Public Relations Review 40 (2014) 226–239

Contents lists available at ScienceDirect

Public Relations Review

Perceptions of taxation: A comparative study of different population groups in South Africa

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ARTICLE INFO

Article history:
Received 28 October 2013
Accepted 13 November 2013

Keywords:
South African taxpayers
Population groups
Perceptions of taxation
Tax evasion

ABSTRACT

South Africa is a country of diverse cultures, languages, beliefs and backgrounds. It is conceivable that these different population groups may have differing perceptions of taxation resulting from their cultural backgrounds or even their political and social histories. These perceptions may, in turn, influence their attitudes towards tax compliance. It is, therefore, argued that in order to change taxpaying behaviour, perceptions must be first be identified, and then influenced in a positive way towards tax compliance.

This study extends prior research by investigating and comparing taxpayers' perceptions amongst the four major South African population groups (that is, Black/African, Indian, Coloured and White).

The data for this study was collected from a sample of 260 South African taxpayers by means of face-to-face interviews, based on a questionnaire, compiled from an extensive literature review. The scope of the study was limited as it focused only on natural taxpayers within the Tshwane metropolitan area (which includes Pretoria, the capital city of South Africa) in Gauteng, as the purpose was not to generalise conclusions to the entire South African population.

It was found that different population groups in South Africa may have different perceptions towards taxation. In order to create a more positive tax culture, government could possibly focus more strongly on educating the various population groups about the importance of paying their taxes. A multifaceted approach is needed in order to understand and influence the large number of factors that play a role in individual behaviour.

1. Introduction

Taxes have been levied in South Africa since 1914. Every year the Minister of Finance presents the annual budget, in which the total intended government expenditure for the following year is detailed. During this process, the manner of funding the expenditure is also indicated. Government expenditure in South Africa is predominantly funded by means of revenue generated from tax levies (Mohr, Van der Merwe, Botha, & Inggs, 1988; Venter, Hamel, & Stiglingh, 2004).

A significant tax gap exists in South Africa. The tax gap merely portrays the wedge between economic reality and a purely legal construct called statutory taxes (Franzoni, 1998). A figure of R30 billion is often quoted in the press as the extent of the gap (Cokayne, 2002; Kemp, 2002; Leuvennink, 2003; Mabanga, 2004; Temkin, 2002, 2003). Kemp (2002) is of the opinion that individual taxpayers make up the vast majority of the "tax gap".

South Africa is a country of diverse cultures, languages, beliefs and backgrounds. It is conceivable that these different population groups may have differing perceptions of taxation resulting from their cultural backgrounds or even their political

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http://dx.doi.org/10.1016/j.pubrev.2013.11.010

and social histories. These perceptions may, in turn, influence their attitudes towards tax compliance. This study, therefore, attempted without any pre-conceived ideas or expectations, to assess the perceptions about taxation amongst the different population groups in South Africa.

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

This study, therefore, aimed to determine whether the perceptions about taxation are different amongst the various population groups in South Africa.

This research makes a contribution to existing research as only limited research on taxpayers' perceptions has been conducted within a South African context.

2. Literature review

The reasons for evading taxes have been explored by both economists and psychologists. In order to establish the theoretical basis, an extensive literature review was conducted and prior research on various aspects relating to tax evasion was analysed.

2.1. Why do people evade taxes? – an economist's viewpoint

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

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

Over the years a number of extensions have been made to the classical model. One of these extensions defined the interactive (game-playing) models (Benjamini & Maital, 1985; Corchon, 1984 in Webley, Robben, Elffers, & Hessing, 1991). Further models incorporate the idea of limited rationality (Jackson & Milliron, 1986; Kahneman & Tversky, 1979, 1984; Schadewald, 1989).

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

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

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

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

In the first stage, the *problem-editing phase*, the individual reformulates options so that the subsequent choice is simplified. This editing consists of operations that transform the probabilities and outcomes, such as simplification (for example, rounding a probability of 0.49–0.50) and segregation (decomposing a choice into a more or less risky option). An important