

# **An exploratory study on taxpayers' preference for type of advice from tax practitioners with regard to small businesses**

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## ABSTRACT

### **An exploratory study on taxpayers' preference for type of advice from tax practitioners with regard to small businesses**

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Taxpayers engage widely with tax practitioners for various reasons, like filing accurate tax returns and/or minimising their tax liabilities. This relationship may influence tax compliance behaviour, although it is still unclear to what extent each party contributes to this. International research shows that taxpayers prefer a conservative tax approach, while others may insist on a more aggressive approach. Research available in South Africa on this issue is limited. South African small businesses are growing enterprises and various tax reliefs apply to them. These entities, on the other hand, do not necessarily have skilled tax staff and therefore make extensive use of tax practitioners' services. Studies on this tax practitioner/client relationship are therefore relevant in order to increase the existing knowledge of taxpayer compliance behaviour. The first objective of this study is, therefore, to determine whether small business taxpayers prefer to receive conservative or aggressive advice from their tax practitioners. A second objective is to determine whether small business taxpayers would continue to make use of the services of their tax practitioners if they disagreed with the proposed tax approach.

Using questionnaires, the data was obtained from 50 small businesses in a rural town in South Africa. The results show that when asked directly which type of tax advice they preferred, the majority of small business taxpayers indicated that they would rather receive conservative advice. On the other hand, it appeared that they would prefer aggressive advice when the deductibility of an ambiguous expense was in question. The results also

showed that small business taxpayers tended to agree with the tax practitioner, irrespective of the type of tax advice offered. The results also showed that they would mostly, as long as it did not relate to tax evasion, retain the services of a tax practitioner despite the type of advice they were given and whether or not they agreed with it.

The conclusion drawn was that taxpayers in the small business sector prefer, to a great extent, to receive conservative tax advice from their tax practitioners and that they want to file accurate tax returns. The regulation of tax practitioners is therefore crucial, as taxpayers rely heavily on their information when it comes to tax compliance.

## OPSOMMING

### **'n Verkennende studie rakende belastingbetalers se voorkeur vir tipe advies komende van belastingpraktisyns met betrekking tot klein besighede**

deur

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Belastingbetalers maak om verskeie redes op groot skaal gebruik van belastingpraktisyns, byvoorbeeld om akkurate belastingopgawes in te dien en/of hulle belastingaanspreeklikhede te minimaliseer. Hierdie verhouding kan belastingnakomingsgedrag beïnvloed, alhoewel dit steeds onduidelik is in watter mate elke party hiertoe bydra. Internasionale navorsing dui aan dat belastingbetalers 'n konserwatiewe belastingbenadering verkies, terwyl ander kan aandring op 'n aggressiewer benadering. Navorsing wat in Suid-Afrika beskikbaar is rakende hierdie vraagstuk is beperk. Suid-Afrikaanse kleinsake is groeiende ondernemings en verskeie vorme van belastingverligting geld vir hulle. Aan die ander kant beskik hierdie entiteite nie noodwendig oor die vaardige belastingpersoneel nie en maak dus grootliks gebruik van die dienste van ervare praktisyns. Studies oor hierdie belastingpraktisyn-kliëntverhouding is dus van toepassing om die bestaande kennis rakende belastingbetaler-nakomingsgedrag uit te bou. Die eerste doelwit van hierdie studie was dus om vas te stel of kleinsake-belastingbetalers verkies om konserwatiewe of aggressiewe advies van hul belastingpraktisyns te ontvang. 'n Tweede doelwit was om te bepaal of kleinsake-belastingbetalers sou voortgaan om van die dienste van hul belastingpraktisyns gebruik te maak as hulle nie met die voorgestelde belastingbenadering sou saamstem nie.

Deur van vraelyste gebruik te maak is die data bekom van 50 kleinsake in 'n plattelandse dorp in Suid-Afrika. Die resultate het getoon dat wanneer hulle direk gevra word watter tipe belastingadvies hulle verkies, die meerderheid kleinsake-belastingbetalers aangedui het dat hulle eerder konserwatiewe advies sou wou ontvang. Aan die ander kant het dit voorgekom of hulle aggressiewe advies sou verkies wanneer die aftrekbaarheid van 'n twyfelagtige uitgawe in die gedrang was. Die resultate het ook getoon dat kleinsake-belastingbetalers daartoe geneig was om met die belastingpraktisyn saam te stem, ongeag die tipe belastingadvies wat hy aangebied het. Die resultate het verder getoon dat hulle meestal, solank dit nie verband gehou het met belastingontduiking nie, die dienste van 'n belastingpraktisyn sou bly behou ongeag die tipe advies wat hy gee en of hulle daarmee saamstem of nie.

Die gevolgtrekking waartoe gekom is, was dat belastingbetalers in die kleinsake-sektor verkies, in 'n groot mate, om konserwatiewe belastingadvies van hul belastingpraktisyns te ontvang en dat hulle akkurate belastingopgawes wil indien. Die regulering van belastingpraktisyns is dus van kritieke belang, aangesien belastingbetalers swaar op hulle inligting steun wanneer belastingnakoming ter sprake kom.

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# AN EXPLORATORY STUDY ON TAXPAYERS' PREFERENCE FOR TYPE OF ADVICE FROM TAX PRACTITIONERS WITH REGARD TO SMALL BUSINESSES

## CHAPTER 1

### INTRODUCTION

#### 1.1 BACKGROUND

The German philosopher and political economist Karl Marx once said,

*Civil servants and priests, soldiers and ballet-dancers, schoolmasters and police constables, Greek museums and Gothic steeples, civil list and services list – the common seed within which all of these fabulous beings slumber in embryo is taxation* (Proverbia.net, not dated).

Taxation can be a very complicated subject. Even the famous mathematician Albert Einstein admitted that income tax is one of the hardest things to understand (Proverbia.net, not dated). If the brightest of people struggle to comprehend taxation, it is therefore obvious that taxpayers, be it individuals or businesses, engage with tax practitioners for diverse reasons.

One of the reasons taxpayers seek the services of tax practitioners is the need to file accurate tax returns (Tan, 1999:445; Collins, Milliron & Toy, 1990:15). Another reason for using tax practitioners is to minimise tax liabilities (Sakurai & Braithwaite, 2001:14-15). Taxpayers' needs can be fulfilled by applying the relevant taxation acts, such as the Income Tax Act (58/1962) (the "Act"), conservatively or by exploiting possible grey areas contained in such acts.

Some research shows that taxpayers favour conservative tax reporting (Tan, 1999:445; Hite & McGill, 1992:398), while others insist on aggressive tax reporting (Schisler,

1994:124-142). Stephenson (2007:418) found that tax practitioners were more aggressive than their clients would prefer, but in a study conducted by Mason and Garrett-Levy in 2004 (in Stephenson, 2006:15), the results revealed lower than expected degrees of aggressiveness among tax practitioners. The extent to which taxpayers, as opposed to tax practitioners, contribute to tax non-compliance is still unclear. The South African Revenue Service (“SARS”) (not dated) indicates that tax practitioners play a critical role in shaping taxpayers’ attitudes and behaviours, and in defining their actual levels of tax compliance. It can therefore be deduced that the greater the engagement with tax practitioners, the greater the impact of this tax compliance relationship.

Internationally, taxpayers make extensive use of the services of tax practitioners. The Australian Taxation Office indicated that, during 2002, 77% of the population used the services of a tax practitioner or tax agent when they submitted their tax returns (Sakurai & Braithwaite, 2001:9). In South Africa, SARS (not dated) revealed that the use of tax practitioners had increased significantly, from 3% over the period 1970-1979 to 68%, from 2000 to date. SARS stated that during 2004 approximately 95% of South African small businesses had to outsource certain of their tax functions to tax practitioners (Killian, Karlinsky, Payne & Arendse, 2007:32-33). South African small businesses are growing enterprises which have become the primary focus of the South African government since the start of South Africa’s new democratic era in 1994 (the Department of Trade and Industry (“DTI”), not dated:3). Various tax relief measures are available to these entities, and, because they do not necessarily have skilled tax staff to attend to their tax affairs, they make use of tax practitioners’ services (Venter & de Clercq, 2007:146).

Owing to the increased use of tax practitioners, the regulation of tax practitioners has become crucial. It should be noted that the regulation of South African tax practitioners is still in the process of development, as it has currently only reached the phase when a revised version of the draft Regulation of Tax Practitioners Bill, which was issued in June 2008, is available (SARS, not dated). Apart from the fact that tax practitioners should be regulated as a result of the increase in the engagement of their services, the relationship between the taxpayer and tax practitioner, as already mentioned, also becomes much more significant.

Studies on this relationship are therefore relevant in order to increase the existing knowledge of taxpayer compliance behaviour. One such study was carried out by Tan (1999:431-447) in a certain area of New-Zealand to determine taxpayers' preference for certain types of advice from tax practitioners. However, only limited research is available on the effect of the tax practitioner/client relationship on the South African taxpayer compliance behaviour. This paper explores the research done by Tan (1999:431-447) in the context of South Africa.

On account of the limited research on this effect, and the relevance of South African small businesses, this exploratory study was regarded as sufficiently important to be conducted. It examined the preferences of the owners or financial supervisors of small businesses situated in a South African rural town, the name of which cannot be disclosed for ethical reasons, as to conservative or aggressive advice from tax practitioners.

Focusing on the above-mentioned information, the problem statement and research objectives are presented below.

## **1.2 PROBLEM STATEMENT**

The main purpose of this exploratory research was to investigate whether taxpayers in the small business sector prefer receiving conservative or aggressive advice from their tax practitioners.

## **1.3 RESEARCH OBJECTIVES**

The exploratory research was guided by the following specific research objectives:

- To determine whether small business taxpayers prefer to receive conservative or aggressive advice from their tax practitioners;
- To determine whether small business taxpayers would continue to make use of the services of their tax practitioners if they disagreed with the tax approach proposed to them.

## 1.4 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

From the academic perspective, this exploratory study makes a valuable contribution to the existing knowledge on taxpayer compliance behaviour in general. It is also valuable because of the limited South African academic research available on the tax practitioner/client relationship on South African taxpayer compliance behaviour, as already indicated.

From a practical perspective, it is interesting to explore what the preferences of the South African taxpayers are concerning the type of advice to be obtained from their tax practitioners. If aggressive tax reporting is preferred, then the introduction into the Act of the more onerous provisions on impermissible tax avoidance arrangements was indeed necessary. These provisions, to be found in sections 80A to 80L of the Act, have been effective since 2 November 2006. They replaced the previous section 103(1) of the Act on general anti-avoidance. If there is a preference for conservative advice, then the effective regulation of South African tax practitioners should be ensured when the Regulation of Tax Practitioners Act becomes effective in the near future.

## 1.5 DELIMITATIONS AND ASSUMPTIONS

### 1.5.1 Delimitations

The following delimitations applied to this exploratory study:

- The target population was small businesses in a rural town in South Africa, the name of which cannot be disclosed for ethical reasons. Different results may be obtained from another target population. The statistics disclosed in this study are, however, official statistics, although their source can also not be disclosed, but is available from the researcher.
- Franchises or branches whose head offices dealing with their financial affairs were situated elsewhere were specifically excluded from the sample in this study, as they were presumed to have a total turnover exceeding R14 million.

- The scenarios sketched in the questionnaires were kept straightforward. In reality, various factors would be considered and effectively communicated by tax practitioners to their clients before a decision was made on a tax-ambiguous situation. Taxpayers would also consider more eventualities before deciding to disengage from their tax practitioners.
- Other variables, such as the preference by different South African population groups, past experiences with tax practitioners, SARS audits and/or tax penalties, may have an impact on taxpayers' preference for the type of advice they receive. The effects of these variables were, however, not tested in this study.
- Survey-based research was used in this study, which has the limitation of participant bias, as indicated in the chapter dealing with research design and methodology.

### 1.5.2 Assumptions

The study was based on the following assumptions:

- Franchises or branches whose head offices dealing with the financial affairs were situated elsewhere were specifically excluded from the sample in this study, as they were expected to have a total turnover exceeding R14 million.
- The participants were honest as to how they would behave in the scenarios in the questionnaires.
- The reference to tax ambiguity in the questionnaires was based on the assumption that the tax practitioner who provided advice on an ambiguous tax situation had sufficient tax knowledge and advisory experience. Also, no distinction was made between the qualifications of the tax practitioners.

## 1.6 DEFINITION OF KEY TERMS

The definitions and key terms are explained for purposes of this study below.

**Aggressive tax advice:** If one is tax aggressive and provides such advice, one would take tax positions where there is some reasonable probability that it would not be upheld in

a SARS audit. It is risky because of the possibility of its being subject to an audit with possible legal disputes (Hite & McGill, 1992:400). Stephenson (2006:5) indicates that to be tax aggressive is to make use of every legal opportunity to minimise tax, but that it specifically excludes tax evasion or fraud. There are many tax situations in which the interpretation and presentation of facts lead to different tax liabilities. An aggressive tax practitioner would be more likely to interpret facts to the benefit of the client, so that the client incurred the minimum possible tax liability as long as there was at least 33.33% chance of success should litigation be involved (Stephenson, 2006:5).

**Conservative tax advice:** If one is tax conservative and provides such advice, one would exclude income or take deductions in determining taxable income which could easily be defended in the South African context should SARS perform an audit on the return (Tan, 1999:432).

“Aggressive tax advice” and “conservative tax advice” are key terms used throughout the literature review.

**Small businesses:** There are various definitions of a small business in the South African context, which range from economic to taxation perspectives:

- From an economic perspective, the National Small Enterprise Act (102/1996) defines a small enterprise as a business entity which can be separately identified. The definition includes co-operative enterprises and non-governmental organisations which are managed by one or more owners. The businesses of these entities, together with their branches or subsidiaries, are conducted mainly in a sector or subsector of the economy, and can be classified as micro-, very small, small or medium enterprises. In a study conducted by the Foreign Investment Advisory Service (“FIAS”) (2007:110), it was indicated that small businesses were also sometimes referred to as small, medium and micro-enterprises (“SMMEs”) and referred mostly to the same type of businesses as those included in the definition of a small business. Other definitions of a small business are used by The Black Economic Empowerment (“BEE”) Codes of Good Practice, the DTI and the Small Enterprise Development Agency (FIAS, 2007:110).
- From a taxation perspective, section 12E(4)(a) of the Act provides a definition of a small business corporation. This section lists all the requirements which should be met

in order to qualify as such and to qualify for certain taxation relief. One of the requirements is that the gross income (similar to turnover for taxation purposes) of such a concern for a tax year should not be greater than R14 million. All requirements should, however, be met in order to qualify. It is important to note that a turnover of less than R14 million was used to distinguish a small business in this study (see Appendix A). In addition, the Sixth Schedule was included in the Act with effect from 1 March 2009. This schedule deals with micro businesses, which qualify for, inter alia, to be taxed on a turnover basis.

The economic and taxation classifications of small businesses are discussed in more detail in the literature review. For purposes of this study, the taxation perspective and specifically the requirement of a turnover of R14 million or less was used for the target population.

**Tax ambiguity:** A tax situation is ambiguous if its proper tax treatment is uncertain, for example, if no clear authority exists or there is conflicting authority on a tax issue (Schmidt, 2001:158). This key term is used throughout the literature review.

**Tax avoidance:** Tax avoidance refers to a situation in which a taxpayer has arranged his/her affairs in a legal manner, which leads to a reduction in his/her taxable income or leads to a nil taxable income (Van Schalkwyk, 2009:657).

**Taxpayer compliance:** Various definitions of taxpayer compliance have been used in tax compliance research (Devos, 2008:3). For the purpose of this study, this term means the complete, accurate and timely filing of the required tax returns, specifically, the accurate reflection of amounts relating to the calculation of the tax liability which is done by way of complying with the relevant Act (the Act), regulations and court decisions applicable at the time of the filing of the return (Devos, 2008:3).

**Tax evasion:** Tax evasion, on the other hand, refers to illegal activities consciously undertaken by a taxpayer to free himself/herself from a tax burden (Van Schalkwyk, 2009:657).

“Tax avoidance” and “tax evasion” are key terms used throughout the literature review.



**Tax practitioner:** In the South African context, any natural person who provides taxation advice or who completes or assists any person with the finalisation of any document which should be submitted to SARS should register as a tax practitioner with SARS. This requirement is in terms of section 67A(1) of the Act, but there are also certain exclusions from the requirement to register as found in section 67A(2) of the Act. This key term is used throughout the literature review.

**Tax year:** For purposes of this study, the definition of section 1 in the Act of a “year of assessment” is used. This means any year or other time-frame according to which any tax or duty chargeable in terms of the Act is calculated. It always ends, other than in the case of “companies”, on the last day of February. The financial year-end of a company is used.

Some abbreviations were used throughout the study. These abbreviations are listed in Table 1 below:

**Table 1: Abbreviations used in this document**

<b>Abbreviation</b>	<b>Meaning</b>
DTI	Department of Trade and Industry
SARS	South African Revenue Services
The Act	Income Tax Act No. 58 of 1962

## CHAPTER 2

### LITERATURE REVIEW

#### 2.1 INTRODUCTION

In this chapter the compliance behaviour of taxpayers is first explained by way of different theoretical frameworks outlined in prior research. A discussion on tax practitioners follows. This discussion focuses mainly on the demand for the services of tax practitioners, the critical roles which they play, as well as matching what taxpayers and tax practitioners want. A short discussion on the regulation of tax practitioners in South Africa is also included. Finally, small businesses as examples of taxpayers are explored in more depth, as these entities were the target population of this exploratory study. This discussion includes the importance of small businesses, the taxation and taxpayer compliance of these businesses, and their reliance on the services of tax practitioners.

#### 2.2 TAXPAYER COMPLIANCE BEHAVIOUR AND ITS IMPORTANCE

First of all, before exploring taxpayers' preference for the type of tax advice, it is necessary to look at taxpayer compliance behaviour. Extensive research has been conducted on the numerous factors that may influence taxpayers to engage in tax evasion. Various theoretical frameworks have been developed, ranging from economic to social psychological explanations. These frameworks are discussed in the subsections that follow. The economic perspective is explored first, and then the social psychological perspectives. Finally, the regulation theory framework is briefly discussed.

##### 2.2.1 Economic frameworks

###### 2.2.1.1 *The classic model and the deterrence theory framework*

The first model of discussion is the classical model used by Allingham and Sandmo (1972:323-338), which assumes that people are rational, immoral taxpayers who wish to

maximise value. This model regards the tax rate as a factor which determines the benefits of engaging in tax evasion, while it regards the possibility of detection as well as legal punishment as factors that determine the costs associated this (Webley, Robben, Elffers & Hessing, 1991:8). Taxpayers weigh the benefits and costs against each other in order to maximise value.

A further development of the classical model is the deterrence theory framework. It is based on the notion that the compliance behaviour of taxpayers is shaped by their perception on the possibility of detection and legal punishment (Tan, 1999:433). This means that it is expected of a taxpayer to break the law by practising tax evasion unless the expected legal penalties are greater than the additional savings from tax evasion (Murphy, 2004:308).

Of these two theories, the deterrence theory is the main theoretical framework which has been applied to explain the compliance behaviour of taxpayers (Smith & Kinsey, 1987:641). For purposes of this study, the deterrence theory framework will be used, as it was the framework used by Tan (1999:431-447), whose study will be explored in the South African context.

However, the deterrence theory has certain shortcomings. Smith and Kinsey (1987:641) were of the opinion that most taxpayers were compliant, even when the possibility of detection and tax penalties was low. A primary shortcoming of the deterrence theory is thus that it does not provide sufficient explanation relating to the high levels of compliance observed (Murphy, 2004:308).

Further additions have been made to the deterrence theory framework. Two of these additions are the interactive (game-playing) framework by Corchon (in Webley *et al.*, 1991:10) and the suggestion of limited rationality, such as the prospect theory framework by Kahneman and Tversky (1979:263-291). These frameworks are discussed below.

### **2.2.1.2 The interactive (game-playing) framework**

One of the developments in the deterrence theory framework is the interactive (game-playing) framework. This framework assumes that it is not the taxpayer alone who has to

make a decision about his/her compliance behaviour, but that there are other “game players” whose decisions may also influence a taxpayer’s compliance behaviour.

An example of these “game players” is the tax authorities. The tax authorities can take decisions in order to increase or decrease the possibility of detection, as well as the severity of legal punishment (Webley *et al.*, 1991:10). Cowell (1990:122) describes it as a game played between the taxpayer and the tax authorities. In this game, the taxpayer has to choose between compliance and non-compliance, while the tax authorities have to choose between investigation and non-investigation. If the taxpayer complies with tax laws, then the tax authorities will not investigate. However, if taxpayers realise that the tax authorities do not investigate, they may choose not to comply with the tax laws. Further, the possibility of non-compliance increases when the marginal cost of investigation increases, and decreases when the size of the penalty increases.

Another example of “game players” is other taxpayers and their compliance behaviour. The taxpayer may find himself/herself in a population of taxpayers who demonstrate high compliance with tax laws. Should such a taxpayer be found guilty of non-compliance with tax laws, then his/her reputation may be negatively affected (Webley *et al.*, 1991:10).

### **2.2.1.3 The prospect theory framework**

Another development in the deterrence theory framework is the prospect theory framework of Kahneman and Tversky (1979:263-291). This framework suggests the notion of limited rationality when an individual has to choose between options. It indicates the decisions that individuals are expected to make under conditions of uncertainty. The writers note that individuals tend to ignore components that are shared between alternative options, but tend to focus on components that distinguish different options. As a result, this may lead to inconsistent preferences (Kahneman & Tversky, 1979:271).

The prospect theory framework shows that, if a decision-maker has to make a choice, the option with the highest estimated benefit will be chosen. More importantly, this framework illustrates that whenever a decision has to be made where a gain is certain, the individual is expected to be risk-averse and choose this positive option. However, in the case of

certain loss, the individual is expected to choose a riskier option in the hope of preventing the definite loss (Kahneman & Tversky, 1979:263-291; Tversky & Kahneman, 1981:453).

As far as tax compliance is concerned, the prospect theory framework predicts that taxpayers become more aggressive and risky when they are in a tax-payable position than when they find themselves in a tax-refund position (Schmidt, 2001:170).

### **2.2.2 Social psychological frameworks**

Apart from the economic frameworks, Lewis (1982:37-120,215) proposes two frameworks for compliance behaviour when psychology and economics are combined. One framework combines the interests of the individual and the authorities, while the other framework concentrates on the relationship between tax mindsets and tax behaviour (Webley *et al.*, 1991:14).

Lewis's first framework maintains that there are three factors on both the taxpayer's and the authorities' side that influence compliance behaviour. As far as the taxpayer is concerned, the three interacting factors are summarised and listed by Webley *et al.* (1991:14) as follows:

- the taxpayer's feelings towards the economy and his/her view thereof (such as their encouragement of government policies, their view of the tax system and feelings of isolation and discrimination);
- the taxpayer's view of enforcement and opportunity; and
- taxpayer individuality (demographics and character).

Regarding the authorities, the three factors which affect each other to eventually affect compliance behaviour are:

- government's economic policy;
- government's tax enforcement policy; and
- policy-makers' beliefs about taxpayers (Webley *et al.*, 1991:14).

Further, it is considered that the two above-mentioned “game-players” influence each other to a certain extent. For example, a taxpayer’s fiscal attitudes and perceptions interact with government policy to affect each other. The same goes for a taxpayer’s perceptions of enforcement and opportunity and the tax enforcement policy of the authorities, which interact and influence each other (Webley *et al.*, 1991:14).

Lewis’s second framework focuses on the relationship between tax mindsets and tax behaviour, and explains how decisions by the taxpayer and authorities are reached. Different demographics, feelings towards the authorities and also personality characteristics influence a taxpayer’s mindset and, ultimately, their tax behaviour (Webley *et al.*, 1991:14-15). It should be noted that Lewis (1982:174) states that, in the case of tax evasion, it is not easy to test the second framework in relation to the taxpayer’s intentions and behaviour.

Apart from the two frameworks suggested by Lewis, another framework that explains compliance behaviour from a social viewpoint as well as in prospect theory terms is the framework of Smith and Kinsey (1987:642-657), which distinguishes between the process and content of decisions regarding compliance behaviour.

Smith & Kinsey (1987:644-648) explain that the process in decisions concerning compliance behaviour shows that taxpayers initially move through an analytical step where the change in a situation is identified. Changes in a situation from a social perspective include tax amendments, economic changes and changes in remuneration. These changes prompt taxpayers to change their normal compliance behaviour. Taxpayers analyse the effect of these changes on their personal tax situation and anticipate a potential gain or loss, which is thus in line with the prospect theory framework. It is at this stage that the content of a decision plays a role. Smith and Kinsey (1987:651-657) point out that taxpayers consider groups of factors when they formulate their intentions as to compliance behaviour. These factors include financial consequences, other people’s moral principles, their own perceived norms, opinions about the government and the tax system and, finally, even feelings of frustration about tax administration. Taxpayers also weigh the potential gains and losses relating to these factors against each other (Smith & Kinsey, 1987:651-657).

Second follows the action step (Smith & Kinsey, 1987:645), when taxpayers take a conscious decision to structure their intention and their compliance behaviour. Third and last, the implementation step follows when taxpayers decide how to implement their objectives (Smith & Kinsey, 1987:646).

As this study explores taxpayers' preference for the type of advice given by tax practitioners, it is important also to note the regulation theory framework. This framework deals with the type of advice that can be expected from a regulated or an unregulated tax practitioner, in which case it can be expected that the taxpayer will rely on aggressive tax advice received.

### **2.2.3 The regulation theory framework**

Apart from the economic and social psychological frameworks, the regulation theory framework, applied in context of tax, predicts that regulated practitioners are going to be more aggressive than unregulated practitioners in ambiguous tax situations (Schmidt, 2001:161). The rationale behind this theory is that regulated practitioners are considered able to offer a greater variety of client services and to negotiate with the taxation authorities (Schmidt, 2001:161).

Schmidt (2001:170) indicated that taxpayers relied more on aggressive advice received from professional tax practitioners, who belong to a highly regulated institution in comparison to those who do not belong to such an institution. An example of a regulated institution in the South African context is the South African Institute of Chartered Accountants ("SAICA").

### **2.2.4 The importance of tax compliance**

Taxpayer compliance is crucial to the government of a country, because taxation is a source of revenue for the government. The United States Department of the Treasury (2009) indicated that, of the total receipts from source categories of R2 952 430 563 296, 35 for the 2009 fiscal year, R1 053 537 538 295, 60 comprised of total income taxes.

From the South African perspective, the National Treasury (2009:2) indicated that the tax revenue for 2007/2008 was comprised of R572 814.6 million of the actual budget revenue figure of R559 773.8 million. The actual budget revenue figure of R559 773.8 million was arrived at after adding non-tax revenue of R11 671.7 million and deducting payments in terms of Customs Union agreements of R24 712.6 million. The budget revenue, in turn, aids the government with its fiscal aims, such as economic services, education, welfare and other social security.

It is therefore obvious that any potential loss in tax revenue, especially through non-compliance by taxpayers, is a high priority for the government and specifically for SARS. With reference to taxpayers, tax practitioners play a critical role in shaping their attitudes and behaviours, and in defining their actual levels of tax compliance (SARS, not dated). The following section provides a detailed discussion on tax practitioners, specifically the demand for their services, the critical roles they play and matching the needs of taxpayers and tax practitioners.

## **2.3 TAX PRACTITIONERS**

### **2.3.1 The demand for tax practitioners' services**

A number of studies suggest that the main reason that taxpayers engage with tax practitioners is to file an accurate tax return. Tan (1999:439) showed that taxpayers engaged with tax practitioners mainly in order to file an accurate tax return and to avoid serious tax penalties. In a study conducted by Collins *et al.* (1990:15), 70% of the participants confirmed that they preferred accuracy, while only 25% preferred tax minimisation. These choices suggest that taxpayers prefer conservative advice, which is also indicated in the studies by Tan (1999:445) and by Hite and McGill (1992:398).

It appears that taxpayers do not feel sufficiently competent to file an accurate tax return on their own. Sakurai and Braithwaite (2001:11-12) conducted a study on Australian citizens and found that only 12% of the participants felt able to complete their own tax returns without any external assistance. 36% of these respondents did not feel competent at all to complete their own tax returns. In another study, Rupert and Fischer (1995:51) reported



that taxpayers who engage with tax practitioners are less familiar with the marginal tax rate applicable to them than those who prepare their own tax returns.

This was confirmed in South African study by Venter and de Clercq (2007:131-151), who found that most South African small businesses outsource their tax functions. Venter and de Clercq (2007:146) found that these small businesses largely outsourced their tax responsibilities owing to a lack of skilled tax personnel and lack of the time required to manage the tax functions. Cost saving was not regarded as a significant motivation for outsourcing tax responsibilities in comparison with the first two reasons (Venter & de Clercq, 2007:146).

Taxpayers worldwide engage extensively with tax practitioners. For example, during 2002 the Australian Taxation Office indicated that 77% of the population made use of the services of a tax practitioner or tax agent when they submitted their tax returns (Sakurai & Braithwaite, 2001: 9). Over the past few decades in South Africa there has also been a significant increase in engaging the services of tax practitioners. SARS (not dated) shows that the number of tax practitioners has increased from 3% in 1970-1979 to 68% from 2000 to date. According to a briefing note on the revised draft Regulation of Tax Practitioners Bill issued in June 2008, nearly 23 000 tax practitioners are registered with SARS (SARS, not dated).

It is thus evident that clients rely heavily on their tax practitioners and trust them with their tax affairs. The most important role tax practitioners can play for taxpayers is to provide assurance that their tax affairs are under control and that these matters are lawful (Sakurai & Braithwaite, 2001:20).

### **2.3.2 The tax practitioner's role and its importance**

In this taxpayer/tax practitioner relationship, the role of the tax practitioner must be explored. Boccabella (1993:392) was of the opinion that the tax practitioner's role was originally the same as that of an accountant, which focused on tax compliance, but that it had evolved to:

- providing an opinion on transactions such as financing and/or any structuring arrangements within an organisation;
- providing an opinion on the taxation matters which should be included in an entity's annual financial statements;
- tax planning around the frequency and timing of events which lead to taxation liabilities;
- networking with attorneys and others with legal experience regarding the interpretation and practical application of tax laws; and
- acting and discussing, on behalf of their clients, with regulating entities such as revenue authorities and legal counsel.

Tax practitioners give their clients advice to assist them in minimising their tax liability, while going to the level of risking the possibility that the return might be challenged. Klepper and Nagin (1989:168) indicate that a tax practitioner's advice can take two forms:

- With the tax practitioner's specialised knowledge and experience, s/he can merely indicate any reporting positions to the client which are likely to be challenged by tax authorities.
- The tax practitioner could also advise the client how to take advantage of any ambiguity in the tax law which may affect the client's reporting position. This alternative may lead to aggressive tax advice from the tax practitioner.

It is interesting to note that Klepper and Nagin (1989:168) also take the view that the exploitation of legal ambiguity could benefit the client in the following two ways:

- Firstly, a tax return position based on legal ambiguity may succeed if challenged by tax authorities.
- Secondly, even if the taxpayer is found to be non-compliant in some respect, the penalty of non-compliance may be less if the reporting position is based on a credible interpretation of the law.

Further studies by Klepper, Mazur and Nagin (1991:228) suggest that tax practitioners can play a "dual role": as tax law enforcers in unambiguous scenarios and as tax law exploiters in ambiguous scenarios. This "dual role" was also indicated in the findings by Sakurai and

Braithwaite (2001:20), in which the majority of the taxpayers preferred practitioners who enacted the role of tax enforcer to practitioners who enacted the role of exploiter. It was also found that those taxpayers who were interested in minimising tax preferred tax practitioners who assumed the exploiter role and who were familiar with both low- and high-risk tax schemes.

Sakurai and Braithwaite (2003:376) mention that the extent to which this “dual role” is influenced by tax practitioners’ preferences regarding compliance behaviour is still unclear. Owing to the extent of taxpayers’ reliance on tax practitioners, the latter do influence the compliance behaviour of taxpayers (Sakurai & Braithwaite, 2001:19; Tan, 1999:445).

Sakurai and Braithwaite (2001:12) found that honesty and risk-aversion were the two most important characteristics required of tax practitioners by taxpayers, while the least popular were creativity and aggressiveness. Other preferences in tax practitioners’ characteristics included (Sakurai & Braithwaite, 2001:14-15):

- the ability to interpret tax ambiguities;
- skills in tax minimisation; and
- the ability to warn their clients against tax-planning schemes.

Contrary to the findings of Sakurai and Braithwaite (2001:12), tax practitioners are considered to have the knowledge and experience needed to exploit ambiguities in the tax law. Tax practitioners may, therefore, take an aggressive tax approach which could lead to tax non-compliance. Spilker, Worsham and Prawitt (1999:88) found that tax practitioners were more cautious about providing aggressive advice on tax planning than on tax compliance. In the latter case, they found that tax practitioners interpreted an ambiguous tax situation to the advantage of their clients.

Interestingly, studies have been conducted to determine whether professionally-prepared tax returns show higher levels of non-compliance than do self-prepared returns. Findings from some of these studies, such as those of Klepper and Nagin (1989:167), suggest that professionally-prepared returns do display greater non-compliance. Klepper and Nagin (1989:167) reported that, during 1979 in the United States, approximately 44% of tax

returns were prepared by tax practitioners and these returns resulted in 74% of all tax non-compliance.

If taxpayers rely on tax practitioners for assistance in their tax matters, reassuring them that their tax matters are under control, tax practitioners do indeed play a definite role in setting standards and identifying acceptable risks (Sakurai & Braithwaite, 2001:20).

Marshall, Smith and Armstrong (1997:11) indicated further that a variety of factors may determine the perceived judgements and potential compliance behaviour of tax practitioners. These factors include, inter alia:

- the likelihood of audit exposure;
- the quantitative figure of the client's tax law violation;
- the severity of such a violation;
- client pressure to act unethically; and
- client importance in terms of revenue contribution to the tax practice.

Numerous studies have also been conducted on the compliance behaviour of taxpayers who make use of the assistance of tax practitioners (Sakurai & Braithwaite, 2001:20; Tan, 1999:445; Hite & McGill, 1992:398). Some of the research reports that tax practitioners maintain that taxpayers insist on aggressive tax reporting (Schisler, 1994:124-142). There are also research findings showing that, on the contrary, taxpayers prefer conservative advice (Tan, 1999:445; Hite & McGill, 1992:398).

### **2.3.3 Matching the needs of taxpayer and tax practitioner**

Sakurai and Braithwaite (2001:20) found that taxpayers prefer tax minimisation with conflict avoidance to tax minimisation involving creative accounting and aggressive tax planning. This indicates that taxpayers are cautious about the extent of the risk they wish to engage in (Sakurai & Braithwaite, 2001:20).

Although taxpayers are considered able to differentiate between low- and high-risk tax minimisation, the possibility still exists that they could engage with similar types of tax

practitioners and that the two parties could, in certain instances, push each other towards tax evasion (Sakurai & Braithwaite, 2001:21). It is important to note their finding that taxpayers looked for tax practitioners who matched their needs (Sakurai & Braithwaite, 2001:18).

The risk, however, exists that tax practitioners and taxpayers could misinterpret each other's messages as to what a low- or a high-risk tax minimiser exactly entails. This could ultimately result in their failing to meet each other's expectations (Sakurai & Braithwaite, 2001:22). In addition, Schmidt (2001:170) observes that tax practitioners should be mindful of communicating information accurately to their clients, as such information could influence their clients' behaviour. In this study, Schmidt (2001:170) found that, when the tax practitioner communicated to a client that the probability of an audit or a penalty was low, most taxpayers overestimated this low probability.

According to Christensen (1992:78), the greatest mismatch between client and tax practitioner is that in which the tax practitioner considerably underestimates the client's preference for conservative tax advice. Stephenson (2007:418) also found in her study that tax practitioners were more aggressive than their clients preferred. It is interesting to note that a study conducted by Mason and Garrett-Levy in 2004 (in Stephenson, 2006:15) delivered results to the contrary, which revealed lower than expected degrees of aggressiveness among tax practitioners.

Studies by Tan (1999:431-447) and Hite and McGill (1992:389-403) found that taxpayers preferred conservative advice. In these studies they presented an ambiguous tax situation to the sample of taxpayers in which they had to indicate their preference for the type of tax advice they would like. This leads to the first research objective as stated in Chapter 1 of this study.

The scenarios sketched in this exploratory study to test the taxpayers' preference for the type of advice comprised mainly tax ambiguous situations in which an ambiguous tax inclusion and an ambiguous deduction were in question (refer to the chapter dealing with the research design and methodology). It is interesting to note that, in a study conducted by Christensen and Hite (1997:8-9), they found that taxpayers believed that there was a greater likelihood that an audit would detect the overstatement of income rather than the

overstatement of deductions. It is, therefore, more probable that taxpayers would rather deduct an ambiguous expense than exclude an ambiguous income item from their tax returns (Christensen & Hite, 1997:14). This agrees with the findings of an American study conducted by Hite and Hasseldine (2003:7) on tax audits of the Internal Revenue Service (“IRS”) office from October 1997 to July 1998. They found that there were more adjustments relating to incorrect tax deductions (59%) than for taxable income (22%). This indicates a preference for aggressive reporting in the case of tax ambiguity on deductions (Hite & Hasseldine, 2003:5).

In the studies by Tan (1999:431-447) and Hite and McGill (1992:389-403), the taxpayers were also asked whether they would disengage from their tax practitioner depending on the advice received. If taxpayers disagreed with aggressive advice it strengthened the preference for conservative advice. In the study by Hite and McGill (1992:398), the taxpayers wanted to terminate the services of their tax practitioners, specifically when they disagreed with aggressive advice received. Tan (1999:443) found that there was no significant evidence to indicate that taxpayers who preferred conservative advice would disengage from their tax practitioner if they were given aggressive advice. These results did not support the findings by Hite and McGill (1992:389-403).

Tan (1999:441) found that those participants who agreed with the advice wanted to continue making use of the tax practitioner’s services, while those who disagreed wanted to disengage from the practitioner. Tan (1999:441) also showed that there was a greater willingness to continue engaging with a tax practitioner when conservative advice was provided. The second research objective is derived from this information, as stated in Chapter 1.

It is interesting to note the other factors that make taxpayers disengage from their tax practitioners. Zeithaml, Bitner and Gremler (2009:83-87) identified five factors affecting clients’ definition of adequate quality of service, including the following when applied to services by tax practitioners:

- The first factor is reaction and timeliness, on account of deadlines like tax deadlines.
- Secondly, when clients perceive many service alternatives it increases their expectations of service quality. This means that when clients can more easily resolve

tax matters on their own or see that any other tax practitioners could resolve them, the clients expect better service from the designated tax practitioner. For clients with more complex tax matters, where more specialised knowledge is required from tax practitioners, they are expected to be more easily satisfied.

- The third factor is the role clients perceive themselves as playing in relation to service from the tax practitioner. The more involved taxpayers are in the process of resolving the tax issues, the more personal responsibility they are likely to take in the process. It is also expected that they will be less critical of the tax practitioner.
- Fourthly, the frequency of occurrence of certain taxation matters can influence client expectations. This means that taxpayers are more likely to demand high-quality service on tax matters which commonly and regularly occur, but will be more lenient when it comes to their expectations of service quality in once-off or unusual transactions.
- Finally, client expectations of expected services also help define service quality from the taxpayers' point of view, with prior tax practitioner experience or advertisements creating these expectations.

The finding by Tan (1999:443) that there was no significant evidence to indicate that taxpayers would disengage from their tax practitioners, even if they received aggressive advice with which they disagreed, emphasises the importance of client trust in tax practitioners.

It is clear that the tax practitioner has a very important role to fulfil and the regulation of tax practitioners in South Africa should therefore ultimately be noted, which will be discussed below.

#### **2.3.4 The regulation of tax practitioners in South Africa**

The regulation of South African tax practitioners is still in the process of development, which involves the following two phases, as explained in a briefing note by SARS (not dated):

- The first phase requires the registration of tax practitioners with SARS. This was achieved with the introduction of section 67A into the Act by the Second Revenue Laws

Amendment Act (34/2004), promulgated on 24 January 2005. This section prescribes that on 30 June 2005 or otherwise 30 days after a natural person starts to render tax practitioner services, as discussed in this section, such a person should register as a tax practitioner with SARS.

- The second phase involves the creation of an independent regulatory board for tax practitioners, which is regulated by its own law and acts (SARS, not dated).

The second phase with regard to the creation of an independent regulatory board is still in progress, with only a revised draft Regulation of Tax Practitioners Bill currently available. A revised version of the draft Regulation of Tax Practitioners Bill was issued in June 2008 (SARS, not dated). According to the briefing note by SARS (not dated), the main objectives of this independent regulatory board with regard to tax practitioners will be:

- to specify the level of qualification and experience;
- to monitor the registration process;
- to apply a code of professional conduct; and
- to take disciplinary steps when required.

The briefing note on the revised draft Regulation of Tax Practitioners Bill indicates one of the more significant changes as being that tax practitioners who are regulated by any other relevant statutory body will be subject to the disciplinary and other procedures of that body (SARS, not dated). Such tax practitioners will be required to register with SARS only in terms of the revised draft Regulation of Tax Practitioners Bill (SARS, not dated).

It is thus evident that tax practitioners are not currently as highly regulated as intended in the ultimate Regulation of Tax Practitioners Bill. Until the Regulation of Tax Practitioners Act has been finalised and effectively brought into operation, conditions may exist which could create the opportunity for tax practitioners to follow more aggressive tax approaches. An example of this may be the case of tax practitioners who do not belong to any statutory body and who are therefore not controlled by any code of professional conduct and subject to that body's disciplinary procedures.



In the final section of the literature review, small businesses are discussed in more detail. Despite the fact that there are many taxpayers in South Africa, this exploratory study focuses on small businesses as taxpayers.

## **2.4 SMALL BUSINESSES**

### **2.4.1 Definitions of small businesses**

As indicated, there are various definitions of small businesses. The economic perspective, of which only the classification in terms of the National Small Enterprise Act (102/1996) is discussed, along with taxation perspectives, is examined in more depth.

#### **2.4.1.1 *An economic perspective***

The National Small Enterprise Act (102/1996) section 1 classifies small businesses as micro-, very small, small or medium enterprises thereof and is based on certain thresholds relating to different industries. These thresholds are listed in the Schedule to the National Small Enterprise Act (102/1996) – see “Schedule” hereafter.



**Table 2: Schedule**

<b>Column 1</b>	<b>Column 2</b>	<b>Column 3</b>	<b>Column 4</b>	<b>Column 5</b>
Sector or sub-sector in accordance with the Standard Industrial Classification	Size of class	The total full-time equivalent of paid employees	Total turnover	Total gross asset value (fixed property excluded)
Agriculture	Medium	100	R5m	R5m
	Small	50	R3m	R3m
	Very Small	10	R0.50m	R0.50m
	Micro	5	R0.20m	R0.10m
Mining and Quarrying	Medium	200	R39m	R23m
	Small	50	R10m	R6m
	Very Small	20	R4m	R2m
	Micro	5	R0.20m	R0.10m
Manufacturing	Medium	200	R51m	R19m
	Small	50	R13m	R5m
	Very Small	20	R5m	R2m
	Micro	5	R0.20m	R0.10m
Electricity, Gas and Water	Medium	200	R51m	R19m
	Small	50	R13m	R5m
	Very Small	20	R5.10m	R1.90m
	Micro	5	R0.20m	R0.10m
Construction	Medium	200	R26m	R5m
	Small	50	R6m	R1m
	Very Small	20	R3m	R0.50m
	Micro	5	R0.20m	R0.10m
Retail and Motor Trade and Repair Services	Medium	200	R39m	R6m
	Small	50	R19m	R3m
	Very Small	20	R4m	R0.60m
	Micro	5	R0.20m	R0.10m
Wholesale Trade, Commercial Agents and Allied Services	Medium	200	R64m	R10m
	Small	50	R32m	R5m
	Very Small	20	R6m	R0.60m
	Micro	5	R0.20m	R0.10m
Catering, Accommodation and other Trade	Medium	200	R13m	R3m
	Small	50	R6m	R1m
	Very Small	20	R5.10m	R1.90m
	Micro	5	R0.20m	R0.10m

Column 1	Column 2	Column 3	Column 4	Column 5
Sector or sub-sector in accordance with the Standard Industrial Classification	Size of class	The total full-time equivalent of paid employees	Total turnover	Total gross asset value (fixed property excluded)
Transport, Storage and Communication	Medium	200	R26m	R6m
	Small	50	R13m	R3m
	Very Small	20	R3m	R0.60m
	Micro	5	R0.20m	R0.10m
Finance and Business Services	Medium	200	R26m	R5m
	Small	50	R13m	R3m
	Very Small	20	R3m	R0.50m
	Micro	5	R0.20m	R0.10m
Community, Social and Personal Services	Medium	200	R13m	R6m
	Small	50	R6m	R3m
	Very Small	20	R1m	R0.60m
	Micro	5	R0.20m	R0.10m

Source: National Small Enterprise Act (102/1996).

The three criteria used to classify small businesses according to the Schedule to the National Small Enterprise Act (102/1996) for different industrial sectors or sub-sectors are therefore the number of full-time employees, the amount of the annual turnover, and the amount relating to gross asset value (excluding fixed property). It should be noted that a business with the number of full-time employees indicated per industrial sector or sub-sector would not necessarily generate the same total turnover as indicated in line with it, for various reasons, such as productivity and use of machinery. The number of employees is a measure often used by researchers to classify businesses according to size (in Thong, 1999:197). It should also be borne in mind that the most recent updating of the figures contained in the above-mentioned Schedule was in the National Small Business Amendment Act (26/2003). It would therefore appear that the figures have not been updated with inflation to reflect the current economic position.

### **2.4.1.2 A taxation perspective**

Despite the economic perspective, section 12E(4)(a) of the Act deals with the taxation perspective. This section defines a small business corporation as a close corporation, co-operative or private company in which all the shareholders (members in the case of a co-operative) are natural persons throughout the tax year. Other requirements to be met for qualification are:

- Its gross income for a tax year should not be greater than R14 million;
- No shareholder is allowed to have an interest in any other company, close corporation or co-operative (few exceptions to this requirement);
- Investment income and income from rendering “personal service” may not be greater than 20% of the total receipts and accruals. “Personal service” is defined in section 12E(4)(d) of the Act and includes a wide variety of services, but excludes companies or close corporations with three or more full-time employees;
- It may also not be a “personal service provider”. A “personal service provider” is defined in paragraph 1 of the Fourth Schedule to the Act and is basically any company or trust in which a connected person delivers services on behalf of the company or trust to its clients. Moreover, the client exercises some form of control over the “personal service provider” or contributes a significant proportion of the total income of the “personal service provider”. “Personal service providers” with three or more full-time employees are excluded from this definition.

In addition, the Sixth Schedule, which deals with micro businesses, was included in the Act with effect from 1 March 2009, and its provisions are applicable to years of assessment starting on or after 1 March 2009. In terms of paragraph 8 of the Sixth Schedule to the Act, a person may elect to register as a micro business, which is not compulsory. A natural person or company with a “qualifying turnover” of R1 million or less will basically qualify as a micro business. A “qualifying turnover” is defined in paragraph 1 of the Sixth Schedule to the Act. It should be noted that paragraph 3 of the Sixth Schedule to the Act excludes certain persons from qualifying as a micro business.

The fact that so many definitions of a small business exist in the South African context is already an indication of the importance of these businesses, which will be discussed next.

#### **2.4.2 The importance of small businesses in South Africa**

According to the DTI (not dated: 3) small business development became a primary focus by the government at the start of South Africa's new democratic era in 1994. In March 1995, the first comprehensive policy and strategy on small business development was prepared when the government made public its *White Paper on national strategy for the development and promotion of small businesses in South Africa*. This included measures to stimulate the creation and growth of small businesses, such as streamlining regulatory conditions, creating access to information, finance, provide training and introducing differential taxation.

The DTI (2005) indicated the following reasons in support of the importance of these businesses. These reasons reflect the major roles these businesses play in economic development, which are:

- They stimulate economic growth;
- They are a significant tool in black economic empowerment;
- They provide a way in which to achieve wealth distribution and more equitable growth;
- They could address the increase in the unemployment rate; and
- They play a crucial role in technical and other innovation.

Small businesses add 36.1% to South Africa's gross domestic product ("GDP") and contribute to 68.2% of employment within the private sector. Also, in the agriculture, construction and retail sectors, more than 80% of the total workforce is employed by small businesses (Killian *et al.*, 2007:17).

As already indicated, tax relief is one of the measures which the South African government has introduced to stimulate the growth of small businesses. This will be discussed in more detail hereafter.

### **2.4.3 Taxation of small businesses**

Various forms of tax relief are applicable to small businesses. It should be borne in mind that tax aggressiveness applied to this existing tax relief could lead to a smaller tax liability, so some of the tax relief applicable to small businesses will be briefly discussed.

#### **2.4.3.1 *Value added tax (“VAT”)***

It is important first to note that, as from 1 March 2009, section 23(1)(a) of the VAT Act (89/1991) indicates that the compulsory VAT registration threshold is currently R1 million with regard to the annual value of proceeds of any supply subject to VAT. In addition, section 23(8) of the VAT Act (89/1991) specifically determines that micro businesses may not register as VAT vendors. For micro businesses, the VAT regime is now specifically included in the turnover tax system.

“Persons” as defined in section 1 of the VAT Act (89/1991) may still register for VAT on a voluntary basis in order to benefit from input tax credits of 14% on the value of expenditure, but they also have to pay output tax of 14% on the value of income and adhere to other compliance requirements. This voluntary registration, as stated in section 23(3)(c) of the VAT Act (89/1991), is applicable to persons with “taxable supplies” greater than R20 000 a year.

#### **2.4.3.2 *Small business corporations***

Small business corporations in terms of section 12E(4)(a) of the Act enjoy, inter alia, the following tax relief:

- An immediate 100% write-off in respect of manufacturing assets and a 50:30:20 write-off rate over a 3-year period for all other assets.
- Capital gains tax relief in the form of a once-off exclusion to the value of R750 000 is available to a natural person meeting certain requirements, on a capital gain realised on the disposal of certain “active business assets” belonging to a small business. This relief, including the definitions of “active business assets” and “small business” are provided for in paragraph 57(3) of the Eighth Schedule to the Act.

- Tax rates as per Appendix I to the Taxation Laws Amendment Act (17/2009) applicable to any tax year ending during 1 April 2009 and 31 March 2010 are as follows: 0% for taxable income up to R54 200; 10% for taxable income from R54 201 to R300 000. Where the taxable income exceeds R300 000, the taxation is a fixed amount of R24 580 plus 28% of the amount above R300 001.

### **2.4.3.3 “Micro businesses”**

The turnover tax system applicable to “micro businesses” as defined in paragraph 1 of the Sixth Schedule to the Act basically replaces normal tax (which includes capital gains tax) and VAT (Stiglingh, 2009:951).

The tax liability resulting from the turnover tax system is aligned with that of the current income tax system (Stiglingh, 2009:950). This taxation is calculated on “taxable turnover” as defined in paragraph 1 of the Sixth Schedule to the Act, with certain inclusions and exclusions, as indicated in paragraphs 6 and 7 of the Act.

The following tax rates are applicable to the 2010 tax year as indicated by SARS (not dated): 0% for “taxable turnover” up to R100 000 and 1% for “taxable turnover” from R100 001 to R300 000. Where the “taxable turnover” ranges from R300 001 to R500 000, a fixed amount of R2 000 applies plus 3% of the amount above R300 000. Where the “taxable turnover” ranges from R500 001 to R750 000, the taxation is calculated as R8 000 plus 5% of the amount above R500 000. Finally, where the “taxable turnover” is in excess of R750 000, the taxation is calculated as R20 500 plus 7% of the amount in excess of R750 000.

The turnover tax system provides compliance relief such as a reduction in the keeping of detailed accounting records (Stiglingh, 2009:950). In terms of paragraph 14 of the Sixth Schedule to the Act, these entities have to keep records only of amounts received, dividends declared, details of every asset on hand as well as each liability exceeding R10 000 each at the end of the year of assessment. Owing to the fact that micro businesses may not register for VAT, compliance relief is also provided, in that they do not have to file VAT returns.

Therefore, because of the importance to the economy of small businesses and the fact that they have tax rules which are specifically applicable to them, as indicated above, the tax compliance of these entities is discussed next.

#### **2.4.4 Tax compliance of small businesses**

Ahmed and Braithwaite (2005:554) found that small business taxpayers are law abiding and that they take their tax responsibilities seriously.

However, in an American study conducted by Hite, Stock and Cloyd (1992:26), they indicated that approximately one-fifth of small businesses either understated their taxable income or overstated their tax deductions. The following findings of two Australian studies may provide reasons for the possibly inaccurate tax returns of small business taxpayers:

- Small business taxpayers may take an aggressive tax approach owing to cash flow pressures. Wallschutzky and Gibson (1993:527-528) state that small-business owners regard cash flow as their main concern. This may particularly affect the timely payment of taxes.
- In an Australian study conducted by McKerchar (1995:40), it was found that small business taxpayers lacked sufficient tax knowledge to comply with the tax law.

In a study conducted on the New Zealand tax system, Caragata (1997:214) disclosed that small businesses, the self-employed and individuals in general represented the highest percentage of tax evasion. The Inland Revenue of New Zealand compared tax evasion by the tax-sensitive sector with the criminal activity sector. The tax-sensitive sector consists of small businesses, the self-employed and individuals in general, and tax evasion in this sector is motivated by potential tax savings. The criminal activity sector comprises fraud and theft, which result in tax evasion, but which are motivated by factors other than tax savings. The Inland Revenue of New Zealand revealed that tax evasion among the tax-sensitive sector increased from 48% to 64% during the period 1969 to 1994, while the criminal activity sector accounted for the remainder (Caragata, 1997:214). Small businesses should thus be regulated, which is where tax practitioners can play a significant role.



It has already been indicated that tax practitioners play an important role in setting standards and identifying acceptable risks (Sakurai & Braithwaite, 2001:20) regarding their clients, so the following section explores the engagement of small businesses with tax practitioners.

#### **2.4.5 Small businesses and tax practitioners**

Hite *et al.* (1992:21) investigated the reasons in the American context why small business taxpayers rely on the services of tax practitioners. The two main reasons arrived at were filing accurate tax returns and reducing the potential for any tax penalties. This concurs with the findings of other studies, which showed that taxpayers relied on the services of tax practitioners on account of their main motive of filing an accurate tax return (Sakurai & Braithwaite, 2001:20; Tan, 1999:445; Hite & McGill, 1992:398).

With regard to service quality, Cameron (in Tan, 1999:444) shows that, apart from the fact that small-business owners rely on tax practitioners for filing tax returns, they also prefer a tax practitioner who is approachable, or who communicates well and who shows that they are important as clients.

From the South African perspective, and as already indicated in the study conducted by Venter and de Clercq (2007:146), it was revealed that small businesses outsource their tax functions owing to a lack of skills and time. During 2004, SARS determined that about 95% of small businesses needed to outsource certain of their tax functions to tax practitioners (Killian *et al.*, 2007:32-33). The increase in the use of tax practitioners in South Africa may therefore also be a result of the necessity for small businesses to outsource their tax functions.

Taking the above literature into account, it will be of interest and value to explore what the preferences of small businesses, specifically in the South African rural town, are for either conservative or aggressive advice by their tax practitioners.

## CHAPTER 3

### RESEARCH DESIGN AND METHODS

#### 3.1 INTRODUCTION

This chapter describes the overall research design and sampling plan relevant to this exploratory study. Following this, the method of data collection is discussed in which, *inter alia*, the connection between the questionnaire design and the research objectives are indicated. The techniques used to analyse the data obtained are subsequently described.

At the end of this chapter, the methods used to ensure the quality and rigour of the research design, as well as the ethics applied to this study, are delineated.

#### 3.2 DESCRIPTION OF OVERALL RESEARCH DESIGN

This is an empirical study in which new data is collected relating to the problem statement (Babbie & Mouton, 2001:75). As more knowledge was obtained on the problem statement on taxpayers' preference for a particular type of tax advice, an exploratory study was conducted (Saunders, Lewis & Thornhill, 2007:598).

The research is cross-sectional, focusing on taxpayers' preferences at the time when the surveys had been completed and it was not observed over a period of time (Saunders *et al.*, 2007:148).

The research furthermore represents basic research. Saunders *et al.* (2007:592) describe basic research as research performed in order to better understand the outcomes which are indicated in the research objectives. This research will add to the academic research available on the compliance behaviour of taxpayers.

Primary data was collected to address the research objectives of this study. Primary data refers to data which is specifically collected for the specific research to be conducted (Saunders *et al.*, 2007:607). Quantitative data was obtained by way of questionnaires.

Saunders *et al.* (2007:145) explain that quantitative data refers mainly to data collection procedures like questionnaires or to data analysis techniques that deliver numerical data. In addition, the research was descriptive in nature, as the purpose was to produce an accurate representation of persons or situations (Saunders *et al.*, 2007:596) that were the preference of taxpayers regarding the type of tax advice they were given.

This study was based on Tan's study (1999:431-447). It is not an exact replication, but rather an extension of the study, as it was specifically tested on small businesses and also on a different geographical area, that of a rural town in South Africa. Tan (1999:437) conducted the study on businesses, not specifically small businesses, in the Manawatu region of New Zealand. Further, a unique questionnaire (see Appendix A) was also designed.

### **3.3 SAMPLING**

The study focuses on the preferences for the type of tax advice among a statistical representative sample of small businesses in a rural town in South Africa. The findings of this study can, therefore, not be generalised to all the taxpayers of South Africa or of the rest of the world.

#### **3.3.1 Target population and units of analysis**

The target population consisted of small businesses in a rural town in South Africa during the period July 2009 to September 2009. According to Terre Blanche and Durrheim (2002:37), the units of analysis are the beings on whom the researcher wants to draw conclusions. For purposes of this study, the units of analysis were the owners or financial supervisors of these small businesses. If the businesses qualified as a small business which made use of the services of tax practitioners, the owners or financial supervisors were asked to complete the questionnaire. It is important to note that, to qualify as a small business for purposes of the study, a business should not have a turnover exceeding R14 million (see Appendix A). This is one of the requirements for qualifying as a small business corporation for income tax purposes, as indicated in the literature review. This method of classification of a small business was also used in a study conducted by the

FIAS (2007:16). Franchises or branches in which the head offices dealing with the financial affairs were situated elsewhere were specifically excluded from the sample in this study, as they would presumably have a total turnover exceeding R14 million.

The rural town to which the target population belongs was selected for the purposes of convenience and cost. It is a medium-sized town with a population of approximately 250 000 people. The differentiated economy of the town includes nearly 600 commercial businesses, agricultural and industrial activities and industries.

According to statistical information from Global Insight (2008) on the economics of this town in 2006, the main contributors to the gross operating surplus are real-estate activities (approximately 16%) and finance and insurance (approximately 13.7%). The other main contributors are agriculture and hunting (approximately 7.6%), education (approximately 7.2%), post and telecommunication (6.9%), and retail trade and repairs of goods (approximately 6.1%).

### **3.3.2 Sampling method and sample size**

An alphabetical list was obtained containing the contact details of 788 names of either businesses or their owners. The chairperson of the business association of the town provided this list. According to the chairperson, the list comprised the local businesses as listed in the telephone directory of 2007 to 2008. This was also the most recent list available at the time of sampling. These businesses are regarded as members of the business association.

The limitation to the above-mentioned list and the telephone directory was that not all the existing businesses were indicated, as businesses were continuously emerging and closing down or were not listed in the telephone directory at all. A couple of duplications were also discovered on the list, but were not immediately apparent as, for example, in a few instances the name of the contact person was used as the heading to the contact details, while the business was also listed as a separate heading along with the contact details.

The sample may, therefore, not necessarily be representative of the target population of the current businesses in this rural South African town. A population was selected with a sample size of 50 participants. It is important to note that 50 completed questionnaires were obtained by way of the sampling design to ensure a 100% response rate.

The sampling design consisted of systematic sampling using a predetermined sequence (Leedy & Ormrod, 2005:203). In order to select 50 businesses from the list of 788 businesses, it was mathematically determined by way of division that every 16<sup>th</sup> business on the list should be selected. A computer-simulated random number was obtained, which was number 11. From that number on, every 16<sup>th</sup> business was selected. The list was checked for completeness regarding the numerical sequence of the businesses.

This sampling method used was considered to be the most logical and feasible manner by which to identify the target population and units of analysis of this study.

Unfortunately, businesses which had closed down, did not qualify as small businesses, did not make use of tax practitioners, or were franchises, were often selected. In these instances, the next business on the list was selected. This was also done in cases in which the businesses indicated that they did not want to participate in the study. In this way a 100% response rate was obtained.

The online telephone directory was consulted when there were problems with the telephone numbers or when phones continued to ring after numerous attempts to make contact. Whenever possible, an internet search on the name of the business was conducted in order to see whether it was a franchise. The annual financial statement was also consulted to check whether the turnover was more than R14 million.

Most importantly, once a respondent who was willing to complete the questionnaire had been selected, the first two questions determined whether they were a small business and whether they engaged with tax practitioners. If they answered in the negative to either one of the questions, they did not have to complete the remainder of the questionnaire (refer Appendix A) and were excluded from the sample.

### 3.4 DATA COLLECTION

The following section focuses on the survey method, the questionnaire design and the pilot-test for the final questionnaire.

#### 3.4.1 Survey method

Questionnaires were used for collecting data in this study. The reasons for using questionnaires were the following:

- Primary data can be collected through the use of questionnaires (Saunders *et al.*, 2007:354);
- Questionnaires are considered an appropriate data collection method for descriptive research (Saunders *et al.*, 2007:356); and
- They also yield quantitative information (Leedy & Ormrod, 2005:179).

An example of the questionnaire is included in Appendix A.

In order to conduct the survey by way of questionnaires, the owners or financial supervisors of the businesses were contacted telephonically to enquire whether they would participate in the study by completing the questionnaire. The participants were asked to indicate whether an appointment could be scheduled to complete the questionnaire in the presence of the researcher or whether they would rather complete it in their own time. The questionnaires were self-administered and were delivered by hand in a sealed blank envelope to either the participants themselves or to their administrative officer. The use of blank envelopes ensured anonymity and confidentiality, as only the owners or financial supervisors would receive and complete the questionnaire. A follow-up telephone call was made to participants who were to complete the questionnaire in their own time but did not respond within a week. The questionnaires were collected by hand after completion.

This method of data collection was considered the most efficient in terms of obtaining a high response rate in the shortest period of time.

The fact that the questionnaires were delivered and collected and that some were completed in the presence of the researcher ensured that the responses were reliable. This had a positive influence on the quality and rigour of the research design, which is also discussed in this chapter. In most cases, the businesses indicated who would be responsible for completing the questionnaire. The names of the owners or financial supervisors could be obtained, ensuring that as far as possible the correct respondent would complete the questionnaire. This enhanced the reliability of the data (Saunders *et al.*, 2007:357). If the questionnaires were completed in the presence of the researcher, the participants could also ask for an explanation of the questions if they needed.

After the completed questionnaires had been collected, they were briefly scanned to determine whether all the questions had been answered.

Saunders *et al.* (2007:359) indicate that a disadvantage of using questionnaires is that the response rate is expected to be lower than that of a telephonic or structured interview. The researcher overcame this by making telephonic contact with most of the participants and meeting them in person.

### **3.4.2 Measurement**

The measuring instruments used in this study were questionnaires consisting of sufficient and appropriate questions to address the research objectives. The questionnaires were of reasonable length, so completing them was not too time-consuming (refer to Appendix A for the questionnaire).

The questionnaire was designed taking cognisance of previous research, as discussed in the literature review. It was also reviewed by Mrs Rina Owen, a research consultant in the Faculty of Economic and Business Sciences at the University of Pretoria. As the subject of taxation is a sensitive one, special care was taken to ensure that the questions referred to generic examples. Although open-ended questions were used, the participants were also required to motivate the rationale behind their answers *apropos* of questions which referred specifically to the research objectives.

The questionnaire is comprised of the following questions:

1. *Does the/your business have a turnover smaller than R14 million per tax year?*

The R14 million limit matches the turnover limit used for income tax purposes to determine whether a business is a “small business corporation”, and was used in this study to qualify a business as a small business.

2. *Do you make use of the services of a tax practitioner with regard to the/your business?*

This question was crucial, as the study explores taxpayers’ preference for the type of advice they receive from their tax practitioners, and it is important that they indeed engage with them.

3. *If questions 1 and/or 2 were not applicable, the participants were informed in 3 that they did not have to complete the remainder of the questionnaire. If both questions 1 and 2 were applicable, they were required to complete the rest.*

4. *Why do you make use of the services of a tax practitioner with regard to the/your business?*

A list of reasons is provided and includes some of the reasons explored in the study by Tan (1999:439), as well as those explored by Venter and de Clercq (2007:146) on South African small businesses, as indicated in the literature review. The options from which the participants could select were:

- *lack of time;*
- *to limit the tax liability to a minimum;*
- *to reduce the chance of being investigated by SARS;*
- *a lack of skilled personnel and/or own knowledge;*
- *to file an accurate tax return;*
- *it is cheaper than doing it internally; or*
- *other reasons (where a blank space was provided in which to write their reasons).*

5. *Will you agree with your tax practitioner (“he”) if he provides the following advice with regard to the/your business in the situations indicated below?*

This question addresses both research objectives. It measures the participants’ preference for the type of advice given by asking to what extent they would agree with



their tax practitioner's advice in certain generic tax scenarios. The participants also had to indicate whether they would continue to make use of the services of the tax practitioner based on the advice received. A four-point Likert-type design was used for responses which were expressed as follows: (from *definitely yes* = 1; *maybe* = 2; *maybe not* = 3 and *definitely not* = 4) (see Appendix A). The following generic tax scenarios were used:

5.1 *Assume there is no clear authority in the Income Tax Act ("Act") or any interpretation thereof on whether a certain income on your return should be included.*

Question 5.1 sketches a tax-ambiguous scenario in which uncertainty reigns in the tax treatment of an income item. Tax-ambiguous scenarios were used, as it is in these scenarios particularly that aggressive tax advice could be given. Regarding the generic income item, the tax practitioner provides the following advice:

5.1.1. *To include the income.* This represents conservative advice.

5.1.2. *Not to include the income.* This represents aggressive advice.

If, for example, the participants disagreed with the conservative advice (question 5.1.1) on the four-point Likert scale, it would show that they preferred aggressive advice. On the other hand, if they disagreed with the aggressive advice (question 5.1.2), it would show that they preferred conservative advice.

5.2 *Assume there is no clear authority in the Act or any interpretation thereof on whether a certain expense is deductible on your return.*

Question 5.2 sketches a tax-ambiguous scenario in which there is uncertainty about the tax treatment of an expense item. The tax practitioner provides the following advice, in response to which the participants had to indicate how far they agreed or disagreed with the advice on the four-point Likert scale:

5.2.1. *Not to claim the expense as a deduction.* This represents conservative advice.

5.2.2. *To claim the expense as a deduction.* This represents aggressive advice.

In addition, the participants had to indicate in relation to each of the four scenarios (questions 5.1.1, 5.1.2, 5.2.1 and 5.2.2) above whether they would continue to engage with the tax practitioner as a result of the advice received. Once again, they

had to reflect their answers on the four-point Likert scale. There were various motivations for these questions, one being to determine whether there was any correlation between taxpayers' engagement with or disengagement from tax practitioners and the type of tax advice they received. Another reason is to determine if there was any correlation between taxpayers' engagement with or disengagement from tax practitioners and taxpayers' agreement or disagreement with the advice. The results would also have agreed with the answers to questions 6 and 7.

5.3 *Will you agree with the advice of your tax practitioner with regard to the/your business if an expense which should have been deducted in a prior tax year was erroneously not deducted and he advises not to reopen that return (which would have been the correct action), but to claim it as a deduction in the current tax year.*

5.4 *Will you agree with the advice of your tax practitioner with regard to the/your business if an income which should have been included in a prior tax year was erroneously not included and he advises not to reopen that return (which would have been the correct action), but to include it in the current tax year.*

Questions 5.3 and 5.4 contain examples of aggressive advice. Section 1 of the Act states that an income item should be included in the gross income of the tax year in which it is received or accrued. Section 11(a) of the Act states that an expense should be deducted from taxable income when it is actually incurred. The participants were asked to indicate on the same four-point Likert scale how far they agreed or disagreed with the advice. For example, if they disagreed with the advice, it would appear that they preferred conservative advice.

6. *Should you in any situation disagree with the advice of a tax practitioner due to ethical or technical reasons, would you continue to use him?*

To answer this question, the participants could choose between *Yes* = 1, *No* = 2 or *Uncertain* = 3. This question did not refer to the participants' own tax practitioners, but to a hypothetical tax practitioner. This was for ethical reasons and for the reduction of participant bias. As no personal reference was made to their personal tax practitioners, there could be no alleged libel or negative consequences. This question addressed the second research objective by way of an upfront question.

7. In question 7, the participants were asked to provide a reason or reasons to substantiate their answer to question 6, to which they would answer “Yes” or “No”.
8. *Which type of tax advice do you prefer from a tax practitioner in general?* Question 8 required the participants to indicate in general whether they would prefer conservative or aggressive tax advice from a tax practitioner. Conservative and aggressive tax advice are defined in the questionnaire and these definitions are basically the same as those in this study. Once again, ethical considerations were taken into account as no mention was made of participants’ personal tax practitioners, but of a hypothetical tax practitioner. This question addresses the first research objective by way of an upfront question, in contrast with question 5.
9. The participants are asked in question 9 to provide a reason or reasons to substantiate their answer to question 8.

### **3.4.3 Pilot testing**

In order to determine whether participants would experience any problems in answering the questionnaire and to adjust it appropriately, a pilot study was conducted (Saunders *et al.*, 2007:386). The pilot study tests the face validity of the questionnaire. Saunders *et al.* (2007:598) explain that if a measure, in this case a questionnaire, has face validity, it means that the measure is logical in ensuring that it evaluates precisely what the study aims to evaluate. In addition, any difficulties with data analysis would also be revealed when the data obtained from the pilot test was analysed (Saunders *et al.*, 2007:386).

A pilot study was conducted during the week of 29 June 2009 – 3 July 2009, when the questionnaire was pre-tested by two academic colleagues and three acquaintances who were small business owners and met the stated requirements.

The academic colleagues made the following suggestions leading to more specific data which, in turn, would deliver more satisfactory conclusions:

- Question 4, referring to the reasons why taxpayers make use of tax practitioners’ services should be asked in the form of a preference rating, instead of participants being asked to mark all the relevant reasons. The questionnaire was not adjusted to

take this into account. The existing structure is regarded as sufficient and also agrees with the way the research was conducted in accordance with the studies by Tan (1999:439) (see 2.3.3) and Venter and de Clercq (2007:146), as discussed in the literature review and on which this question was based.

- Question 5, which tests the preference for the type of tax advice given in different scenarios, should be in the form of a Likert-type scale with an equal number of options, instead of a three-point scale where the possibility exists that the participants will choose the easiest and safest option, that is, the average provided in the middle. The questionnaire was adjusted accordingly, as it had originally made use only of a three-point scale.

These colleagues also emphasised the limitation of participant bias because taxation is of a sensitive nature. Various strategies were employed to reduce participant bias, which is discussed in more detail later in this chapter. They indicated that taxpayers in the small business sector were seen to be more interested in paying as little tax as possible than in obtaining a higher net profit than that of larger companies. Larger companies are more interested in a high net profit because this keeps the shareholders satisfied.

They also provided suggestions on the expansion of questions 6 and 8, which were not taken into account as they were irrelevant to the research objectives. Minor comments were received on the format, style and grammar, which were considered and used to amend the questionnaire where necessary.

The pilot test on the three small business owners was carried out in approximately the same manner the actual data collection would be carried out, except that one of the three, on account of logistical constraints, received and responded to the questionnaire by e-mail.

The following problem areas in the original questionnaire were revealed and adjusted. These were:

- Confusion as to the way in which the answers should be indicated, i.e. whether the correct answer should be marked with a circle, a cross or a tick, and whether the

incorrect answer should be crossed out. A phrase was included to indicate that the participants should circle their answers.

- Uncertainty as to who a tax practitioner is and whether the term refers to an auditor, accountant or both. The definition of a tax practitioner was included in the questionnaire.
- Question 5 originally included two questions that sketched the scenarios of a non-disputable taxable income item and an expense that was definitely non-deductible. In these scenarios the tax practitioner was said to have provided advice to the contrary. It was indicated that these scenarios were examples of tax evasion. The two questions were subsequently removed from the questionnaire, as aggressive tax advice specifically does not refer to tax evasion.

On data analysis, it was decided to include the sub-questions 5.1.1.1, 5.1.2.1, 5.2.1.1, and 5.2.2.1, as more specific detail would be obtained on whether the type of advice participants preferred would influence their decision to engage with tax practitioners. In addition, question 7 was inserted, which required the participants to motivate their reasons for continuing or discontinuing their use of the services of a tax practitioner if they disagreed with the advice on ethical or technical grounds. Apart from these adjustments, minor formatting changes were once again made to the questionnaires before the actual data collection.

### **3.5 DATA ANALYSIS**

Numerical codes were assigned to all the questions, except for the first two qualifying questions determining whether the participants should proceed with answering the remainder of the questionnaire. Questions 7 and 9 were also not coded, as the participants had to provide their own reasons in writing.

The completed questionnaires were collected and the numerical codes were entered into the coding boxes on the questionnaires. The analysis was carried out by the Department of Statistics at the University of Pretoria. The coded responses were then captured and analysed by means of the Statistical Analysis Software (SAS) package (Version 9.2). (Refer to Chapter 4 for the detailed data analysis).

### 3.6 ASSESSING AND DEMONSTRATING THE QUALITY AND RIGOUR OF THE RESEARCH DESIGN

Various strategies were followed to ensure the validity and reliability of the data, including limiting any possible source of bias or error, so that reliable conclusions could be drawn.

If a questionnaire has internal validity, it means that it should be an accurate measure of what the study intends to measure as reflected in the research objectives (Saunders *et al.*, 2007:366). To ascertain that this questionnaire had internal validity, it had to provide adequate coverage of the actual investigative questions, otherwise referred to as the content validity of the questionnaire (Saunders *et al.*, 2007:366). Investigative questions are those asked to make sure that the research questions and subsequently the research objectives are achieved (Saunders *et al.*, 2007:601). The literature reviewed provided a thorough definition of the research, and the content validity of the questionnaire was further enhanced through prior discussion with experts on research specifically relating to taxation (Saunders *et al.*, 2007:366).

Reliability, on the other hand, refers to whether the participants consistently interpret a question in the same way that the study expects it to be interpreted (Saunders *et al.*, 2007:367). The questionnaires, which were available in both English and Afrikaans, were reviewed for language proficiency by a professional. As already indicated, a pilot study was conducted on the questionnaires in order to identify and remove any potential source of error when the participants completed it.

As mentioned earlier, the fact that the questionnaires were delivered and collected or completed in the presence of the researcher meant that the responses were reliable. The participants who completed the questionnaire were either the owners or the financial supervisors of the businesses and were therefore expected to be knowledgeable about the tax affairs of the company. Unfortunately, it appeared that, when it came to taxation, the participants trusted the advice of their tax practitioners completely. This was evident in some of the answers to question 5 asking whether they would accept the type of advice provided by tax practitioners.

Because taxation is a sensitive subject, it was expected that some of the participants would be afraid of compromising confidentiality if they indicated that they preferred aggressive advice. The participants may have thought that their answers could be revealed to SARS, which would investigate their tax affairs. This study may therefore be subject to participant bias, which could compromise the reliability of the data (Saunders *et al.*, 2007:149).

In order to reduce the potentially negative impact of participant bias, the participants had to indicate that they had read through the informed consent form at the beginning of the questionnaire (see Appendix A). The informed consent form is discussed in more detail later in this chapter. In addition and as already indicated, only generic examples were used and no reference was made to participants' existing tax practitioners.

The accuracy of the answers was further enhanced in the instances where the questionnaires were completed in the presence of the researcher, as the participant could ask questions if they were unsure of anything. The questionnaires were examined briefly to determine whether all the questions had been answered when the completed questionnaires were collected. Where some of the questions had not been completed in full, the participants were asked to fill in the outstanding information. In these instances, potential sources of error were eliminated, as the participants were asked whether those questions were unclear, and were then given an explanation so that they could answer fully.

### **3.7 RESEARCH ETHICS**

Apart from ethical clearance from the Faculty of Economic and Management Sciences' Research Ethics Committee, other research ethics were applied to this study. These included informed consent from participants, anonymity of participants, confidentiality of data provided and voluntary participation (Saunders *et al.*, 2007:181).

### **3.7.1 Ethical clearance from the Faculty of Economic and Management Sciences' Research Ethics Committee**

An application for ethical clearance was submitted to and approved by the Research Ethics Committee of the Faculty of Economic and Management Sciences. This application included information such as:

- the problem statement and research objectives;
- the research design and methods;
- a copy of the questionnaire (which included the informed consent letter); and
- the ways in which privacy of participants and confidentiality of data would be guaranteed.

Collection of data commenced only once approval had been obtained from the Faculty of Economic and Management Sciences' Research Ethics.

### **3.7.2 Informed consent**

The participants were informed by way of the informed consent form at the front of the questionnaire (see Appendix A) that, inter alia, the survey was anonymous, as their names would not appear, and that they would not be identified in any way by their answers. They were also informed that their participation and continuation in the study would remain voluntary. The informed consent form stated that information obtained would be treated confidentially. The results of the study would be used for academic purposes only and may be published in an academic journal.

The participants were informed that they should mark in the spaces provided on the form that they had read and understood the information in the informed consent form and that they give their consent to participating voluntarily in the study. They did not have to sign the form, but only date it to ensure their anonymity.



### **3.7.3 Anonymity of participants and confidentiality of data provided**

The questionnaires were physically delivered in blank envelopes during the data collection phase. For ethical reasons, the questionnaire did not refer to the participants' own tax practitioners, but to the general concept of a tax practitioner. These factors should have indicated to the participants that the study would be anonymous. The measures would reduce participant bias and enhance the reliability of the data.

After collection, the questionnaires were numbered and the name of the participant did not appear. The completed questionnaires were collected by the researcher, who was the only person to know the identity of the participants.

It is important to note that the name of the town from which the respondents were selected was never mentioned in this study and has remained undisclosed. The results will be used for academic purposes alone and may be published in an academic journal. This was indicated to the participants in the informed consent form (see Appendix A).

A great deal of confidence is placed in the researcher's integrity (Saunders *et al.*, 2007:192). This was maintained throughout this study, especially regarding personal anonymity and the confidentiality of the data.

### **3.7.4 Voluntary participation**

The participants were informed by way of the informed consent form (see Appendix A) that their participation in this study was voluntary and that they had the right to withdraw at any time without repercussion. It is also important to note that no incentives were offered to the participants.

## CHAPTER 4

### ANALYSIS OF RESULTS

#### 4.1 INTRODUCTION

This chapter provides an analysis of the results which emerged from this exploratory study. The outcome of questions 4 - 9 of the questionnaire (see Appendix A) are each discussed separately. Any relationships and differences in the results of the variables in different questions are indicated and discussed. Where applicable, any comparisons with the results of other studies indicated in the literature review are also shown.

As indicated in Chapter 3, the data analysis was performed on the 50 completed questionnaires with the Statistical Analysis Software (SAS) package (Version 9.2) by the Department of Statistics at the University of Pretoria. The outcomes of Fisher's Exact Test were used to test for the statistical significance of the relationships between the results of the different questions. Where the p value was equal to or less than 0.05, it was regarded as a statistically significant relationship (Saunders *et al.*, 2007:441).

To facilitate analysis of the results, the research objectives as indicated in Chapter 1 are stated again:

- To determine whether small-business taxpayers prefer conservative or aggressive advice from their tax practitioners;
- To determine whether small-business taxpayers would continue to use the services of their tax practitioners if they disagreed with the tax approach proposed to them.

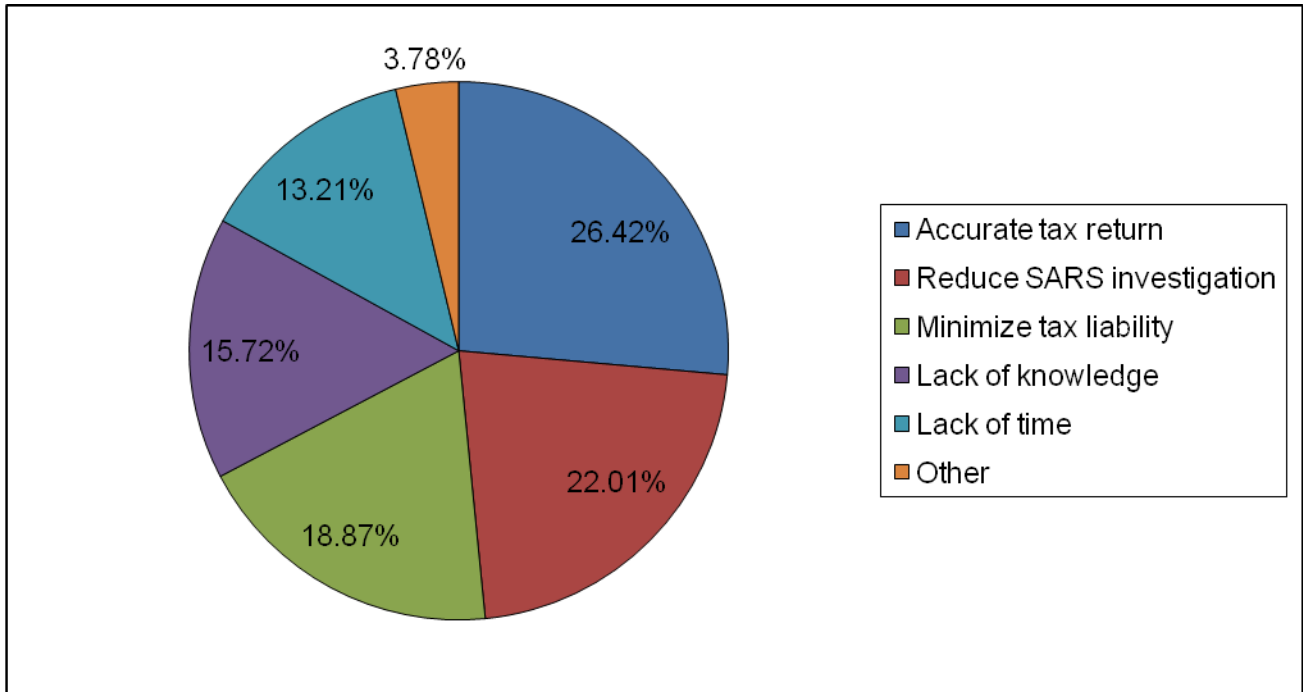
#### 4.2 RESULTS OF THE QUESTIONNAIRE

The outcome of the questionnaire was as follows:

*Why do you make use of the services of a tax practitioner with regard to the/your business? (Question 4.)*

Figure 1 indicates the participants' responses as to why they engaged with a tax practitioner.

**Figure 1: Reasons for engaging with a tax practitioner**



It is evident from the data obtained that the main reason for the participants (26.42%) engaging with a tax practitioner was to file an accurate tax return. This finding is in line with the findings of previous studies, such as those by Tan (1999:445) and Collins *et al.* (1990:15), as indicated in the literature review. The second main reason was to reduce the risk of being investigated by SARS (22.01%). These two main reasons are regarded as indicative of a preference for conservative advice. The third main reason was to limit the tax liability to a minimum (18.87%), which is, of course, indicative of a preference for aggressive advice.

However, the results differ from the main reasons found by Venter and de Clercq (2007:146) as to why South African small businesses outsource their tax functions. In their study, only 15.72% indicated a lack of own knowledge and/or skilled personnel as a reason and only 13.21% indicated lack of time as a reason. The reason why there may be not be such a high correlation with the findings of Venter and de Clercq (2007:146) could be that they focused on business services, manufacturing and retail sectors, and this study did not differentiate between sectors. Other reasons could be that the geographic

region on which they focused differed from the region in the study. Further, the structure of their questionnaire, particularly this question, was different from the questionnaire in this study (see Appendix A). Very low percentages were ascribed both to the fact that making use of the services of a tax practitioner is cheaper than doing it internally (2.52%) and other reasons specifically indicated by the participants for making use of the services of a tax practitioner (1.26%).

*Will you agree with your tax practitioner (“he”) if he provides the following advice with regard to the/your business in the situations indicated below? (Questions 5.1.1, 5.1.2, 5.2.1 and 5.2.2)*

Scenarios were indicated for which the participants had to assume that there was no clear authority in the Act or any interpretation of the tax treatment of a certain income and expense. The tax practitioner provided both conservative and aggressive advice for each of these scenarios and the participants had to indicate their responses to each type of advice. The different scenarios, together with the responses of the participants regarding their preferences for the type of tax advice, are set out in Table 3.

**Table 3: Responses regarding taxpayers’ preferences for the type of tax advice**

<b>Tax advice with regard to the tax treatment of an ambiguous item on the tax return</b>	<b>Percentage of participants who would definitely agree with the advice</b>	<b>Percentage of participants who might agree with the advice</b>	<b>Percentage of participants who might disagree with the advice</b>	<b>Percentage of participants who would definitely disagree with the advice</b>
Include an ambiguous income	58%	18%	14%	10%
Exclude an ambiguous income	24%	24%	16%	36%
Do not deduct an ambiguous expense	34%	20%	22%	24%
Deduct an ambiguous expense	40%	26%	8%	26%

The results show that when the tax practitioner provided conservative advice on an ambiguous income item, 76% of the participants preferred the conservative advice. The 76% was comprised of participants who would either definitely agree (58%) or who might agree (18%) with the conservative advice. It appears that when the advice was asked in the negative form, which was to exclude the ambiguous income item, the participants' preference for conservative advice was not as strongly supported. Only 52% would disagree, either definitely (36%) or maybe (16%), with the aggressive advice.

When an ambiguous expense was in question, the participants likewise did not indicate a significant preference for conservative advice when the tax practitioner advised against deducting the expense. Only 54% would agree with the advice, either definitely (34%) or maybe (20%). However, when the tax practitioner provided aggressive advice on an ambiguous expense, the majority, represented by 66% of the respondents, preferred aggressive advice, either definitely (40%) or maybe (26%). This concurs with the findings by Hite and Hasseldine (2003:7) and of Christensen and Hite (1997:14), as indicated in the literature review. The two tests on the preference for the type of advice relating to an ambiguous expense did not support each other at all.

It is therefore evident that, overall, although not significantly, the participants preferred conservative advice. However, the participants tended to be more aggressive when the deduction of an ambiguous expense was an issue. More detail of the most to the least common sets of responses by the participants to the different scenarios is provided in Table 4 below. Responses in which they definitely or maybe agreed are grouped together and those in which they definitely or maybe disagreed are grouped together for purposes of this table.

**Table 4: Summary of sets of responses (frequency and row percentage) regarding taxpayers' preferences for the type of tax advice**

Agree to include the said income	Disagree to include the said income	Agree to exclude the said income	Disagree to exclude the said income	Agree not to deduct the said expense	Disagree not to deduct the said expense	Agree to deduct the said expense	Disagree to deduct the said expense	Frequency and row percentage
x			x		x	x		11 (22%)
x		x		x		x		10 (20%)
x			x	x			x	7 (14%)
	x	x			x	x		6 (12%)
x			x	x		x		5 (10%)
	x	x		x			x	5 (10%)
x			x		x		x	3 (6%)
x		x			x	x		1 (2%)
x		x			x		x	1 (2%)
	x	x			x		x	1 (2%)
<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>50 (100%)</b>

It is evident that, of the 50 participants, 11 (constituting 22% of the total participants) agreed to include the ambiguous income item (either definitely or maybe) and did not agree to exclude the income. They thus preferred conservative advice on an ambiguous income item. These 11 participants, however, preferred aggressive advice on an ambiguous expense, as they disagreed (either definitely or maybe) with the scenario not to deduct the expense but agreed (either definitely or maybe) with the scenario to deduct it.

With a difference of just one set of responses, the second most common set of advice, the choice of 10 participants (constituting 20% of the total participants), was one in which they agreed with the tax practitioner in all cases, irrespective of the type of advice given. This is significant, as it indicates that taxpayers rely heavily on their tax practitioners and trust them completely. Evidently tax practitioners have a possible influence over the compliance behaviour of taxpayers, as noted by Sakurai and Braithwaite (2001:19) and Tan (1999:445).

*Will you continue to make use of his services as a result of the abovementioned advice?  
(Questions 5.1.1.1, 5.1.2.1, 5.2.1.1 and 5.2.2.1)*

Each of the scenarios in which tax advice was provided, together with the responses of the participants as to whether they would continue to make use of the tax practitioner's services, is presented in Table 5.

**Table 5: Responses regarding the retention of the tax practitioner due to the type of tax advice received**

<b>Tax advice on the tax treatment of an ambiguous item on the tax return</b>	<b>Percentage of participants who would definitely continue to engage with him/her</b>	<b>Percentage of participants who might continue to engage with him/her</b>	<b>Percentage of participants who might disengage from him/her</b>	<b>Percentage of participants who would definitely disengage from him/her</b>
Include an ambiguous income	86%	8%	2%	4%
Exclude an ambiguous income	54%	14%	10%	22%
Do not deduct an ambiguous expense	70%	8%	14%	8%
Deduct an ambiguous expense	70%	18%	0%	12%

The results indicate that, despite the type of advice provided, the majority of the taxpayers would still continue to use the services of the tax practitioner. This was evident in all four scenarios. When the tax practitioner advised including or excluding the said income, 94% in the first instance and 68% the latter instance, would either definitely or maybe continue to use their services. When the tax practitioner advised not to deduct or to deduct the said expense, 78% in the first instance and 88% in the latter instance would either definitely or maybe continue to use the services. This finding is similar to the finding by Tan (1999:443) that there was no sizeable correlation between the type of tax advice received and whether or not the services of a tax practitioner would be retained.

It is also evident that, when conservative advice was given on an income item, there was a greater willingness (94%) to continue engaging with the tax practitioner than when aggressive tax advice was provided. Where the tax practitioner advised excluding the income item, 68% would continue to engage with him. However, when aggressive tax advice on an expense was given, there was a greater willingness (88%) to retain the practitioner's services than when conservative advice was given, in which case 78% indicated they would continue to engage with him. This is different from the finding by Tan (1999:441), where it was indicated that there was a greater willingness to continue using the services of a tax practitioner when conservative advice was provided, which was specifically with reference to the deduction of an expense. This finding, however, correlates with the findings on the participants' preference for the type of advice given on income and expense.

*Will you agree with the advice of your tax practitioner with regard to the/your business if an expense which should have been deducted in a prior tax year was erroneously not deducted and he advises not to reopen that return (which would have been the correct action), but to claim it as a deduction in the current tax year. (Question 5.3)*

Of all the participants, 64% indicated that they would agree, either definitely (32%) or maybe (32%), while 10% stated that they might not agree and 26% stated that they would definitely not agree with this advice.

These results indicate that the participants preferred aggressive tax advice when it related to an expense. The results may also imply a correlation with the findings already indicated that the participants tended to agree with the tax practitioner, irrespective of the type of tax advice.

*Will you agree with the advice of your tax practitioner with regard to the/your business if an income which should have been included in a prior tax year was erroneously not included and he advises not to reopen that return (which would have been the correct action), but to include it in the current tax year. (Question 5.4)*

In this case, only 56% of the participants showed that they would either definitely agree (24%) or may agree (32%), while 12% may not agree and 32% would definitely not agree

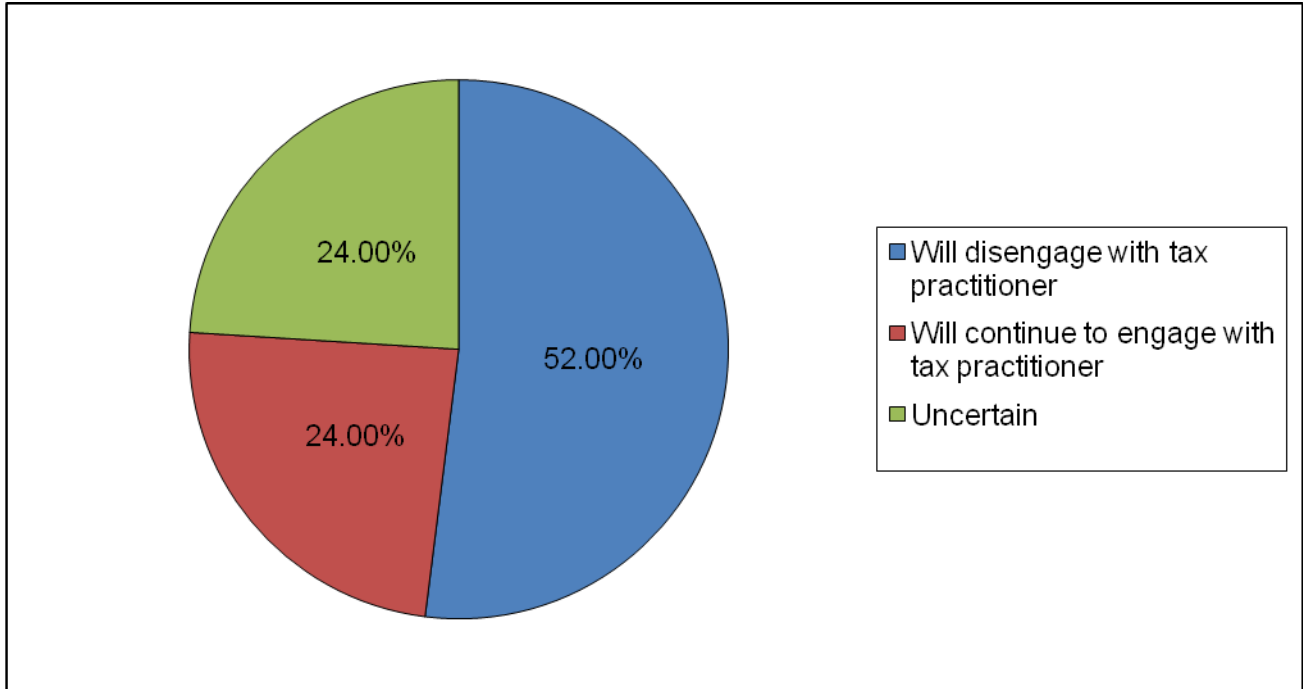


with it. These results indicate, though not as significantly as for an expense, that the participants preferred aggressive tax advice when it related to an income. These results show no correlation at all with the findings on taxpayers' preferences for conservative tax advice on an income item as indicated. Possibly the participants did not really understand the significance of the timing issue, even though it was explained in the question. Once again, there is also a correlation with the findings of the previous scenarios that the participants tended to agree with the tax practitioner, irrespective of the type of tax advice given.

*Should you in any situation disagree with the advice of a tax practitioner due to ethical or technical reasons, would you continue to use him? (Questions 6 and 7)*

Figure 2 indicates the participants' responses to whether they would continue to use a tax practitioner if they disagreed with him/her on ethical or technical grounds.

**Figure 2: Responses regarding the retention of the tax practitioner should taxpayers disagree on ethical or technical grounds**



From the results it is evident that the participants felt strongly about the fact that they would discontinue their use of a tax practitioner's services if they disagreed on ethical or technical grounds. This was confirmed by 52% of all the participants. If the participants

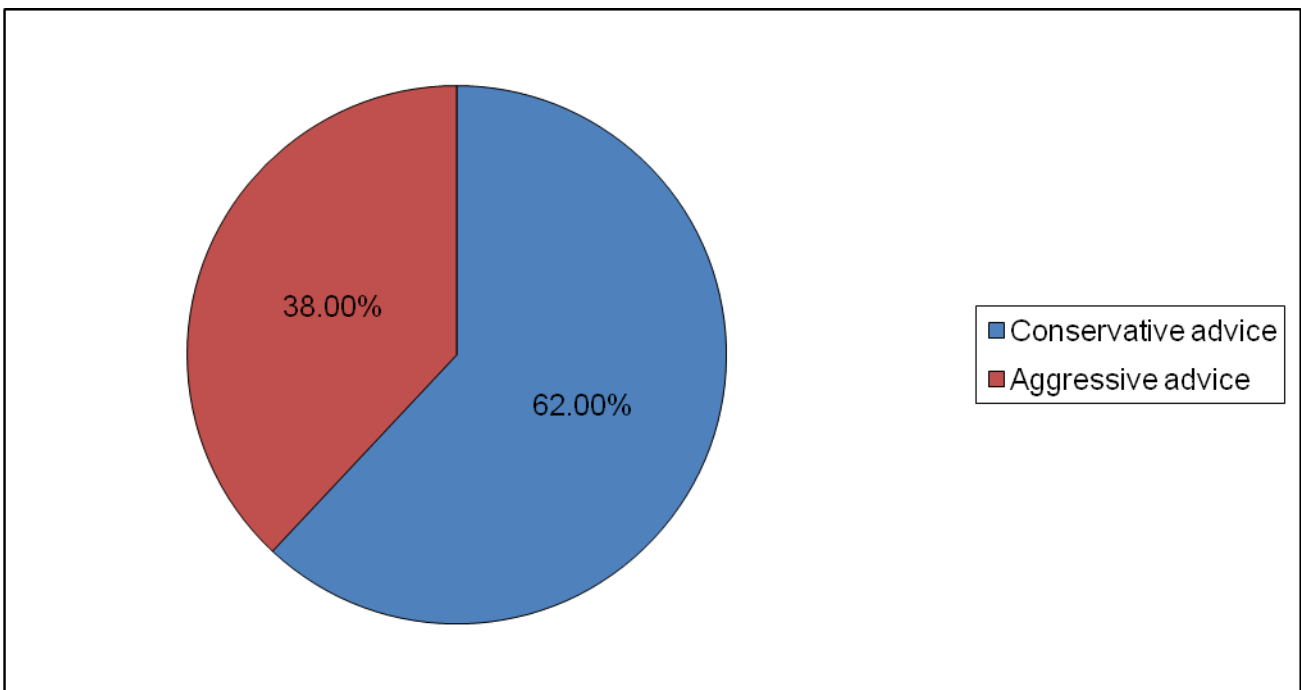
who were uncertain (24%) were to be excluded from the results, it would indicate that approximately 68% would disengage from the practitioner and 32% would still continue to use the services.

The majority indicated, in substantiation of why they would terminate the services that they felt strongly about being honest and ethical. The participants did not want to be associated with tax evasion, which appears contrary to the findings by Caragata (1997:214) that, in New Zealand, small businesses, the self-employed and individuals in general comprised the highest percentage of tax evaders. Most of those who would continue to use practitioners' services indicated that they relied on their expertise and that they had a trusting, loyal relationship.

*Which type of tax advice to you prefer from a tax practitioner in general? (Questions 8 and 9)*

Figure 3 shows the preferences of the participants for the type of tax advice.

**Figure 3: Responses regarding taxpayers' preferences for conservative or aggressive tax advice**



The information gathered shows that the majority (62%) of the participants indicated that they preferred conservative advice, while 38% indicated that they preferred aggressive advice. The outcome of the first research objective is, therefore, that taxpayers prefer conservative advice, as there is a correlation between taxpayers' agreement with tax practitioners' advice in the case of conservative advice. This is also evident from the analysis of the results of the responses to questions 5.1.1, 5.1.2, 5.2.1 and 5.2.2, which are indicated in the discussion of Table 3.

The majority indicated that their preference for conservative advice was prompted by their desire to do the correct thing and not take chances. Other reasons given were that they wanted a good relationship with SARS; that they did not want to waste time and money on addressing queries from SARS, and that they did not want to pay tax penalties and interest. Most of those who preferred aggressive advice substantiated this by saying that they regarded the Act as open to challenge and that they wanted to take care of their own concerns by limiting their tax liability to a minimum.

### **4.3 RELATIONSHIPS BETWEEN THE RESULTS OF THE VARIOUS QUESTIONS**

#### **4.3.1 Relationship between the type of tax advice and taxpayers continuation of engagement with tax practitioners**

Table 6 below contains a summary of the participants' responses as to their preferences for the type of tax advice given in each scenario and whether they would continue to make use of the tax practitioner's services in each case. Significant relationships existed and are indicated in the discussion following. Responses showing that the participants indicating definitely or maybe are grouped together and those indicating that they definitely or maybe disagreed are grouped together for purposes of this table.

Fisher's exact test was done to test for significant relationships between the type of tax advice and whether taxpayers would retain a tax practitioner as indicated in the various scenarios for question 5.

**Table 6: Summary of responses (frequency and row percentage) regarding taxpayers' agreement with the tax advice to include the ambiguous income and the retention of the tax practitioner**

	<b>Agree to include the said income</b>	<b>Disagree on including the said income</b>
<b>Continue to engage</b>	38 (100%)	9 (75%)
<b>Discontinue engaging</b>	0 (0%)	3 (25%)
<b>TOTAL</b>	<b>38 (100%)</b>	<b>12 (100%)</b>
<b>Fischer's <math>p</math>-values</b>	<b>0.0112</b>	<b>0.0112</b>

In this instance, as indicated,  $p = 0.0112$ , which is statistically significant on the 5% level. This shows that there is a significant relationship between taxpayers' engagement with their tax practitioner and their agreement with the advice offered. All the participants who agreed with the advice would continue to engage with the tax practitioner, while some of participants (25%) would disengage if they disagreed with the advice.

From the qualitative viewpoint, there is a connection between the fact that taxpayers would continue engaging with a tax practitioner when conservative tax advice was provided, and the fact that they would do so even if they disagreed with the advice. As already indicated, all of the participants who would agree (either definitely or maybe) to include the ambiguous income item would continue (either definitely or maybe) to do so. Of the participants who indicated that they would disagree (either definitely or maybe) with this advice, 75% would still continue (either definitely or maybe) with the practitioner.

**Table 7: Summary of responses (frequency and row percentage) on taxpayers' agreement with the tax advice to exclude the ambiguous income and the retention of the tax practitioner**

	<b>Agree to exclude the said income</b>	<b>Disagree to exclude the said income</b>
<b>Continue to engage</b>	24 (100%)	10 (38.46%)
<b>Discontinue</b>	0 (0%)	16 (61.54%)
<b>TOTAL</b>	<b>24 (100%)</b>	<b>26 (100%)</b>
<b>Fischer's <math>p</math>-values</b>	<b>0.0001</b>	<b>0.0001</b>

In this case  $p = 0.0001$ , which is significant on the 5% level. There is, therefore, a significant relationship between taxpayers' engagement with their tax practitioners and their agreement with the advice offered. All the participants who agreed with the advice would continue to engage with the tax practitioner and the majority of the participants (61.54%) would disengage if they disagreed with the advice.

Based on a qualitative review, there is a relationship to some extent between the fact that taxpayers would continue to engage with a tax practitioner when aggressive tax advice was given, even if they disagreed with that advice. As indicated, all of the participants would continue to engage with the tax practitioner when they agreed with the advice to exclude the ambiguous income item. An aggregate of only 38% of the participants who indicated that they would disagree would still continue to engage with the practitioner, while the majority (62%) would disengage.

**Table 8: Summary of responses (frequency and row percentage) regarding taxpayers' agreement with the tax advice not to deduct the ambiguous expense and the retention of the tax practitioner**

	<b>Agree not to deduct the said expense</b>	<b>Disagree not to deduct the said expense</b>
<b>Continue to engage</b>	26 (96.30%)	13 (56.52%)
<b>Discontinue to engage</b>	1 (3.70%)	10 (43.48%)
<b>TOTAL</b>	<b>27 (100%)</b>	<b>23 (100%)</b>
<b>Fischer's <math>p</math>-values</b>	<b>0.0012</b>	<b>0.0012</b>

In this instance, as indicated,  $p = 0.0012$ , which is significant on the 5% level. This indicates that there is a significant relationship between taxpayers' engagement with their tax practitioner and their agreement with the advice offered. An aggregate of 96% of the participants who agreed with the advice would continue to engage with the tax practitioner and an aggregate of 43% of the participants indicated that they would disengage if they disagreed with the advice.

Qualitatively, there is a relationship between the fact that taxpayers would continue to engage with a tax practitioner when conservative tax advice was given, even if they disagreed with that advice. As already indicated, an aggregate of 96% of those who indicated that they would agree not to deduct the ambiguous expense would continue to engage with the practitioner. An aggregate of 57% who indicated that they would disagree with the said advice would continue to engage with him.

**Table 9: Summary of responses (frequency and row percentage) regarding taxpayers' agreement with the tax advice to deduct the ambiguous expense and the retention of the tax practitioner**

	Agree to deduct the said expense	Disagree with deducting the said expense
<b>Continue to engage</b>	32 (96.97%)	12 (70.59%)
<b>Discontinue</b>	1 (3.03%)	5 (29.41%)
<b>TOTAL</b>	<b>33 (100%)</b>	<b>17 (100%)</b>
<b>Fischer's <i>p</i>-values</b>	<b>0.0136</b>	<b>0.0136</b>

In the last case  $p = 0.0136$ , which is significant on the 5% level. This shows that there is a significant relationship between taxpayers' engagement with their tax practitioner and their agreement with the advice offered. An aggregate of 97% of the participants who agreed with the advice would continue to engage with the tax practitioner and an aggregate of 29% of the participants indicated that they would disengage if they disagreed with the advice.

However, according to a qualitative review, there is a relationship between the fact that taxpayers would continue to engage with a tax practitioner when aggressive tax advice was provided, even if they disagreed with the advice. An aggregate of 97% of the participants who indicated that they would agree with the advice to deduct the ambiguous expense would continue to engage with him. An aggregate of 71% of the participants who indicated that they would disagree would continue to engage with him.

Despite the statistical evidence and based on a qualitative review, in all of the above-mentioned instances, except when the participants disagreed with the advice to exclude the income item, they would continue to engage with a tax practitioner, even when they disagreed with the advice. These findings, therefore, do not support the findings by Tan (1999:441) and by Hite and McGill (1992:396).

Based on a qualitative review, the outcome of the second research objective is, therefore, that taxpayers would continue to engage with a tax practitioner if they disagreed with the advice, as there is no relationship between agreement with advice and termination of

services. The difference in findings could be ascribed to the fact that Tan (1999:437) conducted the study on businesses in general and not specifically on small businesses, while the geographic region was also different, Tan's being the Manawatu region of New Zealand.

#### **4.3.2 Relationship between the responses to the general question and the different scenarios on retention of the tax practitioner**

There was no significant relationship between their answers on whether the participants would continue to engage with the tax practitioner (question 6) and their responses to whether they would retain his services based on the advice provided in the different scenarios in question 5. As already indicated, the difference can be ascribed to the fact that the participants felt strongly about not being engaged in tax avoidance, which was indirectly implied in question 6, while tax evasion did not really mean that they would disengage from a tax practitioner. The responses to question 5 also indicated that the participants tended to agree with the tax practitioner, irrespective of the type of advice.

#### **4.3.3 Relationship between the responses to the general question and the different scenarios on taxpayers' preference for type of advice**

Again, there was no significant relationship between the preferred tax advice indicated in question 8 and the preferred tax advice indicated in the different scenarios that were presented to the respondents in question 5. As already indicated, the difference can be ascribed to the fact that when a differentiation is made between the type of tax advice on an income and an expense, taxpayers prefer aggressive advice on the expense and conservative advice on the income. On the other hand, when the taxpayers were asked directly without distinction between an income or an expense item, 62% indicated that they preferred conservative advice.



## CHAPTER 5

### CONCLUSION

#### 5.1 INTRODUCTION

The main purpose of this exploratory research was to examine the preferences of taxpayers in the small business sector for the type of advice offered by their tax practitioners. The following research objectives were set out to address this:

- To determine whether small business taxpayers prefer to be given conservative or aggressive advice by their tax practitioners;
- To determine whether small business taxpayers would continue to use the services of their tax practitioners if they disagreed with the proposed tax approach.

This chapter summarises the findings and draws conclusions from the research objectives. A summary of contributions and suggestions for future research are also offered.

#### 5.2 SUMMARY OF FINDINGS

Three main findings emerged from this study on the preference of small business taxpayers for the type of tax advice offered by practitioners.

- Firstly, when asked directly which type of advice they preferred, the majority indicated that they preferred conservative tax advice from their tax practitioners as they wanted to do what was right and not take chances. This was corroborated by the fact that they were concerned mainly with filing an accurate tax return and avoiding investigation by SARS.
- Secondly, it is of interest that, when ambiguous scenarios were presented to the participants, it appeared that they preferred aggressive advice when an ambiguous expense was in question.
- Thirdly, the results also showed that small business taxpayers tended to agree with the tax practitioner, irrespective of the type of tax advice. This may particularly have been the case if they were not knowledgeable about a tax issue and relied on their tax practitioners for guidance.

In support of their reliance on and trust in their tax practitioners, the participants indicated that they would in most cases retain the services of a tax practitioner irrespective of the type of advice given, even if they disagreed with it, as long as it did not relate to tax evasion. Tax practitioners could, therefore, play a vital role in the compliance behaviour of taxpayers.

### **5.3 CONCLUSIONS**

The findings of this study show that taxpayers in the small business sector would prefer conservative tax advice from their tax practitioners. The validity of this conclusion is, however, not 100% clear cut, as taxpayers tended to choose more aggressive advice when the deduction of an expense was in question or when they did not understand the significance of a tax issue. In that case, they would merely follow the advice of the tax practitioner.

What is clear, though, is that taxpayers in the small business sector would, for the most part, continue to engage with a tax practitioner even if they disagreed with the tax approach proposed to them. This means that they relied heavily on their tax practitioners. The implications of this, together with the conclusions on the research objectives and on the problem statement, lead in turn to practical implications, which are included in the next section.

### **5.4 SUMMARY OF CONTRIBUTIONS**

The findings of this study, indicating to an extent that small business taxpayers would prefer conservative tax advice, concur with Tan's conclusions (1999:445) and with those of Hite and McGill (1992:398). The findings by Sakurai and Braithwaite (2001:20), Tan (1999:439), Hite *et al.* (1992:21) and Collins *et al.* (1990:15) were corroborated, in that the most important reason why taxpayers engage with tax practitioners is to file an accurate tax return.

The taxpayers did, however, indicate that when an ambiguous expense was in question, they would prefer aggressive advice. This concurs with the findings by Hite and Hasseldine (2003:7) and by Christensen and Hite (1997:14).

As far as the retention of a tax practitioner's services is concerned, it is evident that small business taxpayers would remain loyal to a tax practitioner irrespective of the type of advice they were given or even if they disagreed with it, except in the case of tax evasion. This finding, however, contradicts the findings in previous research by Tan (1999:441) and by Hite and McGill (1992:396). In these earlier studies, the taxpayers indicated that they would disengage from a tax practitioner should they disagree with his/her advice. However, Tan (1999:443) showed that no significant relationship existed between the type of tax advice received and the retention of a tax practitioner, which was evident also in this study.

The fact that small business taxpayers are very clear that they do not want to be associated with tax evasion corroborates the findings by Ahmed and Braithwaite (2005:554). Unfortunately, there are no available supporting statistics on the actual levels of the association of small businesses with tax evasion.

As indicated, taxpayers do rely on their tax practitioners for guidance and trust them with their tax affairs, concurring with conclusions in studies such as those by Sakurai and Braithwaite (2001:19) and Tan (1999:445), which stressed practitioners' important role in the compliance behaviour of taxpayers. It is therefore necessary for tax practitioners to be strictly regulated in South Africa. This in turn emphasises the reason for the Regulation of Tax Practitioners Act, which will and should become effective within the very near future. It is crucial for the relevant statutory body which will carry out the regulation of tax practitioners to be both efficient and stringent in the enforcement of the relevant code of conduct. This would include the necessary disciplinary steps as well as the monitoring of adequate knowledge and expertise on the part of all South African tax practitioners. This will benefit not only the taxpayer in reducing penalties and audit exposure, but will also aid the government as far as their revenue income is concerned.

## **5.5 SUGGESTIONS FOR FUTURE RESEARCH**

More detailed information on small businesses in the different geographic areas of South Africa is still required, as this study was conducted only on a rural town. It could also be extended to taxpayers other than South African small businesses, such as large companies or individuals.

Different variables, such as the likelihood of penalties or audit exposure, which were used in Tan's study (1999:437) could also be introduced in the questionnaire to test how they would influence taxpayers' decisions as to their preference for the type of advice offered. An exploration into the actual levels of tax compliance by small businesses should also be conducted.

## **5.6 CONCLUSION**

Taxpayers in the small business sector prefer a certain amount of conservative tax advice from their tax practitioners and they want to file an accurate tax return. They rely on their tax practitioners for guidance on their tax compliance. The above-mentioned studies should be conducted to gain more insight into South African taxpayers and tax compliance, as well as the actual levels of tax compliance of specifically small businesses.

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## **APPENDIX A**

**- Final questionnaire used to collect the data for the study -**



Faculty of Economic and  
Management Sciences  
**Department of Taxation**

## **Informed consent for participation in an academic research study**

### **Department of Taxation**

#### **An exploratory study on taxpayers' preference for type of advice from tax practitioners with regard to small businesses**

Research conducted by:

Ms. M. Lubbe (26400121)  
Cell: 083 629 6619

Dear Respondent

You are invited to participate in an academic research study conducted by Melissa Lubbe, a Master's degree student in the Department of Taxation of the University of Pretoria.

The purpose of the study is to explore the preference of small business taxpayers for conservative or aggressive advice from their tax practitioner.

Please note the following:

- This study involves an anonymous survey. Your name will not appear on the questionnaire and the answers you furnish will be treated as strictly confidential. You cannot, based on the answers you give, be identified in person.
- Your participation in this study is very important to us. You may, however, choose not to participate and you may also stop participating at any stage without any negative consequences.
- Please answer the questions in the attached questionnaire as completely and honestly as possible. This should not take more than 10 minutes of your time.
- The results of the study will be used for academic purposes only and may possibly be published in an academic journal. We will, on your request, provide you with a summary of our findings.
- Please contact my study leader, Mr S.G. Nienaber, at 012 420 4098, or at gerhard.nienaber@up.ac.za, should you have any questions or comments regarding the study.

Please tick in the boxes below to indicate that:

- You have read the information provided above and understand it.
- You give your consent to participate in the study on a voluntary basis.

---

**Date**



## Questionnaire

For office use only

V1

**Mark the applicable answer/s, by circling your choice: O.**

1. Does the/your business have a turnover **smaller than** R14 million per tax year?

<b>Yes</b>	<b>1</b>
<b>No</b>	<b>2</b>

2. Do you make use of the services of a *tax practitioner* with regard to the/your business?

*A tax practitioner is basically any person who provides tax advice or completes or assists in completing any return and therefore includes an accountant, auditor or legal advisor.*

<b>Yes</b>	<b>1</b>
<b>No</b>	<b>2</b>

**3. If you have answered “No” to the above-mentioned questions, you do not have to complete the remainder of this questionnaire. *Thank you for your time in completing the questionnaire.***

**If you have answered “Yes” to the above-mentioned questions, please complete the remainder of the questionnaire.**

4. Why do you make use of the services of a tax practitioner with regard to the/your business?

*Please indicate **all** the reasons applicable to you.*

Lack of time.	<b>1</b>
To limit the tax liability to a minimum.	<b>2</b>
To reduce the chance of being investigated by the South African Revenue Services (SARS).	<b>3</b>
Lack of own knowledge and/or skilled personnel.	<b>4</b>
To file an accurate tax return.	<b>5</b>
It is cheaper than doing it internally.	<b>6</b>
Other. <i>Please specify below.</i> _____ _____	<b>7</b>

For office use only

V2

V3

V4

V5

V6

V7

V8



5. Will you **agree** with your tax practitioner (“he”) if he provides the following advice with regard to the/your business in the situations indicated below? (These situations do not refer to your personal tax affairs).

	Yes, definitely	Maybe	Maybe not	No, definitely not	For office use only
5.1 Assume there is <b>no clear authority</b> in the Income Tax Act (“Act”) or any interpretation thereof on whether a certain <b>income</b> on your return should be included. Your tax practitioner advises:					
5.1.1 To <b>include</b> the income.	1	2	3	4	V9 <input type="text"/>
5.1.1.1 Will you continue to make use of his services as a result of the abovementioned advice?	1	2	3	4	V10 <input type="text"/>
5.1.2 <b>Not to include</b> the income.	1	2	3	4	V11 <input type="text"/>
5.1.2.1 Will you continue to make use of his services as a result of the abovementioned advice?	1	2	3	4	V12 <input type="text"/>
5.2 Assume there is <b>no clear authority</b> in the Act or any interpretation thereof on whether a certain <b>expense</b> is deductible on your return. Your tax practitioner advises:					
5.2.1 <b>Not to claim</b> the expense as a <b>deduction</b> .	1	2	3	4	V13 <input type="text"/>
5.2.1.1 Will you continue to make use of his services as a result of the abovementioned advice?	1	2	3	4	V14 <input type="text"/>
5.2.2 To <b>claim</b> the expense as a <b>deduction</b> .	1	2	3	4	V15 <input type="text"/>
5.2.2.1 Will you continue to make use of his services as a result of the abovementioned advice?	1	2	3	4	V16 <input type="text"/>
5.3 An <b>expense</b> which should have been deducted in a <b>prior</b> tax year was <b>erroneously not deducted</b> . Your tax practitioner advises: <b>Not to reopen</b> that return ( <i>which would have been the correct action</i> ), but to <b>claim it as a deduction in the current tax year</b> .	1	2	3	4	V17 <input type="text"/>
5.4 An <b>income</b> which was received and accrued during a <b>prior</b> tax year was <b>erroneously not included</b> . Your tax practitioner advises: <b>Not to reopen</b> that return ( <i>which would have been the correct action</i> ), but to <b>include it in the current tax year</b> .	1	2	3	4	V18 <input type="text"/>

6. Should you in any situation disagree with the advice of a tax practitioner due to ethical or technical reasons, would you continue to use him?

<b>Yes</b>	<b>1</b>
<b>No</b>	<b>2</b>
<b>Uncertain</b>	<b>3</b>

For office use only
V19 <input type="text"/>



7. If you have answered “Yes” or “No” in 6 above, please substantiate your answer by providing a reason or reasons.

7.1 \_\_\_\_\_

7.2 \_\_\_\_\_

7.3 \_\_\_\_\_

8. Which type of tax advice do you prefer from a tax practitioner in general?

- **Conservative advice**, i.e. advice which can easily be motivated in terms of the Income Tax Act or any interpretation thereof should SARS query it; or
- **Aggressive advice**, i.e. advice which will result in the lowest possible tax liability, but which has a less reasonable probability of judiciary success should SARS query it. Research has indicated that the realistic probability of success in this case refers to a one-in-three chance of judiciary success. Please note that aggressive tax advice does not refer to tax evasion.

<b>Conservative advice</b>	<b>1</b>
<b>Aggressive advice</b>	<b>2</b>

For office use only V20 <input type="checkbox"/>
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9. Please substantiate your preference for conservative or aggressive advice in 8 above, by providing a reason or reasons.

9.1 \_\_\_\_\_

9.2 \_\_\_\_\_

9.3 \_\_\_\_\_

**Thank you for completing the survey.  
We appreciate your assistance.**



Fakulteit Ekonomiese en  
Bestuurswetenskappe  
**Departement Belasting**

## **Ingeligte instemming tot deelname aan 'n akademiese navorsingstudie**

### **Departement Belasting**

#### **'n Verkennende studie rakende belastingbetalers se voorkeur vir tipe advies komende van belastingpraktisyns met betrekking tot klein besighede**

Navorsing uitgevoer deur:

Mej. M. Lubbe (26400121)  
Sel: 083 629 6619

Geagte Respondent

U word genooi om aan 'n akademiese navorsingstudie deel te neem wat uitgevoer word deur Melissa Lubbe, 'n Meestersgraadstudent in die Departement Belasting van die Universiteit van Pretoria.

Die doel van die studie is om die voorkeur van kleinbesigheid-belastingbetalers rakende konserwatiewe of aggressiewe advies van hul belastingpraktisyn te verken.

Let asseblief op die volgende:

- Die studie sluit 'n anonieme opname in. U naam sal nie op die vraelys verskyn nie en die antwoorde wat u verstrek, sal as streng vertroulik hanteer word. U kan nie, gebaseer op die antwoorde wat u verstrek, as persoon geïdentifiseer word nie.
- U deelname aan die studie is vir ons baie belangrik. U mag egter die keuse uitoefen om nie deel te neem nie, en u mag ook u deelname te eniger tyd sonder enige negatiewe gevolge staak.
- Beantwoord asseblief die vrae in die aangehegte vraelys so volledig en eerlik moontlik. Dit behoort nie meer as 10 minute van u tyd in beslag te neem nie.
- Die resultate van die studie sal slegs vir akademiese doeleindes aangewend word en sal moontlik in 'n akademiese vaktydskrif gepubliseer word. Ons sal op u versoek 'n opsomming van ons bevindings aan u verskaf.
- Indien u enige navrae of kommentaar rakende die studie wil rig, neem asseblief kontak op met my studieleier, mnr. S.G. Nienaber, by 012 420 4098, of by gerhard.nienaber@up.ac.za.

Merk asseblief in die blokkies hieronder om aan te toon dat:

- U bogenoemde inligting gelees het en dit verstaan.
- U instem om vrywillig aan die studie deel te neem.

---

**Datum**





## Vraelys

Slegs vir kantoorgebruik V1

**Merk die toepaslike antwoord/e deur jou keuse te omring: O.**

1. Het die/u besigheid 'n omset van **kleiner as** R14 miljoen per belastingjaar?

<b>Ja</b>	<b>1</b>
<b>Nee</b>	<b>2</b>

2. Maak u van 'n *belastingpraktisyn* se dienste ten opsigte van die/u besigheid gebruik?

*'n Belastingpraktisyn is basies enige persoon wat belastingadvies verskaf of voltooi of bystand verleen om enige opgawe te voltooi en sluit daarom 'n rekenmeester, ouditeur of regsadviseur in.*

<b>Ja</b>	<b>1</b>
<b>Nee</b>	<b>2</b>

**3. Indien u “Nee” op bogenoemde vrae geantwoord het, hoef u nie die oorblywende deel van die vraelys in te vul nie. *Dankie vir u tyd ten opsigte van die invul van die vraelys.***

**Indien u “Ja” op bogenoemde vrae geantwoord het, vul asseblief die oorblywende deel van die vraelys in.**

4. Waarom maak u van die dienste van 'n belastingpraktisyn ten opsigte van die/u besigheid gebruik? *Dui asseblief **alle** redes aan wat op u van toepassing is.*

Gebrek aan tyd.	<b>1</b>
Om die belastingaanspreeklikheid tot 'n minimum te beperk.	<b>2</b>
Gebrek aan eie kundigheid en/of opgeleide personeel.	<b>3</b>
Om die kans te verminder om deur die Suid-Afrikaanse Inkomstediens (SAID) ondersoek te word.	<b>4</b>
Om 'n akkurate belastingopgawe in te dien.	<b>5</b>
Dit is goedkoper as om dit intern te doen.	<b>6</b>
Ander. <i>Spesifiseer asseblief hieronder.</i> _____ _____	<b>7</b>

Slegs vir kantoorgebruik	
V2	<input type="checkbox"/>
V3	<input type="checkbox"/>
V4	<input type="checkbox"/>
V5	<input type="checkbox"/>
V6	<input type="checkbox"/>
V7	<input type="checkbox"/>
V8	<input type="checkbox"/>



5. Sal u met u belastingpraktisyn (“hy”) **saamstem** indien hy die volgende advies ten opsigte van die/u besigheid in die gevalle hieronder aangedui, lewer? (Die gevalle verwys nie na u persoonlike belastingsake nie).

	Ja, definitief	Miskien	Miskien nie	Nee, definitief nie	Slegs vir kantoor-gebruik
5.1 Aanvaar daar is <b>geen duidelike gesag</b> in die Inkomstebelastingwet (“Wet”) of enige interpretasie daarvan of ’n sekere <b>inkomste</b> op u opgawe ingesluit moet word nie. U belastingpraktisyn adviseer:					
5.1.1 Om die inkomste <b>in te sluit</b> .	1	2	3	4	V9 <input type="checkbox"/>
5.1.1.1 Sal u voortgaan om van sy dienste a.g.v. die bogenoemde advies gebruik te maak?	1	2	3	4	V10 <input type="checkbox"/>
5.1.2 Om die inkomste <b>nie in te sluit nie</b> .	1	2	3	4	V11 <input type="checkbox"/>
5.1.2.1 Sal u voortgaan om van sy dienste a.g.v. die bogenoemde advies gebruik te maak?	1	2	3	4	V12 <input type="checkbox"/>
5.2 Aanvaar daar is <b>geen duidelike gesag</b> in die Wet of enige interpretasie daarvan of ’n sekere <b>uitgawe</b> op u opgawe aftrekbaar is nie. U belastingpraktisyn adviseer:					
5.2.1 Om <b>nie</b> die uitgawe as ’n <b>afrekkings te eis nie</b> .	1	2	3	4	V13 <input type="checkbox"/>
5.2.1.1 Sal u voortgaan om van sy dienste a.g.v. die bogenoemde advies gebruik te maak?	1	2	3	4	V14 <input type="checkbox"/>
5.2.2 Om die uitgawe as ’n <b>afrekkings te eis</b> .	1	2	3	4	V15 <input type="checkbox"/>
5.2.2.1 Sal u voortgaan om van sy dienste a.g.v. die bogenoemde advies gebruik te maak?	1	2	3	4	V16 <input type="checkbox"/>
5.3 ’n <b>Uitgawe</b> wat in ’n <b>vorige</b> belastingjaar afgetrek moes gewees het, was <b>foutiewelik uitgelaat</b> . U belastingpraktisyn adviseer: Om nie die opgawe <b>te laat heropen nie</b> (wat die regte handeling sou wees), maar om dit in die <b>huidige belastingjaar as ’n afrekkings te eis</b> .	1	2	3	4	V17 <input type="checkbox"/>
5.4 ’n <b>Inkomste</b> wat u ontvang en toegeval het gedurende ’n <b>vorige</b> belastingjaar was <b>foutiewelik nie ingesluit nie</b> . U belastingpraktisyn adviseer: Om nie die opgawe <b>te laat heropen nie</b> (wat die regte handeling sou wees), maar om dit in die <b>huidige belastingjaar in te sluit</b> .	1	2	3	4	V18 <input type="checkbox"/>

6. Indien u in enige geval a.g.v. etiese of tegniese redes van mening verskil ten opsigte van die advies van ’n belastingpraktisyn, sou u voortgaan om van hom gebruik te maak?

<b>Ja</b>	<b>1</b>
<b>Nee</b>	<b>2</b>
<b>Onseker</b>	<b>3</b>

Slegs vir kantoor-gebruik V19 <input type="checkbox"/>
---

7. Indien u “Ja” of “Nee” in 6 hierbo geantwoord het, staaf asseblief u antwoord deur ’n rede of redes te verstrek.

7.1 \_\_\_\_\_

7.2 \_\_\_\_\_

7.3 \_\_\_\_\_

8. Watter tipe belastingadvies verkies u van ’n belastingpraktisyn in die algemeen?

- **Konserwatiewe advies**, *d.w.s. advies wat maklik ingevolge die Inkomstebelastingwet of enige interpretasie daarvan gemotiveer kan word sou die SAID dit bevraagteken; of*
- **Aggressiewe advies**, *d.w.s. advies wat tot die laagste moontlike belastingaanspreeklikheid lei, maar wat ’n kleiner redelike waarskynlikheid van geregtelike sukses sal hê sou die SAID dit bevraagteken. Navorsing het getoon dat die realistiese waarskynlikheid in hierdie geval op ’n een-uit-drie kans van geregtelike sukses dui. Let asseblief daarop dat aggressiewe belastingadvies nie na belastingontduiking verwys nie.*

<b>Konserwatiewe advies</b>	<b>1</b>
<b>Aggressiewe advies</b>	<b>2</b>

Slegs vir  
kantoorgebruik  
V20

9. Staaf asseblief u voorkeur vir konserwatiewe of aggressiewe advies in 8 hierbo deur ’n rede of redes te verstrek.

9.1 \_\_\_\_\_

9.2 \_\_\_\_\_

9.3 \_\_\_\_\_

**Dankie vir die invul van die vraelys.  
Ons waardeer u ondersteuning.**