TAX009

FACTORS INFLUENCING SOUTH AFRICAN SMALL BUSINESS VALUE-ADDED TAX REGISTRATION COMPLIANCE

Abstract:

Revenue losses due to tax non-compliance pose a substantial risk for all governments, including the South African government. As part of its risk management system the South African Revenue Service has identified the small, medium and micro enterprise sector as one of the seven high-risk areas and indicated that non-compliance in this sector remains high. The first focus area of any tax compliance risk management system is to ensure registration for the relevant taxes payable.

This study analyses survey data obtained from 2 772 respondents across South Africa to determine whether factors can be isolated that will assist the South African Revenue Service to identify businesses that are potentially non-compliant, with specific reference to Value-Added Tax Act registration compliance.

The study found that several factors had an impact on the registration compliance of small businesses. The group with the highest non-compliance rates were found to be small businesses in the service sector making a profit of less than R17 500 per annum located in the Free State. An analysis of the demographic factors of owners of non-compliant businesses revealed that the owners of these businesses are mostly coloured females aged between 16 and 24 years of age with only some primary education.

The result of the study can be used by the South African Revenue Service to target their compliance and information actions to help improve compliance with regard to value-added tax registration by small businesses.

Key words:

Small, Medium and Micro Enterprises (SMMEs)
Value-Added Tax (VAT)
Value-Added Tax registration
Tax registration compliance

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Acknowledgement:

The authors thank FinMark Trust for their support in obtaining the fieldwork data used in this study.

Declaration:

We hereby acknowledge that this manuscript or a similar one has not been published and is not, nor will be, under consideration for publication elsewhere while being reviewed for this SAAA conference.

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1. INTRODUCTION

Despite its limitations the SMME sector is expected to create approximately 90 per cent of new jobs in South Africa by 2030 (National Planning Commission, 2011:93). Minister Trevor Manuel confirmed that this sector plays an important part in achieving the objective of the National Development Plan –Vision for 2030, namely:

"*Reducing poverty through tackling unemployment along with dealing with poor education* *are the most important*(Bauer,2011) *of the 20*

In South Africa, as in most African countries, Small, Medium and Micro Enterp play a vital role in economic growth and job creation (National Treasury, 2013). According to

Cant and Ligthelm (2002:1) a strong SMME sector can lead to economic and political stability and sustainability in a country. Despite a relatively high failure rate, SMMEs contribute up to a

third to South Africa's gross domestic produ South Africa's(WorldBank,workforce2007:1).

The importance of the sector is further illustrated by the fact that although the average GDP growth between 2004 and 2007 was only 5 per cent per annum, the SMME sector grew by 27 per cent (Manuel, 2008:2; Department of Trade and Industry, 2008: xxvi). This rapid growth is partly

due to the fact that SMMEs form one of cornerstones of go poverty-alleviation and job creation strategy, resulting in various support and development

programs being implemented (Mahadea & Pillay, 2008:432, Department of Trade and Industry, 2008: xxiv). Despite this growth, Philip and Hassen (2008) identified the regulatory burden as the biggest constraint in developing the sector, with government strategies to reduce the burden proving to be ineffective.

Although studies investigating reasons for SMME failure identified taxes and associated administration as one of the biggest threats facing the small business sector, it is important that all businesses contribute their fair share to government income (Cant & Ligthelm, 2002:2; Smulders, 2008:8; Gordhan, 2012). According to the Constitution of South Africa, 1996, no discriminatory legislation can be enacted unless it is administratively justifiable in terms of section 36 of the Bill of Rights.

Despite various sections of South African taxation legislation discriminating based on the size of a business, the courts have ruled that these provisions are justifiable in terms of the Constitution as they are aimed at meeting specific objectives of government (Metcash Trading Ltd v The Commissioner: South African Revenue Service and the Minister of Finance (63 SATC 13)). The first point of discrimination in the Value-Added Tax Act, 89 of 1991 (hereafter the VAT Act) is the registration requirements (section 23). Only enterprises that make taxable supplies in excess of R1 million are required to register and enterprises making taxable supplies in excess of R50 000 have the option to register as a vendor. Although government has various programmes and incentives to support business growth, compliance with legislation and specifically tax compliance is of critical importance in meeting national objectives.

According to the Organisation for Economic Co-operation and Development (OECD), the first step in ensuring tax compliance is to ensure that taxpayers register for each of when they are required to. Being registered for a tax will enable government to monitor and ensure compliance in terms of filing, reporting and payment (OECD 2004). This is also the tax compliance model followed by South Africa, with registration being the starting point to ensure compliance (South African Revenue Service, 2012a).

In the present study, the results of field work conducted amongst SMMEs will be used to determine if any corporate-specific factors influence the registration compliance of small business. As value-added tax is the largest source of government revenue after income tax (National Treasury, 2013) and has a specific registration threshold, this tax was selected to investigate registration compliance practices by small business in South Africa. Although income tax is the largest source of tax revenue in South Africa it is unsuitable for the purpose of this study, as most small businesses are registered automatically during incorporation. The results of this study can benefit the South African Revenue Service (SARS) as it will help to identify factors that can assist in selecting businesses for registration compliance audits.

2 RESEARCH QUESTION

The research question investigated in this study is as follows:

Can any corporate-specific factors be used to identify registration compliance behaviour of SMMEs in South Africa, with specific reference to Value-Added Tax?

In order to be able to answer this research question it is firstly important to understand the conceptual framework within which the study takes place. The first important concept that needs to be defined is that of a small business. An analysis of studies done amongst Small, Medium and Micro Enterprises in South Africa revealed that various definitions and classifications exist (World Bank, 2007:3, Tustin *et al*, 2005: xi, Venter & De Clercq , 2007).

Government defines a small business as: "a separate and distinct business entity, including co-operative enterprises and non-governmental organizations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy."(National Small Business Act, No 102 of 1996: section 1). The subsector classification uses the number of full-time employees, the total annual turnover or total gross asset value to classify an enterprise as either micro-, very small, small or medium within a specific industry (National Small Business Act, Schedule). Certain other pieces of legislation also contain provisions that define a small business for the purpose of that legislation, for example the Income Tax Act, 58 of 1962 (Sixth Schedule).

As the present study aims to determine if any company-specific factors influence registration compliance and voluntary registration. The questions used to determine the registration status of a small business formed part of an omnibus study conducted by Finscope in order to profile small business in South Africa. For the purposes of the omnibus study an SMME was defined as an enterprise owned by an owner who is 16 years or older, who perceive themselves to be business owners and employ less than 200 employees (Finscope 2010). This definition was therefore used to identify sample elements to be included in the present study.

The next concepts that need to be analysed are that of a compliance framework as well as the registration requirements for Value-Added Tax. These will be discussed in a later section in order to develop a heuristic model of factors influencing SMME

3 RESEARCH METHODOLOGY

The study follows a mixed method approach firstly using a qualitative approach where the results of the literature survey were used to develop a heuristic model. The second phase of the study followed a quantitative approach to collect primary data. During the first phase of the research a model was developed to identify factors that can influence compliance behaviour of small businesses. In addition the legal framework within which they are required to comply with the provisions of the VAT Act was analysed. During the second phase of the study data was gathered from the small businesses in South Africa and analysed to determine if any factors influence the compliance behaviour of small business in relation to value-added tax. The data used in the survey was collected as part of an omnibus study conducted by Finscope to profile South African small businesses (Finscope 2010).

An omnibus survey is a periodic research survey conducted by a professional marketing research company, during which members of a specifically targeted community are interviewed about their habits, product and brand preferences etc. The survey respondents are selected using probability sampling. The term omnibus refers to the fact that different organisations can provide questions to be added to a core set of questions. The nature of the questions differs depending on the needs of the participating organisations but relate to the target audience. The main advantage of this form of survey is that it provides information at a relatively low cost and it is provided by professional research organisations via telephonic, face-to-face or other survey methods. (Market Research Society 2013; Monash University 2004; Ispos Mori 2013).

The current study formed part of the omnibus study investigating the overall profile of small business in South Africa. Although the survey took the form of an omnibus survey it differed slightly from traditional omnibus studies as FinMark Trust acted as the main sponsor which provided other institutions such as government and academic institutions opportunity to identify aspects to be considered during the investigation. This study is based on a question about the VAT registration status added to the survey, however, due to the nature of omnibus surveys access is also gained to the demographic information of respondents (Market Research Society 2013). As the current study is used for academic purposes, FinMark Trust granted the authors access to additional information contained in the data set. The following section provides an overview of the methodology applied during the sampling and data collection process.

The first phase of the data collection consisted of 15 focus groups with small business owners from both urban and rural areas, during which qualitative data was collected. The results of this phase of the survey and interaction with other stakeholders were used by FinMark Trust to construct a structured questionnaire with mainly closed-ended questions. The questionnaire construction was done in collaboration with TNS Research Surveys (fieldwork experts and the research house responsible for collecting the data).

Due to the nature of the study no sampling framework existed and therefore a multi-stage small business listing exercise was performed with the aid of sampling experts. The sampling method made use of enumerator areas (EAs) that were representative at a national, urban-rural and regional level. During the sampling process a random sample was selected of small business owners to be interviewed for each of the sampled EAs. To ensure representivity across all sampling levels, a sample of 1 000 EAs was drawn with the aim of interviewing six small business owners as defined (refer to section 2 above). It was not possible to interview six small business owners in all of the 1 000 sampled EAs as in some EAs the listing exercise indicated that there were less than six small business owners whilst in other EAs there were none. The validity of the listing exercise was evaluated, where less than six interviews were recorded for a specific EA. If a specific EA had no interviews, a replacement EA was sampled at random to be added to the original sample of 1 000 EAs in order not to affect the planned sample size of 6 000 interviews.

Of the 6 450 sample elements identified during the sampling process 5 676 interviews were completed successfully. All interviews were conducted by TNS Research Surveys, the research house contracted to obtain the data to be used by all organisation included in the omnibus. Extensive and comprehensive quality controls were applied during the data capturing and cleaning process. This was done to ensure the quality and accuracy of the data collected as well as ensuring that the survey methodology was effectively implemented so that the validity and accuracy of the extrapolation of the survey data could not be questioned. Data recapturing was done to verify and ensure the quality of data captured. Extensive forensic checks were also carried out on the entire dataset. Data analyses are done by means of descriptive statistics.

This section of the article has described the process of selecting and collecting the data. The next two sections provide the results of the first phase of the study, namely the model for tax registration compliance and the legal framework within which businesses must register.

4 TAX REGISTRATION COMPLIANCE

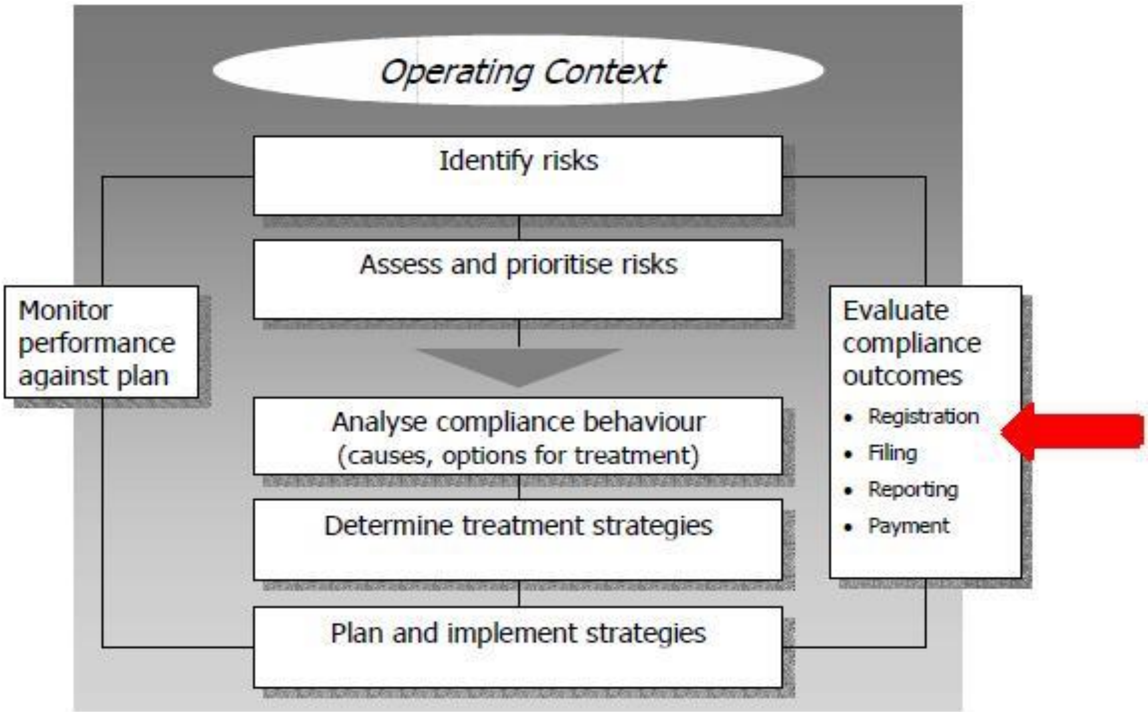
Already in his book, The Wealth of Nations, Adam Smith (1776) stated that citizens of a country should contribute to the state in order to receive the privileges of living in a country. Tax compliance refers to the extent to which citizens of a country meet their legal obligations to

register and pay taxes. Many reasons exist for non-compliance ranging from unintentional error to deliberate fraud (OECD 2004:7).

The OECD (2004) developed the “Compliance R identify key areas of risk for the tax authority, for which they should consider introducing

processes to improve compliance and reduce the risk. The present study will focus on the first compliance risk identified in this framework, namely registration compliance (refer to figure 1). The motivation for this selection is that a business that is not registered for a specific tax will not meet the other compliance outcomes - file returns, submit reports or make payments.

Figure 1: Compliance risk management process



(OECD, 2004:9)

When considering factors that could influence registration compliance, factors influencing tax compliance in general must be analysed. Previous studies investigating compliance behaviour by taxpayers found that several factors influence each other and work conjointly to determine a taxpayer's complianceStudiesinvestigatingbehaviourcompliance. of taxpayers are traditionally done from within a specific discipline, normally economic (Allingham & Sandmo

1972; Cowell 1985) or the fields of psychology and sociology (Hessing, Elffers & Christiaanse 1989 and Hasseldine & Li 1999).

The modern approach seems to favour mixed models where the two approaches are used to reinforce each other. Both Kirchler (2007) and Torgler (2007) review and analyse existing tax compliance research and describe several determinants that may have an influence on tax compliance. Kirchler (2007) reviews and analyses existing tax compliance research and describes several determinants that influence tax compliance, for example complexity of tax law, the shadow economy, social representations of taxes, and the interaction between tax authorities and taxpayers. Following a similar approach, Torgler (2007) found that the relationship between taxpayers and governments can shape tax morale.

Studies investigating the relationship between income level and compliance yielded contradictory results. Some studies found a direct relationship between income levels and tax compliance (Ali, Cecil & Knoblett (2001)), whilst Fjeldstad and Semboja (2001) found a negative relationship. Interestingly Muelbacher, Kirchler, Hoelzl, Ashby, Berti, Job, Kemp, Peterlik, Roland-Lévy and Waldherr (2008) found in a multi-country study that compliance is linked to the perceived effort to earn income.

Several studies have been conducted into factors influencing tax compliance in South Africa. The following factors were identified as contributors to tax compliance in South Africa: socio-economic and cultural factors (Lieberman 2002, Gcabo & Robinson 2007), knowledge of government's responsibilities (Hlope & Fried government and perceived fairness of tax administration (Cummings, Martinez-Vazquez, McKee & Torgler 2005;), compliance costs (Abrie & Doussy 2006, Foreign Investment Advisory Service 2007,Venter & De Clercq 2007); income levels (Gcabo & Robinson 2007, Oberholzer & Stack 2009, Venter, de Clercq, Swanepoel, Posthumus, Doussy, Heyns & van Aardt 2010). As in the case of international studies it is to be expected that these factors influence each other to determine a taxpayer's compliance behaviour.

Venter *et al* (2010) summarised the relationship between different variables and tax compliance, as shown in figure 2.

Figure 2: Factors influencing the level of tax compliance

Hard variables

Fully compliant

4.4 Interaction between tax authorities and taxpayers 4.5 Salaried taxpayers (compliance are [sic] done on their behalf) 4.6 Income levels	4.1.4 Limited/no measurable direct benefit: e.g. standard of education or health care 4.1.5 Deliberate understatement of income 4.1.6 Deliberate overstatement of deductions 4.1.7 Deliberate incorrect application of the Act to minimise tax payable 4.1.8 Non or late submission of tax returns 4.1.9 Creative business structures to reduce tax liabilities 4.1.10 Income levels 4.1.11 High compliance costs 4.1.12 Cash flow problems
4.1.3 Tax compliant decisions (timeously submission of returns and payments etc.) 4.1.4 High tax morale –compliance is believed to be the norm 4.1.5 Opportunity costs of evasion 4.1.6 Effort required to earn the income 4.1.7 Tax enforcers'[sic]attitudestoward taxpayers – service provider to taxpayers 4.1.8 Perceptions regarding fairness of tax administration 4.1.9 Sound advice from tax consultants	4.1.13 Diminishing state effectiveness 4.1.14 Perceptions regard appropriation of tax received: ○ Impact of crime on taxpayer (Police [sic] services not up to standard) ○ Failure of education systems Overall failure in service delivery 4.1.11 Complicated tax law 4.1.12 Shadow economy 4.1.13 Social representation 4.1.14 Low tax morale –compliance is believed not to be the norm 4.1.15 Opportunity costs of evasion 4.1.16 Tax enforcers [sic]' attitudes – seen as potential criminals 4.1.17 Incorrect advice from tax consultants 4.1.18 Lack of personal benefit 4.1.19 Inequality

Fully non-compliant

Soft variables

Venter, de Clercq, Swanepoel, Posthumus, Doussy, Heyns & van Aardt (2010)
Webley, Robben, Elffers and Hessing (1991) found that compliance is influenced by the risk of detection and the consciences of those not understand the risk of detection a brief analysis of some of the aspects of the South African

Revenue Service’s-yearcomplianceprogrammefiveare provided. Seven broad areas have been identified on which the SARS will focus (South African Revenue Services 2012a). Small businesses have been identified as one of the seven focus areas of the compliance program. As part of the program SARS indicated that registration drives will be undertaken. The compliance activities for small businesses will focus on:

- improving registration of small and micro businesses through a registration drive with other government agencies;
- encouraging small businesses toward a developed structure of record-keeping for the purpose of sound business practice and assisting in tax compliance;
- providing more electronic options for registration, filing and payments;
- cooperation with other government agencies to enhance the existing -stop”“one shop w small businesses can have all their regulatory needs serviced;
- imposing administrative penalties for non-compliance, including late submission of returns; and
- the use of agency appointments for the collection of outstanding debts (South African Revenue Services 2012a).

It is clear that the SMME sector represents a high risk area from a compliance perspective, especially in light of the number of SMME enterprises, the fact that their income fluctuates and that the income is not easily verifiable against third party data. Other factors such as the commercial set-up of the business, which lacks formal record-keeping, independent audits and proper cash handling, also contribute (South African Revenue Services 2012a).

From the analysis of the SARS Compliance Programme 2012/2013- 2016/2017 (South African Revenue Services 2012a) it is clear that the risk of detection will increase for small business. In order to understand the registration requirements and consequences of non-compliance the legal framework within which value-added tax is levied must be investigated.

5 THE LEGAL FRAMEWORK FOR REGISTERING FOR VALUE-ADDED TAX

According to the VAT Act, a person is liable to register for VAT if he/she carried on an enterprise on or after 30 September 1991 and the total value of taxable supplies within the:

- preceding 12 month period exceeded the threshold of R1 million (section 23(1)(a));
- next 12 month period is likely to exceed the threshold of R1 million (section 23(1)(b)).

The proviso to section 23(1) provides that if threshold is exceeded solely due to:

- a once-off transaction, e.g. the sale of a property;
- the replacement of plant and machinery or other capital assets used in the enterprise; or
- abnormal circumstances of a temporary nature,

the vendor will be deemed not to have exceeded the threshold.

In terms of section 22 of the Tax Administration Act, 28 of 2011 (hereafter referred to as the TAA), any person who has become liable for registration must apply for registration not later than 21 days after such a person has become liable to register for the first time.

The VAT Act states that a person is registered as a vendor for VAT and not in respect of each activity or enterprise (South African Revenue Services 2012b). Where a person carries on business by way of separate branches or enterprises, the registration threshold is determined for all divisions or enterprises combined. Section 50A gives the Commissioner the right to regard the various separate legal entities as one vendor for VAT purposes.

Only the value of taxable supplies must be considered in order to determine if a business should register as a vendor for value-added tax purposes (section 7). The definition of supply includes performance in terms of a sale, rental or instalment credit agreement and all other forms of supply (section 1).

In terms of the definition, taxable supplies include any supply of goods or services which are chargeable with tax under the provisions of section 7(1)(*a*), including tax chargeable at the rate of zero per cent under section 11. The only amounts excluded from taxable supplies are supplies that are exempted in terms of section 12 of the VAT Act.

If an enterprise does not meet the requirements for compulsory registration, it can elect to voluntarily register to become a VAT vendor. In order to be eligible for register voluntarily, the value of taxable supplies already made by the enterprise must exceed the minimum threshold of R50 000 in the preceding 12 months (section 23(3)). It may be advantageous to register voluntarily if goods or services are supplied mainly to other vendors and consequently the vendor will be able to deduct the VAT charges as input tax.

One of the aspects businesses consider when deciding whether to comply with legislation, is the consequences of non-compliance. The TAA prescribes two types of penalties, namely administrative non-compliance penalties (sections 208 to 220) and understatement penalties (sections 221 to 223). The Act also lists certain actions as criminal offences (sections 234 to 238).

Administrative non-compliance penalties are divided into two groups in the TAA:

- *fixed amount penalties*: the fixed amount penalties are imposed for non-compliances, including failure to register (section 211). The penalty system provides for recurring monthly penalties for each month that a tax return remains outstanding;

- percentage-based penalties: if SARS is satisfied that an amount of tax was not paid as required, SARS must also impose a penalty based on a prescribed table. This penalty must also be calculated on amounts not paid due to non-registration (section 213).

An understatement penalty can also be levied if non-payment is due to non-compliance and, depending on the reason for non-compliance, the rate varies between 25% and 200% (section 222).

Sections 234 to 238 of the TAA identify four types of actions that are considered to be criminal offences, the first being non-compliance with tax Acts. The Act states that “failure to register or notify SARS of a change in registered particulars”is regarded as a criminal offence, which can lead to a fine or imprisonment for a period not exceeding two years.

6 RESULTS

The detailed analysis of previous South African and international studies (refer above) identified various corporate-specific and owner demographic factors that influence compliance by SMMEs. The aim of the present study is to identify any corporate-specific factors that may influence registration compliance behaviour of small businesses. As no comprehensive sample framework exists the first aspect to consider is the profile of the small businesses that participated in the survey. The profile of participants will be followed by an analysis of the value-added tax registration status of the businesses. The profile of businesses that do not comply with the current legislation will be analysed and as well as those businesses that elect to register voluntarily for value-added tax purposes.

6.1 Profile of small businesses

Profiles of respondents are provided in Table 1. It appears from this table that all critical demographical attributes required for this study and the overall omnibus study were adequately captured, including an acceptable distribution of respondents across provinces, gender, area, age, marital status, population group, level of education, main type of business, as well as number of employees.

Table 1: Demographic profiles of respondents (omnibus)

	N	%
PROVINCE		
Eastern Cape	727	12.8
Free State	445	7.8
Gauteng	1 137	20.0
Kwa-Zulu Natal	892	15.7
Limpopo	535	9.4
Mpumalanga	472	8.3
Northern Cape	283	5.0
North West	496	8.7
Western Cape	689	12.1
Total	**5 676**	**100.0**
AGE		
16 –24	537	9.5
25 –34	1 353	23.8
35 –49	2 201	38.8
50 –64	1 277	22.5
65+	291	5.1
Refused	17	0.3
Total	**5 676**	**100.0**

	N	%
GENDER		
Male	2 547	44.9
Female	3 129	55.1
Total	**5 676**	**100.0**
MARITAL STATUS		
Married/Living with someone	3 311	58.3
Single/Divorced/ Widowed	2 365	41.7
Total	**5 676**	**100.0**
LEVEL OF EDUCATION		
Some primary education	1 071	18.9
Some secondary education	3857	68
Some tertiary education	748	13.2
Total	**5 676**	**100.0**

	N	%
POPULATION GROUP		
Black	3 935	69.3
Coloured	599	10.6
Asian/Indian	395	7.0
White	747	13.2
Total	**5 676**	**100.0**
TURNOVER OF BUSINESS		
R0 –R49 999	1368	24.1
R50 000 – R499 000	1146	20.2
R500 000 – R1 million	132	2.3
R1 000 000+	132	2.3
Refused	1467	25.9
Don't know	1431	25.2
Total	**5676**	**100.0**
MAIN BUSINESS		
Services	1 599	28
Products	4 077	72
Total	**5 676**	**100.0**

	N	%
ANNUAL NET PROFIT OF BUSINESS		
< R7 500	537	9.5
< R17 496	599	10.6
< R30 000	611	10.8
< R24 000 000	1 025	18.0
Refused	1 486	26.1
Don’t know	1 418	25.0
Total	5 676	100.0
AREA CLASSIFICATION		
Urban formal	3 389	59.7
Urban informal	472	8.3
Tribal area	1 370	24.1
Rural formal	445	7.9
Total	**5676**	**100.0**
TOTAL WORKERS		
0 (Owner only)	3 715	65.5
1	804	14.2
2-5	877	15.5
5+	280	4.8
Total	**5 676**	**100.0**

As this study is part of an omnibus study, the targeted group of respondents (SMMEs) provided information relevant to all participating organisations. Based on the nature of the sector investigated it is expected that a large portion of the businesses would not be required to register for VAT. The results of the variable calculated based on the VAT registration status included in the omnibus survey, revealed that 646 respondents (11.38%) indicated that the business is registered as vendors. Due to turnover being a critical factor in determining if the businesses are compliant with VAT registration requirements, only business that provided information regarding turnover (i.e. excluding “refuse”and “don’t”responses)knowwere included in this study. The realised sample for purposes of this study is therefore 2 772 respondents, of which 335 (12.1% of realised sample) either had to register for VAT or elected to register voluntarily .

Applying the VAT registration requirement to the respondent profiles, it was found that only 127 respondents were required to register as vendors. Comparing the actual number of respondents registered as vendors and those required to register it is clear that a large portion of small businesses elect to register as vendors in terms of the voluntary registration provisions.

Although considerably more businesses are registered as vendors than required, an analysis of the businesses that should have been registered revealed that only 58.3% of these businesses are compliant. The 41.7% of respondents not meeting their registration obligation, confirms anecdotal evidence that leakage in the VAT system occurs within the SMME sector.

As part of the objective of the study is to determine if any corporate-specific information could be used to focus the efforts of SARS to improve compliance, the compliance status of businesses that should be registered for VAT purposes will be analysed in the next section (section 6.2), followed by a discussion of corporate-specific information of businesses that are registered voluntarily (section 6.3)

6.2. COMPLIANCE PRACTICE

6.2.1 Introduction

In this section the businesses that should have been registered for VAT purposes will be analysed using different corporate-specific factors. The number of businesses not registered will be analysed per factor. As the results could be influence by the sample distribution per factor, the compliance behaviour of businesses within each variable subgroup will also be further investigated. For example, when identifying non-compliant businesses using net profit, the majority of businesses come from the group with a net profit above R30 000. A further analysis per subgroup reveals that businesses in this subgroup are the most compliant. In order to facilitate comparability between different subgroups an index score will be calculated. The following formula will be used to determine the index score for each subgroup.

$$\pi_n = X_n \ / \quad (_{1\text{-}2}) \ \text{x}\sum 100X$$

where the following values will be used

π_1 = The index score of businesses that are compliant with the VAT.

π_2 = The index score of businesses that are not compliant with the VAT.

X_1 = Number of businesses (N) that should have been registered for VAT and are registered, therefore compliant with registration requirements.

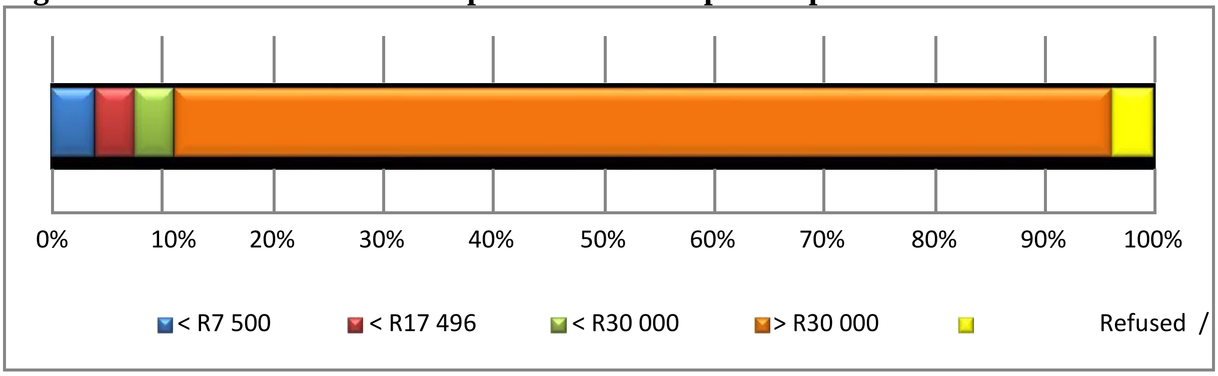
X_2 = Number of businesses (N) that should have been registered for VAT but are not registered, therefore not compliant with registration requirements.

The index scores calculated per subgroup will provide an indication of the compliance behaviour of businesses within that group.

6.2.2 Profitability of business

The income and profitability of a business is expected to have an impact on the registration status of the business, with non-profitable businesses having to focus more on survival of the business, resulting in less time to comply with different pieces of legislation. Figure 3 provides the distribution of the businesses that were classified as non-compliant (i.e. should have been registered as a vendor but are not).

Figure 3: Distribution of non-compliant businesses per net profit of business



The information in figure 3 clearly indicates that the largest proportion of non-compliant businesses have profits of more than R30 000. This result confirms the findings of Ali, Cecil & Knoblett (2001) that non-compliance increases as income increases. However, the result provided in figure 3 should be interpreted with care, as the main registration requirement is a turnover of more than R1 million and there is not an even distribution of businesses between the different net profit subgroups. To obtain a better understanding of the compliance behaviour of the businesses per sub group the index scores should be analysed (refer to table 2).

Table 2: VAT registration per net profit of business (index scores)

Annual net profit	VAT registration compliance status	
	Compliant (π_1)	Non-compliant (π_2)
Less than R7 500	33	67
Between R7 500 and R17 496	0	100
Between R17 496 and R30 000	33	67
More than R30 000	61	39

The results indicate that although the majority of businesses that are not registered for VAT have an annual net profit of more than R30 000, when considering all the businesses included in this group, these businesses are more compliant than those not as profitable. Although net profit can be a basis of selecting businesses for compliance audit, it is probably not the best criteria if used in isolation as businesses with a profit of more R30 000 should be targeted but this group generally has a high compliance rate. It is therefore clear that to target resources effectively towards improving compliance behaviour other factors should be considered and used in combination with net profit.

6.2.3 Main business

The VAT Act states that both businesses that sell goods or provide services must register as vendors (section 7). The initial analysis found that three out of every five small businesses that are not registered are providing services. It is however interesting to note (table 3) that when analysing per subgroup there is only a small difference between the registration compliance statuses of small businesses providing services and those selling goods.

Table 3: VAT registration per main business (index scores)

Main business	VAT registration compliance status	
	Compliant (π_1)	Non-compliant (π_2)
Services	57	43
Products	60	40

An analysis of the subcategories within each of the two main groups revealed that businesses providing goods in the agricultural sector are most compliant (100 index score) compared to businesses in the manufacturing sector (e.g. make products such as clothes, furniture or bricks) with the lowest index score of 33 index score. Analysing businesses in the services sector revealed that professional services providers, for example doctors and lawyers, were the most compliant (85 index score) whilst business in the other services category (taxi services, garden services) being the least compliant (41 index score).

6.2.4 Province

An analysis of businesses not registered per province (figure 4) indicates that the largest number of businesses not compliant with the compulsory VAT registration requirement are in the Western Cape, followed by Limpopo. In order to determine if there is a difference in the compliance status of businesses that should be registered within any province, the index scores for the provinces are provided (refer to table 4).

Figure 4: Distribution of non-compliant businesses per province

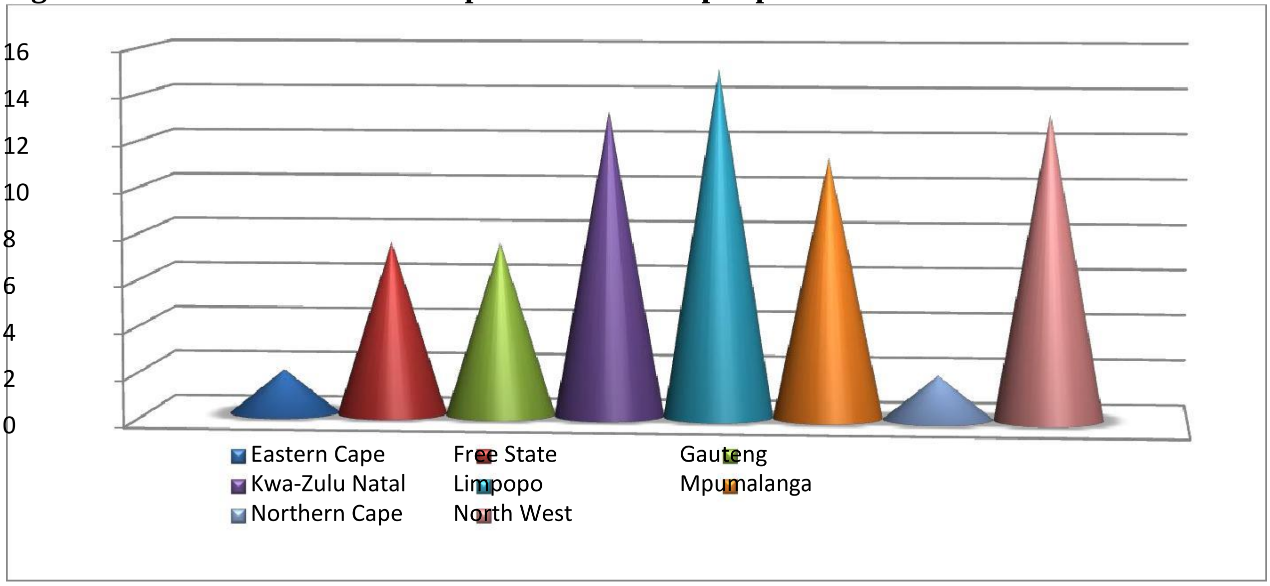


Table 4: VAT registration status per province (index scores)

Province	VAT registration compliance status	
	Compliant (π_1)	Non-compliant (π_2)
Eastern Cape	75	25
Free State	20	80
Gauteng	88	12
Kwa-Zulu Natal	42	58
Limpopo	27	73
Mpumalanga	50	50
Northern Cape	91	9
North West	42	58
Western Cape	44	56

The compliance analysis per province indicated that the Northern Cape has the highest level of compliance, with 9 out of 10 businesses meeting their obligations. Only three of the provinces have more businesses meeting their compliance obligations, than those who do not. The province with the highest non-compliance record is the Free State with only one in five businesses meeting their obligations.

6.2.5 Business owners' demographic informati

Age of business owner

The analysis of the age distribution of owners of small businesses found that owners between the ages of 35 to 49 years of age represented the largest proportion of non-compliant businesses (32.1%), followed by business owners aged between 50 to 64 years (28.3%) and between 25 to 34 years (26.4%). Businesses owned by people younger than 25 years of age and older than 65 years of age represented a small portion of all non-compliant businesses. As previous studies found that the age of business owners has an impact on their perceptions of the importance of tax compliance (Oberholzer & Stack 2009; Lieberman 2002), the results of this study are also analysed per age group to determine if there is a difference in their behaviour.

Table 5: VAT registration status per age group (index scores)

Age of business owner	VAT registration compliance status	
	Compliant (π_1)	Non-compliant (π_2)
16 –24 years of age	0	100
25 –34 years of age	53	47
35 –49 years of age	63	37
50 –64 years of age	61	39
65 and older	60	40

From the analysis it is clear that the age of the business owner does not have a major impact on the compliance status of the business. Although the analysis indicates that owners younger than 24 years of age have the worst compliance record, the result should be interpreted with caution due to the limited number of respondents in this group that are required to register as vendors.

Population group

The distribution of owners per population group found that proportionately the highest non-compliant group were black business owners (50.9%), followed by coloured and white business owners (20.8% each) and Asian business owners (7.5%). The compliance analysis per subgroup (table 6) found that the majority of businesses owned by Asian and white respondents are compliant compared to the majority of businesses owned by black and coloured owners being non-compliant.

Table 6: VAT registration per population group (index scores)

Population group	VAT registration compliance status	
	Compliant (π_1)	Non-compliant (π_2)
Black	34	66
Coloured	31	69
Asian/Indian	64	36
White	81	19

Gender

Although the analysis of non-compliant businesses found that 56.6% of them are owned by males, the total businesses owned by males are more compliant (π_1 = 67) compared to female owned businesses (π_2 = 38). The analysis indicated that businesses owned by male respondents are more compliant than those owned by female respondents.

Level of education

Previous tax compliance studies found that the education level of a person has an impact on his or her tax compliance status (Lieberman 2002). Figure 5 provides the distribution of the non-compliant businesses based on the education levels of the owners of the business. Table 7 provides the compliance behaviour per subgroup based on the level of education of the owners.

Figure 5: Distribution of non-compliant businesses per education level of owner

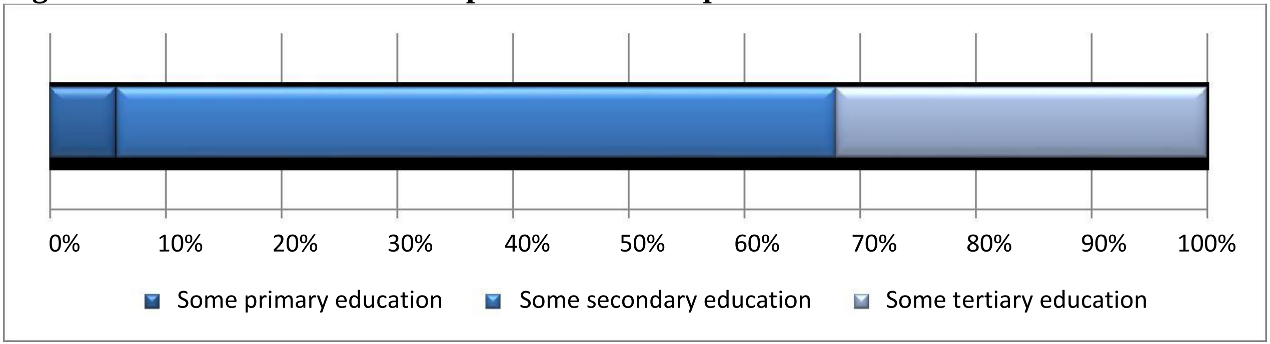


Table 7: VAT registration per level of education (index scores)

Level of education	VAT registration compliance status	
	Compliant (π_1)	Non-compliant (π_2)
Some primary education	25	75
Some secondary education	48	52
Some tertiary education	72	28

The results of the analysis confirm the results found by Lieberman (2002), namely that compliance increases with an increase in the education level of a respondent. Only one in four businesses owned by respondents with primary education meet their registration compliance obligations, compared to approximately one in four not meeting their obligations for businesses owned by respondents with some tertiary education.

6.2.10 Conclusion

The analysis of the corporate-specific factors and demographic factors of owners of small businesses confirmed that different factors do have an impact on the small business VAT registration compliance. These results could be used to target compliance actions by revenue authorities and accountants to ensure clients are compliant.

6.3 VOLUNTARY VAT REGISTRATION

6.3.1 Introduction

A surprising result from the survey was the large number of businesses that elected to register for VAT on a voluntarily basis. In total 1 278 respondents meet the voluntary registration requirements of the VAT Act. Of these respondents 208 elected to register voluntarily, representing 16.3%. An interesting phenomena was that 222 of the 1 468 respondents (15.12%) that refused to provide information regarding turnover were also registered for VAT. A possible contributing factor for the high levels of voluntary registration is the fact that the compulsory registration turnover level was R300 000 until 1 March 2009 resulting in previously compulsory registered businesses electing not to deregister as vendors.

The next section investigates corporate-specific factors of businesses electing to register voluntarily. The results can assist in identifying businesses that can be supported using the VAT system as mode of delivery. The results provided are based on the number of businesses that elected to register voluntarily compared to the total number of businesses.

6.3.2 Net profit

A small business development study found that more profitable small businesses contribute to economic growth and employment (Cant & Ligthelm 2002). The analysis of the profitability of the businesses (table 8) indicates that businesses whose profit is less than R30 000 are almost half as likely to register voluntarily compared to those with a profit of more than R30 000. 21% of businesses with a turnover of more than R30 000 elected to register voluntarily. Despite the slight anomaly in first subgroup, results confirm that as the profitability increases more businesses elect to register voluntarily. A possible explanation for this is that access to certain contracts and tenders requires the business to have a VAT registration number.

Table 8: Voluntarily registered businesses per annual net profit

Annual net profit	Percentage of voluntarily registered businesses (within subgroup)
< R7 500	10%
< R17 496	7%
< R30 000	8%
> R30 000	21%

6.3.3 Turnover of business

The analysis of voluntarily registered businesses based on their turnover is provided in table 9. The results found a relationship between the turnover in the company and the voluntary registration levels, with an increase in voluntary registration as turnover increases.

Table 9: Voluntarily registered business per turnover of the business

Turnover	Percentage of voluntarily registered businesses (within subgroup)
R0 –R49 999	0%
R50 000 –R499 000	14%
R500 000 –R1 000 000	40%

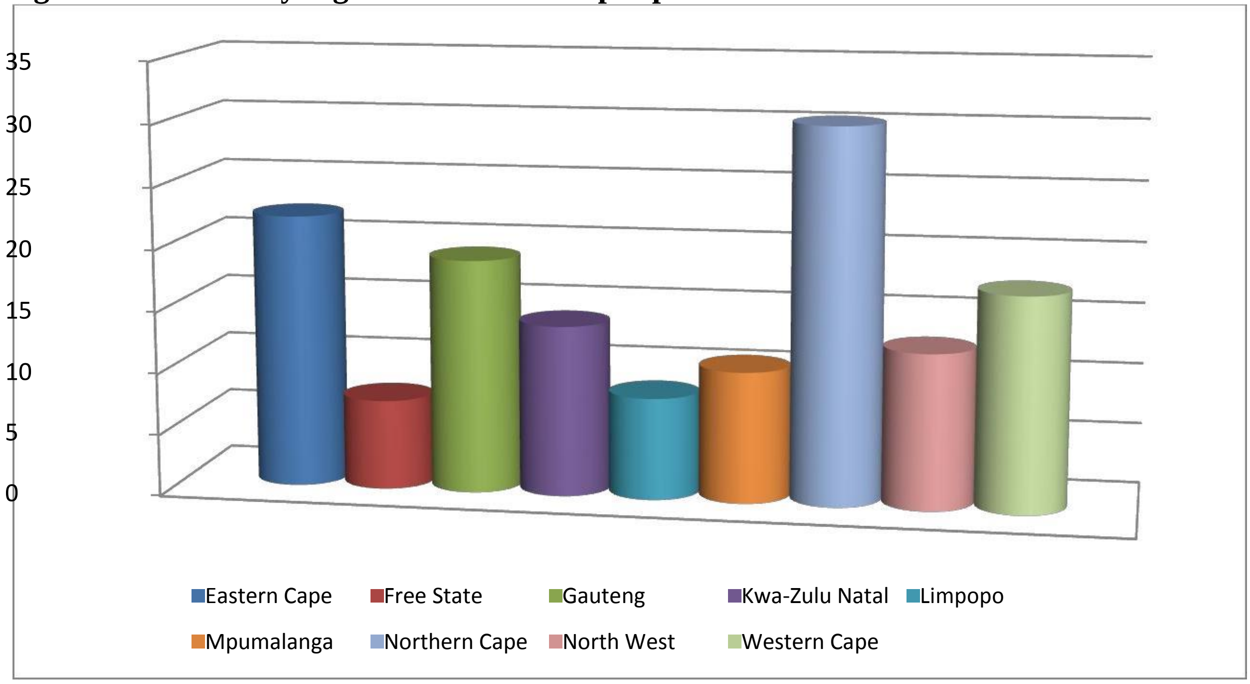
6.3.4 Main business

More businesses that sell goods (22%) are voluntarily registered for VAT purposes, than those providing a service (14%). This result is to be expected as a business buying and selling goods benefits more from the VAT system as they are able to claim input tax on the goods purchased thus reducing the overall cost of purchases for the business. One of the major expenses of service businesses are salaries and wages. As no input tax can be claimed on these costs there is not as much motivation to register for VAT as it provides fewer benefits for service businesses.

6.3.5 Province

Figure 6 provides a summary of the businesses voluntarily registered based on geographical distribution.

Figure 6: Voluntarily registered businesses per province



The Northern Cape had the highest percentage of voluntarily registered businesses (30.4%) with Free State the lowest (7.3%). It interesting to note that the Northern Cape also had the highest compliance rate amongst businesses that had to register for VAT and the Free State also had the lowest compliance rate.

6.3.6 Business owners' demographic information

Table 10 provides a summary of the demographic factors of the business owners of businesses registered in terms of the voluntary registration provisions of the VAT Act.

From the information provided business owners aged above 65 years of age make marginally more use of the option to register voluntarily for VAT purposes. Considerably more business owned by white respondents elects to register voluntarily. Interestingly proportionately male business owners are more inclined to register voluntarily than their female counterparts. The results relating to educational levels mirror patterns identified in compliance studies, namely that the higher the education level the higher propensity to register voluntarily.

Table 10: Voluntarily registered businesses per business owners' demog

Demographic factor	Percentage of voluntarily registered businesses (within subgroup)	Demographic factor	Percentage of voluntarily registered businesses (within subgroup)
Age		**Population group**	
16 –24 years of age	9.4%	Black	11.5%
25 –34 years of age	11.6%	Coloured	14.3%
35 –49 years of age	19.0%	Asian/Indian	22.6%
50 –64 years of age	18.0%	White	35.2%
65 years and older	19.6%	**Level of education**	
Gender		Some primary education	3%
Male	18.3%	Some secondary education	14%
Female	14.4%	Some tertiary education	35%

7 CONCLUSION

The objective of this paper is to determine whether any demographic factors can be used to identify businesses that can be targeted to improve VAT registration compliance by small businesses in South Africa. The results provided in this paper are based on the results of a nationwide survey. The results of the analysis provided in this paper identified the following factors that can be used to target compliance measures:

Factor	Most compliant group	Least compliant group
Main business	Products	Services
Net profit	> R30 000	< R17 496
Province	Northern Cape	Free State
Business owner'	35 –49	16 –24
Business owner'	White	Coloured
Business owner'	Male	Female
Business owner'	Some tertiary education	Some primary education

Having identified demographic factors that can be used to identify non-compliant businesses, an interesting finding was that the demographic profile of business electing to register voluntarily followed similar patterns to the level of compliance. Factors that resulted in higher levels of compliance also indicated higher levels of voluntary registration.

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