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Tax compliance costs for the small business sector in South Africa — establishing a baseline

Sharon Smulders, Madeleing Stiglingh, Riel Franzsen and Lizelle Fletcher*

Abstract

This study is part of an international research project (across four countries) which is evaluating and comparing tax compliance costs affecting the small business sector. The primary objective of this empirical study was to measure the tax compliance costs of small businesses in South Africa and to establish a baseline against which future studies and enhancements to the tax system could be measured. The study also differentiated tax compliance activities from core accounting activities in order to identify the managerial benefits of tax compliance. It also investigated whether various South African small business tax concessions are perceived to be achieving their objective of relieving the tax compliance burden. The study, conducted by means of an electronic survey, provided plausible estimates proving that tax compliance costs as well as core accounting costs are regressive with respect to business size, with the compliance burden being heavier for smaller businesses. The perception that managerial benefits exist was also established for the first time in South Africa. Overall, small business tax concessions were perceived as being more complex than useful. A re-evaluation of these concessions or the introduction of a truly simplified tax system for small businesses is considered desirable.

1. INTRODUCTION

1.1 Background to the study

The single all-encompassing objective of the South African government's "New Growth Path" is employment creation (National Treasury, 2011:2). According to South Africa's Minister of Finance, employment creation will be the principal barometer of South Africa's progress in its aim to achieve a more inclusive and equitable economic future for the country (National Treasury, 2011:1). To achieve this objective, the government's aim is to create five million jobs over the next ten years and, in so doing, reduce the unemployment rate from 25% to 15% (National Treasury, 2011:39). The sector of the economy that will predominantly assist in achieving this objective is the small business sector (National Treasury, 2011:46).

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However, despite this critical role in the economy, this sector faces various challenges, one of them being a regulatory burden imposed by tax legislation (Strategic Business Partnerships for business growth in Africa (SBP), 2005:44; SBP, 2011:28). This plight of small businesses in South Africa with regard to taxation is confirmed in the following statement by one of the directors of the South African Black Entrepreneurs Forum:

“Overall, it is quite clear that our current [tax] system is biased against one of the most important sectors in the economy being small businesses. At a time where it is difficult for people to gain employment, they should be encouraged to start their own ventures and not be punished when they do.” (Qabaka, 2011:17).

This concern is echoed by the Small Business Project (2003:1), Abrie and Doussy (2006:1), the Foreign Investment Advisory Service of the World Bank Group (FIAS, 2007:1), Hassan (2011:1) and Retief (2011:2) who all concur that the tax system and its compliance requirements are a stumbling block to the growth of small businesses in South Africa.

The South African government is not oblivious to this dilemma. The following statement made in the 2005 budget speech by the then Minister of Finance, Mr Trevor Manuel, relating to small business and taxation, indicates governments’ acknowledgement of the problem:

“...we have directed attention this year at the costs and complexity for small businesses of the tax code, because there is compelling evidence that simplified arrangements can assist significantly in creating an environment conducive to enterprise development” (Manuel, 2005:28).

In 2005 the process of change in the South African Revenue Service (SARS) commenced. The intention was that these changes would assist small businesses in their start-up phase, reduce compliance costs and administrative complexity (red-tape), and include tax education and assistance (Manuel, 2005:1).

However, six years later, despite further tax relief offered to small business in South Africa in the 2011 budget speech (Gordhan, 2011:3), Retief (2011:1), the chairman of the South African Institute of Professional Accountants (SAIPA), points out that the relief was not enough and more needs to be done to push for a more equitable tax regime that enables growth for this sector. This sentiment is echoed by Hassan (2011:1), at that time the project director for tax of the South African Institute of Chartered Accountants (SAICA). Qabaka (2011:15) also has the following to say regarding small business tax incentives that have been introduced by the SARS since 2005 and the overall effect of the tax system on small businesses:

“While such incentives may have resulted in some limited relief, it is argued here that the actual structure of South Africa’s current tax system is so heavily biased against small businesses that any such relief is negligible”.

1.2 Need for the present study

Statements such as the above (made in 2011) might have merit, but have no value without statistical evidence validating them. Studies were conducted by FIAS in 2006 (FIAS, 2007) and by Govender and Citizen Surveys in 2007 (Govender & Citizen Surveys, 2008) to identify and measure the tax compliance costs for small businesses in South Africa. These studies found that tax compliance costs for small businesses were regressive. No recent follow up study has been conducted to determine whether the tax compliance costs are still regressive and if they have increased or decreased since 2006/7.

Furthermore, although the abovementioned two studies considered the tax compliance costs incurred by small businesses, they did not consider or take into account in their determination of the tax compliance costs all the activities (broken down into their various components) that are necessary for a business to be tax compliant; nor did they delve into the time taken to perform the core accounting functions (broken down into their various components) involved in running a business — which is essential in addressing the tax/accounting overlap which is regarded as one of the pitfalls in tax compliance cost research (Tran-Nam, 1999:161).

The concept of tax compliance benefits, which come in the form of cash flow, tax deductibility and managerial benefits (Sandford, Godwin & Hardwick, 1989; Tran-Nam, Evans, Walpole & Ritchie, 2000:232) is another consideration that was not addressed in the above two compliance cost studies.

The perception of the effectiveness of the small business tax concessions is also considered an important element for consideration in the measurement of tax compliance costs, as is highlighted by Qabaka (2011:15). A need therefore arises to evaluate the perceptions of the effectiveness of these concessions.

1.3 Objective of the study

The research objective of the study was the measurement of tax compliance costs for small businesses in South Africa. In fulfilling this objective, an evaluation of the gross tax compliance costs incurred by a small business in South Africa to meet its tax obligations was performed. An attempt was made to identify and measure the benefits (specifically managerial benefits) derived by small businesses in South Africa as a result of complying with tax obligations with the aim of establishing the net tax compliance costs (i.e. gross tax compliance costs less tax compliance benefits). To establish if the small business tax concessions are effective in reducing the level of compliance costs incurred by small businesses, an evaluation of the eligibility for,

adoption and usefulness and complexity of these concessions — as perceived by the respondents — was investigated.

This study will provide a baseline of tax compliance costs against which future studies and enhancements to the tax system could be measured. This study also forms part of an international tax compliance cost study across four different countries which, apart from South Africa, include Australia, Canada and the United Kingdom.

The remainder of the article will first describe the research methodology employed (section 2) and then define the terms used in the study (section 3). Thereafter, the empirical results will be presented (section 4), the conclusions documented (section 5), the need for future research highlighted (section 6) and acknowledgements for assistance with this study noted (section 7).

2. RESEARCH METHODOLOGY

2.1 Overall methodology employed

A deductive research approach was adopted using a survey strategy (Saunders, Lewis and Thornbill, 2007:119-122, 138). An empirical study was conducted collecting data from respondents by means of an electronic questionnaire distributed by the SARS, which was the measurement instrument in this study. The design of the electronic questionnaire (measuring instrument) was based on international best practice and utilised a common framework (adapted for South Africa) to ensure ultimate comparability in the international comparative study.

In order to detect weaknesses, not only in the design of the questionnaire but also in the procedures and protocols utilised during the data collection process (Cooper & Schindler, 2008:91), a pilot study was initiated on 17 March 2011 and completed on 3 April 2011. The pilot study was conducted in the same manner as envisaged for the final survey. Where possible, the recommendations made by local and international academics, and the World Bank international survey experts, were taken into consideration and adjusted where possible without jeopardising the international comparability. In addition to these comments, 28 responses from small businesses were received. This appears to be in line with the numbers contemplated by Cooper and Schindler (2008:91). These responses provided insight into potential questionnaire problems, as well as future analysis considerations. To the extent possible, the problems detected in the pilot study were corrected, thus ensuring that the final questionnaire was suitably adjusted to cater for the eventualities identified and to ensure that problems encountered did not occur again.

2.2 Population and response rate

The unit of analysis and population consisted of small businesses (turnover of R14 million or less) registered with SARS for which SARS had an e-mail address at the time the questionnaire was distributed. As the whole target population (as described above) was selected, no statistical sampling techniques were used.

The questionnaire was sent out to 88 057 small business taxpayers (Murugan, 2011a). Reminder e-mails were sent out during the survey period and there was a definite increase in the number of responses due to these reminders (Meintjes, 2011). The number of usable questionnaires received from the respondents amounted to 5 865, which represents a response rate of 6.7%. Although Saunders et al. (2007:358) indicated that internet based surveys are likely to have a response rate of 11% or lower, these response rates are considered rather low even for web surveys (Cook, Heath & Thompson, 2000:829; Dilmann, Phelps, Tortora, Swift, Kohrell, Berck & Messer, 2009:7, Shih & Fan, 2008:257). However, it must be mentioned that the electronic survey platform used to distribute the questionnaire could unfortunately not determine how many of the e-mails that were sent out were undeliverable (Murugan, 2011b:2). This could have had a major effect on the response rate and consideration should be given to this fact before concluding on the response rate. In addition to this, various other reasons and possible explanations for the low response rates, such as, inter alia, the fact that the questionnaire responses could not be saved at any given time resulting in the questionnaire having to be completed in one sitting by the respondents, the length of the questionnaire (it was long and of a detailed nature), the server downtime and the fact that the questionnaire was only provided in English should also be taken into account. Although one can therefore not come to any definite conclusions about how representative and statistically reliable the sample was, 5 865 responses should nevertheless provide invaluable information and insight into an area where there is currently no reliable and up to date statistical information available.

3. DEFINITION OF TERMS

Before the results of the survey are discussed, it is critical to first establish what is meant by a “small business”, “tax compliance costs/benefits” and “small business tax concessions”. The definitions and explanations of these terms are discussed below.

3.1 Small business

South Africa has, from an economic as well as taxation perspective, no single consistent definition of a “small business” available (SARS, 2011a; Smulders, 2006:15-19). To ensure comparability to previous compliance cost research in South Africa, this study defined a small business as a business with a turnover of R14 million or less.

3.2 Tax compliance costs

For the purposes of this study, tax compliance costs include internal costs, as defined by Turner, Smith & Gurd (1998) that is, the cost of collecting, paying and accounting for tax on products or profits of the business, and on the wages and salaries of employees together with the costs of acquiring the knowledge to enable this work to be done; and external costs, mainly in the form of advisors costs — using professional tax service providers is one of the main costs contributing to the cost of complying with taxation legislation (Coolidge, Ilic & Kisunko, 2009:26). In an attempt to prompt the respondents to differentiate between their time spent on tax-related activities and time devoted to accounting activities, a separate list of both tax and accounting activities were provided to them in the questionnaire. It was hoped that this would minimise the impact of the purely accounting compliance costs on the survey results.

3.3 Tax compliance benefits

Tax compliance does not necessarily only result in costs, but may also result in benefits (Sandford et al., 1989:13). Three broad categories of tax compliance benefits have been identified and become established by various authors in tax compliance literature (Lignier, 2009a:6, Tran-Nam, 2001:281; Tran-Nam et al., 2000:232; Pope, 1993:81; Sandford et al., 1989:89). The first being cash-flow benefits, the second being managerial benefits, and the third being tax deductibility benefits.

Cash-flow benefits arise from the use of tax revenues for a period before they must be paid over to SARS (Pope, 1993: 75; Rametse, 2010:4; Tran-Nam et al., 2000:232). An example of such a benefit is the lawful delay in payment of the tax collected by the business on behalf of the revenue authority — such as VAT and employees' tax (PAYE) in South Africa — to the revenue authority (SARS).

Managerial benefits, may arise in various forms such as better record-keeping and use of technology (Rametse, 2010:1; Coolidge et al., 2009:4), improved knowledge of the financial affairs of the business in particular in the form of increased knowledge of their complex accounting information systems (Lignier, 2008, 2009b:6-7, Lignier, 2009c:8,12), and improved business or managerial decision-making due to a requirement in terms of tax legislation to maintain records (Tran-Nam et al., 2000:232; Lignier, 2009c:6). For the purposes of this study, the focus will be on managerial benefits because, as far as small businesses are concerned, managerial benefits are expected to be much more significant than cash-flow and tax deductibility benefits and also because they have not been covered by previous studies (Lignier, 2011:1).

Tax deductibility benefits arise when the income tax system permits some tax compliance costs to be treated as a legitimate deduction for tax calculation purposes (Tran-Nam et al., 2000:233; Pope, 2001:14). An example would be provisions in the tax system permitting businesses a deduction from their taxable income for the services of their tax practitioners and tax-related incidental expenses.

3.4 Small business tax concessions (SBTCs)

The South African government, recognising that small businesses are important to the economy, has granted certain tax concessions (tax relief measures) to these businesses. These concessions come in various forms such as the small business corporation (SBC) tax regime, the small retailers VAT package, the capital gains tax (CGT) concession for small businesses, the ability to submit VAT returns every four months (as opposed to every two months), the simplification of the basis on which to pay the second provisional tax payment and a reduced application fee for a private binding ruling. Annexure A summarises each of these concessions. Each of these concessions, except for the last two, was considered individually in the study. The fact that the last two concessions were not considered separately is noted as one of the possible areas for future studies of a similar nature.

4. EMPIRICAL RESEARCH FINDINGS

4.1 Measurement criteria

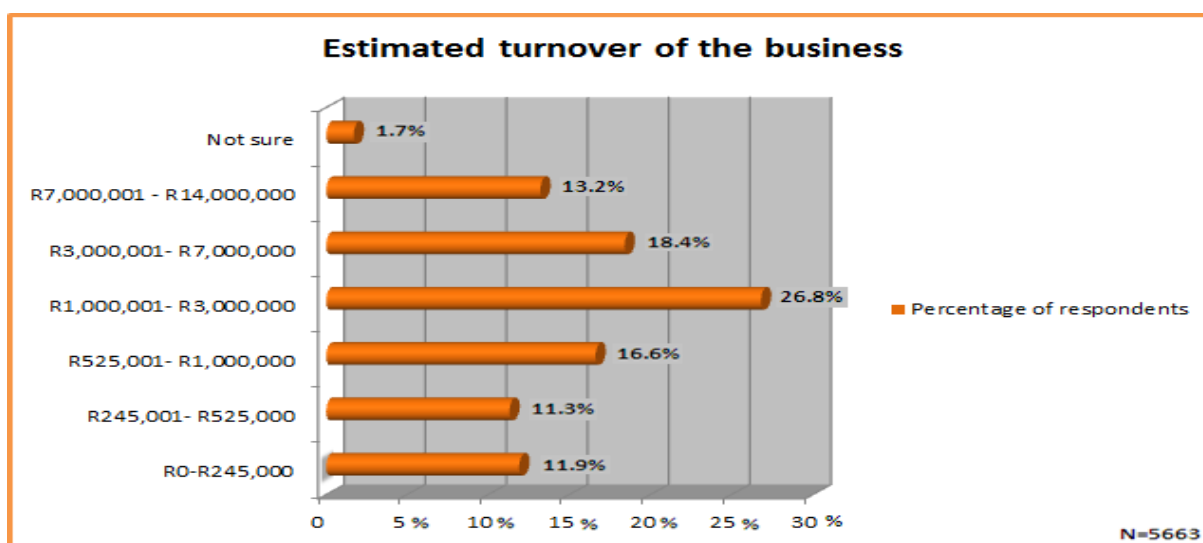
All compliance costs and times were calculated using the 5% trimmed mean, rather than the ordinary mean (average), to compensate for unusually high values being recorded in the responses to most of the questions. The trimmed mean is slightly different from the mean in that it removes a certain percentage of the responses from each extreme distribution (in this case 5% from the top and 5% from the bottom) before calculating the mean (Field, 2009:163). The use of a trimmed mean smoothes distortions in the data and provides a more systematic and useful method for detecting changes over a period of time, which is required for this study if it is to be used as a benchmark (Field, 2009:163). It was also used to ensure comparability of information across the five countries involved in the survey.

The questionnaire used to collect the information was divided into five components, namely (1) the profile of the respondents, (2) the time the respondents spend on internal tax and accounting activities, (3) the money the respondents spend on internal and external tax and accounting related activities, (4) the perceptions that the respondents have of the benefits of tax compliance, and (5) small business tax concession considerations. Each of these components will be discussed next.

4.2 Profile of the respondents

The majority of respondents conducted their activities in the professional services sector, traded in the form of close corporations (CCs), were established businesses that had been in operation for more than five years, and had a turnover (see Figure 1) and employee numbers that tended to lean towards the higher end of the small business spectrum.

Figure 1: The estimated turnover of the business



When the demograph profile (number of employees and age distribution) of the survey respondents was compared to the FinScope (2010:5-17) study, which included interviews with 5 676 small business respondents (businesses throughout South Africa with a turnover of between R70 000 and R14 million), it revealed that start-up businesses appear to be under-represented in the current study, possibly due to their lack of internet access/e-mail addresses, which could have resulted in their exclusion from this study from the start. As no scientifically valid universe or reliable database of small businesses currently exists (African Response, 2006:11, Statistics South Africa, 2010a:vii, FinScope, 2010:4), and since details of the total small business population on the SARS database were not available at the time of the research, it cannot be conclusively determined whether these respondents are representative of the whole small business population in South Africa, but there is potentially a systematic bias against the smaller and less sophisticated businesses — as is further discussed below.

To ensure that the results of the current study were comparable to the two tax compliance cost studies previously conducted in South Africa (FIAS, 2007, and the Govender & Citizen Surveys, 2008), the demographics of the respondents to the current study were compared, where possible, to those of the other two studies. The FIAS (2007:18) and Govender and Citizen Surveys (2008:31) studies used different turnover categories from this survey, making any form of direct comparison difficult, but Table 1 below, indicates the distribution of the businesses over two broad turnover categories for all three studies.

Table 1: Comparison of turnover categories between current and other study results

TURNOVER/STUDY	Current study	FIAS (2007)	Govender & Citizen Surveys (2008)
R0 — R1 000 000	40.5%	56%	47%
R1 000 001 — R14 000 000	59.5%	44%	53%

This table shows that, although the current survey is more in line with the Govender and Citizen Surveys' results, it is definitely more biased towards the "larger" small businesses (businesses with a turnover of more than R1 million).

Despite these slight differences in the turnover, it was found that the current study appears to share a discernible common trend or pattern with the two other studies, which justifies a comparison between the three studies.

4.3 Quantification of internal tax compliance costs

In line with the latest methodology adopted by the Inland Revenue (New Zealand) (2010a:26), a four-step approach was adopted to quantify the internal tax compliance costs incurred by small businesses. The first step entailed establishing the hours taken by small businesses on tax compliance activities (per tax, per annum). A matrix format, as used by Evans, Ritchie, Tran-Nam & Walpole (1996), Colmar Brunton Social Research (2005:38) and the Inland Revenue (New Zealand) (2010a:16 and 2010b:37) in their surveys of small businesses, was used to collect the information regarding the time spent on the different taxes per tax compliance activity.

The second step required the respondents to indicate who performed the internal tax compliance activities in the business (owners, employees, or unpaid friends and relatives) and the percentage of time each of these persons spent on these tax activities. Establishing who spends the hours on tax compliance activities in the business facilitated the quantification of the tax compliance costs but, before this could be done, step three had to be performed.

The third step requested the respondents to provide what they would consider to be an appropriate hourly value for each of the categories of persons performing the tax compliance activities (owners, employees, or unpaid friends and relatives). To ensure that these values were reasonable, these self-evaluated values were benchmarked against externally available salary information to ensure that there was some degree of quality control over the values provided by the respondents.

Step four ultimately quantified the internal tax compliance costs by multiplying the total compliance time (hours) spent on each tax by the percentage of time spent by the different category of persons (owners, employees, or unpaid friends and relatives) on each tax, which was further multiplied by the appropriate cost (hourly rate) of internal time as established above. The results of this process are presented next.

4.3.1 Step 1 — *Hours spent on tax compliance activities*

a) Survey results

Table 2 below reveals that it took small businesses an average of 255 hours per annum to deal with all tax compliance related matters. For those businesses on the turnover tax system (TTS) — a simplified tax system for micro businesses: a business with a qualifying turnover of R1 million or less — it took a total of 155.2 hours (which consists of 67.3 hours to comply with the TTS and 87.9 hours to comply with PAYE as the TTS does not replace PAYE).

Table 2: Annual internal hours spent on different taxes: all small businesses

Taxes	VAT	IT	PAYE	CGT	Customs	Excise duties	Total all taxes (excl TT)	TTS
Mean	283.9	209.4	154.5	17.9	14.1	5.7	685.6	89.5
5% Trimmed mean	98.9	69.9	83.2	2.5	0.5	0.1	255.1	67.3
Median	31.0	29.0	38.0	0.0	0.0	0.0	98.0	30.5
5% Trimmed mean - percentage of total time	39%	27%	33%	1%	0%	0%	100%	-
5% Trimmed mean - hours spent on PAYE by TT respondents	-	-	-	-	-	-	-	87.9
Total hours spent on tax by TT respondents	-	-	-	-	-	-	-	155.2

To ensure that the total tax compliance time by a business registered on the TTS is taken into account, the PAYE time was also included in the comparison. What was found was that the total time spent by a micro-business on complying with tax is slightly less than two thirds of the time (61%) taken by a normal business (business not registered on the turnover tax system) with a turnover of less than R1million (registered for VAT and not paying customs and excise duties). It appears that the turnover tax regime is meeting one of its intended objectives — reducing compliance costs by reducing the number of hours required for tax compliance activities.

When analysing the individual taxes, it was found that VAT is the most time-consuming tax for small businesses. From a size perspective, the number of hours needed internally to comply with tax legislation increased as the size of the business increased; however, it is evident that this time is regressive if taken as a percentage of turnover. This finding is graphically illustrated in Figure 2 below.

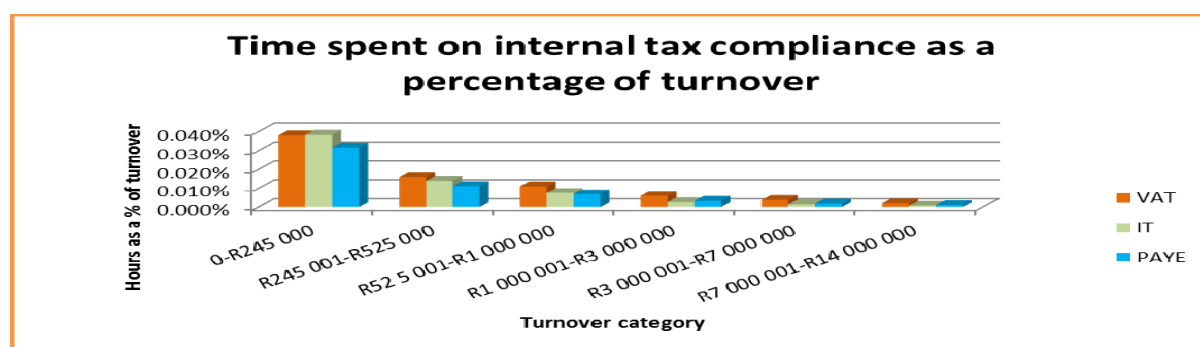
Figure 2: Annual internal hours spent on tax compliance activities per tax (excluding the turnover tax) — as a percentage of turnover

Figure 2 highlights the disproportionate burden faced by smaller businesses when it comes to tax compliance activities. When analysing this time in more detail (refer to Table 3 below), it became evident that recording information needed for tax, especially VAT, is the tax compliance activity that is the most time-consuming for small businesses. PAYE was the tax that took the most time to calculate, submit and pay the tax due. The number of hours spent dealing with SARS and learning about tax was also the highest for PAYE, which is possibly due to the recent changes to this tax brought about by SARS (SARS, 2011b:1-3). Tax planning and dealing with the tax advisor is the highest in respect of income tax.

Table 3: Mean* annual hours spent on different tax activities

Activity	VAT	IT	PAYE	CGT	Customs	Excise duties	Total all taxes (excl TT)	TT
Recording information	64.78	31.4	35.31	0.46	0.18	0.02	132.24	26.7
Calculating tax, filing return & paying tax	13.77	11.32	18.50	0.25	0.07	0.01	43.92	17.4
Dealing with SARS	6.50	6.2	10.62	0.08	0.04	0.00	23.46	5.0
Tax planning	2.73	5.0	4.66	0.30	0.02	0.00	12.71	4.0
Dealing with tax advisor	5.14	8.2	5.48	0.28	0.02	0.01	19.11	6.9
Learning about tax	6.00	7.6	8.61	1.15	0.21	0.09	23.70	7.2
Other activities	0.00	0.0	0.00	0.00	0.00	0.00	0.00	0.0
Total time spent	98.92	69.85	83.18	2.52	0.54	0.13	255.14	67.31

* 5% trimmed mean was used in this table

b) Comparison to other research

Unfortunately, none of the previous tax compliance cost studies broke the time taken to deal with tax activities down into as much detail as the current study did. However, certain activities were dealt with in both the current and previous studies, and these are set out in the table below.

Table 4: Comparison to other tax compliance cost studies of time taken to perform various tax activities

STUDY	Current study (mean)	Current study (5% trimmed mean)	FIAS (2007)	Govender & Citizen Surveys (2008)
HOURS PER TAX TAKEN TO:	Record information needed for tax	Record information needed for tax		Record information needed for tax & submit tax returns
VAT	167.26	64.78	-	Included below
Income Tax	82.43	31.49	-	Included below
PAYE	62.58	35.31	-	Included below
TOTAL	312.27	131.58	-	Included below
	Calculate tax, submit return & pay tax	Calculate tax, submit return & pay tax	Prepare, complete & submit tax returns	Record information needed for tax & submit tax returns
VAT	36.10	13.77	18.77	Included below
Income Tax	26.78	11.32	5.34*	Included below
PAYE	34.26	18.50	13.93	Included below
TOTAL FOR SUBMISSION OF RETURNS	97.14	43.59	38.04	Included below
	Record information needed for tax + Calculate tax, submit return & pay tax	Record information needed for tax + Calculate tax, submit return & pay tax	Record information needed for tax + Calculate tax, submit return & pay tax	Record information needed for tax + Calculate tax, submit return & pay tax
VAT	203.36	78.55	-	56.14
Income Tax	109.21	42.81	-	51.29*
PAYE	96.84	53.81	-	21.29**
TOTAL FOR RECORDING TAX INFORMATION AND SUBMISSION OF RETURNS	409.41	175.17	-	128.72***

* Includes provisional tax

** Includes UIF and SDL

*** An overall average time of 181.57 was mentioned in the study, which differs from the above due to (it is assumed) averaging of information per tax as calculated from information per turnover category. As the more detailed averages were needed for comparative purposes, these totals were used in the table above rather than the 181.57 hours.

Despite the activities and taxes being slightly different across all three studies, what is evident is that the overall time taken (using either the means or the 5% trimmed means) to record information needed for tax, prepare, complete and submit tax returns, has increased. If the activities are reviewed individually, an exception to this overall increase arises in respect of the filing and paying of VAT returns (FIAS study) and the recording of tax information and submission of the tax return (Govender and Citizen Surveys study) — but only if the 5% trimmed mean is used. The extent of the overall increase cannot be commented on further due to the differences mentioned above, but notwithstanding this, an increase in time to comply with tax legislation is not desirable, either from a SARS or taxpayer perspective.

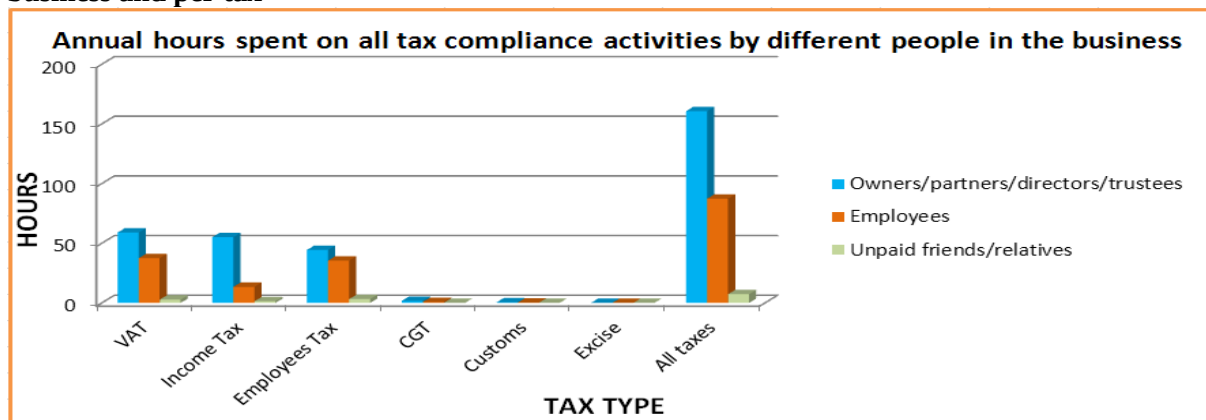
From a broad overall time perspective, a comparison can also be made with the PricewaterhouseCoopers (PwC) and IFC (2011:69) Paying taxes 2011 report which records the time taken to prepare tax figures, complete and file tax returns, and also pay the three major taxes — VAT, income tax (including provisional tax and CGT), and taxes on employees (PAYE, SDL and UIF). A case study methodology is used to record this information whereby tax experts from a number of different businesses compute the taxes and contributions payable based on standardised case study facts. This global study reveals that it takes 200 hours to perform the abovementioned functions in South Africa. This is slightly more than the 175.88 hours taken by the respondents of the current survey, i.e. 175.17 hours as in Table 4 above, plus CGT of 0.71 (0.46 + 0.25) being the time taken to record information, calculate, file and pay the tax due.

It is evident that the hours recorded by the respondents to the current survey are only slightly less than the PwC and IFC hours. What is of concern is that the PwC and IFC study bases its information on a “medium-sized” company that has five owners and 60 employees and that has a turnover of approximately R46 million (this is closer to a medium to large sized business from South Africa’s perspective). Although there are slight discrepancies between the exact tax activities that are included in these estimates, overall it appears that small businesses in South Africa are spending a large amount of time to comply with tax legislation when compared to medium to large-sized businesses.

Having established the hours spent internally on various tax compliance activities per year, it was necessary to determine how much this time is costing the business. Before this could be achieved, it was essential to determine who actually performs these functions within the business as the value of the time might depend on the person rendering the service.

4.3.2 Step 2 — Who performs the tax compliance activities?

Figure 3 indicates that most of the internal time spent on tax compliance activities was attributable to the owners, who performed 63% of annual hours related to tax compliance activities, with the employees performing 34% and unpaid friends or relatives the remaining 3%.

Figure 3: Annual internal hours spent on tax compliance activities — by different people in the business and per tax

VAT compliance took up most of the owners' and employees' time, with employees spending relatively more time on PAYE after VAT.

4.3.3 Step 3 — Valuation of time spent on different taxes

A contentious issue discussed amply in the literature (Allers, 1994:54; Evans, Ritchie, Tran-Nam, & Walpole, 1997:11; Pope in Sandford, 1995:101) is the value to be placed on the time spent by owners and employees of a small business. The valuation of this time in the current research was based on the methodology adopted by the Inland Revenue (New Zealand) (2010a:26) in their study on the quantification of small business tax compliance costs. Using this valuation method, the values provided by the respondents (per turnover category) for each type of person working or assisting in the business are set out in Table 5 below.

Table 5: Hourly rate of various persons' time according to the size of the business

BUSINESS SIZE CATEGORY	Owner	Employee	Unpaid friend/relative
R0 — R245 000	R353.53	R153.07	R192.13
R245 001 — R525 000	R423.36	R180.50	R200.48
R525 001 — R1 000 000	R470.39	R155.08	R225.44
R1 000 001 — R3 000 000	R483.97	R159.82	R243.93
R3 000 001 — R 7 000 000	R432.89	R167.19	R230.22
R7 000 001 — R14 000 000	R508.50	R201.54	R158.15
Not sure	R456.51	R157.39	R93.33

The respondent's self-reported values were benchmarked against average hourly rates obtained from recently conducted local publicly available salary surveys. The Accountants on Call (2010:1) Salary Survey as well as the Statistics South Africa (2010b:xii) Monthly Earnings of South Africans Survey were both carried out in 2010 and were considered appropriate as a benchmark for two reasons; firstly, they were recent and related to the same or similar period that the survey related to and, secondly, because they contained information on "accounting type" positions which are similar to the functions/positions that a person would be required to carry out in order to comply with tax. Two managerial positions were selected to obtain a benchmark of the owners' time: financial manager and financial accountant, because both of these positions seemed to encompass the functions that an owner would fulfil in a small business, and were more aptly suited than the other categories documented.

As no indication of the size of the business paying these remuneration packages was provided in the Accountants on Call (2010) Salary Survey to ensure that these rates were reasonable in respect of payments made by small businesses, the average rates in terms of that salary survey were compared to the Chartered Institute of Management Accountants (2010:15) South Africa Part Qualified Salary Survey, which provided a break-down of the salary information by business size. This comparison revealed that the average salary initially chosen was too large compared to the average salaries paid by small businesses in South Africa. The rates used for the owners were therefore adjusted to a lower level, more in line with remuneration paid by small businesses. To ensure this choice was valid, a further comparison of average salaries in the accounting/finance field was made with the Walters (2011:408) Global Salary Survey and Macdonald & Company's (2011:6) Rewards and Attitudes Survey. The results of this comparison further justified the use of the lower-paid category of person to obtain the most appropriate and reasonable value for persons working in these positions in South African small businesses.

A valuation of the employee's time was obtained by selecting two clerical functions: assistant accountant and balance sheet bookkeeper from the Accountants on Call (2010) salary survey. A rate for a trial balance bookkeeper was also provided (at a lower remuneration package) in the survey, however, this was not used, as more of the respondents to the current survey indicated that they had a good rather than a basic bookkeeping knowledge, implying that the higher salary option would be more appropriate in the current circumstances. The remuneration for both clerical functions was selected from the category of staff without a degree and with two to eight years' experience because more than half of the respondent clerks or administrative staff, and more than a third of the respondent bookkeepers, indicated that their highest qualification was having completed high school. Although the managers that completed the survey indicated that their highest qualification was a university education, for the reasons mentioned above (specifically payments by small businesses rather than larger ones), it was decided to use the lower category of remuneration. The values obtained are set out in Table 6 below.

Table 6: External average salary per hour* for selected tax functions

POSITION / VALUES	Lowest rate	Highest rate	Average rate
OWNER			
Financial manager	R 181.25	R 317.71	R 249.48
Financial accountant	R 145.83	R 250.00	R 197.92
EMPLOYEE			
Balance sheet bookkeeper	R 125.00	R 156.25	R 140.63
Assistant accountant	R 109.38	R 125.00	R 117.19

* An average of 48 working weeks consisting of 40 hours per week was assumed

As these values were lower than those provided by the respondents in the present survey, it was decided to obtain a further benchmark against which these rates could be tested. This benchmark was obtained from the values in the survey of monthly earnings of South Africans (Statistics South Africa, 2010b:xii). These rates (refer to Table 7) are significantly lower than both the self-assessed hourly values of this survey, and the values recorded in the salary survey of Accountants on Call (2010:1).

Table 7: Alternative national average salary per hour* for selected tax functions

POSITION / VALUES	Median
OWNER	
Manager	R65.63
Professional	R62.50
EMPLOYEE	
Technician	R46.88
Clerk	R28.13

* An average of 20 working days per month consisting of 8 hours per day was assumed

One possible reason for this is because the Statistics South Africa survey included all occupations and not specifically those in the accounting or finance field. Taking cognisance of this and the fact that the Accountants on Call salary survey data appears reasonable in relation to other surveys performed in this sector of the working community, it appeared reasonable to adopt the Accountants on Call salary survey values. As to which of the category values would best represent the value of time spent by these people, it was believed that, because the owner would most likely be regarded as performing the role of financial manager whereas the employee's role could more likely be akin to that of a bookkeeper, these functions were considered to be the most appropriate representation for each of these categories of persons. In addition to this, the values for these categories were also more aligned with the self-reported values provided by the respondents in the present survey. Thus the average rate of each of these roles was considered the most appropriate basis for representing

the value of time for owners and employees of small businesses. The hourly rates to be used as an alternative valuation of the internal compliance costs of small businesses were therefore R249.48 for owners and R140.63 for employees.

The valuation of time for the unpaid friend or relative was a difficult undertaking and one which could not successfully be performed as no benchmark or selection criteria were clearly evident or available from the information obtained. For valuation purposes it was therefore decided to use the same values as those obtained for employees. This is regarded as prudent especially in the light of the fact that the respondents indicated that their unpaid friends or relatives were worth more than the employees of the business.

4.3.4 Step 4 — Quantification of time spent on tax compliance

a) Survey results

When the time recorded in step one was converted into Rand values using the rates discussed above, the internal tax compliance costs for small businesses in this survey amounted to R53 356 (see Table 8 below).

Table 8: Valuation of annual internal tax time by all persons

TAX / PERSON	Mean (R)*	Median
VAT	20 317.75	6 367.27
IT	15 821.91	6 568.87
PAYE	16 532.52	7 552.72
CGT	540.09	-
Customs	116.50	1.59
Excise	28.05	0.55
Total all taxes	53 356.81	20 491.00
TT	14 030.34	6 365.87

* 5% trimmed mean was used in this table

It is evident that cost of the internal time spent on VAT (mean: R20 317.75) was more than a third (38%) of the total amount spent on all taxes. Employees' tax was the next most expensive tax (mean: R16 532.52, closely followed by income tax (mean: R15 821.91) — this is the case even if CGT is added to the income tax time.

b) Comparison to other research

No direct comparison of these costs can be made to the FIAS and Govender and Citizen Surveys reports as the Govender and Citizen Surveys report did not manage to get respondents to attach a monetary value to the time taken by the owner or

employees on internal tax compliance activities and the FIAS study only calculated the cost incurred by small businesses to prepare, complete and submit tax returns for VAT, income tax, provisional tax and PAYE. Therefore Table 9 compares the findings of the current study to the FIAS study but only in respect of the costs to prepare, complete and submit the tax returns for those taxes. However, the FIAS study also established that an average retainer for tax services would cost small businesses R24 158 per annum (FIAS, 2007:31). A retainer is usually paid annually up-front and would generally include most tax-related services not only the preparation and submission of the tax return. The value of the retainer was therefore compared to the total value for all tax compliance activities as calculated in Table 9 below.

Table 9: Comparison between two tax compliance cost studies of the valuation of annual internal tax compliance time

INTERNAL TAX COMPLIANCE COSTS (PER TAX) / STUDY	Current study (mean) (cost for all tax services)	Current study (5% trimmed mean) (cost for all tax services)	FIAS (2007) Retainer usually = cost for all tax services)	Current study (mean) (only cost to calculate tax, submit return and pay tax)	Current Study (5% trimmed mean) (only cost to calculate tax, submit return and pay tax)	FIAS (2007) (only cost to prepare, complete & submit return)
VAT	58 307	20 318	-	7 415	2 828	2 975
IT	47 427	15 822	-	6 066	2 564	1 175*
PAYE	30 708	16 533	-	6 809	3 677	2 880
Total all taxes	136 442	52 672	24 158	20 290	9 069	7 030

Reaching definitive conclusions from this comparative data is contentious for the following reasons:

1. The FIAS study used means and not 5% trimmed means to calculate their costs (but the means for the current study have been provided in the table above for comparative purposes).
2. The FIAS study included the value of time to prepare, complete and submit the tax returns. Whether or not this includes recording of information for tax (record-keeping) and/or the payment of the tax is uncertain. The value for the current study excluded the record-keeping time, but included the value of the time to pay any tax due. Furthermore, the values above for the current study excluded any time taken to deal with SARS. Some of this time could arguably relate to the completion and/or submission of the tax return and should thus have been allocated here, but this has not been done (and the amounts used in the current study may therefore be understated).

3. The FIAS study separated provisional tax from income tax and did not mention CGT separately. The current study did not mention provisional tax separately, but did separate CGT from income tax (current study amounts above exclude CGT values and are presumed to include provisional tax).

Bearing all of these differences in mind, and if the FIAS (2007) figures are increased for inflation (at an average rate of 6.55% from 2007 to 2011 (Statistics South Africa, 2008:1; 2011a:1 and 2011b:1)), it appears that there has been an overall increase in internal tax compliance costs as the retainer value of R24 158 (R31 136 adjusted for inflation) has almost doubled if compared to the current study (R52 672). To ensure that a reliable conclusion on the incidence of internal tax compliance costs can be obtained, it is suggested that the current values be used as a baseline for future studies so that meaningful comparisons can be made in future and that the exact areas that have caused the increase in internal tax compliance costs can be pinpointed. This will ensure focused reforms that should be able to address the root of the problem.

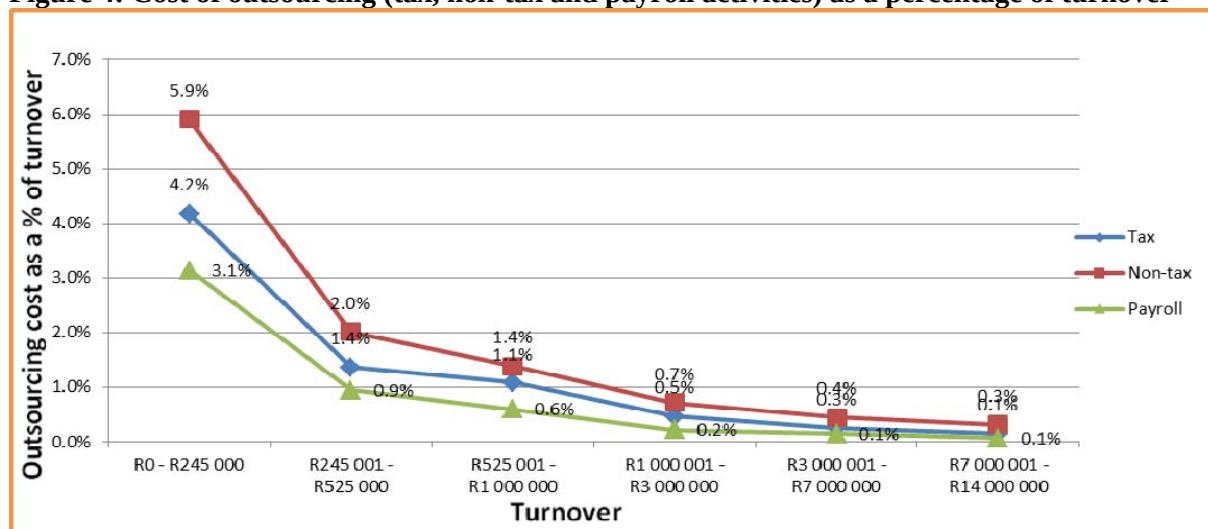
Tax compliance costs include not only the value of the time taken by the owners and employees of a business (internal costs) in complying with tax legislation, but also the money spent by these businesses on external service providers (for example accountants, bookkeepers, tax practitioners and lawyers) to assist with the business's tax compliance obligations. These costs will be considered next.

4.4 External costs of tax compliance

a) Survey results

It was found that more than three quarters (76%) of the respondents used the services of external service providers for tax, accounting and payroll services. These services are used the most by businesses in the professional, scientific and technical services sector and it appears that the use of these external services increases as the turnover of the business increases, no matter what form the small business is trading in. These external services are mainly in relation to tax services as opposed to non-tax services.

From a cost perspective, small businesses tend to spend on average R31 996 on outsourcing. If this is analysed further, it is found that small businesses spend on average R9 882 on external tax related services — which is less than the amount spent on non-tax services (R16 634) but more than the amount spent on external payroll services (R5 480). All these costs are regressive (as can be seen from Figure 4), with the smaller businesses spending disproportionately more than those with higher turnovers.

Figure 4: Cost of outsourcing (tax, non-tax and payroll activities) as a percentage of turnover

Almost half (48.9%) of the respondents perceived that there is a value in the information provided by their external service providers beyond the provision of tax services and tax advice, as they indicated that they would be prepared to pay for external accounting and payroll services even if South Africa were tax free. It was generally the smaller businesses (turnover of less than R1 million) that would probably not incur these expenses and therefore it appears as if they do not perceive as much value in the information provided by their external accounting and payroll service provider. Taxpayers who currently pay for external non-tax and payroll related services would be more likely to spend on external services in a tax compliance free environment.

Assuming that there were no tax obligations, these respondents were prepared to pay R10 095 for external accounting services and R4 764 for external payroll services. Some (10.9%/19%) were even prepared to spend more than they were currently paying, implying that they derive more benefits from their relationship with their accountant/external payroll service provider than what they are currently paying for.

b) Comparison to other research

A comparison of the findings in respect of the use of external service providers for tax and accounting services in the FIAS (2007), the Govender and Citizen Surveys (2008) and the current study are displayed in Table 10 below. The average (mean) costs as well as the 5% trimmed mean for the current study have been provided because the other two studies did not use the 5% trimmed mean, but rather the ordinary mean (Kisunko, 2011:1).

Table 10: Three study comparison of annual costs of external tax and accounting related services

COST OF EXTERNAL SERVICE PROVIDERS / STUDY	Current study (mean)	Current study (5% trimmed mean)	FIAS* (2007)	Govender & Citizen Surveys* (2008)
Tax costs	R24 370	R9 882	R24 158	?
Accounting costs	R28 283	R16 634	R12 185	?
Total annual tax and accounting cost (excluding payroll costs)	R52 653	R26 516	R36 343	R14 030
Payroll costs	R9 267	R5 480	?	?
Total tax and accounting outsourcing cost	R61 920	R31 996	R36 343	R14 030

* These studies used an ordinary mean to calculate these costs rather than the 5% trimmed mean

If one first considers the costs of outsourcing tax functions (excluding payroll costs), using the 5% trimmed mean as the comparative indicator, these have reduced since 2006 (when the FIAS study was conducted) and 2007 (when the Govender and Citizen Surveys study was undertaken) — even if inflation is taken into account and if it is assumed that the R14 030 was incurred exclusively for tax purposes, as 51% of the study's respondents believed this to be the case). This is a positive finding but the caveat here is that this is not necessarily the only cost incurred by the small business as other internal costs may need to be incurred to ensure its total tax compliance. Nevertheless, it is encouraging to see that tax outsourcing has not increased the compliance burden for small businesses. This, unfortunately, does not appear to be the case in respect of external accounting costs, which have increased (taking inflation into account).

4.5 The accounting/tax overlap

Previous research (Tran-Nam in Evans, Pope & Hasseldine, 2001:51, 55) suggests that accounting and tax compliance activities overlap. What this implies is that various accounting and record-keeping functions are performed both for tax and accounting purposes (that is, for instance producing managerial information and also information required for complying with tax legislation) — resulting in a joint purpose. Determining how these joint-purpose costs should be divided between these two functions is what causes the “disentanglement” dilemma in tax compliance cost research (Lignier, 2009c:124).

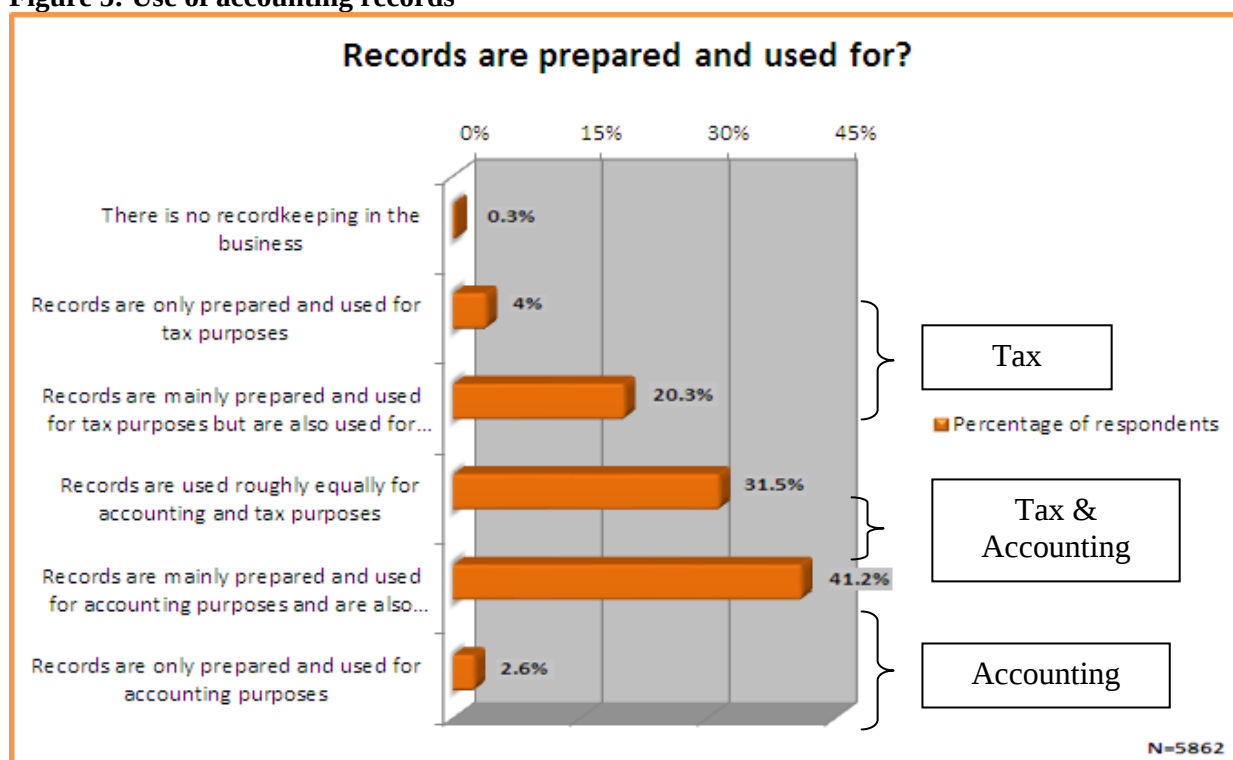
In an effort to disentangle the accounting and taxation costs from each other to ensure that only the tax compliance costs are taken into consideration in the tax compliance cost measurement criteria, the questionnaire prompted respondents to provide information regarding the type of accounting system used by their business, the reasons for keeping records and, ultimately, the time spent internally on accounting functions considered essential to the operation of the business.

4.5.1 Nature of the accounting system and reasons for keeping accounting records

The results indicated that just over three quarters of the respondents (77.7%) operated a computer based accounting system. Of those that didn't use a computer-based accounting system, 1.6% indicated that they used no accounting system at all. Of those that used no accounting system, 67.2% were businesses with a turnover of less than R1 million, with the majority of these having a turnover of between R0 and R254 000. This result is to be expected given the nature and size of the business, but what was surprising was that there were companies (12.5%) that have a turnover of between R3 million and R14 million, that also did not use any form of accounting system. The reasons for this and its effectiveness would need more investigation. Of the category of respondents that did not use a computerised accounting system, that is those that used a paper-based or manual system (11.9%), nearly half (48%) were also businesses with a turnover of less than R1 million. Respondents with a turnover of R1 million to R3 million were the ones that used a paper-based or manual system the most.

In a further endeavour to disentangle tax from accounting costs, the type of accounting system used (and for what it was used — tax versus accounting) and the owner's perception of the importance of accounting information and record-keeping (for tax and accounting purposes) were investigated. The results are set out in Figure 5 below.

Figure 5: Use of accounting records



Most of the respondents used computerised accounting systems with the micro businesses (turnover of R1 million or less) being the ones that tended not to use any accounting system at all. The reason for keeping records was mainly for accounting

purposes, with just under a third of the respondents stating that the records were kept roughly equally for accounting and tax purposes. It was interesting to note that a fifth of the respondents kept records mainly for tax purposes (but they were also used for accounting purposes). Tax therefore featured as a very important reason for keeping accounting records (even more important than for reporting to owners, internal management, other regulatory bodies and lenders).

4.5.2 Time spent on various accounting activities

a) Survey results

In order to identify accounting activities that were not just carried out for tax purposes and that were beneficial to the business in some other way, question 14 in the questionnaire invited respondents to indicate the annual hours spent on specific core accounting activities. A similar methodology was used by Evans et al (1996:15), but two additional categories of activities were added to the list used in that study — those being investment planning unrelated to tax and budgeting and control. Venter and de Clercq (2007:147) found that small businesses in the three largest sectors in the South African economy (manufacturing, retail and business services) hardly use tax inputs, advice or information for management and planning purposes. It was therefore appropriate to see if perhaps the accounting information was used for investment planning and budgeting and control purposes as this could help resolve the disentanglement dilemma in respect of this activity. It was found (see Table 11) that the respondents spent on average 1 117 hours on core accounting activities, with most of this time spent processing customer invoices and cash received.

Table 11: Annual hours spent on different accounting activities by small businesses

ACCOUNTING ACTIVITY	Mean*(hours)	Median (hours)
Processing customer invoices and cash received	394.07	190.00
Following up debtors	105.74	30.00
Paying bills	100.29	48.00
Calculating and paying wages	62.46	30.00
Checking banking records against cash records	112.66	48.00
Stock-taking and stock control	44.20	5.00
Investment planning unrelated to tax	12.51	2.00
Budgeting and control	57.04	24.00
Other activities	0.76	0.00
Total all taxes	1 117.34**	610.00**

* These results were based on the 5% trimmed mean

** Not calculated as the sum of the above column but obtained from the 5% trimmed mean data set

The average of 1 117 hours (median: 610 hours) spent on core accounting activities is nearly four and a half times as much as the time spent on tax activities (255 hours). These hours spent were disproportionately high for the “smaller” businesses.

b) Comparison to other research

The FinScope study (2010:26) revealed that the average small business owners spend 63.8 hours per week working on their businesses. If this is grossed up to an annual figure (using 48 working weeks as a basis), then small business owners spend on average 3 062 hours per year working on their businesses. When this is then compared to the hours obtained in the current study of 1 372 — tax activities: 255 hours, and accounting activities: 1 117 hours — it is evident that the times obtained in this study, although just less than half of the FinScope study time, appear to be reasonable — if not underestimated. Unfortunately no other benchmarks are available against which these results can be tested, and these times are therefore the best available to be used as a baseline for future studies in this area.

4.5.3 Valuation of accounting time

If the same valuation used for tax related activities is applied to the hours spent above, the costs involved in ensuring that all the internal accounting activities of the small business are performed, amount to the following:

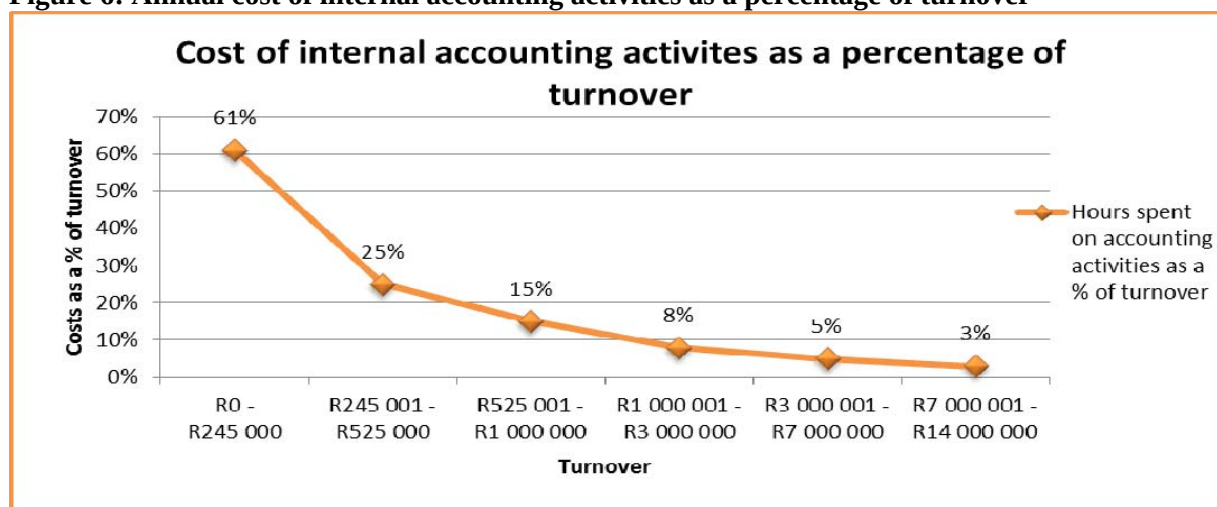
Table 12: Annual internal cost of time spent by different people on accounting activities

ANALYSIS OF COSTS INCURRED ON ACCOUNTING ACTIVITIES PERFORMED BY:	Mean* (R)	Median (R)
Owners, partners, directors and trustees	147 739.61	80 656.88
Employees	68 195.08	37 230.39
Unpaid friends & relatives	5 656.73	3 088.23
Total all persons in business	221 591.43	120 975.51

* These results were based on the 5% trimmed mean

The value of time spent on accounting activities is R221 591 (median: R120 976) per year. It was also found that, as the business grows, so do the accounting costs, but that these costs are nevertheless regressive as is shown below.

Figure 6: Annual cost of internal accounting activities as a percentage of turnover



When comparing the total costs of R221 591 (median: R120 976) spent internally on accounting activities with the costs of tax activities (excluding the turnover tax) which amount to R53 356 (median R20 491), it is clear that performing the accounting activities of the business costs just over four times as much as the tax compliance activities. Thus more time and costs are spent on accounting activities than on tax compliance activities.

Having established the internal and external tax compliance costs incurred by small businesses, it was considered appropriate to establish if the respondents thought that there were any benefits that arose from complying with tax legislation. The next section thus focuses on the respondents' views of tax compliance benefits (if any).

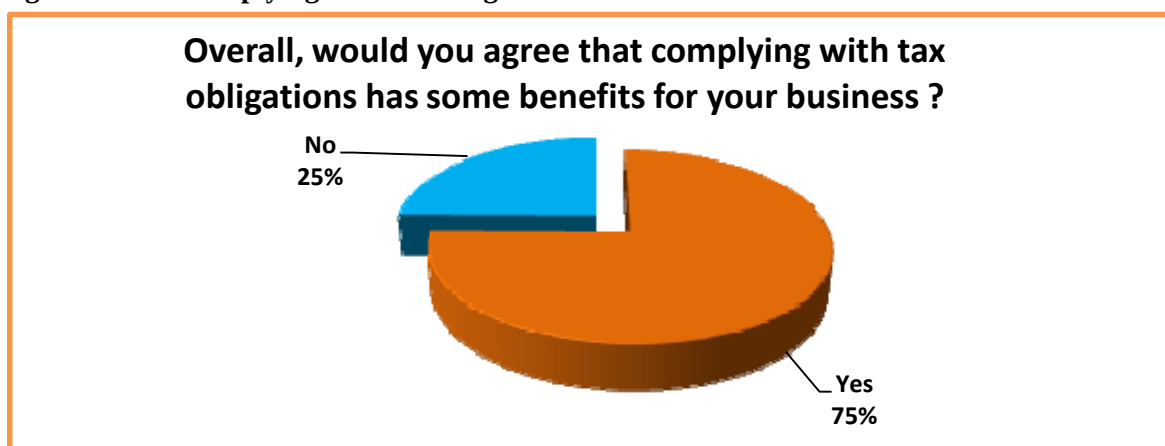
4.6 Tax compliance benefits

The thought that tax compliance activities give rise not only to costs, but also to benefits, first came about in the early 1980's (Sandford, Godwin, Hardwick & Butterworth, 1981), but this has never been investigated from a South African perspective.

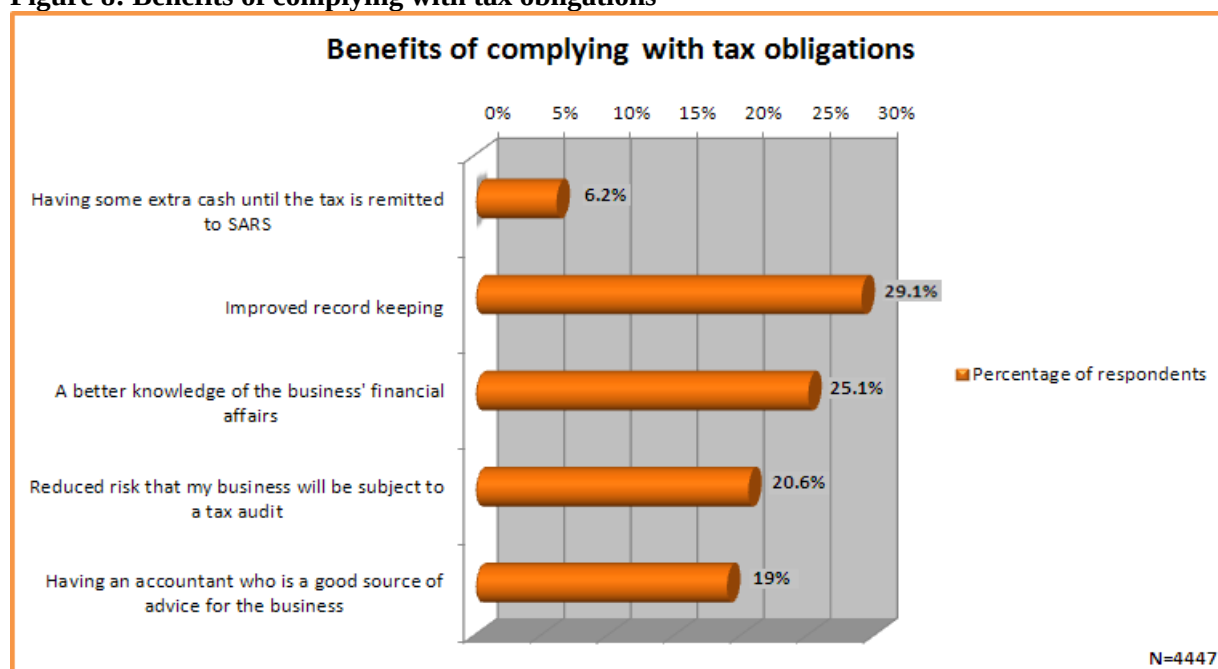
4.6.1 Do tax compliance benefits exist?

This research, as is shown in Figure 7 below, established for the first time in South Africa that there is a perception that tax compliance benefits exist.

Figure 7: Does complying with tax obligations have benefits for the business?



This existence was acknowledged by three quarters of the small businesses irrespective of their size. The major perceived benefit of compliance with tax obligations (especially among the smaller businesses) is an improvement in record-keeping by the business, closely followed by a better knowledge of the business's financial affairs (see Figure 8 below). A reduced risk of having an audit and having an accountant who is a good source of advice for the business are also perceived as benefits, but not as great as the abovementioned benefits. The benefit that is perceived as the least significant is having some extra cash until the tax is submitted to SARS.

Figure 8: Benefits of complying with tax obligations

It has been argued that the requirement to keep tax records also has its benefits for the small business (Lignier, 2009a:106). Respondents were provided with a list of five statements regarding the benefits of keeping tax records and their perceptions about these benefits (based on a five point Likert scale) were sought. These perceived benefits and the responses thereto are set out below.

Table 13: Perceptions about benefits of tax compliance

	Agree or strongly agree		Disagree or strongly disagree		Unsure or not applicable	
	Count	%	Count	%	Count	%
Improves record keeping	4 329	76.2	951	16.7	404	7.1
Improves maintenance of accurate records	4 434	78	893	15.7	358	6.3
Improves knowledge of financial position of the business	3 659	64.7	1 373	24.3	619	10.9
Improves knowledge of profitability	3 567	63.1	1 422	25.2	663	11.7
VAT compliance obligations provide up to date information	3 532	62.5	1 417	25.1	699	12.3

The greatest perceived benefit was having more accurate records as a result of tax compliance obligations.

To determine if there was any perceived benefit in having an external advisor beyond the value of the tax information and services provided by their accountant, respondents were asked whether they would be prepared to pay for these external services if South Africa were tax free. Table 14 shows that 39% of the respondents would still be prepared to pay for external advisors for accounting service costs even if there were no tax obligations.

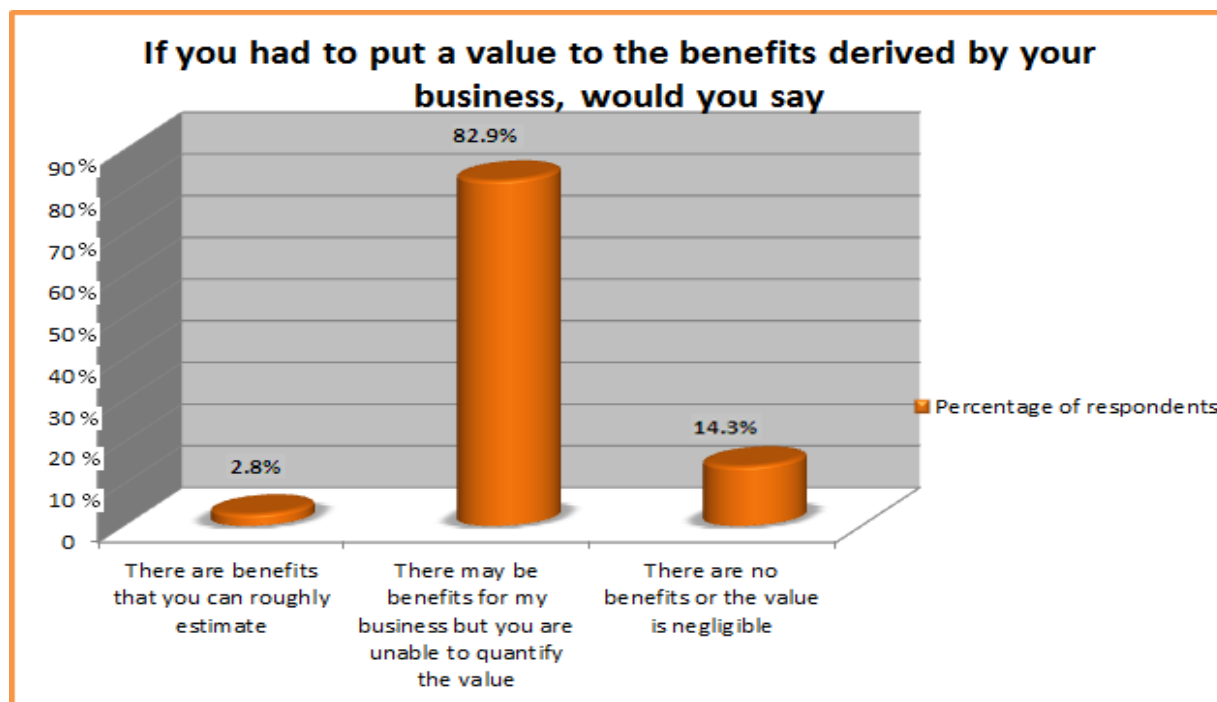
Table 14: Analysis of respondents' use of external service providers

	Number	Percentage
Respondents currently paying for external services (tax & non-tax)	4 463	76.1%
Respondents currently paying for non-tax services	2 987	50.9%
Respondents who would pay for external services even if there were no tax	2 312	39.4%
Respondents who would spend more than the current amount they are spending on non-tax services	641	10.9%
Respondents who would spend the same amount as the current amount they are spending on non-tax services	385	6.6%
Respondents who would spend less than the current amount they are spending on non-tax services	1 128	19.2%
<i>Total Number of respondents</i>	5 862	-

An interesting finding is that just over one tenth of those who actually paid for non-tax services would be willing to pay more than they are currently paying even if South Africa were tax free. This is a possible indication that these taxpayers may be deriving more benefits from the relationship with their accountant than what they are paying for; a conclusion also reached by Lignier (2008:370).

4.6.2 What is the value of tax compliance benefits?

Various methods have been employed to measure tax compliance benefits (Sandford et al. 1981:94; the National Audit Office (UK), 1994:20; Lignier, 2006:55 and Lignier 2009c:124). These methods all have their limitations, and taking these limitations into consideration as well as the financial and time constraints present during this research, the approach followed in this study was a subjective approach as used by Lignier (2006:55). Figure 9 below shows the results obtained from the respondents when they were asked if there were any benefits to complying with tax obligations and whether they could possibly be measured.

Figure 9: Valuation of tax compliance benefits by respondents

Despite the fact that, for the first time in South Africa, the establishment of the perception that tax compliance benefits exist was established, 82.9% of the respondents indicated that they could not accurately quantify these benefits. The research was thus unable to accurately measure the tax compliance benefits and future research in this area, using a more sophisticated approach as suggested by Lignier (2009c:38), is proposed.

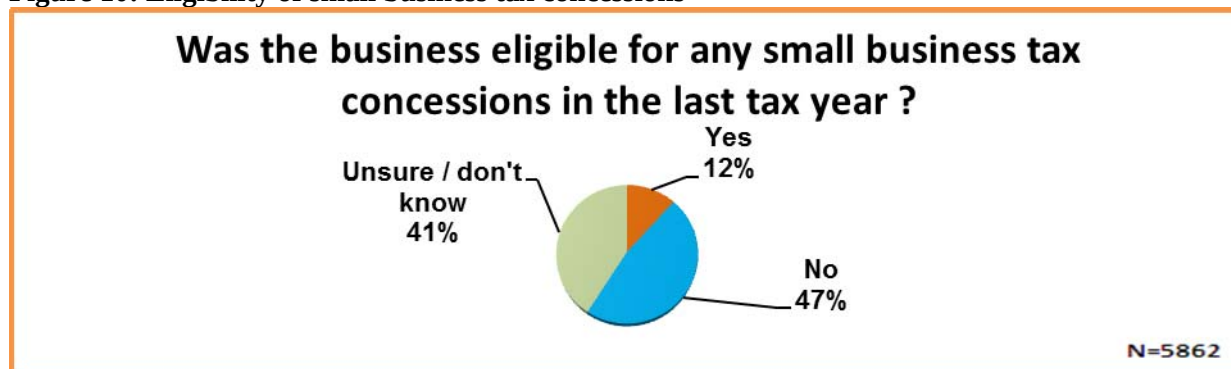
4.7 Small business tax concessions (SBTCs)

Small businesses are arguably the most dynamic sector of the economy, but they are much more vulnerable than any other sector to the compliance burden created by the tax law and its complexity (OECD, 2010:5). The South African government, have made endeavours to reduce this compliance burden by introducing various strategies and measures (tax concessions) to achieve this reduction in the tax compliance burden (SARS, 2011c:30-32).

In view of these developments, it was believed that there would be value in researching the extent to which SBTCs achieved their objective of reducing the tax compliance burden in South Africa. In order to do this, the take-up (eligibility) of the specific tax concessions by small businesses in South Africa and the reasons why they were or were not used by these businesses were investigated in this study. The small businesses' perceptions of the concessions with regard to their usefulness and level of complexity were also considered.

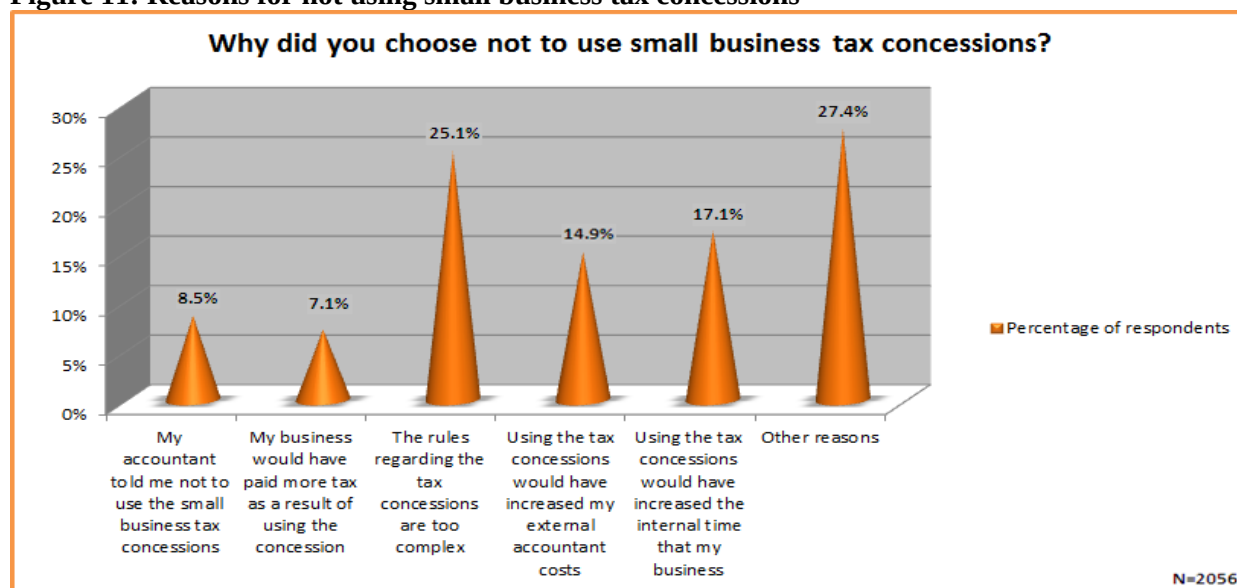
What was found (refer to Figure 10) was that almost half (47%) of the respondents indicated that they were not eligible for the SBTCs, 41% indicated that they were “not sure” if they were eligible, leaving only 12% stating that they were in fact eligible.

Figure 10: Eligibility of small business tax concessions



This finding is an indication that the eligibility criteria for the SBTCs could be too restrictive (confirmed by certain of the respondents' views provided in the survey) or that some small businesses or their external service providers are ignorant, not updated or not knowledgeable of the SBTCs, or that the marketing of these concessions has not been adequate or appropriately targeted. Upon further analysis of the data, it was found that there existed some confusion about the eligibility and use of these concessions (especially in respect of the turnover tax system).

Of those small businesses that were eligible for the SBTCs, 68% actually used the SBTCs, indicating good adoption of the concessions once the businesses are aware of them. Of those that did not use the concession despite being eligible for them, it was found that the main reason for not using the SBTCs was because the rules of the concessions were too complex, followed by the increase in internal or external time spent on tax related activities.

Figure 11: Reasons for not using small business tax concessions

The SBTCs used the most, are the SBC concession and the turnover tax system. The majority of the respondents felt unsure about the usefulness (Table 15) and complexity (Table 16) of these SBTCs and that in itself indicates that more research is needed into these concessions — because the very reason why they were implemented was to assist the small business community with their tax compliance burden, yet this appears not to have been successful.

Table 15: Perceptions about usefulness of SBTC

Concessions	Moderately or very useful	Not useful or not very useful	Unsure
			Not Applicable
			Not relevant
Small Business Corporation	10.10%	7.50%	82.40%
	(488)	(360)	(3 965)
Small Retailers VAT Package	6.30%	9.80%	83.90%
	(305)	(470)	(4 037)
CGT concession	7.10%	7.90%	85.00%
	(338)	(378)	(4 067)
Submission of VAT returns four-monthly	15.20%	11.50%	73.30%
	(735)	(554)	(3 542)
Turnover Tax System	8.70%	12.10%	79.30%
	(418)	(583)	(3 822)

Table 16 : Perceptions about complexity of SBTC

Concessions	Not complex or not very complex	Moderately to very complex	Unsure Not Applicable Not relevant
Small Business Corporation	7.10%	11.60%	81.20%
	(347)	(565)	(3 945)
Small Retailers VAT Package	5.60%	9.90%	84.50%
	(269)	(478)	(4 082)
CGT concession	4.30%	10.60%	85.00%
	(209)	(511)	(4 090)
Submission of VAT returns four-monthly	13.50%	10.10%	76.30%
	(655)	(490)	(3 693)
Turnover Tax System	8.40%	10.80%	80.70%
	(406)	(524)	(3 903)

All of the respondents, irrespective of their eligibility for or use of the SBTCs were asked their overall general attitude towards the SBTCs and if the SBTCs were a waste of time for everybody and whether small businesses would be better off with a lower tax rate and a simpler tax system. The findings are set out in Table 17 below.

Table 17: Attitudes of respondents towards SBTC in general

Statement	Agree or strongly agree	Disagree or strongly disagree	Unsure Not applicable Not relevant
SBTC saved my business some tax Rands	14.80%	13.40%	71.80%
	(715)	(644)	(3 463)
SBTC are so complex that it is hardly worth the effort	29.00%	12.10%	58.90%
	(1 400)	(585)	(2 844)
I was well advised by my accountant regarding the benefits of SBTC for my business	24.90%	14.70%	60.30%
	(1 198)	(708)	(2 901)
Accountants have a self-interest in pushing the use of SBTC	7.90%	22.00%	70.10%
	(379)	(1 049)	(3 345)
SBTC are a waste of time, we would be better off with lower taxes and a simpler tax regime instead	40.80%	10.40%	48.70%
	(1 992)	(510)	(2 380)

A preference for lower tax rates and a simpler tax system over the current SBTCs is what 40.8% of the respondents indicated was their attitude towards SBTCs. The large “unsure” and “not relevant/applicable” categories indicate either an unawareness or

lack of understanding of the SBTCs. Based on these views, it may be concluded that further research into the SBTC's role in reducing the compliance burden, and perhaps the effectiveness of the marketing campaign of SARS, is warranted.

5. CONCLUSION

Small businesses are critical in expanding the economy, because as they grow they become the employers of the future. Addressing the tax concerns of this sector of the economy should be a priority of the South African government. This study was designed as a large-scale survey with the objective of collecting primary data that would allow an evaluation of the impact of the tax system on small businesses' tax compliance costs. While evaluating and measuring the tax compliance costs incurred by small businesses, the study sought to differentiate tax compliance activities from core accounting activities, and to determine whether there were any managerial benefits or other tax compliance benefits that could offset the gross compliance costs identified. An attempt was also made to establish whether or not the SBTCs were effective in relieving some of the effects of the tax compliance burden on small businesses.

The findings of the survey indicate that there is possibly a slight bias towards the larger end of the small business sector, but that comparison with previous tax compliance cost studies was nevertheless justified. It was estimated that it took small businesses (not on the turnover tax system) an average of 255 hours per year to comply with tax legislation. Turnover tax respondents spent just under two thirds of the time (155 hours) to comply with their tax obligations compared to similar businesses not registered for this tax.

This study confirmed that gross tax compliance costs are regressive, and overall it cost small businesses R53 356.81 per annum on internal tax compliance activities and R9 982 to obtain external tax compliance assistance. It appears as if the internal costs have increased (for certain tax compliance activities) if compared to studies performed four to five years ago, although exact comparisons were difficult. The amounts paid for external tax services decreased when compared to previous studies performed four to five years ago, but the external non-tax services showed a noticeable increase.

Compliance with VAT represented around 38% of internal time costs, thus confirming previous research that compliance with this type of tax is very costly for the taxpayer. The most time-consuming activity for all taxes was recording information (representing 52% of total internal time).

The mean gross tax compliance cost for small businesses is R63 328 per year (R53 356 internal plus R9 982 external tax service provider costs). Net tax compliance costs could not be calculated as the value of the managerial benefits could not be quantified. Notwithstanding this, it was confirmed for the first time in South Africa that a large majority (75%) of the respondents perceived there to be benefits to tax compliance. In particular, they believed that keeping tax records was an incentive to keep better and more accurate records and that this, in turn, led to a better knowledge about the financial position and profitability of their businesses.

The findings regarding the effectiveness of small business tax concessions revealed that almost half of respondents (47%) in this survey were not eligible for any SBTCs, with a further 41% indicating that they were “unsure” if they were eligible. There is an indication that taxpayers generally did not understand SBTCs and that this is an obstacle to their adoption. The overall perception towards SBTCs is that they are more complex than useful and not worth the effort. Further empirical research in this area is clearly warranted.

Despite the government’s commendable efforts in efficiency and compliance cost reduction — South Africa’s tax system is ranked number one in the BRICS (Brazil, Russia, India, China and South Africa) economies for its efficiency and in easing the compliance burden for taxpayers (PwC, 2011:1) — the findings of this study tend to confirm the sentiments of Qabaka that the South African small business population is still in need of tax reform that will assist in minimising its tax compliance costs so that it can concentrate on one of the country’s primary needs — job creation. A truly simplified tax system available to all small businesses is regarded as desirable by the respondents. Research into the specifics of this system (or adjustments to the current concessions) is therefore considered a priority for a sector that is found in every inch of our economy.

6. FUTURE RESEARCH

From a size perspective, the lower end of the small business sector (those with a turnover of R1 million or less, or with less than five employees) also known as “microbusinesses”, should also be investigated in more detail, especially those without internet access. This additional research is necessitated as the results of this survey were predominantly received from the “larger” small businesses. Some doubt was cast on the turnover tax respondents as there appeared to be some contradicting information obtained from these respondents with regard to their eligibility. This additional research is especially important as it is possible that these micro businesses could have adopted the turnover tax system, and their views on this system’s ability to reduce their compliance costs would be most valuable in providing further insight into the effectiveness of this tax regime. Should they not have adopted this system, their reasons for not doing so would also provide insight into this tax system and its effectiveness.

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ANNEXURE A

SMALL BUSINESS TAX CONCESSIONS IN SOUTH AFRICA

Concessions (since 2001) introduced by the National Treasury and/or SARS that specifically relate to small businesses are as follows:

1. The introduction in 2001 of section 12E of the Income Tax Act (South Africa, 1962), being the Small Business Corporation (SBC) regime.
2. The Small Retailers VAT Package (SRVP) which was introduced in 2004 to assist small businesses in VAT record-keeping and calculation (deleted from 1 March 2010) (SARS, 2011a:1).
3. The capital gains tax relief of R900 000 (R750 000 before 1 March 2011) for the sale of small business assets introduced into the Income Tax Act (1962) in 2001 (South Africa, 1962: Eighth Schedule paragraph 57).
4. Filing of VAT returns every four months (instead of every two months) for small businesses with taxable supplies of less than R1.5 million (R1.2 million before 1 March 2008) introduced from 1 August 2005 (South Africa, 1991:section 27&4B).
5. The exemption, from 1 August 2005, from having to pay the skills development levy (SDL) for employers with an annual payroll of R500 000 or less per annum (South Africa, 1999: section 4(b)).
6. The introduction of the turnover tax for micro businesses from 1 March 2009 (this coincided with the increase in the VAT threshold for registration from R300 000 to R1 million) (South Africa, 1962: Sixth Schedule).
7. The ability, from 1 March 2009, for businesses with a taxable income of R1 million or less to base the second provisional tax payment on either the “basic amount” or an estimate of the actual taxable income for the year of assessment (rather than just an estimate as is required by businesses with taxable income of more than R1 million which might require additional time and calculations) without having to incur a 20% underestimate penalty. The “basic amount” is essentially the taxable income for the last year assessed. This is only valid as long as the estimate used is at least equal to 90% of the actual final taxable income (South Africa, 1962: Fourth Schedule).
8. The payment of a reduced application fee (R2 500 rather than R10 000) by an SME (as defined in section 12E(a)(i)) for a binding private ruling application which includes 8 hours of reviewing free of charge (which is not available to other applicants either) (SARS, 2011d:5).

The benefits for a small business of being eligible for each of these small business tax concessions are summarised below.

SBC benefits

Should the business entity qualify as a SBC, the tax-related benefits that it is entitled to are as follows: Reduced taxation payable as it is calculated on a sliding scale with a maximum rate of tax (currently 28%) applying only on taxable income in excess of R300 000, compared to a normal company, where this rate is levied from the first R1 of taxable income.

An accelerated (100%) write-off in comparison with the normal rules of the cost of manufacturing assets (plant and machinery) in the year the asset is brought into use for the first time. An accelerated write-off allowance in comparison with the normal rules for non-manufacturing assets (50% in the first year, 30% in the second year, and 20% in the third year) (South Africa, 1962).

SRVP benefits

A Small Retailers VAT Package was introduced by SARS in 2004 (SARS, 2005:1). This package provided an alternative method for qualifying small retail businesses to determine the value of the total taxable supplies — that is, it assisted in determining what proportion of the business' sales were taxable at the standard or zero rate. It was aimed at those small retail businesses that found it difficult to issue tax invoices for a large number of supplies made direct to the public. To qualify for this package, the business had to apply to SARS and had to sell standard, as well as zero-rated foodstuffs from the same business premises and had to make taxable supplies (excluding VAT) of less than R1 million in any 12 month period and did not have adequate point of sale equipment (SARS, 2005:1-3). The benefits of being registered for the SRVP was that the business was not required to purchase specialised equipment to record all of its standard and zero-rated sales and would only be required to retain limited records for VAT purposes (SARS, 2005:2). In addition, SARS would have supplied the approved small retailer with pre-printed booklets to assist it in determining its daily gross takings and zero-rated sales (SARS, 2005:2).

Capital gains tax benefits

Persons who operate small businesses as defined in paragraph 57 of the Eighth Schedule to the Income Tax Act (South Africa, 1962) are entitled to exclude R900 000 (R750 000 before 1 March 2011) of the capital gain made on the disposal of active business assets (subject to certain conditions) when they attain the age of 55 years, or where the disposal is in consequence of ill-health, other infirmity, superannuation or death.

VAT benefits

Small businesses with taxable supplies not exceeding R1 000 000 are not required to register for this tax and are therefore spared the burden of administering this tax. These businesses may, however, apply (in certain cases) for voluntary registration, which enables them to benefit from input tax credits on certain expenses, but also then imposes upon them the administrative burden of this tax. Certain small businesses are permitted to submit VAT returns every four months, instead of the normal monthly or two-monthly requirement (South Africa, 1991: section 27) which could assist in reducing their administrative burden. In addition, small businesses with taxable supplies of less than R2.5 million per year may elect to pay VAT on the cash basis, rather than the accrual basis (South Africa, 1991: section 15) which again might assist small businesses with their cash flow concerns.

SDL benefits

No SDL needs to be paid by businesses whose total remuneration subject to SDL paid/payable to all its employees does not exceed R500 000.

Turnover tax system

In essence, the benefits of being registered as a microbusiness under the turnover tax system is that these entities are subject to a low rate of tax on turnover without having to keep a record of their expenses and deductions (National Treasury, 2007:39-40). Minimal record-keeping is, however, required – micro businesses will need to retain records of the amounts received and dividends declared during the year of assessment, as well as proof of each asset and liability that has a value of more than R10 000 at the end of the year of assessment (SARS, 2011c:12).

Provisional tax benefits

The benefit available for businesses with a taxable income for the tax year that is R1 million or less, is that it may base its estimate of taxable income for purposes of calculating its second provisional tax payment on the lesser of the basic amount or 90% of its actual taxable income, without incurring any penalties for under-estimating its taxable income. A business that has taxable income of more than R1 million is not permitted to use the basic amount without the risk of incurring under-estimation additional tax/penalties.

Binding private ruling benefits

A small business has to pay only a R2 500 as opposed to a R10 000 application fee for a binding private ruling.

General

The exemption from SDL and relief on under-estimate penalties for provisional tax, were not separately considered in the survey. This is perhaps a flaw in the questionnaire, however, although the SDL is a separate tax, it is contained on the same return, almost calculated in the same way and is paid for in the same manner as employees' tax (PAYE) and is only payable at a rate of 1% (on a very similar amount used for PAYE purposes) and was thus not considered of great importance to this research.

In respect of the provisional tax, it must be noted that this is not a separate tax, but rather a system that makes taxpayers provide for their final tax liability by paying at least two amounts in a tax year. Thus it was inferred in the questionnaire that provisional tax was included in the income tax questions, but this fact could have been made clearer to the respondents and specific reference (in the small business tax concessions questions) could have been made to the provision of the alternative (simplified) manner in which the second provisional tax payment is calculated for businesses with a turnover of R1 million or less. This benefit should be incorporated into future studies of this nature.

The reduction in the binding private ruling fee is not a major benefit that is used frequently by small businesses, and was thus not considered important for the purposes of this study.