

CHAPTER 4: THE PERCEIVED TAX BURDEN

4.1 INTRODUCTION

The objective of this study is to develop a conceptual framework that can be used to evaluate the tax burden of individual taxpayers in South Africa. As has already been explained in Chapter 2, the tax burden can be evaluated objectively by looking at the actual taxes imposed on a taxpayer by government, but it is also important to evaluate the tax burden as it is subjectively perceived by taxpayers. The attitudes of taxpayers towards their government and taxes may be influenced by the number of official taxes imposed on them and the amount by which they are taxed, but their attitude may also be influenced by how they perceive their tax burdens (Hundsdoerfer *et al.*, 2010:6; Kirchler, 2007:49). The importance of taking the construct of the perceived tax burden into account when tax burdens are evaluated is also stressed by Fochmann *et al.* (2010:2), who argue that the tax burden as perceived by individuals may be vastly different from their real or effective tax burden.

To ensure that the conceptual framework developed in this study incorporates all the relevant aspects required for evaluating the tax burden as perceived by individual taxpayers in South Africa, the construct of the **perceived tax burden** is defined in this chapter on the basis of an analysis of the relevant literature. As this study is concerned with the individual taxpayer in South Africa, the analysis of the perceived tax burden is followed by an analysis that specifically relates to the tax burden as perceived by individual taxpayers in South Africa.

4.2 THE PERCEIVED TAX BURDEN AS A CONSTRUCT

The Beatles, the famous British band from Liverpool, satirise the way people perceive the tax burden in the lyrics of their hit song 'Taxman' (Harrison, 1966):

Should five per cent appear too small,
Be thankful I don't take it all.
'Cause I'm the taxman,
Yeah, I'm the taxman.

(if you drive a car, car;) – I'll tax the street;
(if you try to sit, sit;) – I'll tax your seat;
(if you get too cold, cold;) – I'll tax the heat;
(if you take a walk, walk;) – I'll tax your feet.

The lyrics suggest that people might perceive the tax burden in a very different way from the way it is normally interpreted if one were to refer to the imposed tax burden from only the legal, administrative and economic perspectives. Lewis (1982:16) comments that '[t]here may well be a vast difference between the actual preferences of taxpayers and those that theoreticians and policy-makers have identified'. How individual taxpayers perceive the tax burden is a concept central to the main purpose of the current study. Taxpayers' views and experience of their tax burden may differ from the tax burden imposed and measured by government (Fochmann *et al.*, 2010:2).

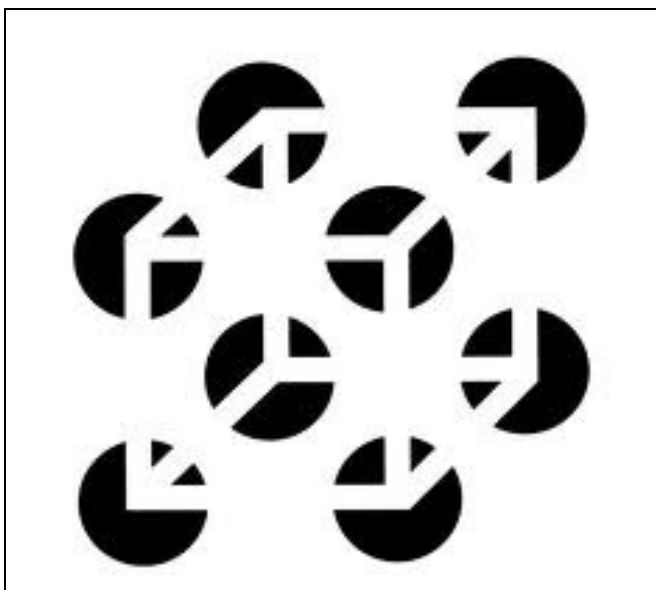
In order to enhance understanding of the construct of the perceived tax burden, it is important to clarify what is meant by 'perceive'. The verb 'to perceive' is defined in the *Oxford Dictionary and Thesaurus* (2009:677) as '[to] understand or interpret something in a particular way'. The *Cambridge Advanced Learner's Dictionary* (2008:1053) defines 'perceive' as '[to] to come to an opinion about something or have a belief about something'.

People's perceptions are subjective and are influenced by their culture, language, gender, and various other factors (Lumsden, Lumsden & Wiethoff, 2010:92; Robbins, 2001:122-124). Lumsden *et al.* (2010:89-92) acknowledge

that people's perceptions are influenced by three main factors. The first factor is that people perceive selectively and that their needs, drives, motives, wants and experiences may prevent them from seeing something that is unacceptable or unknown to them. The second factor is that people's background affects their perceptions. Their culture, language, gender and previous experiences all play a role in creating their perceptions about something. The last factor is that people multiply their misperceptions regarding other people. This means that people cannot really ascertain how another person interprets or experiences something. In this regard, Katona (1963:3) explains that both people's perceptions of their environment and their behaviour are shaped by their attitudes, motives and frame of reference. Kirchner (2007:192), citing Lewis (1978), suggests that people's attitudes, judgements and behavioural intentions are more affected by what they think than by what actually is. Lumsden *et al.* (2010:92) argue that perception is the 'way people do – or do not – pay attention to a stimulus and how they interpret that stimulus for themselves'.

Another way of demonstrating people's perceptions is to refer to an illustration such as the Necker cube in the Figure 2 below.

Figure 2: The subjective Necker cube



Source: Bradley and Petry (1977:254)

A cube can be seen overlying a white surface and eight black discs with illusory contours corresponding to the bars of the cube extending between the discs. The illusory bars of the cube disappear when the discs are seen as 'holes' in an interposing surface through which the corners of a partially occluded cube are viewed; curved subjective contours are then seen demarcating the interior edges of the 'holes' (Bradley & Petry, 1977:254).

The verb 'to perceive' is synonymous with the verbs 'to estimate' and 'to regard' something (*Oxford Dictionary and Thesaurus*, 2009:677). To 'regard' something means to think of it in a particular way (*Oxford Dictionary and Thesaurus*, 2009:774). To 'estimate' something means '[to] guess the cost, size, value, etc. of something' (*Cambridge Advanced Learner's Dictionary*, 2008:478). For the purposes of this study, the term 'perceive' must be interpreted to refer to how taxpayers **estimate** and **regard** their tax burdens.

Lavin, Epping and Davies (2004:162) claim that

...policymakers must study the individual circumstances of the taxpayers in question. Income levels and source, family and employment status, education, gender and age are just a few of the numerous factors that can influence how the tax law impacts citizens.

Taxes are an inevitable part of life and usually have a serious impact on taxpayers' economic spending or saving abilities. Throughout history, tax was a factor in both the prosperity and the decline of nations. Even if governments do not realise or admit to it, taxes are powerful stimuli that can provoke people – and angry taxpayers are a critical threat to governments that institute oppressive taxes (Adams, 1993:xvii).

In the United States, in the Supreme Court case of *McCulloch v. Maryland* 17 U.S. (4 Wheat.) 316, 4 L.Ed. 579 (1819), Chief Justice Marshall said that 'the power to tax involves the power to destroy'. Similarly, Head (1993:3) warns: 'Single-minded pursuit of short-term political benefits or sectional interest under a system of majority voting will not produce meaningful or durable reform.' These

two comments strengthen the argument that although a government may need taxes to fulfil its functions, it also needs to consider how taxes affect taxpayers' tax burdens before it formulates policies that can be damaging to both the government and the taxpayers in the long term.

The way that taxpayers perceive the tax burden plays a very important role in taxpayers' attitudes towards a government's tax policies and administration. For instance, in 1969, in the United States, the public's perception that some of the wealthy did not pay tax was supported by evidence regarding the use of tax shelters, and this in turn led to reforms in United States tax legislation (McLure & Zodrow, 1994:206). The attitude of taxpayers is often also expressed in their willingness or unwillingness to comply with tax legislation. If there is a perception that individual taxpayers with a certain level of income pay more tax than other taxpayers at the same income level, tax evasion is likely to increase (Kirchler, 2007:194).

In order to understand taxpayers' economic and other behavioural manifestations, it is important to study subjective variables. Studying the attitudes, motives and expectations of taxpayers may contribute to an understanding of taxpayers' economic spending and saving patterns, as well as their compliance with tax legislation (Katona, 1963:3). Various studies have been concerned with the perceived tax burden (Blaufus *et al.*, 2010; Dollery & Worthington, 1996; Fochmann *et al.*, 2010; Fuji & Hawley, 1988; Hundsdoerfer *et al.*, 2010; Lavin *et al.*, 2004; Pommerehne & Schneider, 1978; Roberts & Hide, 1994; Rupert, Fischer & Carol, 1995; Vogel, 1974). These studies generally refer to aspects such as taxpayers' estimation of their tax burdens, and taxpayers' perceptions of the tax burden, generally commenting on the fairness of the tax burden, the complexity of taxes and the benefits received in exchange for paying taxes. These studies can be broadly categorised as studies that focus on taxpayers' **estimation** of their tax burdens (the **fiscal illusion**) and studies that focus on the **perceptions** of taxpayers of their tax burden (their **fiscal perception**), as explained by Wagner (1976:47-49). These categories, for the

purposes of this study, are referred to as the **fiscal illusion of taxpayers** and the **fiscal perception of taxpayers**.

4.2.1 Fiscal illusion of taxpayers

The accuracy of taxpayers' estimation of their real tax burdens is a popular topic in tax research literature. The perceived tax burden, based on taxpayers' estimation of the amount of taxes, or the tax rate, may differ significantly from the actual imposed tax burden. This phenomenon of the difference between the estimated and the imposed tax burden is referred to as the **fiscal illusion** (Da Empoli, 2002:378-381; Mourão, 2008:55; Oates, 1988:65; Pommerehne & Schneider, 1978:381; Wagner, 1976:47-49).

The more substantial taxpayers' misperceptions of their tax burden, the more widespread the fiscal illusion in a community will be (Tyran & Sausgruber, 2000:1). Importantly, the concept of a fiscal illusion suggests that a fiscal illusion is caused mainly by relatively invisible indirect taxes rather than by more visible direct taxes (Tyran & Sausgruber, 2000:1). This phenomenon is known as the 'Mill Hypothesis', referring to John Stuart Mill [1848], which imply that people frequently underestimate their tax burdens due to hidden taxes (Mill, 1994:237, Sausgruber & Tyran, 2005:39). This hypothesis by Mill has been confirmed by a number of studies (Blaufus *et al.*, 2010:5; Dollery & Worthington, 1996:261-262; Sausgruber & Tyran, 2005; Tyran & Sausgruber, 2000:1).

The phenomenon of the fiscal illusion, which refers to taxpayers' estimates of their tax burden, is an important indicator of how taxpayers perceive their tax burden. Therefore the fiscal illusion is an important construct to include in the conceptual framework developed in this study for evaluating the tax burden as perceived by individuals as taxpayers.

4.2.2 Fiscal perceptions of taxpayers

Fiscal perception is one of the consequences of the phenomenal realm of the fiscal illusion and it can also be influenced by the expectations that taxpayers hold (Lewis, 1982:4; Wagner, 1976:48-49). As Potgieter (2011:38) explains, our expectations have a strong influence on our perceptions in life. One person cannot really fathom how another person perceives something (Robbins, 2001:122-124). Such insights suggest that a taxpayer's beliefs about the tax burden may be distorted by the person's economic self-interest. Liberals tend to overestimate the poor's tax burden, while conservatives tend to underestimate the poor's tax burden (Williamson, 1976:23). For instance, the issue of what is 'fair' relies heavily on individual value judgements (Slemrod & Bakija, 1996:14-15). Differences in probability perceptions and the behaviour of individuals arise from their knowledge and personal experience (base rate theory) and from the explicitness of a scenario (support theory) (Pforsich, Gill & Sanders, 2010:4; Tversky & Koehler, 2002:441; Weber & Hilton, 1990:781). Taxpayers' subjective knowledge and mental concepts of tax influence their judgements, evaluations, perceptions of fairness and willingness to comply with tax law. This interpretation by taxpayers of the tax burden is important in understanding why taxpayers behave in the ways that they do (Kirchler, 2007:31).

Taxpayers' fiscal perceptions are a popular topic for research and various other debates. From research and other references found in the literature on the perceptions of taxpayers, it is possible to assume that taxpayers' fiscal perceptions generally originate from factors such as the following:

- the **fairness of taxes** (Davidson, 2004; Hite & Roberts, 1991; Hundsdorfer *et al.*, 2010; McClellan, 2003; Roberts & Hite, 1994; Slemrod & Bakija, 1996; Vogel, 1974; Williamson, 1976);
- the **complexity of taxes** (Blaufus *et al.*, 2010; Fochmann *et al.*, 2010; Lavin *et al.*, 2004); and
- the **taxpayer-government exchange** (Dollery & Worthington, 1996; Hanousek & Palda, 2004; Pommerehner & Schneider, 1978; Vermeend *et al.*, 2008; Vogel, 1974).

4.2.2.1 Fairness of taxes

The first maxim of Adam Smith ([1776] 2003:1231) deals with equity,¹²⁰ which is also referred to as the fairness of taxes¹²¹ (Jones & Rhoades-Catanach, 2010:32; Musgrave & Musgrave, 1980:235; Steenekamp, 2012:166-167). Fair and uncomplicated tax policies are necessary for the public to accept, be aware of and have confidence in the tax system (Head, 1993:4; Vermeend *et al.*, 2008:13). The issues of justice and fairness are intrinsically central to tax policy formulation (Green, 1993:87; Head, 1993:3). Countries that regulate fairness, provide effective security, invest in infrastructure and support education are likely to have a positive economy (McClellan, 2003:44).

The requirement that the distribution of tax payments must be 'fair' is a very old demand, and is originally linked to the concept of the ability to pay: 'A man is not rich, because he pays largely; but he is able to pay largely, because he is rich' (Say, 1821:345). Avoiding arbitrariness in taxation was one of the early objectives of governments. This objective gave rise to an alternative theory to the one of ability to pay, namely the benefits theory (Jones & Rhoades-Catanach, 2010:32; Musgrave, 1959:62; Stamp, 1921:6-7; Steenekamp, 2012:167). The benefits theory posits that taxes must be paid in accordance with the benefits received, and not the ability to pay.

The concept of a 'fair tax' is defined as having two dimensions, namely horizontal fairness (also commonly referred to as horizontal equity) and vertical fairness (also commonly referred to as vertical equity) (Gildenhuis, 1989:274-275; Jones & Rhoades-Catanach, 2010:32). Horizontal fairness is based on the equal tax treatment of those with similar circumstances, for instance, a comparison of income after taking into account factors such as marital status, family size and

¹²⁰ In the words of Smith ([1776] 2003:1231), "The subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state".

¹²¹ The present study uses the terms 'fairness of taxes' instead of the term 'equity' in this context.

medical expenses. Vertical fairness, by contrast, is based on the tax treatment of those with dissimilar circumstances (Aaron & Boskin, 1980:4; Feldstein, 1976:82; Head, 1993:7; Jones & Rhoades-Catanach, 2010:32-33; McLure & Zodrow, 1994:168; Salanié, 2003:59; Steenekamp, 2012:169).

Income is the most widely used criterion to measure the relative economic positions of citizens (Musgrave, 1959:20). It is important to ensure that, aside from vertical fairness, horizontal fairness is also achieved between people in equal positions.

The use of income as a criterion for the fairness of taxes inherently creates a problem in the design of tax systems. The variety of forms and channels by which people may receive their income differ even between people in equal economic positions (Musgrave, 1959:20). Tax burdens are apportioned between individuals or classes according to their presumed capacity or ability to pay, but the problem is how this capacity or ability to pay is measured to ensure fairness (Hite & Roberts, 1991:47; Seligman, 1914:5). Asking only the question of how large a person's income is may not be adequate to measure the person's ability to pay. This quantitative question is complicated by aspects such as the period in which this income is received; whether it is pure income or only the realisation of capital; whether it is earned income or is taken from the taxpayer's reserves; whether the person can spend all the income personally or whether he or she has a family that must also be provided for; and similar questions (Stamp, 1921:14-15).

It is also important to mention that although the maxim of fairness is widely accepted as one of the requirements for good tax policy, to ensure fairness amongst citizens in a given country, there are still vast differences that need to be taken into account between the economic conditions, cultures and political environments of citizens in different countries. For instance, in underdeveloped countries, governments generally aspire to improve the economy and increase stability to ensure dignity and political freedom for the citizens (Heller, [1954] 1964:3). In advanced economies, inequalities of wealth and income have been

reduced, but many less advanced economies are characterised by extremes of wealth and poverty, making a compelling case for a redistribution of resources by government (Heller, [1954] 1964:21).

The concept of the fairness of a tax is an important contributor to taxpayers' perceptions of their tax burden, and is generally found in studies on taxpayers' perceptions (Davidson, 2004; Hite & Roberts, 1991; Hundsdorfer *et al.*, 2010; McClellan, 2003; Roberts & Hite, 1994; Slemrod & Bakija, 1996; Vogel, 1974; Williamson, 1976). This concept of fairness revolves around one or more references to comparisons between rich and poor, between male and female, between geographic areas, between generations and between individual taxpayers and corporate taxpayers. In the United States, the federal income tax system is regarded as 'unfair' by quite a number of United States citizens. One reason for this is that it is believed that because the tax system is so complicated, it is 'unfair' and that it only benefits a few 'rich people' (Jones & Rhoades-Catanach, 2010:37). Public opinion polls demonstrate that the majority of United States taxpayers are of the opinion that income tax is not equitable, and that there is a perception that the 'rich' are not paying their fair share (Hite & Roberts, 1991:48; McClellan, 2003:14; Slemrod & Bakija, 1996:5; Vermeend *et al.*, 2008:14). The other side of the coin is the perception that 'wealthy' people in the United States are the hardest hit by taxes (Colvin, 2004:52). Another study indicates that the respondents from the higher income group believe that poverty is due to unfavourable personal attributes, as these respondents argue that the poor do not work as hard as the rich, and these respondents therefore believe that too much tax money is spent on welfare programmes (Williamson, 1976:10). There is a myth in Australia that taxes only appear to be high, and that, because of tax avoidance, the rich do not actually pay much tax (Davidson, 2004:31). This perception has led to the opinion that progressive taxes are fair and that the rich can afford to pay more taxes (Davidson, 2004:31).

It is possible to assume from the discussion above that the concept of the fairness of taxes is an important concept which influences how taxpayers perceive their tax burden. Therefore the fairness of taxes is an important issue to

include in the conceptual framework developed in this study for evaluating the tax burden as perceived by individuals as taxpayers.

4.2.2.2 *Complexity of taxes*

Discussions concerning the complexity of tax systems are also commonly found in the literature on the perceptions and experiences of taxpayers (Blaufus *et al.*, 2010; Fochmann *et al.*, 2010; Lavin *et al.*, 2004; Slemrod & Bakija, 1996). In the United States, around the time when tax returns have to be submitted, taxpayers tend to engage in debates around the perceived complexity of the tax system (Lavin *et al.*, 2004:162). Results from a number of studies indicate that taxpayers generally consider fairness to be the most important aspect of a tax system, but the simplicity, or conversely, the complexity, of taxes is also an important factor for taxpayers (Slemrod & Bakija, 1996:2-3). It emerged that the complexity of taxes, together with the frequency of legislative changes, are strong determinants of the tax compliance burden placed upon taxpayers (Evans, 2003:72).

Ruling political parties can have a critical impact on tax policies, and their influence may lead to complicated tax legislation and systems. This in turn undermines lawmakers' objective of simplicity of the law (Vermeend *et al.*, 2008:12). Political debates often only centre on how taxes affect the economy – these debates very rarely look at the process of tax compliance by taxpayers (Slemrod & Bakija, 1996:4). Hence, it is important that taxpayers' experience of the process of complying with tax legislation be considered when evaluating the tax burden of an individual as a taxpayer.

The second, third and fourth maxims of Adam Smith ([1776] 2003:1231) deal with the compliance with tax laws of a country, in essence with the complexity of tax.

The second maxim deals with the requirement that the tax must be certain and not arbitrary. The time, manner and the quantity to be paid must be clear to taxpayers and other persons (Smith, [1776] 2003:1231). Certainty about and the

non-arbitrariness of taxes must be achieved by defining taxes clearly so that the amount of tax to be paid and time-frame in which it is to be paid are easily understood by the taxpayers (Salanié, 2003:59). Complex tax systems are difficult to enforce and are excessively harmful to the economy (Slemrod & Bakija, 1996:2). Taxes that are certain not only ensure a stable source of income for government, but also provide taxpayers with a degree of certainty regarding their tax liability (Pope *et al.*, 2003:1-13).

Smith's third maxim requires tax to be levied on the taxpayer in a manner that makes it convenient for the taxpayer to pay the tax (Smith, [1776] 2003:1231). A good tax from the government's point of view must also be convenient to administer and it must be collected and administered in such a way that most taxpayers understand these processes. From a taxpayer's point of view, a tax must be convenient to pay, in the sense that taxpayers must be able to compute their taxes with reasonable certainty and not devote unnecessary time to maintaining records, and to compliance considerations (such as tax returns, the payment of taxes, and so on) (Jones & Rhoades-Catanach, 2010:28; Pope *et al.*, 2003:1-13; Salanié, 2003:59).

Smith's last maxim requires a tax to be administered in an economical manner that does not create an additional tax burden on the taxpayer (Smith, [1776] 2003:1231). In other words, taxes must have low costs, both from an administrative viewpoint and the inefficiencies they cause in the economy of a country (Jones & Rhoades-Catanach, 2010:28; Salanié, 2003:59). From the government's point of view, taxes must be simple to administer and the cost of collecting and enforcing taxes must be reasonable in relation to the total tax (Jones & Rhoades-Catanach, 2010:28). For taxpayers, the cost of compliance and administration must not be overly demanding on their resources (McLure & Zodrow, 1994:168). If the tax compliance burden is large and wasteful, it may anger taxpayers and lead to a revolt by them (Salanié, 2003:59; Slemrod & Bakija, 1996:2-3).

These last three maxims all refer to the process of complying with tax laws as the process is experienced by the taxpayer. Tax law that is complicated, difficult to administer and expensive to comply with may affect a taxpayer's experience of the tax burden (Blaufus, Eichfelder & Hundsdorfer, 2011:1). Complicated tax systems and difficult administration requirements force taxpayers to seek help from tax practitioners to be able to understand and comply with tax law (Kirchler, 2007:167). This in turn may lead to expenses for the taxpayer that could be interpreted as an additional tax, affecting how the taxpayer perceives the tax burden. Blaufus *et al.* (2011:1) also suggest that taxpayers may interpret expenses they incur to comply with complicated taxes as an additional 'tax effort' that reduces the economic spending ability of the taxpayers.

The complexity of modern tax systems and the effect thereof on the tax burden were found to be some of the main factors that gave rise to an increase in research related to the cost of tax compliance and the cost of tax administration¹²² (Slemrod & Blumenthal, 1996:1; Sandford, 2000:126; Tran-Nam, Evans & Walpole, 2000:230). Hence, this also emphasises the notion that the complexity of taxes and the effect of that complexity on the perceived tax burden of individual taxpayers are important constructs for consideration in a conceptual framework for evaluating the tax burden of individual taxpayers in South Africa.

4.2.2.3 *The taxpayer-government exchange*

Another factor that is often mentioned in studies on the perceptions and opinions of taxpayers is that of public service delivery by government. In a survey in Hungary, Poland, the Czech Republic and Slovakia, strong evidence was found that citizens try to avoid taxes if they perceive the quality of government services as not justifying the taxes that they are required to pay (Hanousek & Palda, 2004:237). According to Slemrod and Bakija (1996:2), when there was a perception in the United States that government was wasting money, many

¹²² Together, the administrative cost and compliance cost are referred to as 'operating costs' (Sandford, 2000:126).

voters wanted government to reduce the tax burden by reducing the size of the government. In South Africa, research also indicates that the perceived decline in the standard of public services, especially in health and education, together with the high tax levels, are the main reason for skilled people's emigration from South Africa (HSRC, 2004).

Spicer and Lundstedt (1976:296) argue that there is an exchange relationship between taxpayers and government, in the sense that taxpayers exchange some of their economic spending ability for public services from government. The concept of taxpayers' expectations in terms of government's service delivery in exchange for taxes is labelled the **taxpayer-government exchange** (Wenzel, 2003:53).

Historically, the function of governments has primarily focused on the protection of a country and its citizens. This role was gradually extended to the provision of other services and to other functions (Lewis, 1970:5; McClellan, 2003:13). To be able to understand the effect this shift may have on tax burdens as perceived by taxpayers, it is necessary to explain the functions of governments in relation to taxpayers.

The functions of governments can be divided into three main groups, each with its own unique objectives. These three functions are based on the original distinction made by Musgrave (1959:5) and are widely acknowledged in public finance literature (Black, 2012:29-31; Clossen, 1988:127; Green, 1993:87; Salanié, 2003:8; Vermeend *et al.*, 2008:12). These three functions can be broadly summarised as the **traditional** function, the **distributional** function and the **stabilisation** function.

The **traditional function** is considered to be the classic function of government. There was a time when the provision of public goods and services was considered to be the only function of government (Musgrave, 1959:17). This function of government has to do with the satisfaction of the public need for certain goods and services. These goods and services must be paid for from the

revenue of government and must be supplied free of direct charge to the user. The cost of these public goods and services must be covered by the taxes imposed by a government on the citizens of the country concerned (Musgrave, 1959:12-13).

Adam Smith ([1776] 2003:747-875) explains that any government has specific duties towards its subjects, which all refer to the traditional function of government. The first duty is that of protection against violence and invasion from other independent societies. The second duty is to protect every member of society from injustice or oppression by other members of society. The first and second duties relate to the maintenance of law and order and are often considered the primary functions of government (Lewis, 1970:5; McClellan, 2003:13).

The third duty is that of erecting and maintaining public institutions works necessary for the greater benefit of the society, but which are too expensive for individuals to erect and maintain. The third duty relates to the supply of goods and services, for instance, roads, harbours, airports, schools, healthcare, and fire protection. A need that is not specifically mentioned by Smith, but that can be added to the other three duties, is the need for government to influence the use and conservation of resources (Lewis, 1970:5; McClellan, 2003:13).

An important aspect that needs to be considered under this traditional function is the question of what taxpayers expect in return for the taxes that they pay. Sometimes taxpayers expect to receive benefits from government that correlate with the amount of taxes that they pay. In this regard, in Australia, a study found that households in the top two quintiles pay more in tax than they receive in benefits (Davidson, 2004:33). This aspect of expecting something in return for taxes is discussed by Jones and Rhoades-Catanach (2010:4), who cite Judge Stone in the Supreme Court case of *Carmichael v Southern Coal & Coke Co.*, 301 U.S. 495, 522 (1937). Judge Stone said:

A tax is not an assessment of benefits. It is ...a means of distributing the burden of the cost of government. The only benefit to which the taxpayer

is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organised society, established and safeguarded by the devotion of taxes to public benefit.

The judge's view is only one side of the coin. Taxpayers in reality do have expectations regarding benefits in return for the taxes they pay. The difference between the expected and actual benefits received could be a major contributing factor to the way in which the tax burden is perceived by individuals as taxpayers (Dollery & Worthington, 1996:261-262; McCulloch, [1845] 2007:148).

The traditional service function of government is perhaps the one that is most frequently used by taxpayers to criticise the performance, or lack thereof, of government. Taxpayers may form their judgement of the quality of a government's services by comparing what they receive from their government to what they perceive they should receive (Haywood-Farmer, 1988:19). Taxpayers' disapproval of government spending, or their satisfaction with government services, are two important factors influencing people's willingness to comply with government policies (Dawkins, 2007:5; Green, 1993:88; Kirchler, 2007:167,94-195; Maroney, Rupert & Anderson, 1998:60-61; Spicer & Lundstedt, 1976:296).

Taxes are used to a large extent to fund the traditional function of government. Taxpayers are therefore within their rights to expect government to render certain public goods and services in terms of this traditional function. If taxpayers have a perception that their government is not rendering these expected services adequately, this will have an impact on how they perceive the tax burden. An example that clearly illustrates this is where a government does not use the allocated taxes to provide effective police services for protection. Citizens who believe that government is not protecting them may then pay private security companies for protection and interpret this payment as part of the tax burden. These 'perceived taxes' paid by the taxpayer will have a direct impact on the perceptions of taxpayers of the tax burden in a country. The way that taxpayers experience this traditional function of government is therefore essential to

consider if the tax burden as perceived by a taxpayer is measured and evaluated in a study.

The **distributional function** of a government deals mainly with inequalities in society. In modern economies, markets tend to create inequalities in the distribution of wealth and income amongst citizens of a country. This distribution depends on a number of factors, for instance, the laws of inheritance, the distribution of innate talents, educational opportunities, social mobility and market structures. One of government's functions is to address these inequalities. To do so, governments use various forms of taxes to alter these inequalities by reallocating resources between private citizens (Black, 2012:29-30; Green, 1993:88; Musgrave, 1959:17-22). This redistribution function assists in reducing the economic and political power held by the 'wealthy' and increasing socio-economic standards for the 'poor'. Governments can achieve this redistribution function, *inter alia*, by levying additional taxes on the wealthier members of society, specifically using progressive taxation and wealth taxes (Muller, 2010:38). This function of government is directly linked to the concept of the **fairness of taxes** (Black, 2012:30; Musgrave & Musgrave, 1980:7), which affects the way that a taxpayer perceives the division of the tax burden. Therefore the distribution function of government, and the effect it may have on the perceived tax burden, for the purposes of this study, is deemed to be inherently part of the fairness of taxes (see Section 4.2.2.1).

The **stabilisation function** of government differs from the traditional and distributional functions in the sense that this function is not concerned with the allocation of resources, but refers to government's macro-economic objectives. This function needs to maintain a high level of resource utilisation and stability in the economy (Musgrave, 1959:22). This function is important, because failure on the part of the private sector to realise the macro-economic objectives of a country makes it necessary for government to correct this failure by means of monetary and fiscal policy (Black, 2012:30-31). Such economic objectives include encouraging economic growth, maintaining reduced inflation, reducing unemployment, creating price stability, and promoting savings and investments.

Of these, reducing unemployment is usually governments' most important objective. Governments formulate tax policies according to these economic objectives (Lewis, 1970:10; Sandford, 1970:8; Vermeend *et al.*, 2008:1). Because it is a macro-economic issue (Black, 2012:30; Musgrave & Musgrave, 1980:13), the stabilisation function of government and the possible effects it may have on the tax burden of individuals as taxpayers fall beyond the scope of this study. For the purposes of this study, it was not necessary to analyse the stabilisation function of government, because this function does not affect the tax burden directly.

4.2.3 Summary

In summary, the tax burden as perceived by individual taxpayers can be evaluated by referring to the concept of **fiscal illusion** and the concept of **fiscal perception**, which consist of three important elements, namely the **fairness of taxes**, the **complexity of taxes** and the **taxpayer-government exchange**. The present research focuses on individual taxpayers in South Africa and it is therefore important to analyse these concepts, and related elements, of the perceived tax burden from a South African perspective.

4.3 THE PERCEIVED TAX BURDEN IN SOUTH AFRICA

The imposed tax burden may not necessarily reflect how taxpayers regard and estimate the tax burden, as Fochmann *et al.* (2010:2) explain. This situation is a real possibility for individual taxpayers in South Africa. A review of a few articles in the popular media (Hartley, 2009; Jooste, 2009; Theunissen, 2005) in South Africa suggest that people speculate about the tax burden in South Africa without any reference to concrete evidence from research to support, or refute, the substance of their speculations. As already mentioned above, research in South Africa related to the tax burden of individual taxpayers has focused mainly on determining taxpayers' perceptions and attitudes towards tax (Oberholzer, 2008; HSRC, 2000, 2004), but has not explored the concepts of the fiscal illusion and the fiscal perceptions of taxpayers in relation to the imposed tax burden in South

Africa. Both these concepts are important to include in the evaluation of the tax burden of individuals as taxpayers in South Africa, and therefore it is necessary to refer briefly to each of them.

4.3.1 Fiscal illusion of taxpayers in South Africa

The fiscal illusion, in short, refers to the phenomenon of the difference between a taxpayer's estimation of the tax burden and the real imposed tax burden. The estimation of the imposed tax burden is a popular topic for debate, especially in the South African media, where people commonly speculate about the imposed tax burden of individual taxpayers. Van Tonder (2007:1), quoting Mike Schüssler, commented that the tax burden in South Africa had increased, although the Minister of Finance has provided income tax relief to individuals over the past decade. Carolyn Freeman, a director of International Executive Services at KPMG, claimed that individuals in South Africa remain amongst the highest taxed in the world (Jooste, 2009:19).

The South African government has historically used a diverse range of imposts to raise revenue, and in the modern tax environment in South Africa, this is still the case.¹²³ The discussions from the previous section may be an indication that, as with the modern tax systems in other countries, there is a strong possibility that South African taxpayers could be unaware of the total number of taxes imposed on them by government. It is therefore important to include the concept of the fiscal illusion in South Africa in the conceptual framework developed in this study in order to be able to assess the effect this illusion may have on the tax burden as perceived by taxpayers in the country. The importance of including the fiscal illusion in conceptual frameworks is also stressed by Amusa, Mabunda and Mabugu (2008:2), who argue that it is important to explore the fiscal illusion in South Africa, because the fiscal illusion is likely to become an important theme in research geared towards understanding local public choices.

¹²³ See Section 3.2 and Table 69 in Section 3.27 of this study.

4.3.2 Fiscal perceptions of taxpayers in South Africa

Studies on the perceptions of taxpayers in South Africa have touched on some issues relating to fiscal perception, but did not extend to research on the underlying factors that create people's fiscal perceptions. These underlying factors are important to explore, as they directly affect how taxpayers regard and estimate their tax burden. The main issues raised in prior studies relating to fiscal perceptions mainly concern the fair distribution of the tax burden, the complexity of tax systems, and the taxpayer-government exchange.

4.3.2.1 *Fairness of taxes in South Africa*

The fair distribution of the tax burden is a topic that has a bearing on the perceived tax burden of individuals as taxpayers. In a study on the perceptions of taxation, it was found that 63.08% of the respondents believed that rich people should pay a higher tax rate in South Africa (Oberholzer, 2008:102). In another study, the question was raised of whether poor people must pay tax (Steenekamp, 1994:220). Other studies focused on the distribution of the tax burden between males and females in South Africa (Shier, n.d.; Smith, 2000).

In South Africa, poverty and unemployment are arguably the most pressing problems in the economy, and society is characterised by extreme inequalities in the distribution of income (Van der Berg & Borat, 1999). Issues such as a lack of job opportunities, the historically skewed allocation of resources, under-nourishment in a large proportion of the population, inadequate housing, poor education for some and limited access to primary healthcare are all factors contributing to a need for government intervention by means of fiscal policy, amongst other methods (Calitz, 2012:5).

The concept of the 'fairness' of taxes is a hotly debated topic among economists, policy-makers, taxpayers, academics and others.¹²⁴ This is also true in South Africa, where the concept of the fairness of taxes is frequently mentioned in

¹²⁴ See Section 4.2.2.1.

studies relating to taxes (Dorasamy, 2011; Lieberman, 2001; Maroun, Turner & Sartorius, 2011). It is a critical aspect of how taxpayers perceive the tax burden. In order to evaluate the tax burden as perceived by the individual as a taxpayer in South Africa, it was thus important for this study to incorporate the concept of fairness in the conceptual framework developed in this study.

4.3.2.2 Complexity of taxes in South Africa

The complexity of taxes in the form of tax law, and the cost of compliance, are important factors that may influence the perceived tax burden. Tax law was considered to be complex by 37.69% of the participants in a local study on perceptions of taxation, while 24.62% expressed no opinion (Oberholzer, 2008:102). The cost of compliance for small businesses has also been the subject of a number of local studies (Coolidge & Ilic, 2009; FIAS, 2007; Smulders, 2006; Smulders & Stiglingh, 2008). Although similar studies have not yet been done for individuals as taxpayers, the effect on the tax burden is the same for all taxpayers in South Africa.

The complexity of tax laws may have an impact on the cost of compliance for individual taxpayers, and may be interpreted by them as an element of the tax burden, so that it affects their interpretation and experience of the tax burden.¹²⁵ It was therefore necessary, for the purposes of this study, to incorporate this element in the conceptual framework that was developed. If the element of the cost of compliance is incorporated into the conceptual framework, future research will be able to assess the effect of this perceived additional tax on the tax burden as perceived by taxpayers.

4.3.2.3 The taxpayer-government exchange in South Africa

The effective functioning of the government is arguably central to a discussion of the perceived tax burden in South Africa. Ernie Lai King, a respected tax practitioner, has stated that '[w]hen comparing what individual taxpayers pay

¹²⁵ See Section 4.2.2.2.

and what they get back in terms of State benefits – for example, health, education, security and pensions – the net individual tax rate in SA is quite high’ (cited by Jooste, 2009:19). Jooste (2009:19) also cites Stiaan Klue, chief executive of the South African Institute of Tax Practitioners, who claims that the overall ‘bang for buck’ is very poor in South Africa, when one looks at the results of government expenditure in terms of service delivery. Dawie Roodt, a well-known South African economist, echoed Klue’s sentiment, and argued that it is important for taxpayers to receive value for the taxes they pay (cited by Jooste, 2009:19). Theunissen (2006:57) refers to a study by Anthony Altbeker, a senior researcher at the Institute for Security Studies, who determined that in South Africa around R40 billion was spent on private security for the year ending July 2005, in stark contrast to the R30 billion allocated to public policing services in the 2006 budget year.

In terms of Schedule 4 and Schedule 5 of the South African Constitution (108 of 1996), taxpayers can expect to receive benefits from government in return for contributing to taxes, for instance, protection services, education services, transport services and health services. Trust in government to use the taxes imposed on taxpayers effectively to provide the services expected (rightfully) by taxpayers is an important factor that affects taxpayers’ decision to comply, or not comply, with tax legislation (Coolidge & Ilic, 2009:2; Fjeldstad, 2004:539). If taxpayers have a perception that the government does not provide these services effectively in return for the taxes citizens pay, it is possible that taxpayers may perceive private expenses relating to these services as an additional tax placed upon them indirectly by government. In South Africa, this assumption is a real possibility. The majority of respondents in a survey on the perceptions of taxpayers in South Africa indicated that they believed that waste and corruption in the South African government were very high, that a large portion of taxes was used by government for meaningless purposes, and that the benefits received in return for taxes were not reasonable (Oberholzer, 2008:102).

Support for this assumption is also found in the popular media. Numerous references are found in the media relating to taxpayers’ perceptions regarding

the taxpayer-government exchange (Altbeker, 2006:57; Dawkins, 2007:4; Gering 2011; Hartley, 2009:1; Jooste, 2009:16-17; Rademeyer, 2009; Stokes, 2011; Thys, 2010; Visser, 2007:21). Discussions in the media refer mainly to the delivery of public services by the South African government and centres around the argument that, although taxpayers have to pay taxes which government uses for specific public expenditure, the perceived ineffective service delivery by government gives rise to private expenditure to compensate for the ineffective services rendered by government. These debates frequently look at questions such as why citizens should pay taxes to finance things such as a police service, but should then also still need to pay private security services for protection, because the police service is ineffective in protecting the country's citizens; or why taxpayers should pay taxes towards public healthcare if public healthcare services are inadequate, and therefore taxpayers must also pay for private healthcare.

All these debates and discussions can be linked to the way in which taxpayers in South Africa perceive their tax burden in relation to government's responsibility. The debates around poor service delivery by government and the subsequent additional payments by citizens for similar private services may theoretically be an indication that individuals as taxpayers perceive these payments as an additional tax which increases their tax burden. It was therefore important for this study to incorporate the concept of the taxpayer-government exchange in the conceptual framework developed to evaluate the tax burden as perceived by individual taxpayers in South Africa.

4.3.3 Summary

The discussions, speculations, debates and studies in South Africa make it possible to conclude that the imposed tax burden may not necessarily reflect how individual taxpayers in South Africa perceive their tax burden, which may also be vastly different from how theoreticians and policy-makers interpret the tax burden, as Fochman *et al.* (2010:2) explain. Therefore, incorporating the concepts of fiscal illusion and fiscal perceptions in the conceptual framework

developed in the study is essential to be able to evaluate the tax burden as perceived by individual taxpayers in South Africa.

4.4 CONCLUSION

The discussion in Chapters 2, 3 and 4 provides a clear indication that it is important not only to evaluate the imposed tax burden of taxpayers, but also to consider the effect of other factors on how the tax burden is estimated and regarded by individuals as taxpayers (the perceived tax burden).

The **perceived tax burden** consists of taxpayers' estimates of their imposed tax burden, as well as taxpayers' perceptions of their tax burden. The perceived tax burden is a phenomenon that must be considered in order to make sense of, and comprehend, how taxpayers look at and judge the tax burden. The theoretical concepts of the **fiscal illusion**, **fair taxes**, the **complexity of tax systems**, and the **taxpayer-government exchange** are considered to be the main contributing factors that influence the way that taxpayers regard and estimate (perceive) their tax burden. These concepts are therefore vital to consider in evaluating the tax burden from a taxpayer's viewpoint. It is therefore important to investigate these concepts in a real-life context order to use them to build onto the theoretical constructs in the framework that have been identified thus far in the study and are included in the conceptual framework. The investigation into these constructs forms part of the research methodology and design set out in Chapter 6.

The theoretical constructs of the imposed tax burden and the perceived tax burden are important in a conceptual framework to evaluate the tax burden of individual taxpayers. Equally important is a platform from which to evaluate and compare the tax burden. Chapter 5 discusses a theoretical basis for evaluating the tax burden, and formulates a conceptual framework that can be used to evaluate the tax burden as perceived by individual taxpayers in South Africa.