliefs, feelings and evaluations of the political and governmental system as a whole. A summary of Almond and Verba's results concerning education variables, across surveys of approximately 1 000 interviews, conducted in the USA, West Germany, Britain, Italy and Mexico follows in the next paragraph.

Levels of education attained appear to have the most important demographic effect on political attitudes. Better-educated citizens, that are more aware of the impact that a government can have on the individual, pay more attention to political campaigns, possess a broader and greater depth of political information, are more likely to engage in political discussions, and are also more likely to think that they are capable of influencing governments and government policy. Furthermore, citizens with higher levels of education show a greater tendency to become active members of some type of organisation. They also display higher levels of confidence in the trustworthiness and helpfulness of other citizens.

Vogel (1974:507) also considered a person's occupation versus his or her fiscal preferences. He found that self-employed taxpayers are more likely to agree that tax revenue is too high and that the fiscal exchange rate is unfavourable.

As mentioned in chapter 1, only one accredited study has investigated taxpayers' perceptions in South Africa. This study by Oberholzer (2005:249-275) investigated previously disadvantaged taxpayers' perceptions in South Africa. It was found that although the majority of previously disadvantaged South Africans included in the study are paying taxes, they are unable to list the different types of taxes without assistance. Generally, the respondents in Oberholzer's study are positive about paying tax if the government applies it appropriately for the benefit of the taxpayer. A substantial proportion of the respondents indicated that they would not object if lower tax rates were introduced. A significant percentage of the respondents are also of the opinion that government should be transparent in the utilisation of taxpayers' money. Finally, it became evident from Oberholzer's study that there is a need amongst previously disadvantaged South Africans for increased education about tax systems and the application thereof.

2.6 PREVIOUS RESEARCH PERFORMED IN RELATION TO TAXPAYERS IN SOUTH AFRICA

This section considers non-accredited research performed in South Africa regarding taxpayers in South Africa.

A study conducted by Coetzee (1993:5-7) requested a number of taxpayers to indicate their thoughts concerning the tax system in South Africa. Findings from this study show that the two main reasons why people dislike paying tax stem firstly, from the fact that it is compulsory, and secondly, from the inability to immediately perceive the benefits of such tax. The main reasons why people are reluctant to pay tax according to Coetzee's study include:

- taxpayers often believe that the government does not spend the collected revenue effectively and responsibly;
- taxpayers do not get value for their money as reflected, for example, in poor infrastructure, inferior health care and education;
- the tax collection system is substandard and too many taxpayers escape the net;
- taxpayers do not fully understand how to calculate their own tax liability;
- the tax return is seen as a document that is designed to "catch out" the taxpayer;
- government promises to lighten the burden on individuals are not fulfilled;
- taxation in South Africa has long been understood by the Black population to be part and parcel of the apartheid system;

- the burden of tax is carried primarily by individuals in the middle-income group with little or no opportunity for reducing tax;
- fiscal drag on personal income has resulted in a gradual impoverishment, as despite remuneration increases, after tax, salaries show an effective decline;
- in many cases taxation is applied retrospectively; and
- the tax burden is spread unevenly, with many sectors of the population paying little or no tax.

Even though the number of respondents in the above study was not provided, this is one of a few research articles concerning perceptions on tax performed in South Africa (Coetzee, 1993:5-7).

Chait (1993:40-45) performed a study aimed at eliciting responses on general expectations and perceptions of taxation in South Africa. His study found that two-thirds of the respondents did not regard taxes as an effective means of redistributing wealth and that most people are not willing to pay more taxes. This author asserts that there is no doubt that a large portion of the South African population harbour negative attitudes towards taxation due in part to the political injustice of the past.

De Villiers (1996:23) states that South Africans have very negative attitudes towards taxation. He performed a study among four groups of taxpayers (that is, formal enterprises, informal enterprises, White, Asian and Coloured population groups, and the Black population group). Interesting results from his study indicated that all the groups concluded that tax rates are too high and should be reduced. Only 19% of the Black respondents indicated that they understand the process of taxation and registering as taxpayers. This study also showed that millions of people in South Africa do not pay their taxes as due. De Villiers (1996:23) postulates that this may be because individuals are generally not well-informed about tax issues.

According to De Villiers (1997:54-55), if taxpayers are of the opinion that they do not receive their fair share from the tax system they will be reluctant to pay taxes. He also believes that South Africa's tax system is very complex.

According to *Finansies en Tegniek* [Finance Week] (1997:66), SARS cannot meet the expectations of taxpayers in South Africa.

Coetzee (1998:28) criticises the government by stating that if the government does not increase the number of taxpayers in the tax net, then the government itself encourages tax evasion.

According to Pravin Gordhan, the present SARS Commissioner, as quoted by Sawyer (1998:6), possible reasons for tax fraud in South Africa are the government's perceived mismanagement of funds, Value-Added Tax (VAT) fraud, limited awareness within the emerging economy (such as the taxi industry) as well as fraud within SARS.

The editor of *Finansies en Tegniek* [Finance Week] asserts that taxpayers in South Africa dislike paying taxes due to a perception that the tax system is unfair. He remarks that cheating the tax authorities has become a national sport in South Africa (Delport, 2003:4).

Tax legislation in South Africa is so complex that the ordinary man in the street experiences difficulty in understanding it. This, in turn, provides a compliance challenge. The Margo Commission, as far back as 1986 already indicated that the tax system was too complicated. Since then there have been so many changes and additional taxes that only dedicated tax professionals are now capable of understanding the system. The danger here is that individuals and small businesses may inadvertently fail to comply fully with the tax laws because they do not have (and cannot always afford) the knowledge necessary to fulfil their obligations. Naidoo (2005:13) mentions that the majority of taxpayers want to do the right thing and pay their fair share of tax. They do not, however, want to pay more than is necessary. What they seek from SARS is certainty, equity and efficiency. These were the tenets of taxation that were identified by the Katz Commission (Naidoo, 2005:13).

Naidoo (2005:13) further argues that those who diligently pay their taxes and comply to their best ability with the tax laws want to be treated with respect by the revenue authorities. Unfortunately, this is not always the case. Taxpayers often believe that they are being treated as criminals and do not appreciate a heavy-handed approach from SARS with threats for non-compliance, which is often based on technicalities. To have taxpayers who are willing to contribute and comply with the laws and seek every possible way of avoiding tax requires some "give and take" from both parties. Naidoo (2005:13) is of the opinion that while there is a general perception that it is just "take" on the part of SARS, tax morality will not improve.

Another pivotal concept when considering tax-related matters, such as tax evasion and compliance, is tax ethics. The next section investigates the meaning of and prior research performed in relation to tax ethics.

2.7 TAX ETHICS

Tax ethics is defined by Vogel (1974:500) as: "The attitudinal and behavioural orientation of the taxpayer to accurate tax compliance in the sense of completing the tax return promptly, accurately, and legally". In the study concerning Swedish taxpayers conducted by Vogel (1974:499-513), respondents were asked to choose suitable penalties for tax evasion from a set of fixed alternative penalties for other types of offence. The penalties ranged from no penalty or a fine, to prison sentences of various lengths. It was found that the choice of a prison term was a good indicator of the perceived seriousness of tax offences. From the abridged selection of offences shown, there was clearly a tendency of lenience towards tax evaders. Even when the effect of the offences in terms of money was identical ($200), only 11.7% proposed a prison sentence for tax evaders as opposed to 53.9% for housebreaking. It is clear from this data that, on the attitudinal level, the Swedish public is relatively favourably disposed towards tax evasion.

Reckers, Sanders and Roark (1994:825-837) examined the influence of ethical beliefs on tax compliance decisions. They emphasise that factors such as social norms, ethics and personal characteristics may affect how a decision is edited and thus influence the taxpayers' ultimate decision on willingness to evade taxes. These authors focused on tax ethics as an explanatory variable of tax compliance. The results of their studies indicated that individual moral beliefs are highly significant in tax compliance decisions. When tax evasion is seen as a moral issue individuals are less likely to evade taxes, regardless of the tax situation.

A study conducted in North Carolina by Song and Yarbrough (1978:443) showed that most respondents believe that the tax laws should be respected. However, they do not believe that violations constitute so serious a crime as to warrant physical imprisonment as the typical taxpayer apparently views tax evasion as being only slightly more serious than stealing a bicycle. Interestingly, they also found that three in four Americans agreed with the statement that: "A person's tax amount should be determined by his ability to pay rather than the benefits he receives from the government."

According to Webley *et al*. (1991:23), in order to understand evasion, one needs to know something about the history and current functioning of tax systems in different countries as well as the tax mentality of their citizens. The following section, therefore, elaborates on these aspects.

2.8 HISTORY OF TAXES

Benjamin Franklin (a famous American scientist, inventor, statesman, printer, philosopher, musician and economist) wrote of the inevitability of death and taxes as cited by The New Dictionary of Cultural Literacy (2002). For as long as history has been recorded taxes have been paid, and throughout that period the reactions of taxpayers have been as predictable as they have been understandable.

At the most basic level there are interesting semantic differences in the language used to describe taxes. The Dutch word for tax is *belasting*, which also means "load", and thus has the connotation of a burden. This is found in the Latin languages as well where *impôt,* *imposto, impuest,* cognate with the English “imposition”. However, in German *steuer* means “support” and the Scandinavian *skat* denotes a “treasure” or “hoard” (Schmölders, 1970:301-302). According to Webley *et al*. (1991:23) these linguistic differences, though interesting, are probably not very significant.

When considering the question, “What is tax?”, Messere and Owens (1987:94) point out that it is not self-evident when they say: “…taxes are difficult both to define and identify”. The OECD (2004) defines tax as: “…a compulsory unrequited payment to the government”. For Lewis (1982:9), taxation is the principal means by which governments can attempt to redistribute wealth and bring about social change through various social policies. It is, therefore, central in the economic and political framework of Western industrialised countries.

Historical factors provide us with a certain degree of insight into the tax mentality of different countries. The history of taxes began many years ago when the King *was* the state. He was its ruler - spiritual, temporal and financial. The ruler cannot survive without getting (taxes) – and spending. Because taxation and budgeting are ubiquitous state functions whose character can be traced through different ages, cultures and politics, the problems of getting and spending are among the best known to mankind (Webber & Wildavsky, 1986:38).

Originally there was no money and taxes were paid in kind (for example, grains, cattle, cloth, labour and valuable objects) to support the priests, kings, their families, attendants, armies and officials. Goods were transported to the King’s treasury by primitive means (that is, by means of riverboats and on the backs of animals and men). The royal storehouses were monitored by hordes of officials who weighed, measured and stole whenever they could. With the advent of money, a new dual economy of con and kind involved the state in systematic assay. This also demanded a standardised basis of exchange and some method of converting from one system to another (Webber & Wildavsky, 1986:38).

There were several traditional kinds of taxation designed to meet the needs of government. The most regular and familiar of these methods were through customs duties. Customs were of medieval origin, levied on both imports and exports, and enabled the King to maintain a navy which would protect traders from the depredations of pirates and foreign enemies (Douglas, 1999:4; Webber & Wildavsky, 1986:270).

Webber and Wildavsky (1986:40-41) note that the structures of financial administration that appeared repeatedly in the ancient civilisations surveyed resulted from parallel efforts to solve such problems common to them all. Governments of Mesopotamian city-states, beginning in the third millennium B.C., ancient Egypt and Crete (3100-100 B.C.), Mauryan India (300 B.C. – A.D. 200), China during the Shange (1523-1027 B.C.) and Han (200 B.C. – A.D. 200) dynasties, Japan up to the nineteenth century, the Bronze Age civilisations of sub-Sahara Africa (A.D. 1200-1532) all had well-developed, similar systems of financial administration. Although widely dispersed in space and time, these governments produced similar solutions to the problems of supporting monarchs. Similar kinds of taxes were levied, administered in similar ways and the funds were used for like purposes. Similar attempts were also made to guard against fraud and theft.

Webber and Wildavsky (1986:22-24) also point out that for many generations governments collected only a few types of taxes. They levied direct taxes on part of the produce of land (that is, those who grew crops paid by the bur of millet, the catty of rice, or the bushel of oats; or in livestock, lambs and kids, salmon or herring). Governments also assessed head taxes. For millennia, the otherwise untaxable poor paid their dues in compulsory labour service. In ancient Egypt, China, Central America and Europe during the Middle Ages, as well as in the early modern era and colonial Africa during this century, people without money gave the government a number of days each week or each year in compulsory labour service. This time was mostly spent building and maintaining public works. Over the centuries and civilisations the only certainty in government's taxing and spending behaviour appears to be the absence of an ultimate solution.

Tax was introduced in the United Kingdom for the first time in 1799 to help pay for the Napoleonic wars. The United Kingdom introduced various schedules that dealt with income from particular sources in 1803. The "pay as you earn" system, which has been an effective counter to evasion, was introduced under the impetus of the Second World War. Before the war, less than a fifth of the working population paid income tax. However, by 1948 this figure had increased to two-thirds and now stands at more than 90% (Rose & Karran, 1987:18,87).

By way of contrast, the tax system implemented in Spain during the 1960's was described as "primitive" by Schmölders (1970:303). It had a predominance of indirect taxes, was generally regressive and was widely regarded as being unfair. The reform of 1977 brought in a progressive system with far more revenue being collected in the form of income tax. Despite the modernisation of this system, the belief that it is unfair has persisted, probably because of increased public awareness of taxation (direct taxation is more visible than indirect taxation) and also because government is perceived as wasting money (Alvira Martin & Garcia Lopez, 1984, in Webley *et al*., 1991:24).

A different kind of historical factor is implicated in the Italian case. Haycraft (1985:7) claimed that, because for centuries a large part of Italy was ruled by foreigners, citizens never developed a trusting relationship with their government and always preferred to spend money on their friends and relatives rather than on a remote authority. Rather than a duty, the payment of taxes was regarded as something to be avoided if at all possible.

Venter *et al.* (2004:3) explain that taxes are usually categorised as *direct* (income) or *indirect* (consumption). Direct taxes are more visible to the taxpayer (income tax, capital gains tax) whereas indirect taxes (VAT and excise duty) are often less visible and are collected by an intermediary. The rate structure of a tax is usually described as being progressive, proportional or regressive. Taxes that take an increasing proportion of income as it rises, are progressive (income tax levied on natural persons), those that take a constant portion (income tax on companies at a fixed rate) are proportional, and those that take a decreasing proportion are regressive (VAT).

The most important differences between worldwide tax systems concern the overall level of taxation, the tax structure and the marginal tax rates. The overall level of taxation can be expressed as tax revenue as a percentage of Gross Domestic Product (GDP). Tax structures differ from country to country. For example, the "pay as you earn" procedure withholds tax accurately and requires little cooperation from taxpayers as employers and the Inland Revenue do most of the paperwork. This structure does not, however, apply to all tax systems worldwide. Finally, there is a significant difference in tax bands or tax brackets between various tax systems (Webley *et al*., 1991:25-27).

Fiscal policy, like any other governmental policy, derives its meaning and direction from the aspirations and goals of the society within which it operates. The aspirations of the individuals of underdeveloped countries are clear - economic betterment and stability to provide the material soil within which human dignity and political freedom can grow (Bird & Oldman, 1990:5; United Nations Technical Assistance Administration, 1954:1). These aspirations are reflected in the preamble of the Charter of the United Nations (1945): "…to promote social progress and better standards of life in larger freedom".

Bird and Oldman (1990:10) emphasise the fact that the pressing need for large government outlays for economic development strongly influences the approach to the problem of determining the appropriate level of taxation in an underdeveloped country. In a highly developed country, tax policy tends to accept the level of expenditure as its revenue goal. This is modified by considerations relating to the levels of employment, prices and economic activity. The sequence of decision tends to run from expenditures to taxes. But in underdeveloped countries, the level of expenditure relies far more heavily upon the ability of the tax system to place the required revenues at the disposal of the government. By the same token, the size of the government's development programme depends in large part on the economic and administrative capacity of its tax system to marshal the necessary resources. In this sense, the sequence of decision tends to run from taxation to expenditures.

Taxation and public expenditure form the process by which resources are transferred to public use. The tax structure should accomplish its part in this process in an equitable and efficient fashion. However, taxation also has important bearing on other aspects of economic policy such as stability, growth and the distribution of income and wealth (Bird & Oldman, 1990:65).

Tax reform cannot be adapted to a single objective, such as adequate revenue, simplicity or equity. All of these must be considered, as must the broader objectives of economic development, stability and a fair sharing of tax burdens and the fruits of growth (Bird & Oldman, 1990:73-74). McCaffery (2002:3), an American tax lawyer, economist and professor who has been extensively involved with tax reform for more than a decade, states that the problem with most tax systems is that they are usually complicated, inefficient and, most importantly, unfair. According to Peters (1991:20-21), taxes generally have distributional effects on the citizens of a society. Tanzi (1995:1) claims that tax structures will have to adapt to the pressures of an integrating world economy in slow and subtle ways.

As this study was performed in South Africa, a brief discussion follows regarding the history of taxes in South Africa.

Taxes were levied as early as 1894 in terms of the Glen Grey Act (imposed by the British imperialist Cecil John Rhodes) on all Africans who did not enter the mines on a three-month contract. The mining industry transformed South Africa from a closed economy to an international economy. The mining industry, however, required a large, mass-based workforce. To augment this labour tax, poll and hut taxes were imposed on the African rural population, thus increasing the incentive to earn cash on the mines (Van den Berg & Bhorat, 1999:4).

The Income Tax Act 28 of 1914 was the first South African Income Tax Act to be implemented. The current Income Tax Act 58 of 1962 came into operation on 1 July 1962. Further important amendments were introduced in the annual amendment acts: “pay-as-you-earn” in 1963; the “final deduction” system in 1983; the taxation of close corporations and fringe benefits in 1984 and the Standard Income Tax on Employees (SITE) in 1988 (Vorster & Coetsee, 1991:1-4). These acts apply to all population groups in South Africa.

The Estate Duty Act came into operation on 1 April 1955. The rate at which estate duty was payable, was 25%. It has decreased to 20% with effect from 1 October 2001 (Arendse, Jordaan, Kolitz & Steyn, 2001:573). The Master had the power to administer all estates except for African intestate estates, which had to be administered by a magistrate. In Moseneke v The Master, 2001(2) SA 18 (CC), the Constitutional Court declared this section to be invalid with immediate effect. Legislation has been amended subsequently and the same measures for beneficiaries of an intestate estate apply to all population groups in South Africa.

On 3 July 1978, General Sales Tax (GST) was introduced at an initial rate of 4%, and subsequently increased to a rate of 13%. VAT was introduced from 30 September 1991 replacing General Sales Tax and was initially levied at a rate of 10%. This rate was subsequently increased to 14% on 7 April 1993 (Stack, Cronje & Hamel, 2000:4).

VAT, being a regressive type of tax, has a far greater effect on the poor. With the implementation of VAT, South Africans found themselves to be confronted with the prospect of paying tax on a far wider range of items than had previously been the case. VAT would now have to be paid, *inter alia* on water, electricity, union subscriptions, medical services, private and public hospitals, as well as rentals. The system was also more complicated to administer, especially for small enterprises. The implementation of VAT did, therefore, not happen without protest from various groups.

The Congress of South African Trade Unions (COSATU) was launched in December 1985 after four years of unity talks between unions opposed to apartheid and committed to a non-racial, non-sexist and democratic South Africa (COSATU, 2007). Initially COSATU's call was for the postponement of the implementation of VAT to allow for further consultations. Many other lobby groups and organisations welcomed the call and soon COSATU was spearheading a coalition of about 100 organisations opposed to the way in which VAT was being introduced. Barend du Plessis, the Minister of Finance at that time, was adamant that the VAT implementation date would not be postponed. However, he made a number of significant concessions in the early days of the campaign, including no VAT on rentals, union subscriptions and public health care. This was not enough for the coalition and their central demands became:

- no VAT on basic foods, water and electricity;

- no VAT on medicines and medical services; and
- an easier way to administering VAT for small businesses.

COSATU, together with a number of other independent trade unions, called for a general strike on 4 and 5 November 1991. This strike was one of the most successful ever in South Africa. By March 1992 some of the demands of the strike were met. Ranges of basic foodstuffs were exempted from VAT and business had joined the movement to discuss a national negotiating forum. This campaign was a good example of the power and success of alliances on single issues (Seftel, 1992). This is also confirmed by Moody who states that: “The early waves of mass strikes brought collective bargaining and rapid union growth” (Moody, 1997:209). The most important long-term effect of this anti-Vat campaign was that it compelled government and employers to enter into negotiations around economic issues affecting workers. The roots of the tripartism in South Africa today in forums such as Nedlac, where dialogue between organized business, labour and community takes place on issues of social and economic policy, lie in this campaign (Seftel, 1992).

Capital Gains Tax (CGT) was introduced on 1 October 2001. In terms of the Eighth Schedule of the Income Tax Act, a capital gain arises when an asset is disposed of for more than it originally cost. A portion of the gain is added to the taxpayer’s taxable income and is subject to income tax (section 26A of the Income Tax Act).

All registered owners of Municipal property are liable for payment of assessment rates. Assessment rates are used for non-profitable services, for example, library services, sport and recreational facilities and defraying costs associated with traffic, trade, industry, health, parks, open spaces, streets and roads (Marketing and Communication Directorate City Council of Pretoria, 2000:7).

As the focus of this study concerns the perceptions of South African taxpayers, a short discussion follows that considers perception theory.

2.9 DEFINING PERCEPTIONS FOR THIS STUDY

This section provides background regarding the term *perception* as relevant for this study.

2.9.1 Defining perceptions

Lumsden and Lumsden (2000:382) define *perception* as: "The process by which people sense, select, and interpret stimuli". Perceptions concern our awareness of the objects or conditions around us. They are to a large extent dependant upon the impressions these objects make upon our senses. Perceptions are the way things look to us or the way they sound, feel, taste or smell (Allport, 1955:14).

2.9.2 Factors influencing perception

Lumsden and Lumsden (2000:93) note that people perceive *selectively* (that is, people's motives, needs, drives, wants and experiences may keep them from seeing things that are unacceptable or unknown to them), people perceive what their *backgrounds permit them to perceive* (that is, culture, language, gender and experience all affect how people see and think) and people *multiply their misperceptions regarding other people* (that is, one person cannot really be sure how another person perceives objects, ideas or another person).

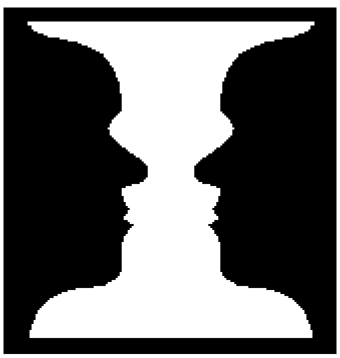
It is true that individuals may look at the same thing, yet perceive it differently. Robbins (2001:122-124) highlights a number of factors that operate to shape and sometimes distort perception. He mentions how these factors can reside in the *perceiver*, in the object or *target* being perceived, or in the context of the *situation* in which the perception is made. A brief exploration of these factors revealed the following:

The perceiver: When an individual looks at a target and attempts to interpret what he or she sees, that interpretation is heavily influenced by personal characteristics of the individual perceiver. Among the more relevant personal characteristics affecting perceptions are *attitudes*, *motives*, *interests*, *past experiences* and *expectations*.

The target: Characteristics of the target that is being observed can affect what is being perceived. For example, loud people are more likely to be noticed in a group than quiet ones. *Motion*, *sounds*, *size* and *other attributes* of a target also shape the way we see it.

What we see also depends on how we separate a figure from its general *background*, illustrated in Figure 3. The prominent object in this figure may first appear as a white vase. If, however, white is taken as the background, one sees two black profiles.

Figure 3: Figure-Ground Illustration



Source: Robinson, A.C. 2005. *Gestalt*. [Online] Available from: http://www.acrstudio.com/projects/teaching/design3_01gestalt.htm [Accessed: 2006-07-17].

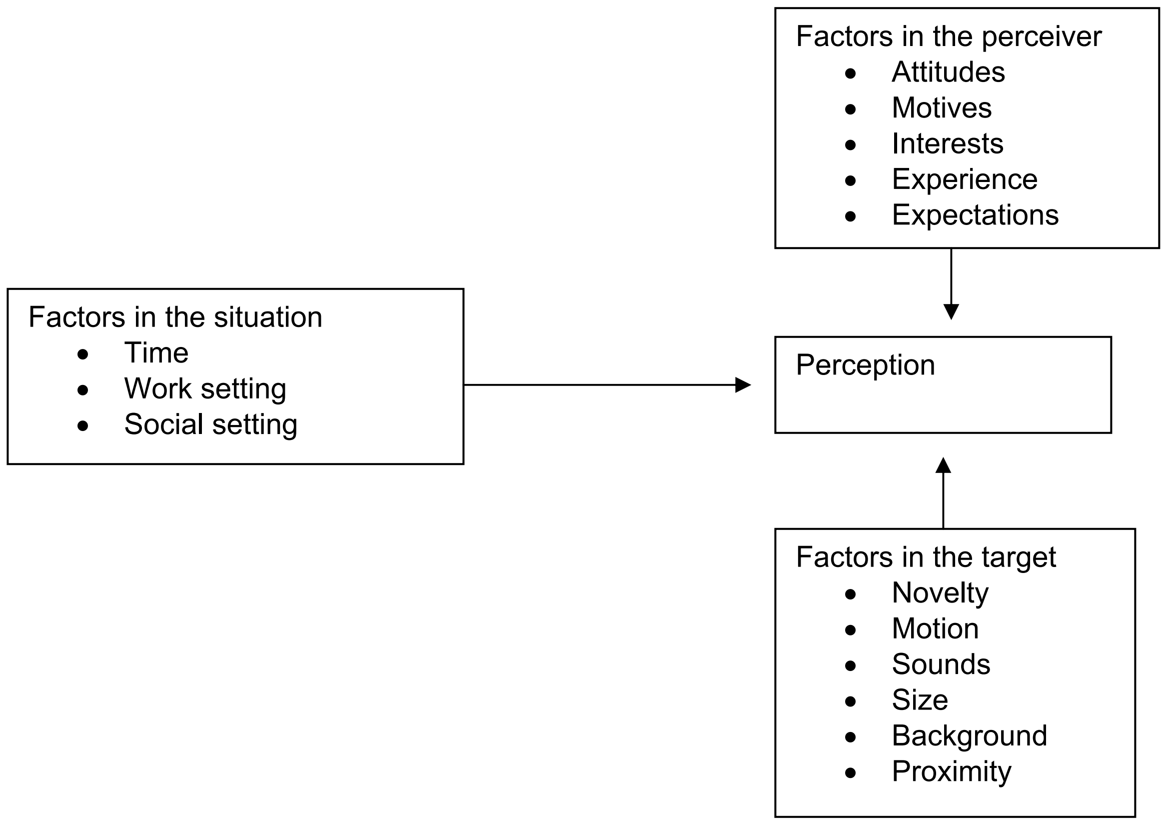
Additional important factors that influence target perceptions include:

- *Physical or time proximity*: as a result of this one tends to group unrelated objects or events. Objects or events that are similar to each other tend to be perceived together rather than separately.
- *Similarity*: persons, objects or events that are similar tend to be grouped together. Greater similarity increases the probability that they would be perceived as a common group.

The situation: The context in which one sees objects or events is important because elements in the surrounding environment influence a person's perceptions. The time at which an object or event is seen also influences attention, as does location, light, heat or any number of situational factors.

Figure 4 highlights a number of factors that might influence the perceptions of an individual as summarised by Robbins (2001:122-124).

Figure 4: Factors that influence perception



Source: Robbins, S.P. 2001. *Organizational behaviour*. 9th ed. Upper Saddle River, New Jersey: Prentice-Hall. p. 124.

From the above it is submitted that various demographic, economic or other circumstances of a particular individual might influence that individual's perceptions, including perceptions about tax.

2.10 SUMMARY

This chapter presented the literature review synthesised for the purposes of this study. Previous research which identified certain sociological and psychological reasons that may influence people to evade taxes was the main focus of the chapter. These reasons were examined from both an economist's and a psychological viewpoint. Previous empirical research performed in relation to tax evasion and previous research performed in relation to taxpayers in South Africa was explored. Tax ethics and the history of taxes were briefly elaborated upon. The way in which the term *perception* has been applied, for the purpose of this study, was also considered.

The next chapter discusses the research methodology followed in this study, with particular, emphasis on the link between the theoretical framework discussed in this chapter and the design of the questionnaire used in the study.