

# ANNUAL TAX COMPLIANCE COSTS FOR SMALL BUSINESSES: A SURVEY OF TAX PRACTITIONERS IN SOUTH AFRICA

S Smulders and M Stiglingh

*Department of Taxation, University of Pretoria*

## Abstract

This study provides a baseline measurement for annual tax compliance costs for small businesses. An empirical study performed amongst tax practitioners to identify and measure the annual tax compliance costs for small businesses throughout South Africa revealed that R7 030 per annum is the average fee that tax practitioners charge their small business clients to ensure that their tax returns (for four key taxes – income tax, provisional tax, value added tax and employees' tax) are prepared, completed and submitted as SARS requires. From the perspective of time and cost, preparing, completing and submitting VAT returns takes the longest and costs the most. It is evident that, overall, the compliance costs are regressive: the smaller the business, the heavier the burden.

JEL H25, L26

## 1 Introduction

### 1.1 Background

Governments all over the world recognise that small businesses are economically very important. They are a great and well-proven engine for wealth and job creation (Chamberlain & Smith, 2006: 3; Commission of the European Communities, 2002: 4; Davie & Hetherington, 1999: 2). In South Africa, the small business sector also has the potential to mop up unemployment and to drive growth (South African Revenue Service SMME Team, 2004: 3; Upstart Business Strategies CC, 2004: 2). Small, medium and micro-enterprises (SMMEs) contribute 36.1 per cent of the country's gross domestic product (GDP) and employ 68.2 per cent of the workforce in the private sector. In the agricultural, construction and retail sectors, SMMEs employ more than 80 per cent of the total workforce. Over the last few years, the growth in employment by SMMEs in South Africa has exceeded the growth in their contribution to the GDP, highlighting

the job creation potential of this sector of the economy (Arendse, Karlinsky, Killian & Payne, 2006: 1).

Business expansion in South Africa is clearly highly desirable, but regulations and red tape are reported to be the greatest constraint to such expansion (Grant Thornton, 2006: 1-2). International research in this field shows that tax regulatory compliance costs make up a significant portion of the total regulatory cost (Evans, 2003: 68). Several other patterns have emerged in various local and international studies; among the most important is that tax compliance costs constitute a much larger proportion of total compliance costs for smaller firms than for large ones (SBP, 2005: 42; Upstart Business Strategies CC, 2004: 7).

In his 2005 Budget Speech, Finance Minister Trevor Manuel (2005: 28) pointed out that regulatory costs relating specifically to small businesses and taxation had been raised, and he commented as follows:

...we have directed attention this year at the costs and complexity for small businesses of the tax code, because there is compelling evidence that simplified arrangements

can assist significantly in creating an environment conducive to enterprise development.

Manuel (2005) further suggested that any approach to assisting small business requires both policy and administration model adjustments if it is to be effective. The 2005 year, therefore, saw the start of a process of structural change in the South African Revenue Service (SARS) that was intended to assist small business in its start-up phase, to reduce compliance costs and red-tape, and to provide tax education and assistance.

Any meaningful discussion of such small business reform initiatives in progress requires an understanding of what a "small business" is. It would appear from the literature reviewed that, from an economic viewpoint, references to the term "small business" include micro and medium-sized businesses and that the term SMME is very often used as a synonym for the term "small business" (BusinessMap Foundation, 2006: 1; Democratic Alliance, n.d.: 4; RSA, 1995: 8; RSA, 1996: 13; RSA, 2004: 4; DTI, 2003: 71; SEDA, 2006: 3). However, there does not appear to be one specific definition of "small business" that is consistently used in the economic sense in South Africa.

From the point of view of taxation, SARS grants various relief measures or special dispensations to small businesses. The qualifying criteria for obtaining these relief measures or special dispensations differ in respect of the individual taxes. Although there are similarities between certain of the criteria, SARS does not appear to apply a consistent approach to the taxation of small businesses. It may be argued that using different definitions is a fundamentally valid approach, because each of the taxes could have different objectives, but it must be recognised that the use of different definitions complicates compliance considerably.

In this study, the term "small business" refers to small, medium and micro-enterprises. Further, as discussed and agreed with SARS and the National Treasury, the turnover limit for a business to qualify as a small business for the purposes of this study was a turnover of less than *R14 million*.

## 1.2 Need for and objective of the study

There is very little information available on the annual tax compliance costs carried specifically by small businesses in South Africa (Chamberlain & Smith, 2006: iii). In South Africa, there is to date no comprehensive system for the regular annual accounting of tax compliance costs (Gurd, Smith & Turner, 1998: 95). The objective of this study is therefore to establish what the cost of annual tax compliance for small businesses is. To do this, it is important to understand what is meant by "compliance costs" (see Section 2 of this article). After clarification of this term, the results of an empirical study, a survey of the accountants and bookkeepers (tax practitioners) who assist small businesses with their tax affairs, is presented.

## 2

### Compliance costs

Irrespective of the size of a business, it is subject to numerous regulations (Commission of the European Communities, 2002: 11; SBP, 2005: 18; Upstart Business Strategies CC, 2004: 3). To comply with these regulations, a small business has to incur certain costs (*Mail & Guardian*, 2005: 2), one of which is compliance costs. This study therefore focuses specifically on tax compliance costs.

While this area of taxation will always give rise to debate, all the definitions or descriptions of tax compliance costs generally appear to include the following elements (Arendse *et al.*, 2006: 4; Evans, 2006: 3, Gurd *et al.*, 1998: 96; SBP, 2003: 2):

- the value of time spent by business owners, managers, staff and others on understanding and applying the rules;
- record-keeping costs, that is, the costs of compiling the necessary receipts and other records and costs incurred in the preparation of tax returns;
- the payments for the expertise of professional advisors such as consultants, lawyers and accountants; and
- incidental costs postage, telephone and travel in communicating with advisers or the tax authorities.

Compliance costs, however, are not limited to direct cash outlays like the costs mentioned above, but also include the time costs spent in carrying out tax-related obligations, along with the stress, anxiety or discomfort incurred in complying with tax liabilities (Katz Commission, 1994: 47).

Certain costs, by virtue of their nature or because they are intertwined with other non-tax compliance costs, make it difficult to separate the different costs (Godwin, Hardwick & Sandford, 1989: 3). According to Evans (2006: 3), examples of such costs are:

- psychological costs;
- social costs;
- computational and tax planning costs; and
- accounting costs.

**Psychological costs** include the mental and emotional costs, anxiety and other such costs experienced by taxpayers and/or their advisors when dealing with tax legislation (Coleman, McKerchar, Walpole, Woellner & Zetler, 2005: 270). Unfortunately, no studies have yet successfully quantified these psychological costs, although some research in this area is currently being carried out (Evans, 2006: 3).

Along with these psychological costs, there may be certain **social costs**. These are difficult to quantify, so they tend to be ignored in the literature. An example of social costs, which are often on the borderline with efficiency costs, is when a tax change, such as the introduction of a higher rate of VAT on a particular range of goods, causes a trader to discontinue stocking those goods to keep tax affairs simple. This is an inconvenience to customers, who have to travel further to continue to buy those goods and who will possibly have to pay more because of the reduction in competition (Evans, 2006: 3).

Compliance costs are sometimes divided into *computational* (unavoidable or involuntary) and *tax planning* (avoidable or voluntary) costs (Johnston, 1963). This distinction is controversial and has not yet been (and possibly never will be) fully resolved in the tax compliance literature. Many tax lawyers and policy makers continue to insist that only computational costs constitute legitimate measures of taxation compliance

costs, and some attempts have been made to disentangle the two (Chen, Fayle & Pope, 1991). However, most of the major recent studies have not distinguished between computational and tax planning costs in their estimates of compliance costs, if only for the obvious reason that it is often almost impossible to disentangle the one from the other. Moreover, as noted by Slemrod and Sorum (in Evans, 2006: 4), “both kinds of costs are real resource costs of collecting the taxes”.

Despite careful attempts in most recent studies to isolate tax compliance costs from the underlying costs of being in business, there is almost certainly some *overlap* between business or *accounting costs* and *tax compliance costs* (Allers, 1994; Evans, 2006: 4). The extent of the overlap is uncertain, so most estimates of taxation compliance costs can only be indicative at best (Evans, 2006: 4). It is very difficult, if not impossible, to distinguish a clear cut-off point between these types of costs and tax compliance costs (Evans, 2006: 4).

Because it is so difficult to isolate and quantify psychological or social costs, no specific consideration was given in this study to separately identifying and distinguishing them from the costs included in the general taxation compliance cost definition, nor was any attempt made to do so. It is thus acknowledged that the results of this study do not include any psychological or social costs, as the study merely identifies the annual general taxation compliance costs incurred and then goes on to attempt to measure these costs, which is also a debatable point. However, a very rough idea of how to calculate the average cost of time spent on taxation compliance activities could be obtained by multiplying the average time taken by the average or market cost per hour, as suggested by Gurd *et al.* (1998: 95).

### 3

## Empirical research findings

### 3.1 Data collection

In order to establish the extent of the tax compliance burden for small businesses,

research was conducted throughout South Africa among tax practitioners registered with the South African Institute of Chartered Accountants (SAICA), the South African Institute of Professional Accountants (SAIPA) and the South African Institute of Certified Bookkeepers (SAICB). A database of all the members of SAICA (20 279), SAIPA (5 294) and the SAICB (2 174) was provided (27 747 participants in total). No sample was selected and the entire population was used.

It is often difficult to obtain information from small businesses (Commission of the European Communities, 2002; Upstart Business Strategies CC, 2004: 35), but their professional advisors might be able to provide the required information. Because they have neither the time nor the expertise to perform the tax function themselves, small businesses generally require the assistance of tax practitioners (Gurd *et al.*, 1998: 98; UNISA, 2005: 118; Upstart Business Strategies CC, 2004: 35). It has also been found that between 60 per cent and 98 per cent of small businesses hire tax practitioners to assist them with their tax affairs (Small Business Deregulation Task Force, 1996: 96; UNISA, 2005: 114; Upstart Business Strategies CC, 2004: 36). Tax practitioners are therefore a valuable source of information in quantifying the tax compliance costs for small businesses, which is why practitioners appointed by small businesses were used as respondents in this study.

An electronic internet-based questionnaire administered by BLUEtub Design and Production was selected as the research instrument for conducting the research. The questionnaire was developed by a team comprised of World Bank survey experts and a South African consultant, a senior lecturer in the Department of Taxation at the University of Pretoria. Pre-identified tax experts from local and international universities, SARS and the National Treasury were selected to review the survey questionnaire for relevance, structure, flow and content.

A pilot study was run from 15 September 2006 to 4 October 2006. The overall response rate in the pilot study was 14.5 per cent. The final questionnaire was sent out on 1 November 2006

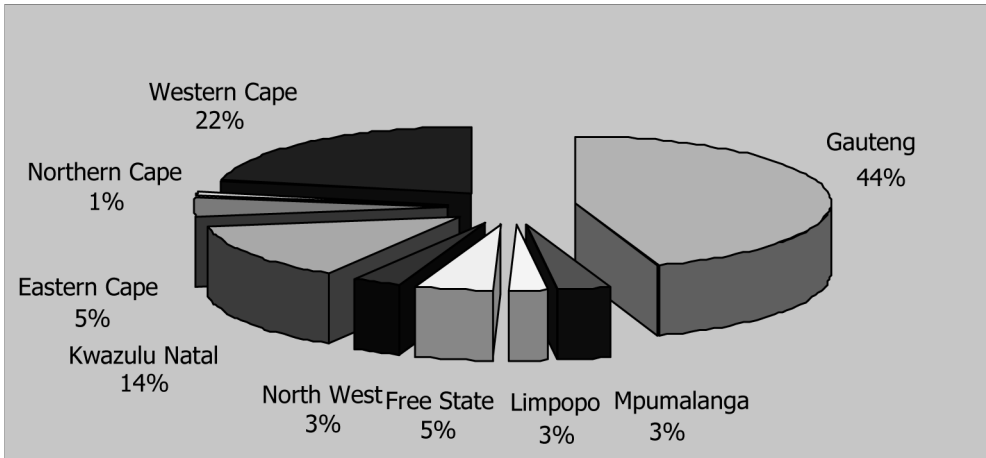
and access to it was closed on 5 January 2007. The overall response rate was 15.75 per cent (3 429 respondents). The pilot response rate and the overall response rate appear to be in line with the response rates received for online surveys (Hamilton, n.d.). The questions contained in the electronic internet-based questionnaire concentrated on the time and costs involved in complying with tax legislation.

It must be noted that the tax practitioners' estimates of these times and costs were obtained during the period 1 November 2006 to 5 January 2007. Unfortunately, they were not given a specific time-frame for the time taken or the costs involved in each compliance procedure. However, it was thought that their most recent experiences would be used to provide a response to the questions in the questionnaire. This would imply that the responses received in respect of the annual tax returns would most likely have been those to the 2006 year of assessment and for the monthly and bi-monthly tax returns for the period from January 2006 to November/December 2006.

### 3.2 Profile of the respondents

As can be seen in Figure 1 below, the largest category of respondents (44 per cent) was from Gauteng; however, at least 3 per cent of the respondents came from each of the remaining eight provinces in South Africa, with the exception of the Northern Cape, which had a 1 per cent representation. This appears to be in line with the demographics of the institutions' members, as the survey team was informed that, for instance, SAICA has fewer than 40 members in the Northern Cape (Coates, 2006: 1). The cities with more than 7 per cent representation were Johannesburg (12.8 per cent), Pretoria (14.6 per cent), Cape Town (10.8 per cent) and Durban (7.1 per cent). As these are arguably the four most important cities in South Africa, it seems appropriate that a higher percentage of responses came from these cities. Of all the respondents, 11 per cent reported that their offices were situated in a rural area.

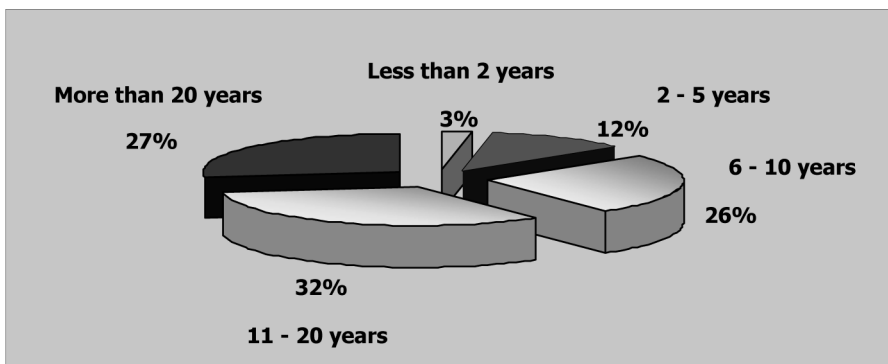
**Figure 1**  
Provinces where establishments are primarily situated



It was established that the majority (53 per cent) of the respondents providing professional services related to taxation matters for individuals and businesses in South Africa were registered with SAICA, whereas 43 per cent were registered with SAIPA and 4 per cent with SAICB. This is in line with the membership size of each of the professional institutions.

When the tax practitioners' levels of experience were considered, it was found that at least 85 per cent of the respondents had more than five years' experience in assisting clients with taxation matters, while 59 per cent had more than 11 years' experience in this task (Figure 2). Thus the majority of the respondents appeared to be well established in their businesses and their responses will therefore be of great value in adding credibility to the results.

**Figure 2**  
Years of professional experience in assisting clients with taxation matters



Because of the nature of tax legislation, changes are inevitable, which means that tax practitioners have to be up-to-date. It was established that it takes, on average, at least *seven days* per year for each tax practitioner to familiarise him/

herself with all the obligations and changes in the Income Tax laws and regulations. Keeping up with each of the other taxes (Provisional Tax, Value Added Tax (VAT) and Employees' Tax) takes tax practitioners on average from

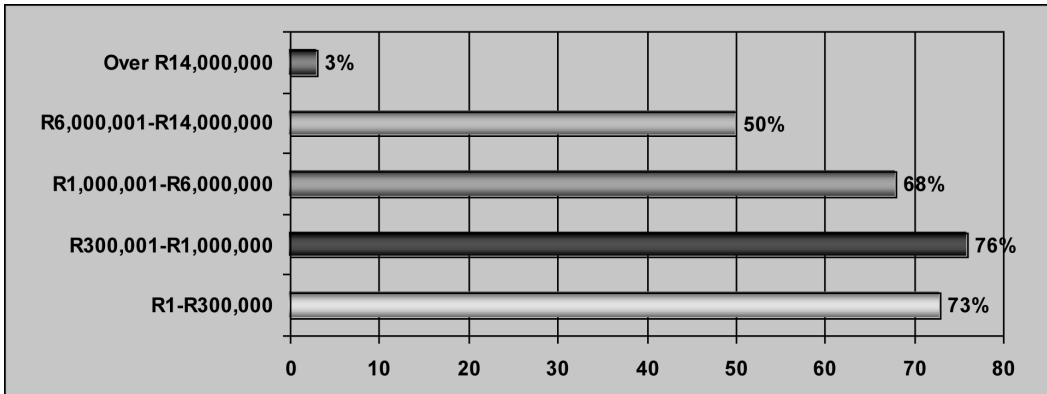
*three to five days* per year. They thus spend in total at least two weeks per year on maintaining and improving their ability to provide clients with the best possible service. This time is not directly billable to tax practitioners' clients, but it will hopefully result in future billable hours. It may even be possible to argue that the time tax practitioners spend on this activity could influence the price they will charge their clients; the longer it takes them to grasp the new legislation, the more expensive the service could potentially be.

### 3.3 Profile of respondents' clients

The distribution of the businesses of tax practitioners' clients according to turnover (see Figure 3 below) reveals that most (76 per cent) of

the tax practitioners surveyed serve clients whose turnover is between R300 001 and R1 000 000. However, the turnover categories below this category (R1 to R300 000) and above it (R1 000 001 to R6 million and R6 000 001 to R14 million) are also frequently served by tax practitioners. As this study was aimed at small businesses (defined as businesses whose turnover is R14 million or less), this is a good indication that the appropriate individuals responded, as all turnover bands are fairly represented. The total of this graph does not add up to 100 per cent, as some tax practitioners may serve clients in more than one turnover band. The graph thus represents the percentage of all the tax practitioners surveyed with clients in each turnover band.

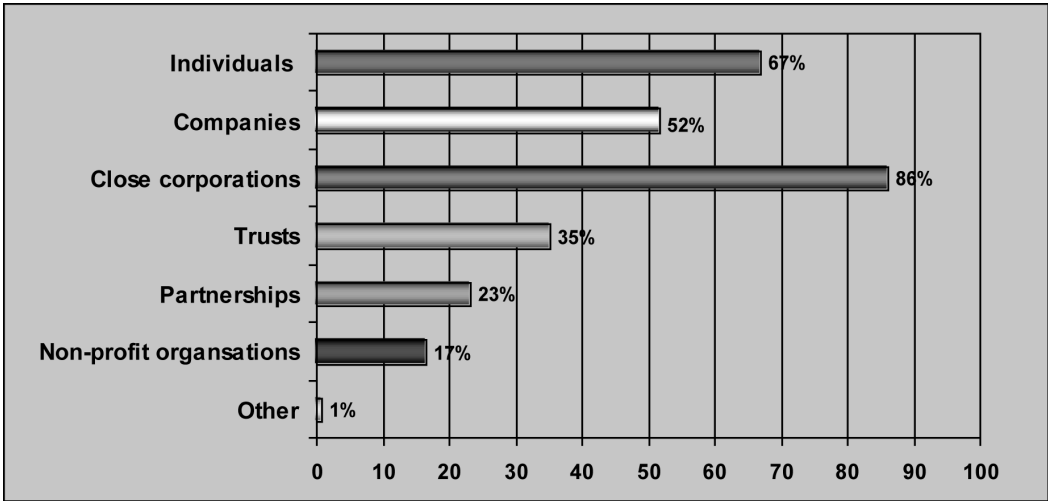
**Figure 3**  
Turnover bands of tax practitioner's clients



The distribution of businesses by legal form (see Figure 4 below) indicates that close corporations followed by individuals/sole proprietors are the dominant legal forms whereby the clients of the tax practitioners surveyed conduct their businesses. Once again there is fair representation of all the other legal forms in which a small business can operate, ensuring

that the results are not significantly biased in favour of legal form. The total of this graph does not add up to 100 per cent, as some tax practitioners may serve clients who conduct their businesses in a variety of legal forms. This graph thus represents the percentage of all the tax practitioners surveyed who have clients in each legal form.

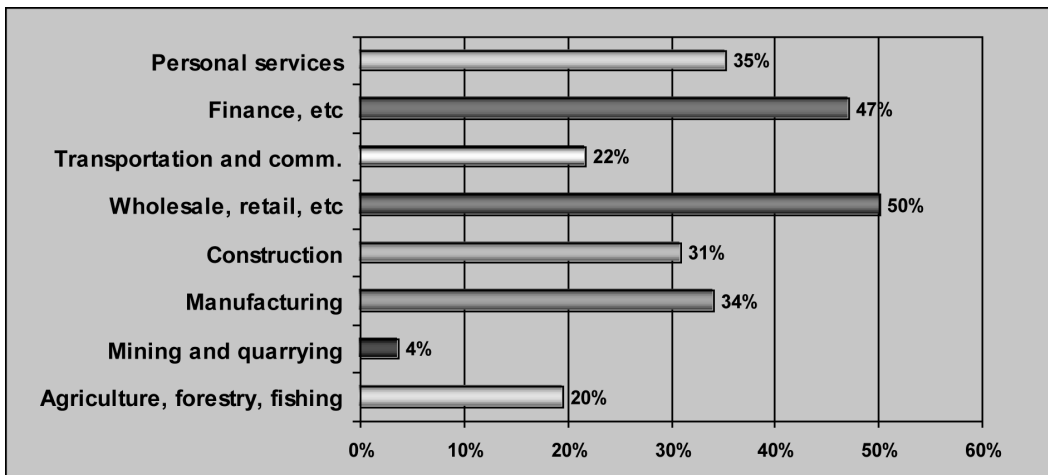
**Figure 4**  
Legal form of respondent's clients



The analysis according to activity as set out in Figure 5 below reveals that the majority of the respondents have clients operating in the wholesale, retail, trade, hotel and restaurant sectors. This is closely followed by the finance, real estate and business services sectors. Mining and quarrying enterprises have the

lowest representation. However, as this is a specialised taxation area, this should not affect the representative nature of the responses received. All sectors of the South African economy are represented in the results received, once again ensuring that there is no significant bias towards the area of activity.

**Figure 5**  
Daily activities of respondents' clients



The tax practitioners were requested to answer most of the questions in the questionnaire according to their "focus" clients, to be randomly selected from the pool of all their

clients. This selection accorded with the clients' economic activity, their turnover, and the types of tax with which the tax practitioners assist them.

### 3.4 Quantifying taxation compliance costs

The primary objective of the survey was to establish the cost of compliance for small businesses in South Africa. This meant that the compliance costs per tax first had to be established and then, where possible, analysed further per size of the business (turnover). The time and costs involved in most of the significant processes related to complying with tax laws, and regulations were investigated to establish the average compliance costs and to discover whether there was any undue tax compliance burden on enterprises with a smaller turnover. Because of time and cost constraints, only the following four key taxes were investigated in this study: Income Tax, Provisional Tax, VAT and Employees' Tax. Various significant processes in complying with the above-mentioned tax laws and regulations were investigated in the study, but this article focuses on and is limited to the preparation, completion and submission of annual tax returns.

The results of the survey are calculated according to the weighted average of the mid-points of each category offered in each question in the questionnaire. In those questions, where the last category was "open", for example, R3 000 and above, the lowest end of this category (that is, R3 000 in this particular example) was

used as the estimate (if respondents did, in fact, choose this category).

#### 3.4.1 Time taken to prepare, complete and submit tax returns

Preparation, completion and submission of each of the provisional tax returns (first, second and third), as well as the (monthly) employees' tax return, takes tax practitioners on average between 1.1 and 1.2 hours. However, for income tax (annual) and VAT returns (per VAT period, ranging from one month to every 12 months, this process takes on average 3.1 hours per return. Preparation of the VAT and then income tax returns thus takes the longest of the four taxes, irrespective of the turnover level of the tax practitioners' clients. Table 1 below sets out the average time taken per annum to prepare, complete and submit tax returns per turnover category and in total. It must be noted that the time reflected in this table in respect of provisional tax represents the average time taken to submit two provisional tax returns per annum. For VAT, this time represents the average time taken to submit the returns every two months for a year. For employees' tax, it represents the time taken to submit 12 monthly employees' tax returns (this excludes the time taken to prepare the annual employees' tax reconciliation, which would take on average 4.11 hours per annum).

**Table 1**  
Average time taken per annum to prepare, complete and submit tax returns

TAX	AVERAGE TIME TAKEN (HOURS)				
	Total	TURNOVER			
		R1 – R300 000	R300 001 – R1m	R1m – R6m	R6m – R14m
Income Tax	3.07	2.87	2.99	2.97	2.91
Provisional Tax	2.27	2.22	2.25	2.29	2.22
VAT	18.77	18.41	19.02	19.40	18.76
Employees' tax	13.93	13.25	13.47	13.79	13.44
Total time taken (p/a)	38.04	36.75	37.73	38.45	37.33



If the time taken per turnover category is investigated, the survey has established that the costs of preparing, completing and submitting the tax returns increase steadily as the turnover increases, until the turnover reaches the R1 million to R6 million band, after which the costs decrease slightly. The exception to this appears to be income tax, where the costs begin to decrease when the turnover of the business reaches R1 million. This might be because the tax deductions, allowances and other items do not change or differ significantly compared with those of a business with a turnover of between R300 001 and R1 million, so a tax practitioner does not have to spend additional time completing the tax return. Further research should be conducted to establish exactly why this is the case.

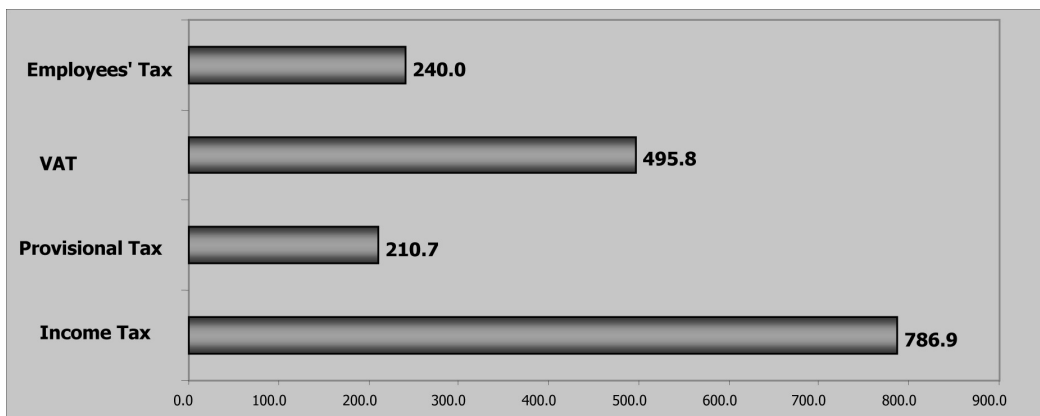
From an international perspective, it was found that the average small and medium enterprise (SME) in New Zealand spends 76.7 hours on *total* tax compliance in a year, with GST (similar to VAT) requiring the greatest time commitment (Brunton, 2005: 8). This is relatively low in comparison with the 141 hours spent by Australian small businesses on *all* tax compliance activities (Gurd *et al.*, 1998: 96). Although cross-country comparisons are difficult to conduct and must be treated with caution (Sandford, 1995: 405), it is interesting

to place the time spent by South African small businesses on preparing, completing and submitting tax returns per annum into some sort of international perspective. Before drawing any conclusions on the differences in time taken in each country, the reader must, however, take into consideration *inter alia* that the New Zealand and Australian surveys were performed amongst small businesses and not tax practitioners, as was the case in the South African survey. This in itself results in possible reasons for the differences in time. One reason could be that tax practitioners, who deal with numerous clients, have the benefit of both the learning curve and a much higher technical tax competency base. In addition, not all taxes were covered in the South African survey, which might explain why the time for South Africa is so much lower than in the other two countries. Caution is thus once again recommended when comparing international results.

#### 3.4.2 Costs of preparing, completing and submitting tax returns

The average rand amount that tax practitioners charge their clients to prepare, complete and submit the annual income tax return, one provisional tax return, one VAT period's VAT return and one month's employees' tax return is set out below.

**Figure 6**  
Cost of preparation, completion and submission of a tax return in rands



In addition to the above costs, there is the average cost of R597 of preparing, completing and submitting the annual employees' tax reconciliation (IRP 5 reconciliation) when a small business uses a tax practitioner to do this.

From Figure 6 above it appears that the income tax return is the most costly of the tax returns that have to be prepared, completed and submitted, but it should be borne in mind that:

- an income tax return has to be submitted once annually;
- an employees' tax return (EMP201) has to be submitted *monthly*;
- a VAT return (VAT 201), depending on the taxable supplies of the enterprise, has to be submitted either *every month* or *every second, fourth, sixth or twelfth month*; and
- *at least two* provisional tax returns have to be submitted per annum.

The costs in Figure 6 for employees' tax, provisional tax and VAT represent only one month's employees' tax return, one VAT period's return and one provisional tax return. To establish what the annual costs would be to ensure that all the tax returns due in one year are prepared, completed and submitted correctly, a new calculation is required (refer to Table 2 below). In this calculation, it is assumed that the small business has to submit only two provisional tax returns (the minimum), employees' tax returns (excluding annual reconciliation) every month (the minimum) and VAT returns every second month. A two-month VAT period was chosen because, according to SARS (Mogotsi, 2007: 1), 91.3 per cent of VAT-filers file every two months. Only 0.1 per cent of the total VAT-filers registered on the SARS system submit their VAT returns annually or every four months.

**Table 2**

Cost in rands of preparation, completion and submission of tax returns (excluding IRP5 reconciliation) per turnover category per annum

	R1 – R300 000	R300 001 – R1 000 000	R1 000 001 – R6 000 000	R6 000 001 – R14 000 000	Total (average)
Income tax (1 return)	723	786	844	835	787
Provisional tax (2 returns)	363	389	398	416	388
VAT (6 returns)	2 825	2 918	3 166	3 195	2 975
Employees' tax (12 returns)	2 693	2 866	2 964	2 672	2 880
<b>TOTAL</b>	<b>6 604</b>	<b>6 959</b>	<b>7 372</b>	<b>7 118</b>	<b>7 030</b>

On average, tax practitioners charge their small business clients R7 030 per annum to ensure that all their tax returns (for the above taxes) are prepared, completed and submitted as required by SARS. VAT returns appear to be the most expensive returns for the businesses if they want a tax practitioner's assistance. This is followed by the monthly employees' tax returns. If the IRP 5 reconciliation is also prepared by the tax practitioner, it will cost the small business on average an additional R597.

It is evident that the costs for preparation of the provisional tax and VAT returns rise as the entity's turnover increases, which is also

the case with income tax and employees' tax. However, the costs start diminishing once the turnover of the business reaches R6 million. This is possibly because the tax complexities relating to preparing, completing and submitting the income tax and employees' tax returns for such a business do not increase proportionally as the turnover of the business increases. More research will have to be undertaken before any final conclusions on this matter can be reached.

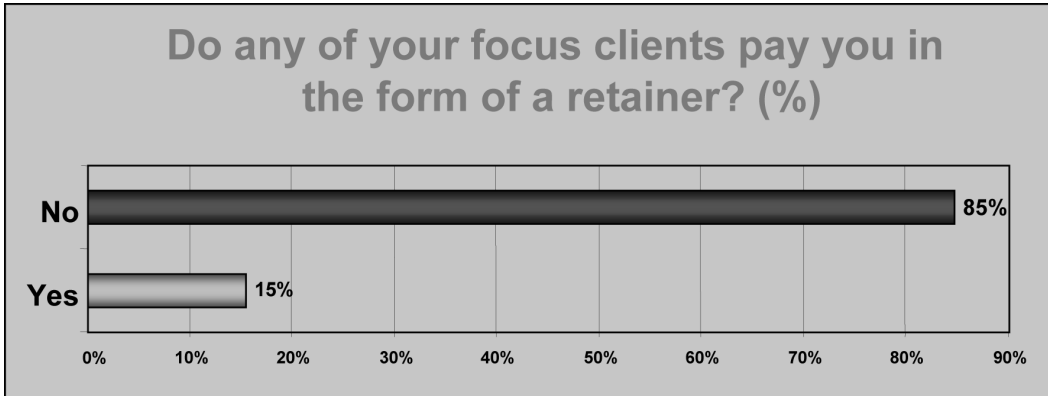
The basic costs that tax practitioners would charge their clients for completing their tax returns per annum for the four taxes covered

in the survey have now been established. An interesting point of comparison would be that of the amount of an annual retainer (for taxation services) paid to a tax practitioner by a small business for the above costs. The respondents were therefore asked the following two questions:

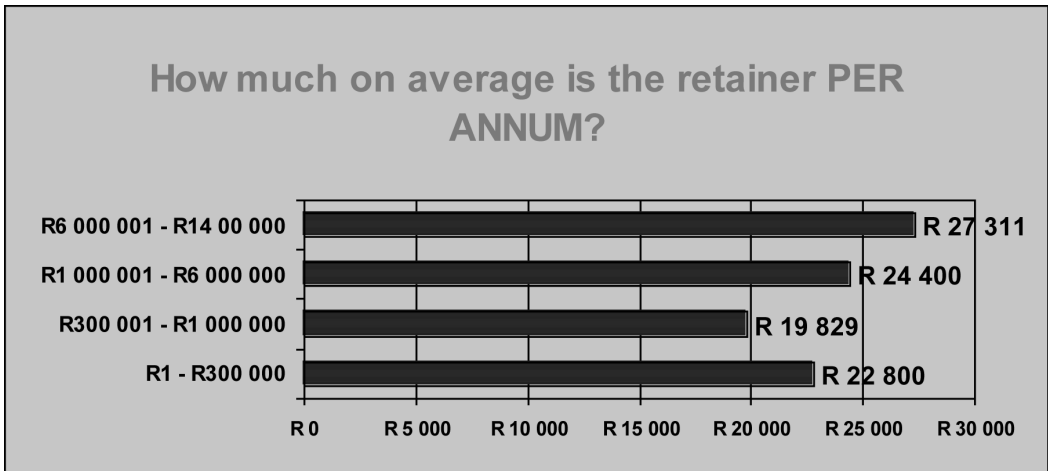
- Do any of your focus clients pay you in the form of a retainer?
- How much on average is the retainer per annum?

The responses are set out in Figures 7 and 8 below.

**Figure 7**  
Payment of retainers for tax-related services



**Figure 8**  
Cost of retainers for tax-related services



It is therefore apparent that small businesses do not often choose to pay retainers to tax practitioners. One reason for this may be the cost of retainers. The average is shown in Figure 8 above.

If the total weighted average retainer paid by a small business were calculated

from the information contained in Figure 8 above, it would amount to R24 158. If this is compared to the total weighted average cost of R7 030 (Table 2) for preparing tax returns for four taxes for a whole year, it is evident from the information in Figure 8 that, per turnover category, that the cost of

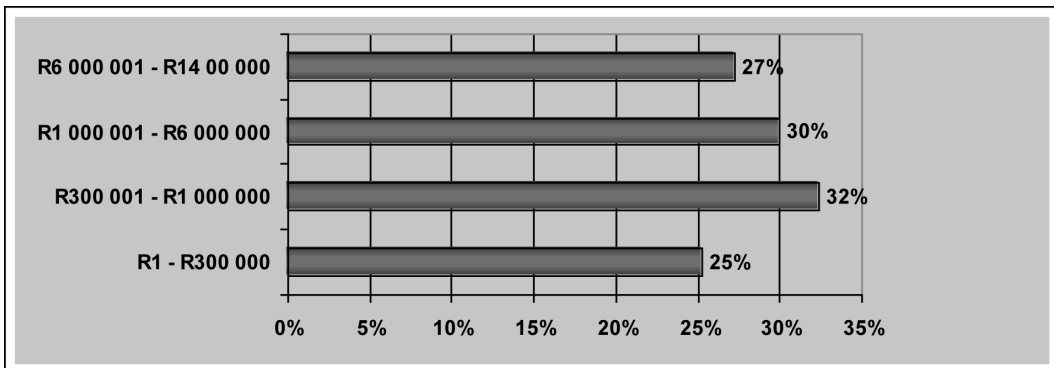
a retainer is significantly higher than the cost of merely preparing tax returns for a whole year (noting, however, that the sum of the individual tax returns reported above is only for four taxes). There may be several reasons for this; the most obvious is that a retainer would include additional tax services, such as objections and appeals, provision of opinions on certain tax matters, and assistance with tax administrative issues such as meetings with SARS. Another obvious reason might be the cash-flow shortages/struggles that most small businesses appear to experience. This would result in a small business being able to pay for tax services only as and when they are required

rather than paying a fixed amount each month, irrespective of the service rendered. More in-depth research is necessary to establish the exact reason(s) for this large difference in costs. This would ascertain whether paying a retainer instead of paying for a tax service as and when it is performed is more or less beneficial for a small business.

As mentioned in Section 1.4 above, one of the problems associated with obtaining reliable estimates of taxation compliance costs is the split between true tax costs and actual accounting costs. Tax practitioners can perform both of these services for their clients, as can be seen from Figure 9 below.

**Figure 9**

Percentage of tax practitioners' clients requesting them to assist them with completing/maintaining their accounting and bookkeeping records

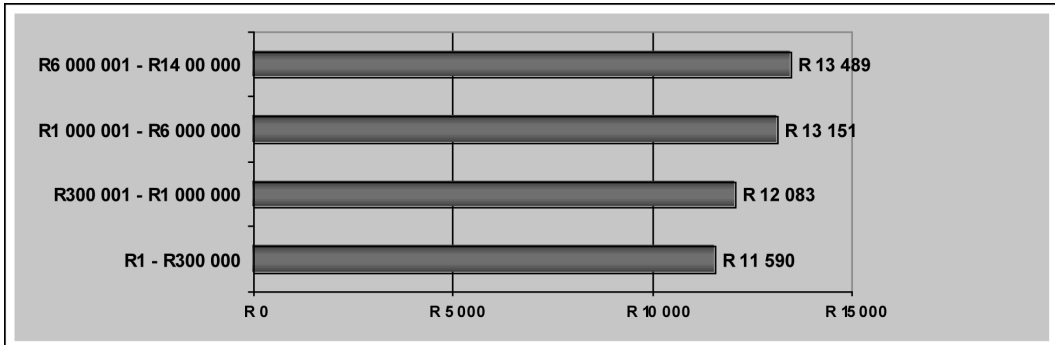


After the annual costs charged by tax practitioners for completing tax returns and tax retainers had been established, the respondents were asked to indicate the annual client costs for completing and maintaining their accounting and bookkeeping records. This ensured that the practitioners themselves drew a distinction

between true tax and accounting costs. From the researchers' discussions with various tax practitioners and small businesses, it appears that the former are better able than small business owners to provide information on this sort of distinction.

**Figure 10**

Average charge PER ANNUM for assisting clients with completing/maintaining their accounting and bookkeeping records



If the overall costs were to be calculated for all small businesses, ignoring turnover bands among them, it is estimated that tax practitioners would, on average, charge R12 185 for assisting their small business clients with their accounting and bookkeeping functions. From Figure 10 above, it is evident that the accounting costs appear to increase as the turnover of the business increases.

A summary of the average costs that a business would pay for taxation and accounting services is set out in Tables 3 and 4 below. Table 4 sets out the following:

- the annual costs for small businesses of employing tax practitioners to assist them in preparing, completing and submitting their income tax, provisional tax (two returns), VAT (two monthly submission of returns) and employees' tax (monthly) returns; and
- annual retainers for taxation services.

**Table 3**

Summary of annual taxation costs per turnover category

SERVICE RENDERED	TURNOVER				AVERAGE
	R1 – R300 000	R300 001 – R1 000 000	R1 000 001 – R6 000 000	R6 000 001 – R14 000 000	
Tax returns	R 6 604	R 6 959	R 7 372	R 7 118	R 7 030
Various services – Tax retainer	R 22 800	R 19 829	R 24 400	R 27 311	R 24 158

A retainer for taxation services normally includes the cost of completing tax returns and can also be regarded as an insurance policy against the likelihood of queries, objections or inspections. It can therefore be concluded that the minimum paid by a small business to a tax practitioner for the preparation, completion and submission of tax returns to SARS would be R7 030. However, this minimum is clearly an under-estimation, given that it covers only four

taxes. If we were then to estimate the maximum exposure to a small business in respect of annual taxation costs (for the four taxes under review), then the retainer figure of R24 158 would be the best estimate. It can also probably be assumed that, if the average maximum cost exceeded the retainer of R24 158, then more entities would be likely to opt for the retainer option. Taking R24 158 as the maximum exposure would therefore seem to be in order.

Figure 9 above reveals that approximately a quarter to a third of tax practitioners' clients request their assistance with completing/maintaining small businesses' accounting and bookkeeping records. Table 4 (below) shows the annual cost to a small business for assistance

with its accounting/bookkeeping functions. The table also shows the maximum amount that a small business would pay a tax practitioner for assistance with its tax and accounting affairs in one year.

**Table 4**  
Summary of annual tax and accounting costs per turnover category

SERVICE RENDERED	TURNOVER				AVERAGE
	R1 – R300 000	R300 001 – R1 000 000	R1 000 001 – R6 000 000	R6 000 001 – R14 000 000	
Tax retainer	R 22 800	R 19 829	R 24 400	R 27 311	R 24 158
Accounting services	R 11 590	R 12 082	R 13 151	R 13 489	R 12 185
<b>TOTAL</b>	<b>R 34 390</b>	<b>R 31 911</b>	<b>R 37 551</b>	<b>R 40 800</b>	<b>R 36 343</b>

If a small business requested a tax practitioner's assistance with its accounting and bookkeeping records, it would have to pay an average of R12 185 in addition to the tax fees. This would amount to a total maximum cost of R36 343 per annum for the basic tax and accounting/bookkeeping services. The size (based on turnover) of the business also appears to influence the costs that the business would incur. In other words, the greater the turnover of the business, the greater the sum it would have to pay a tax practitioner for assistance with tax and accounting/bookkeeping services. The only exception to this appears to be small businesses with a turnover of between R300 001 and R1 million. The reason(s) for this phenomenon need to be researched further.

From an international perspective, according to a report on the international comparisons of Australia's taxes, the average tax compliance costs for SMEs in Australia (based on a study undertaken by the OECD in 1998-99) amounted to US\$8 922 in comparison with US\$25 545 (being the highest) for Portuguese SMEs (Warburton & Hendy, 2006: 389). In terms of a recent New Zealand tax compliance study by Brunton (2005: 10), the combined mean annual payment for external tax advisor services amounts to NZ\$1 465. Croatian SMEs were

found to incur on average HRK10 800 (Croatian kunas) (Blažić, H., 2004: 8). The difficulties of producing meaningful comparisons of tax compliance costs across countries are well known and documented. Many things can affect the measurement of tax compliance costs, which have little to do with the actual tax compliance costs in a given country (Warburton & Hendy, 2006: 387). Researchers have commented that international comparisons in this particular area are 'more likely to mislead than enlighten' (Sanford, 1995). Given this, a true international comparison has not been performed in this study. The above examples of annual tax compliance costs are shown merely for interest's sake should the reader wish to research these comparative compliance costs in more detail. The reader is cautioned not to directly compare these international findings with the South African findings without reviewing such things as the research methodologies, definitions or time periods used by each of these studies. A better comparison would be to compare the annual tax compliance costs as a percentage of turnover, which is provided from the South African perspective in Table 5 below. It is evident that the smaller the business (in terms of turnover), the greater the compliance cost burden.

**Table 5**

Tax and accounting costs as a percentage of turnover (based on highest turnover in each turnover bracket)

COST AS A % OF TURNOVER	TURNOVER			
	R1 – R300 000	R300 001 – R1 000 000	R1 000 001 – R6 000 000	R6 000 001 – R14 000 000
Pay for min tax services	2.2%	0.7%	0.1%	0.1%
Pay for tax & accounting services (maximum)	11.5%	3.2%	0.6%	0.3%

The tax compliance cost burden appears to be much higher for smaller businesses. This finding is consistent with compliance cost studies done throughout the world in developed and developing countries such as the USA, Canada, the UK, Australia, New Zealand, India and Croatia, to name but a few (Blažić, 2004: 9; Brunton, 2005: 10; Chattopadhyay & Das-Gupta, 2002: 28; Crain, 2005: 1; Lignier, 2006: 5; Plamondon, 1993; Sanford, Godwin & Hardwick, 1989: 1011). In Croatia, for instance, the total tax compliance costs as a percentage of turnover range from 0.13 per cent (for the smallest businesses) to 0.04 per cent (for the larger businesses) (Blažić, 2004: 10). In New Zealand this regressivity is more clearly indicated, as the combined mean tax compliance costs as a percentage of turnover are as high as 21 per cent (for businesses with a turnover of up to NZ\$19 999) to a low of 0.2 per cent (for businesses with a turnover of greater than NZ\$1.3 million) (Brunton, 2005: 11). Although a direct comparison cannot be made with South Africa on account of, for instance, such things as the different research methodologies, time periods and definitions used in each of these studies, it is clear that South African small businesses are not alone in the struggle against the burden of tax compliance costs.

Although from the South African perspective the percentages (0.1 per cent to 2.2 per cent) appear to be quite low, it should be noted that, for a small business, it is not necessarily the turnover figure that should be used as an indicator in calculating the compliance cost burden, but rather the net profit before tax, as the ability to pay depends arguably on profitability rather

than on turnover. It is estimated that this figure could become a significant portion of the net profit before tax, resulting in a compliance cost that could be unduly high for a small business. To illustrate this point, a small business operating as a company or close corporation, with an annual turnover of just over R300 000, with a 20 per cent profit margin (R300 000 x 20 per cent = R60 000) for the year, incurring the annual cost of basic tax return compliance (R7 030), would pay the equivalent of an additional effective 8.32 per cent profit tax (over and above the statutory profit tax of 29 per cent) in respect of its tax compliance costs. This percentage is calculated by reducing the R7 030 by 29 per cent (the profit tax), as these tax compliance costs are deductible for tax purposes in South Africa, resulting in R4 991 as the after-tax cost. If this amount of R4 991 is then divided by the profit of R60 000, the result is an additional 8.32 per cent profit tax. This example highlights the significance of the annual tax compliance costs for small businesses in South Africa.

## 4 Conclusion

This study is the first of its kind to attempt an estimate of the tax compliance costs for *all* small businesses in South Africa. This was achieved by questioning tax practitioners from SAICA, SAIPA and the SAICB, who assist small businesses with their tax affairs, as they generally perform the functions that were reviewed.

The findings revealed that R7 030 per annum is the average fee tax practitioners charge their small business clients to ensure that their

tax returns (for four key taxes – income tax, provisional tax, value added tax and employees' tax) are prepared, completed and submitted as required by SARS. From the time and cost perspective, registering and preparing, completing and submitting VAT returns (assuming that six returns are filed annually) takes the longest and costs the most. Overall, it became evident that the compliance costs are regressive – the smaller the business, the heavier the burden. This leaves small firms both more vulnerable to the compliance burden and at a significant competitive disadvantage. These findings are consistent with compliance cost studies done throughout the world in developed and developing countries.

As one of the main reasons why small businesses make use of tax practitioners is their lack of tax expertise, it is recommended that, until they have gained the relevant expertise, training and mentoring services funded by the government should be provided free of charge to small businesses to assist them in becoming and remaining compliant. In providing such a service, SARS will demonstrate its willingness to consult with taxpayers in order to identify the problems faced by small businesses.

In the longer term, the National Treasury should consider making changes to the tax legislative system. This would mean first that SARS and the National Treasury staff would actually spend time with small businesses to help them gain a greater understanding of their needs and concerns. Secondly, the current "Small Business Unit" at SARS should be dedicated to the above activities, and should assess the potential impact that any recommended changes would have on small businesses by implementing an assessment programme. This unit should be empowered to effect any necessary changes. The final assessment of the change or regulation should be published and made available to all interested parties.

If SARS and the National Treasury were to implement these recommendations, SARS would emphasize its commitment to simplifying the tax environment and reducing the compliance cost burden. To ascertain whether SARS had been successful in this endeavor (in other words, to decrease compliance costs on a year-on-year

basis), it is recommended that this study be used as a baseline measurement of compliance costs. It should be continuously updated and used to inform small businesses and their tax practitioners of the progress made in respect of the reduction of compliance costs.

## 5

### Acknowledgements

The survey and its findings could not have been carried out without funding from the Foreign Investment Advisory Service (FIAS), with co-financing from the Government of Switzerland. Sincere gratitude is also expressed to Jacqueline Coolidge and Domagoj Ilic from FIAS, Gregory Kisunko from the World Bank, Hrvoje Corak and BlueTub Design and Production for making the survey and its results possible.

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