

**THE IMPACT OF TAXPAYER EDUCATION  
ON TAX COMPLIANCE IN SOUTH AFRICA**

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## **ABSTRACT**

### THE IMPACT OF TAXPAYER EDUCATION ON TAX COMPLIANCE IN SOUTH AFRICA

The South African economy is faced with the existence of a sophisticated industrial economy alongside an informal sector that is not properly regulated. As a result of poor and delayed compliance from the taxpaying population, a need arose to educate our society on their social responsibility to pay their taxes. This study is aimed at identifying the impact of tax education on tax compliance. The study endeavours to bridge the tax gap and engender a tax culture, by balancing the education and enforcement functions.

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## GLOSSARY

### Taxpayer Education & Communication (TEC) Acronyms

#### Below are Acronyms found in TEC Documents

C&L	Communication & Liaison (Disclosure)
CAS	Customer Account Services
CI	Criminal Investigation
CPE	Continuing Professional Education
EIC/EITC	Earned Income Credit/Earned Income Tax Credit
ETLA	Electronic Tax Law Assistance
FA	Field Assistance
FT	Financial Transactions
HQ	Headquarters
IRM	Internal Revenue Manual
IRTS	Issue Resolution Tracking System
LMSB	Large & Mid-Size Business Operating Division
R-Mail	Referral Mail
SARS	South African Revenue Services
SB/SE	Small Business/Self-Employed Operating Division
SPEC	Stakeholders, Partnership, Education & Communication (W & I)
TE/GE	Tax Exempt/Government Entities Operating Division
TEC	Taxpayer Education & Communication (SB/SE)
TRDA/TRAC	Tip Rate Determination Agreement/Tip Reporting Alternative Committments
W&I	Wage & Investment Operating Division

## CHAPTER 1

# RELEVANCE OF TAXPAYER EDUCATION IN THE SOUTH AFRICAN ECONOMY

### 1.1 INTRODUCTION

"Questions about tax compliance are as old as taxes themselves and will remain an area of discovery as long as taxes exist. There is almost no civilisation that did not tax. Six thousand years ago, tax history started with records on clay cones in Sumer, with the inscription, "There were the tax collectors" (Adams, 1993).

"History has shown that there has always been a reluctance to pay tax. A major reason for this attitude is that the taxpayer does not always perceive that he receives any benefits from parting with his hard earned cash.

Most citizens, however, realise that state expenditure for the purpose of creating or maintaining national infrastructures, such as services and roads, is a necessity. But, citizens object to having to finance unnecessary state expenditure. In this regard, everyone has his own understanding of what is unnecessary. Taxpayers feel that whatever is contributed by way of tax is mostly squandered away and the social responsibilities the government is expected to discharge get neglected. The government's bad image because of its failure to discharge functions is a great disincentive for paying taxes.

Most people feel that tax is a burden and should be avoided. Taxpayers feel that they are being treated harshly and the punitive provisions in the tax laws are applied ruthlessly against them. Hence, it is better to be away from the tax department and the number of non-filers of tax returns is increasing."(Coetzee, 1996)



## **1.2 PROBLEM STATEMENT**

A proper tax culture can develop only when taxpayers and tax collectors discharge their obligations equally well. Many taxpayers become defiant, demotivated and disillusioned because of their lack of understanding of the tax obligations imposed on them. Such notions strike at the roots of a healthy tax culture.

The objectives of taxpayer education are to:

- Support SARS in achieving their collective business objectives.
- Provide the key interface between SARS and taxpayers by means of education and information access.
- Optimize the use of educational resources to build a culture of compliance, awareness, service and responsible taxpayer empowerment.

## **1.3 OBJECTIVES OF THE STUDY**

The most important objectives of a modern tax system are:

1. That the correct amount must be raised by the citizens – this will depend not only on the size of the expenditure that has to be met, but also on the state of the economy.
2. The burden to pay taxes must be distributed amongst taxpayers on an equitable basis.
3. Growth and stability must be promoted.
4. It must be easy to understand and to comply with regulations".(Coetzee,1996)

The objective of this study is to establish whether taxpayer education in ensuring that taxpayers are equipped to understand their tax obligations will voluntarily comply with the requisite regulations.

## **1.4 RATIONALE FOR THE STUDY**

The South African tax system is dependant on taxpayers to voluntarily calculate and pay their taxes. This brings us to question the expectations of the tax administration on taxpayers to comply, if they are not provided with the education and training to do so.

Taxpayer education provides comprehensive tax education and information that promotes partnership and voluntary compliance with the objective of maximising revenue collection for national growth and development.

## **1.5 IMPORTANCE OF THE STUDY**

"The South African Revenue Services in its endeavor to improve their performance, were convinced that there was a burning need for change in the organization. High level diagnoses revealed that their services were not sufficiently customer focused. It was at this point that the transformation into "Siyakha" had begun. Siyakha is a Zulu word meaning "we are building". Since its inception in 2001, Siyakha has become the strategic driver of reform in SARS business processes and the organization's attempts to introduce a service orientated culture focused on taxpayer needs.

With it the following, specific objectives were identified in the transformation process to encourage compliance and achieve a positive experience for taxpayers, traders and other stakeholders interacting with SARS through:

1. Adoption and publication of a Taxpayer Charter.
2. Implementing a customer centric view that supports frontline resolution.
3. Differentiated education strategy based on taxpayer profiles.
4. Integrated view of the taxpayer or trader's affairs supported by technology.

5. Increase service and product offerings to taxpayers and traders.”(accessed via SARS web page)

This marked the occasion at which the concept of Taxpayer Education was born in South Africa. Taxpayer education is core to voluntary compliance. There are many facets to taxpayer education, including outreach programs, small business education programs, programs at post and secondary educational institutions, practitioner education, tax clinics, emergency assistance, media information programs, and the distribution of tax forms and publications. Professional educators and adult education techniques facilitate greater compliance by emphasizing education over enforcement. If properly designed, taxpayer education and outreach can be a proactive method of enhancing compliance.

## **1.6 SUMMARY**

Taxpayer education assists taxpayers in meeting their tax obligations to the government and allows SARS to turn away from high-cost enforcement solutions to noncompliance to lower-cost, non-enforcement solutions. The traditional enforcement approach to compliance is focused on one-by-one enforcement of taxpayers through audit and examination of individual taxpayers. Not only is this approach expensive, but it does not identify patterns of noncompliance. The new approach shifts emphasis to preventing noncompliance by identifying areas in which noncompliance is most likely to occur. By integrating these efforts with other compliance programs, and ensuring proper training and technology resources, the result will be a South African Revenue Service that better serves the needs of the South African people.

## **1.7 STRUCTURE OF THE CHAPTERS**

Chapter 2 seeks to identify trends in taxpaying behaviour. Chapter 3 examines the role of taxpayer education on tax base broadening. Chapter 4 establishes the need for tax awareness amongst the emerging business community. Chapter 5 recognises

the need to empower the youth, who are our future taxpayers and encourage tax compliance. Chapter 6 reviews international best practices amongst international taxpayer education departments. Chapter 7 proposes key recommendations for the efficient functioning of the taxpayer education department that positively impacts on voluntary compliance. Chapter 8 culminates into the conclusion of the study and establishes the effect of taxpayer education on compliance.

## CHAPTER 2

### **IDENTIFYING TAXPAYER BEHAVIOUR IN RELATION TO EDUCATION ON TAX OBLIGATIONS**

#### **2.1. INTRODUCTION**

Taxpayer Education is a relatively new department within the South African Revenue Services, being introduced with the concept of Siyakha in October 2001. The rollout in Kwa-Zulu Natal resulted in the first department of taxpayer education. Departments in the other provinces will emerge as Siyakha rolls out to the rest of South Africa.

#### **2.2. KEY DRIVERS AND BARRIERS INFLUENCING TAXPAYING BEHAVIOUR**

Prior to conducting taxpayer education an understanding of the key drivers and barriers influencing taxpaying behaviour needs to be gained.

The drivers of taxpaying behaviour are:

- Image of SARS is imprinted in the taxpayer's mind, by the perception of the levels of customer service experienced from the organisation and the information received from educational campaigns.
- Fear or a lack thereof of non-compliance.
- Job type of an individual indicates the extent to which the taxpayer will be exposed to taxation, which is dependant on whether the individual is in employment or self employed.
- Individual compliance cost can be a deterrent to paying taxes if the cost of compliance is perceived as excessive. The tax system imposes requirements on the taxpayer to comply. These requirements are converted to the monetary cost of compliance.

- Income level or tax bracket of the taxpayer indicates the perceived level of tax awareness. It can be conceded that individuals in the higher income bracket are aware of the need for taxes and the social benefit derived.
- Tax related knowledge and education, impacts on the taxpayers' ability to comply with the requirements of the tax system.
- Citizenship and social attitude are interpreted from an individual's social background, cultural background and their perception of government.

The levers that the South African Revenue Services have a control over are:

1. Tax System
2. Customer Service
3. Taxpayer Education

The tax system and customer service have been addressed but taxpayer education needs to be further investigated to explore the impact it has on compliance.

Taxpayer education is mandated as indicated by SARS national office:

- To proactively encourage voluntary compliance.
- To reduce errors by empowering taxpayers with knowledge.
- To broaden tax base by an all-inclusive approach.
- To make taxpayers aware of their obligation.
- To create awareness about why we pay tax.
- Reducing costs by reducing errors, objections and complaints.
- To increase service levels.
- To improve revenue collection.

The primary existence of taxpayer education is to encourage voluntary compliance amongst taxpayers, but the theory needs to be developed further to establish whether taxpayer education in isolation can impact on compliance. Before this phenomenon can be explored the components of voluntary compliance needs to be examined. A taxpayer will be considered to be voluntarily compliant if the individual registers for tax when he becomes liable to pay tax, files all returns timeously, discloses financial information accurately, pays taxes when they are due and reports tax evaders.

### **2.3 EFFECT OF ENFORCEMENT MEASURES ON TAXPAYING BEHAVIOUR**

“WHY do South Africans pay tax? And can tax payer behaviour tell us anything about the way we are – and should be - governed?”

To many lay people and specialists, the answer is obvious and not very interesting. We pay because we have to pay. If tax payments increase, either because more citizens pay or because tax payers pay more of what the law says they should, that is because the authorities have become better at forcing citizens to pay. In this view, the implications of tax collection for governance are straightforward: whether taxes are collected or not depends on whether the relevant authority is efficient enough to ensure that they are collected. Efficient collection depends on effective coercion since people will not pay voluntarily. Translated into a general point about governance, that shows that we obey the rules when the government does its job and ensures that the systems are in place to force us to comply.

All of this sounds less like analysis than common sense. And that perhaps explains why trying to understand the dramatic increase in collections by the South African Revenue Service (SARS) can be a frustrating business: few practitioners or analysts are willing to look beyond the common sense story, that SARS has become technically better at doing its job and that its ability to force people to pay has increased.

Why should that be a problem? Because, if we look at the issue a little more closely, there is no reason why SARS's performance should be seen as commonplace. Not only is it at variance with the widespread assumption that compliance is declining in post-apartheid South Africa; improvements in revenue raising are unusual internationally, so this is not a case of a South African government agency catching up with world trends. Nor is there any evidence that the tax collection technologies which SARS is employing are available only to it – if it is doing better than others with the same technologies, then something other than better machinery is at play. SARS's performance is currently the object of research at the Centre for Policy Studies because it holds important lessons for our understanding of how state find the money they need to pay for their functions, and, more generally, of the elements of effective government.

If we want to understand why this is so, we must begin by noting that the conventional approach to tax collection described here is in sharp contrast to the way in which the South African policy debate tends to view compliance with public obligations in other spheres of life. On issues such as payment of municipal service charges or obedience to the requirement that drivers take out a new form of license, to name but two, there is a lively public debate which assumes that the reasons why people comply or refuse to do are more complicated than the tax explanations suggest. Indeed, far from assuming that the desire not to comply is normal, many of the most vocal and articulate commentators take precisely the contrary view to that which is used to describe tax behaviour – they denounce the lack of morality and sense of civic obligation of those who do not comply.

These two views, both regarded as common sense by many participants in the debate, are based on contrasting assumptions of human social behaviour. The 'common sense' view on tax assumes that people will evade their tax obligations if they can. Implicit here is the assumption that self-interest dictates non-compliance, whether or not we like the political system in which we live and those who govern it - and so tax collection is simply a matter of ensuring that we cannot evade our duty. Those who frequently complain of declining standards of civic virtue assume that



non-compliance is a form of deviant behaviour, that it sets us apart from others elsewhere. Behind this must lie the assumption that people tend to obey society's rules – presumably whether or not they are forced to obey. Here, if you like, humans become instinctive compliers, in the tax view they are instinctive non-compliers.

Citizen attitudes to compliance are hold implications well beyond the tax question. Even before our first universal franchise election in 1994 it became clear that ensuring that citizens comply with their public obligations would be one of the key challenges facing democratic government. Predictably, perhaps, that expectation has been vindicated - the post-1994 government has found that ensuring citizen compliance with obligations is among its more difficult tasks. In that context, the story of SARS's enhanced performance is a crucial subject of study – in a context in which we are repeatedly told that levels of compliance are low, tax is one in which they are clearly increasing. Why this should be so is therefore a crucial question for researchers or practitioners who want to derive lessons for more effective governance.

It is also worth noting that tax behaviour would be an important issue even if SARS had not proved so clear an exception to the rule of post-apartheid government. The capacity to tax is one of the key indicators of a state's ability to govern. Recent analyses have also suggested that the extent to which states rely on taxes may also decide what sorts of states they are, since those who rely on collecting from their citizens are likely to be more responsive to those they govern than states which largely rely on rents from commodities such as oil or minerals or on foreign aid. Also, like other states in the global South, South Africa faces a significant challenge to reduce poverty – not only does tax provide resources which would allow the government to do this; tax collection can in itself reduce inequalities by enabling the state to redistribute wealth through the tax system. For all these reasons, SARS's enhanced performance is crucial to our understanding of the prospects of South Africa's post-1994 democracy. And the question of why citizens or companies have

been more inclined to meet their obligations is crucial to understanding SARS's successes and drawing the appropriate lessons from them.

### **Tax Compliance: An Alternative View**

One of the reasons why the conventional view of tax collection seems so self-evident may be that many of its proponents assume that the only alternative is the other position presented here, one which portrays 'normal' tax-payers as enthusiastic compliers. In reality, neither are appropriate.

The argument that tax collection is not purely a matter of coercion – and that, therefore, more is required to ensure compliance than the use of efficient coercive strategies by taxing authorities – is routinely misunderstood. Those who insist that tax collection is simply a matter of management technique note that SARS has indeed enhanced its technical tax collection capacity through a variety of measures. They note too that enhanced tax collection follows the introduction of these measures. Logic would dictate that it is the measures, not some mysterious change in the attitudes of tax payers, which has caused the change. Similarly, they might note that there is no evidence that tax payers have any reason to feel happier better about paying now than they did before SARS performance began improving – indeed, what evidence we have suggests that SARS can be the subject of severe hostility from the tax practitioners or consultants on whom many affluent people rely to complete their tax returns and who have denounced the methods SARS uses to collect revenue. So if enthusiasm for tax-paying has not increased, and vigorous enforcement has, the explanation seems obvious.

Both of these arguments implicitly create a false dichotomy. Either, they imply, we assume that tax is paid by reluctant citizens who must be efficiently coerced – or we are obliged to propose some version of the diligent citizen assumed by those who complain of deficient civic morality. If, therefore, we cannot find evidence of people paying tax voluntarily because they feel they are contributing to a state with which they identify or a government programme which they support, we must assume that

people have been coerced into paying and that the compliance decision depends purely on a cost-benefit calculation in which the costs of punishment are weighed against the benefits of escaping tax. This excludes the possibility that the decision to pay may stem not from enthusiastic endorsement of the state but because payers are embedded in a set of rules, values and relationships which create a culture which makes the decision to pay taxes far more likely. If those elements are present, a technically efficient tax authority may be able to use the routines and attitudes which underpin that culture to enhance collections. Efficiency may matter – but only if a culture conducive to payment already exists. If that culture does not exist among tax payers, then technical efficiency measures may have no effect. And it is also possible that, if increased technical efficiency is not based on an accurate understanding of the culture among tax payers, it may have no effect – or it may reduce the effectiveness of tax collection.

### **The Moral Economy of Shame**

The argument is perhaps best introduced by examining a SARS tactic which forms a significant element in its strategy – the public embarrassment of individuals.

People in public positions, we are told, are prosecuted for alleged tax misdemeanours amid much publicity because SARS believes that this will shame others into avoiding similar ignominy. This is routinely presented as a technically competent enforcement strategy because it sends a signal to recalcitrants that they will be apprehended, altering the cost-benefit calculation in favour of the tax collector. But that is not all that is happening, since SARS insists that 'embarrassment', not simply the application of the law, is a goal of the strategy. This raises an obvious question: why, if tax compliance is purely a matter of coercion, should anyone found not to have complied be embarrassed; there is surely no embarrassment in being found to have done something which everyone else does if they can. To insist that a suspected tax non-payer can be embarrassed is to assume that there is a culture which would make this behaviour appear shameful. This is by no means automatic, since there are societies in which non-payment is not a cause

of shame. Where there is a culture which makes exposure of non-payment a source of shame, a form of technical efficiency which relies on shaming offenders may be extremely effective. This argument has been made elsewhere. It is supported by, for example, subsequent interviews with tax practitioners, some of whom fiercely criticise SARS and are clearly at best sceptical about the post-apartheid order, but who insist also that morality dictates that citizens should pay tax.

The example just cited illustrates an important aspect of tax payer behaviour – that it may have nothing at all to do with enthusiasm for the state or its governing party. One important analysis of tax collection in South Africa and Brazil argues that compliance here may have originally been inspired by political loyalty but that the behaviour may survive even after its cause has passed into history. In this view white South Africans were happy to pay for a state which protected them against a majority they perceived as threatening; this creates a set of habits which become, as it were, ingrained, so much so that they might survive the downfall of the state which inspired the habit and its replacement by one which many of the compliers may view with suspicion. This theory remains speculative. But its accuracy may be relatively unimportant to the argument made here because the insistence that tax-paying depends on an underpinning culture does not depend on the claim that it stemmed originally from loyalty to a political order. It may well be that understandings derived from more complicated forces than identification with a system of government are instrumental in creating that culture.

### **People Like Us: Cultural Efficiencies**

Before discussing this issue, it may be important to note that 'technical efficiency' is a less unambiguous term than many analyses assume. What, for example, are we to make of the observation by a tax practitioner that SARS is to be taken seriously because 'you are no longer dealing with the old-style civil servant with his flask of tea and sandwiches – now the SARS people wear three piece suits and have worked for major accounting firms'? The point, of course, is that nothing is being said, at least directly, about the competence of the new type of tax collector – we learn only

that they have some cultural similarities with the tax practitioners which their predecessors lacked. This raises an important point about understandings of technical competence. It may well be that the practitioner is attempting to convey, in a culturally coded way, that the new consultants are indeed more technically competent than their predecessors because people who work for large firms and dress accordingly are likely to be better able to extract resources from people skilled in tax avoidance. But the comment may also reveal the degree to which technical competence may simply be a code for cultural compatibility – the practitioner does not, on the surface, say anything about competence: he stresses, rather, the degree to which the cultural fit between him and the SARS employee has increased.

But the statement may also mean both – that the new breed of tax official is both more competent and culturally closer to tax practitioners. Part of SARS's strategy is premised on the understanding that effective tax collection requires a far greater understanding of the workings of particular sectors of industry than the tax collection agency has hitherto been able to achieve. Implicit in this is the notion that competence is not simply a matter of forensic accounting technique – it requires a knowledge of how specific industries and those who work in them operate. The divide between technical competence and cultural understanding becomes blurred since the latter is an important component of the former: one of the elements of technical competence is an understanding of the culture of the companies and individuals from whom compliance is sought.

Equally important is the network of rules and understandings which underpin tax behaviour. The first point which seems apposite here is that participation in the market economy may create appropriate conditions for certain types of compliance to become seen as routine. Clearly, the argument here is not that there is any necessary connection between the existence of formal markets and tax compliance. Brazilian tax payers who are said to see the seeking of exemptions as a more appropriate response to tax assessments than payment, also operate in a market economy. However, the point here is that market activity is not simply the exchange of goods and services by private owners. It is, as Douglass North among others has

shown, embedded in rules, understandings and routines. And, while North's work is instructive precisely because it points us to the reality that these differ between market economies, it may well be that there are characteristics of market activity which make a culture of compliance more likely.

That SARS has achieved its greatest efficiency gains with companies rather than individuals may, therefore, not be solely attributable to the reality that, given the relative size of firms and individuals' assets, companies are likely to be more cost-effective sources of revenue than people. It may also be related to the likelihood that the tax decision-making process is rather different in companies. They are far more rule-bound than individuals because they are composed of and engage with a variety of groups of people whose rights can be protected only by ensuring that the activity is bound by rules. Firms – and this point would obviously be emphasised the larger and more complex the company – are forced to establish sets of rules to govern their internal workings and to engage with government agencies in a variety of rule-bound interactions (on import permits, tariffs, health and safety regulations and the like). It seems likely that this form of behaviour creates patterns in which tax compliance is a more 'normal' option than evasion.

To elaborate. SARS has used payrolls as a key source of information to secure greater compliance. But companies who seek to evade tax cannot do so by falsifying payrolls without jeopardising their labour relations. Similarly, companies which misrepresent profits are negatively affecting shareholders and investors as well as the tax authorities – both these constituencies may have as immediate an interest as the revenue gatherer in accurate record keeping and may in some cases have greater direct capacity to enforce it. Market activity forces companies into a variety of relationships which rely on the sort of obedience to rules of disclosure which make tax compliance easier to enforce. Individuals, even if they live in a rule-bound society, do not face the same pressures to disclose information and therefore have greater leeway to evade obligations. To this should be added the reality that firms, like large non-profit organisations, find it more difficult to evade obligations simply because more people are required to participate in the act and there is an obvious



possibility that one or more of them will refuse to co-operate. This ensures that organisations are more likely sources of compliance than individuals. As noted earlier, this does not mean that the factors discussed here mandate compliance – corporate scandals in the United States show that shareholders and workers can indeed be misled while in sub-Saharan Africa it is not uncommon for large organisations, including some which are publicly owned, to evade their fiscal obligations. But it does create conditions for behaviour which makes compliance an easier option than its alternative, while in different environments, ranging from the informal through to that in which individuals decide whether or not to comply, the reverse may be the case.

Similarly, we may find that individuals are more likely to be locked into a culture conducive to tax-paying the more habituated they are to particular forms of administrative routine – more specifically, if they are used to interacting with the state through a set of rules which are seen to have two key characteristics: that they are not arbitrary and that there is a reasonable expectation that compliance will yield benefits – the extension of rights (such as a license to drive a vehicle) and entitlements (a pension or a subsidised place at a state school). It may also be that engagement with the state tends towards compliance if it is assumed, over a fairly long period, to be capable of implementing its own rules. North points towards this when he stresses the role of institutions, or ‘the rules of the game in a society’ in shaping economic behaviour. It seems plausible that individuals who are used to acting within rules which make compliance with public obligations more routine would be more open to altering their behaviour in response to changes in the efficiency of the tax authority.

Thus, the difference between white and black citizens under apartheid may have been not only that whites identified with the government and blacks did not. It may also relate to different experiences of government and its enforcement of rules. Apartheid did not only create a racial hierarchy in access to power and privilege – it also created a state which often behaved very differently towards white and black citizens. To black South Africans, the state often acted arbitrarily and appeared

largely as an alien force. To whites, despite distortions prompted by the fact that intra-white tensions during the system's heyday ensured that Afrikaans-speakers enjoyed preferences which English-speakers did not, the state was experienced as a set of rules which could plausibly be said to underpin mutual rights and obligations between the state and its citizens. Within limits, participation in the state could hold out a realistic expectation that obeying the rules, and complying with the required administrative procedures, could bring benefits. This may be more likely to inculcate a rule-bound form of behaviour which tends towards compliance. It must be stressed, at the risk of belabouring the point, that this does not mean that we can be confident of predicting the compliance behaviour of individuals and groups from their immersion in rule-bound administration which they experience as relatively benign. This argument does not posit a direct and necessary correlation between the two. Rather, the point is that engagement of this sort with government may create a context in which enhanced technical efficiency by the tax authority can yield significant improvements in tax collection performance.

Two important points must be made about these assertions. First, the argument made here about the legacy of the past differs significantly from the argument that people comply if they identify with the state. Rather, the point is that they are more likely to do so if they are immersed in the rule-bound procedures of the state in ways which make these rules seem like legitimate forms of regulation (even when they are resented) rather than the whims of an alien power. This is important not only as a scholastic point since it alters fundamentally our notion of what to look for if we want to establish whether a particular tax culture exists. Rather than seeking tax payers who share a sense of political community with the state, we look, if we want to establish a proclivity for meeting fiscal obligations, for those who are sufficiently immersed in the state's rule-bound institutions in ways which prompt them to assume that the rules are indeed implemented in the manner intended. The question of political likes and dislikes, or even of the stated motives for compliance, become irrelevant. The real test is whether the people from whom compliance is required are used to dealing with the state in ways which would make complying, to them, the most plausible response to obligations.



The second is that apartheid was not ended by a sudden rupture – the constitutional settlement of 1993 was the culmination of a lengthy period of reform apartheid which began in the mid-1970s.<sup>21</sup> As a result, black South Africans' experience of the state during this period was far more complex than the preceding analysis suggested because individuals and collectives experienced arbitrary and rule-bound state behaviour at the same time. On the collective level, the same group of people might, in the 1980s, be engaged in the highly rule-bound activity of registering their trade union within a process which ensured that compliance with legal obligations would guarantee bargaining rights, at the same time as they experienced arbitrary and entirely oppressive police behaviour in response to resistance activity. And individuals might be participating in the rule-bound and mutually obligating process of applying for a title deed for a home (after black property rights in the cities were conceded in the mid-1980s) while experiencing arbitrary police or official behaviour in other contexts. The degree to which this has produced a culture of compliance is an important area for study: if the claim of one SARS official that black tax-payers behave much as white ones do is accurate, then there may have been sufficient incorporation of black people into state institutions to ensure a shared culture of compliance. It is possible too that current experiences of institutions, companies and the state, state are sufficient to compensate for history – that black tax payers now experience a relationship with the rules of the state which tends towards compliance.

This begs an obvious question – how did the rule-bound nature of the state arise? The argument advanced here, to a degree, turns on its head the assertion made earlier, that the tax relationship may determine the nature of the state. While this position does not insist that the nature of the state determines the tax relationship, it certainly suggests that it may have an important impact. But, if the tax behaviour does not determine the nature of the state, then what does? The answer may be beyond this paper. Suffice it to say that this argument does support Brautigam's assertion that, where states have a colonial past, that experience is vital to an understanding of the nature and capacity of the state now. More specifically, it may be that countries who look back on a form of colonialism in which there was a

significant settler presence in the colonised society may inherit forms of state more conducive to tax compliance because rules and procedures designed for people who enjoyed rights in the metropolitan country might be expected to be more open to rule-bound administration in which the state met obligations to citizens rather than merely exerting arbitrary power over them.

These questions deserve further inquiry. However, far more important for those concerned with developing better governance understandings and practices than the genesis of cultures of compliance is the assertion that they matter and that, without them, technical efficiency may have little effect in ensuring compliance. It is common cause that SARS's efficiencies have had far more impact among companies than individuals and in the formal economy than in its informal equivalent. While part of the explanation lies in strategic choice – SARS targeted the formal sector as a result of a fairly obvious cost-benefit analysis – and it does claim modest successes in the informal sector among taxi operators, it may well be that collecting revenues from people engaged in informal economic activity may prove a far greater challenge not simply because of logistical constraints but because the culture of compliance which operates in the rule-bound interaction between the formal sector and the state is absent among informal businesses and those who operate them.

## **Strategic Implications**

What are the implications of this analysis for tax collection in particular, governance in general?

This paper has argued that technical efficiency can only be effective if it is underpinned by a culture favourable to compliance – and that this culture needs to be underpinned by rules, values and routines if it is to influence behaviour. This implies an approach to tax collection different from that which simply relies on more effective means of coercion. It suggests that revenue collection will be enhanced if the tax collection authority is able to devise rules which capitalise on that advantage. This requires 'reading the culture' which underpins tax behaviour effectively enough to know what will influence behaviour and what will not. SARS's

success thus far clearly rests on its accurate reading of the interventions which would be likely to induce compliance - one clear example is the use of public embarrassment techniques, another is the recruitment of officials with a history of working in private accounting firms, who share common understandings with the people from whom they are collecting tax: these have obviously enhanced effectiveness.

Clearly, continued effectiveness will depend on the preservation of the culture and the routines and daily procedures which underpin it. While these cultures may take years to establish themselves, and may be ingrained enough to be fairly robust in the face of tax collection methods of which tax payers disapprove and which therefore might violate the senses of fairness which makes effective revenue raising possible, SARS and other tax authorities may be most effective when they are able to see the complex system which makes relatively easy compliance possible as an asset and ensure, within the limits imposed by the need to ensure compliance, that their strategies do not threaten the underpinnings of compliance.

One way of illustrating this is to examine the role of tax practitioners. As noted elsewhere they would seem to be obstacles to effective collection since their task is to advise clients on how best to avoid paying tax. Thus the Minister of Finance, while not necessarily referring directly to practitioners, expressed an important aspect of the official attitude when he complained that 'tax is avoided by aggressive tax planning, while purportedly adhering to the letter of the law.' However, it may well be that the practitioners play a crucial role in enhancing the efficiency of tax collection, for it is they who communicate SARS's intentions to their clients. If it is accepted that effective collection depends on sending messages to tax payers through the set of routines which underpins the tax-paying culture, then the practitioners are crucial conduits of the message – they must be if they are to do their jobs. Even when they are trying to conceive ways of beating the system, then, they are also essential cogs in its working. If official intentions to regulate practitioners are implemented, regulation will need to be framed in ways which ensure that this function is retained – if it not, a vital element of effectiveness may

be compromised. It is also conceivable that overly aggressive enforcement methods could be counter-productive if they were to appear to violate some of the cultural underpinnings of compliance by appearing arbitrary and capricious. And it is important to stress the degree to which formality is an important ally of a tax collection agency since engagement in formal economic activity tends to incorporate people into the institutional framework which tends towards compliance.

These points are not new to SARS senior leadership who seem very well aware that they are engaged in an activity in which understanding and using the behaviour patterns of tax payers and the assumptions which underpin them are a crucial ingredient of success. As noted above, SARS strategies reflect this and their success is clearly partly attributable to it. But it is open to serious question whether this point is widely accepted in government. Often, compliance is assumed to be the natural mode of citizen behaviour and policies which rest crucially on it are therefore not based on a thorough attempt to understand the institutions and understandings which might tend towards or away from compliance. The assumption that citizens will simply respond to a government decision requiring compliance is repeatedly shown to be flawed – current examples are the switch to new forms of driver license or the registering of domestic workers with the Unemployment Insurance Fund. Ensuring compliance, will, SARS's experience shows, require a far deeper understanding of the behaviours, rules and norms which prompt people to tend towards compliance or towards ignoring particular expressions of public authority. SARS's performance shows too that developing this knowledge is a continuing process, which will be required well after a measure requiring compliance has been implemented.

### **The Informal Conundrum**

The second implication has been noted several times here but requires repetition: incorporating informal economic actors into the rule-bound relationship which produces the possibility of tax compliance may prove far more complex than some in SARS seem to believe since the issue is not simply cost, but also that informal

activity is governed by a different set of institutions and understandings to its formal counterpart. This sharply limits the applicability of the SARS experience in countries in sub-Saharan Africa and elsewhere in the South where formal economic activity is limited – and in those agencies and departments of the South African state which are required to deal with the millions of citizens engaged in informal activity.

The challenge seems daunting since what is required is the creation of a culture of compliance, not the ability to make use of an existing culture, and cultures are not created quickly or easily. But it is one of the key arguments of this analysis that the culture tending towards compliance on which SARS currently relies in its dealings with formal economic activity was also created – it is not an innate feature of human social activity. Given that, there is no reason why such a culture should not be established once again among people who now operate outside the formal rules, even if success is likely to be neither easy nor rapid. And it also seems to follow from this analysis that a starting point will need to be a painstaking and lengthy attempt to understand the ideologies and institutions which underpin informal activity. While it seems axiomatic that the elements of a culture of compliance will be less evident, the strategic exercise would depend on trying to identify elements of informal economic and political culture which might tend towards a compliance-oriented culture – and ways in which they might be strengthened at the expense of the understandings and institutions which obstruct it. Progress may be slow and much preliminary work may be needed before greater understanding can produce sustained gains in much wider and more permanent compliance.

The message for other parts of the government are much the same. The first step on the way to progress is an acknowledgement that many citizens do not work and live within the same set of rules as the people who draft policy. Not only do their rules need to be understood, but as in tax collection, ways need to be found of capitalising on rules and beliefs which open the way to compliance while seeking strategies to weaken those which do not. And the key to this is a much closer link between government and people engaged in informal activity. Three elements seem required to operate parallel to each other – the deepening of representative

democracy so that public representatives develop deeper links with citizens engaged in informal economic activity and thus a greater understanding of the institutions and understandings of informal economic actors; a concerted attempt by government agencies to gather reliable data on this before framing policy and continually as they seek to implement it, and research studies which seek to illumine these patterns over a more protracted period and without being encumbered by the need to produce short-term reports – complex social dynamics are not quickly understood.

None of this would make for the speedy government decisions which some analysts see as the precondition of effective government. But where people underpin their economic activity with a set of rules, values and behaviours which are obstructions to effective government, a hasty approach which does not stop to listen and observe carefully the beliefs and deeds which will decide whether or not a policy succeeds is a sure route to rapid failure. The history of tax collection – perhaps also its present in some cases – suggests that people outside the cultural circle which underpins compliance can be incorporated into it. But the process is likely to be difficult and lengthy, underpinned by a style of government more geared to trying to understand and learn from activity at the informal grassroots than has thus far been evident.” (Friedman, 2003)

## **2.4 SUMMARY**

Tax culture is modelled by a variety of components making up both an enforcement perspective and that of a taxpayer education perspective. Taxpaying behaviour is affected by the levels of compliance amongst taxpayers by key drivers which determine their inherent behavioural patterns towards taxes. Compliance cannot be entirely explained by the level of enforcement. A balancing between the enforcement and taxpayer education drivers would culminate in a greater degree of tax compliance.

## CHAPTER 3

### TAX BASE BROADENING

Taxpayer education is inextricably associated with tax base broadening. Without education it is meaningless to have taxpayers on register who do not understand their tax obligations. Tax base broadening is multi-faceted in terms of legislation and procedure.

Concern is often shown about the small number of people in the tax net compared with the large population. Tax Base Broadening is the tool utilised to effectively close the tax gap and simultaneously increasing the tax base. The size of the tax gap, the number of people and companies not registered to pay tax at all, is not known, but is presumed to be huge.

Government has been strongly committed to broadening the base in order to lower overall rates. This broadening of the tax base could only be achieved through major tax reforms. The most notable of these structural reforms was the introduction of the Capital Gains Tax in 2001.

#### **"3.1 FIRST TAX BASE BROADENING INITIATIVE – INTRODUCTION OF CAPITAL GAINS TAX (CGT)**

The Capital Gains Tax was essential for the base broadening effort because the exemption for capital gains essentially meant that the appreciation on all investment assets went wholly untaxed. While some argue that the receipts of the tax in and of itself are small, proponents of such arguments fail to recognise that the Capital Gains Tax serves as a backstop to the Income Tax. The two broad principles on which Capital Gains Tax are based on are:

- (i) Fairness and economic efficiency
- (ii) International competitiveness



### **3.2 SECOND BASE BROADENING INITIATIVE – TAXATION OF WORLDWIDE INCOME**

Prior to 1994, South Africa was isolated internationally mirrored by its tax regime. A strict regime of Exchange Controls existed, affording South Africans little opportunity to invest abroad. As a result, South Africa only needed to tax income arising within its geographical boundaries.

In 2001, South Africa began taxing its residents on a worldwide basis. South African individuals and companies are now taxed on foreign source income as a general matter. This taxation of foreign source income reflects the new reality – that South African businesses are becoming global players with the relaxation of Exchange Controls. Taxation of foreign source income fully reflects international experience.

### **3.3 THIRD BASE BROADENING THRUST – SIMPLIFYING INDIVIDUAL TAX RETURNS**

The last mechanism for achieving a broader tax base was the removal of tax schemes commonly employed by individuals. The use of “tax free” fringe benefits to structure remuneration packages had become prevalent in the 1990s, resulting in a substantial loss in revenue. In order to stop this tendency, fringe benefits became taxable in full. Directors of private companies were brought into the PAYE tax collection system because many directors simply operate like any other employee. Since some directors often disguise their salaries through loans, a formula was introduced in order to determine PAYE in respect of their remuneration.” As indicated the 2000 Annual Budget Speech.

The role tax education assumes with regard to this aspect of tax base broadening is to increase the awareness, while providing education to the general public as to the functionality of these new approaches to taxation. SARS’ taxpayer education mandate is to promote compliance with the law and to ensure that citizens understand their tax obligations.



The formulation of a Taxpayer Education policy will lead to a reduction in the number of queries as well as have the potential to reduce submission errors. Errors result in penalties and interest, which consequently impacts negatively on the tax culture. The effect that education has is to increase knowledge thereby empowering the individual or the organisation, and stimulates a positive tax culture.

It is imperative that due cognisance is taken that SARS endeavours are not only to collect taxes, but the organisation is continuously fighting to reduce the tax gap to allow for a fair tax system for all. The Minister of Finance, Mr Trevor Manuel, in his budget address to Parliament on 17 February 1999, highlighted government's zero-tolerance attitude to tax evasion, whilst still promoting fairness and redistribution through the tax system."

### **3.4 TAX GAP**

The first step would be to define exactly what is meant by 'tax gap'. In brief, the tax gap would be the difference between the amount of tax collected, and the tax that should be collected if all taxpayers were registered, and if all taxpayers paid the correct amount of tax on taxable income that has not been artificially reduced.

A 'tax shelter' is a structure that is used to artificially reduce the amount of taxable income.

The tax gap is made up of many different constituents:

1. Some known (e.g. salary structuring),
2. Some that cannot be quantified (as there is no tool to quantify the number of tax shelters in use, and the amount of tax that is being sheltered), and
3. Some that would still be unknown (e.g. new shelters that will be developed around new legislation).

A breakdown of the tax gap would include the following (this is not comprehensive):

1. The tax gap created by tax schemes that would artificially reduce the amount of income earned, for example salary structuring.
2. The tax gap created by taxpayers who are not registered, this would include casual vendors as well as professionals (e.g. surgeons) who manage to provide services free of tax. An example would be a surgeon who operates on foreigners, in South Africa, and is remunerated, tax free, overseas.
3. The tax gap created by changing the nature of a capital amount to a revenue amount in order to get a tax deduction.
4. The tax gap created by tax shelters that allow a company to write off the capital and interest elements, e.g. deduct from taxable income the cost of the building, the loan used to finance the building, as well as the interest element. Example: property scheme using convertible debentures.
5. The tax gap created by the creative use of partnerships, trusts, joint ventures.
6. The tax gap created by loopholes in the legislation.
7. The risk of a tax gap that is triggered by specific transactions.

### **3.5 THE NARROW TAX BASE IN SOUTH AFRICA**

"The complaint often raised by those persons who are taxpayers is the fact that this country appears to have a small number of taxpayers relative to the overall population. It also raises the questions of tax morality and ethics and the degree of compliance with the fiscal statutes in South Africa.

An analysis of the various statistics makes interesting reading. In the Department of Finance National Expenditure Survey 2000 published on 23 February 2000 it was indicated that at the end of 1999 a total of 2 675 801 persons were registered as individual taxpayers. This statistic includes trusts but unfortunately no indication is given as to the number of trusts on register. Approximately 3.5 million people were at that stage subject to the Standard Income Tax on Employees (SITE). SITE payers are those persons earning less than R60 000,00 per year, who have tax deducted

from their salaries and who are not obliged to submit an annual tax return to the South African Revenue Service (SARS). Based on these figures South Africa had a total of 6 175 801 natural persons (including trusts) paying tax in this country at the end of 1999.

During January 2002 the Commissioner: South African Revenue Service, Mr P Gordhan, was reported as stating that the total number of individual taxpayers registered in South Africa during November 2001 was increased to a total of R3,4 million. This means that the number of individual taxpayers for tax purposes has increased by 724 199 persons since the Minister issued the National Expenditure Survey referred to above.

It would thus appear that the total number of taxpayers now comprises approximately 6,9 million people in the country.

The most recent statistics relating to 1999, issued by Statistics South Africa indicated that the country had a total population of 29,778 million people between the ages of 15 and 65 years. Out of this total approximately 16,251 million persons were regarded as not economically active and are therefore to be disregarded in attempting to determine how many people should be paying tax in this country.

The statistics indicate that South Africa had an economically active population of approximately 13,527 million persons. It must be noted that the economically active population includes those persons able and willing to work but who are unemployed. The unemployment figure was estimated at approximately 3,158 million in 1999.

South Africa had 10,369 million persons employed, which, when compared to the approximately 6,9 million persons paying tax in the country, represents a gap of approximately 3,469 million people.

This means that approximately 33% of all persons employed in South Africa are not currently in the tax system. The result of this is the narrowing of the tax base which means that those persons in the system are paying more than otherwise should be the case.

It is clear therefore that SARS needs to increase the number of taxpayers on register, thereby increasing collections and ultimately reducing the rate of tax paid by persons currently in the system.

SARS was recently seeking to broaden the tax base. As part of that project businesses throughout the country were visited in order to establish the number of businesses, not complying with fiscal obligations. During the period October 1997 to January 1998 the Commissioner's staff inspected businesses located in the various provinces in order to establish the compliance rate for income tax, value added tax and PAYE. During this period a total number of 98 145 enquiries were made and the default average percentage nationally for income tax was 33%, VAT 32% and PAYE 30%.

Clearly, a large number of businesses are not registered for income tax, VAT or PAYE purposes. This also contributes to those persons on register having to pay more tax than is necessary.

It is difficult to estimate the tax gap in this country, that is the difference between the tax that should be paid under the law and that which is actually paid. The Katz Commission, in its interim report published in 1994 estimated the tax gap in this country at approximately R21 billion. It was estimated that the average tax gap of industrialised countries amounted to 10% and 33% in developing countries. In the 2001 budget speech the Minister estimated revenue at approximately R233,4 billion. Therefore, if one assumes that the tax that could be collected from natural persons and businesses not complying with the tax laws represents, say, 15% of total government revenue, the State would have approximately a further R35 billion to finance its social responsibilities in the country.

From the above analysis it is clear that it is in the interests of all citizens that the tax base is broadened, thereby spreading the tax burden more evenly in the country than is presently the case. I am of the opinion that tax rates could be reduced further and social spending increased in the event that the tax base was broadened to the extent required.

SARS must therefore be supported and encouraged to ensure that those persons who are engaged in economic activity are fulfilling their tax obligations in the country.

The introduction of the New Income Tax System (NITS) should go some way in ensuring that persons in receipt of various forms of income declare such income for

tax purposes. NITS will, in time, allow SARS to cross check far more information than was previously the case and this too should ensure an increase in the number of taxpayers in the country.

The tax laws were amended some time ago to allow the Commissioner to publish the names of persons who had been successfully prosecuted for violating the tax laws of the country. Unfortunately SARS has not used this weapon on a large scale. A few offenders have been prosecuted under the VAT Act and their names published in the media, but it is submitted that the level of tax compliance will increase only once people believe that all people are treated fairly and equally in the tax system and so long as there is a serious deterrent to offenders. The move by SARS to enhance its audit capability must be supported in that the playing field will become level insofar as different taxpayers are concerned.

The tax gap in this country can be reduced, in my view, by increasing the number of taxpayers in the system and more importantly by ensuring that all amounts of income that should be subject to tax are indeed declared and subjected to tax in conformity with the law. SARS has a duty to the citizens of the country to ensure proper compliance with the tax laws and to take strong action against those persons who do not comply with the fiscal statutes of the country. (Croome, 2002)

### **3.6 WIDENING THE TAX NET**

"The South African Revenue Service (SARS) appears to be one of the success stories of post-apartheid government: in a context in which the failure of the state to elicit citizens' compliance with public obligations is seen as a central weakness of the new democracy, and in which the efficiency of government is seen by many analysts to be wanting, the statutory tax collecting agency has substantially increased its revenues.

This alone would make SARS's performance an interesting area of study for those interested in understanding the ingredients of effective post-apartheid government.

But the story of revenue-raising in South Africa's new democracy has a significance beyond this – domestically and abroad.

Discussion of the changing role of the state in general, and in the global south in particular, is common in academic and policy-oriented literature. Much of it has focused on the demise of the welfare model and the rise of neo-liberal regimes that have devolved core functions of the state to the private sector. This has tended to emphasise the limits of the state in providing effective governance and development. This literature has been very useful in charting the market-oriented nature of state transformation, but has overshadowed scholarship documenting the processes and challenges of state-building. Since it is widely agreed across ideological divides that the countries of the south cannot build peace and development without an effective state, it is crucial to understand the processes of state-building that are being developed – and which may counteract the drivers that are eroding the traditional roles and responsibilities of the state towards the citizen. The tax collection or extractive function is a crucial indicator of the state's capacity because it indicates both how effective governments are in raising the revenues they need to perform their functions, and the degree to which they are able to ensure that their citizens meet their public obligations – and are therefore incorporated within a set of rules meant to be applied by the state to all citizens. The tax relationship could be seen as a core element in the 'social contract' between citizens and the state: tax-payers directly meet an obligation to the political authority and may, in theory, be more inclined to demand rights from it in return. Higher levels of revenue collection may therefore not only indicate that states have the resources they require to fulfil their function, but also that they have established a relationship with citizens which may allow them to govern effectively.

In South Africa, revenue-raising takes on a specific importance: it is a crucial measure of the new democratic state's ability to fund its development challenges, and a test of the degree to which citizens are willing to demonstrate compliance with a key state function, given the possibility that those in the racial minority may feel alienated from democratic government – and those in the majority may feel



reluctant to pay on the grounds that the burden should fall on those who benefited from racial privilege in the past.”

While SARS’s improved performance is often discussed, little is known about the nature of this improvement. In what ways has its performance improved? Has it been more successful in extracting revenue from some sources than others? If so, is there anything we can learn from this? More specifically, is improved performance a result purely of SARS becoming more technically proficient? Or could it also stem from a reliance on a culture of compliance and historically inherited understandings of taxpayers’ behaviour, which have helped to build the legitimacy of the tax-collecting function?

SARS’s performance in raising revenues can certainly be attributed to increased technical efficiency. This is not a novel observation. How SARS has become more efficient, however, has barely been explored. Its increased efficiencies have come from a combined strategy of widening the tax net and simultaneously reducing the tax gap, the difference between the tax which should be collected if all taxpayers fully meet their statutory obligations and that actually paid. But what areas of tax collections have contributed the largest gains? And what are the implications of increased performance in certain areas of tax collections over others?

First, SARS’s efforts to widen the tax net by increasing the total number of persons and companies registered for income tax are substantial.

**Table 1: Number of taxpayers registered with SARS over the past four years**

	Total				% increase
	1998/99	1999/2000	2000/01	2001/02	
Persons registered for income tax*	2 485 703	2 798 126	3 187 072	3 556 023	43
Companies registered for income tax	774 864	839 591	976 720	1 081 788	40
PAYE-registered entities	202 806	213 202	211 425	219 732	8
Vendors (registered for VAT)	478 002	424 020	450 630	479 666	0

*Source: SARS national office.*

The table reveals a 43 per cent increase in persons registered for income tax over the past four years. The widening of the tax net for individuals has been achieved through several initiatives: the treasury has introduced legislative changes to tighten loopholes that have brought company directors into the PAYE system, as well as a change in the definition of labour brokers to make PAYE more effective.

Broadening the tax register does not necessarily increase revenue substantially, but it does deepen state penetration of society by bringing more people into the tax-paying relationship between state and citizens. In principle, this should also enable the authorities to gain information on the demographic profile of the tax-paying public, thus making government in general, and tax collection in particular, more effective.

An initial glance at the profile of this expanded tax base shows that about 57 per cent of taxpayers earn less than R60 000 a year, meaning that they only pay SITE (standard income tax of employees); they are subject to monthly deductions, and do not have to file returns. The bulk of new entrants to the tax system are thus in the low- to lower-middle income brackets and, as a whole, contribute 22 per cent of total revenues collected by SARS. But this only scratches the surface. What we do not know is the socio-economic profile of the new entrants who only pay SITE. For example, what proportion of these new taxpayers were previously liable for tax but were outside the system? What is the racial breakdown of these new taxpayers? This information may be important to understandings of likely trends in tax-collecting performance.

On the first score, an understanding of whether SARS is bringing more citizens who should be paying tax into the system – or merely widening the net in response to changes in legislation – would give us some idea of its capacity to bring new sections of society into the tax system rather than solely or largely relying on extracting more from those already in the system, or on implementing legislative changes.

On the second, the issue of race and compliance is important considering South Africa's history of tax payments. An examination of the racial profile of new



taxpayers could shed light on new patterns of compliance in a country that has taxed widely but granted representation narrowly. The history of taxation in South Africa coincides with the racialised historical patterns of exclusion from, and inclusion in, the formal economy. Most white participants in the formal economy are middle- to high-income earners, schooled in a culture of compliance. It is only in the post-apartheid period that largescale formal economic opportunities have opened up to the black majority. While a highly skilled new black elite has developed, the bulk of the new black entrants to the formal economy are matriculants whose pay scales are still at the bottom end. This could be a plausible hypothesis for explaining why 57 per cent of new tax entrants since 1998 only pay SITE, and may indicate that black South Africans are increasingly becoming part of the tax-paying public in a way that does not yet require them to relate directly to the revenue-collecting authority by submitting returns. Whether this form of incorporation into the tax system indicates any changes in new taxpayers' approach to citizenship is a question for further research. It would throw new light on whether, if at all, the regular payment of tax enhances citizens' belief that they need to meet obligations to the state – and demand rights and services from it in return.

During the same period (1998-2002) companies registered increased by 40 per cent. The treasury has helped SARS to widen the tax base for companies by drafting legislation a common objective in enhancing revenue collection and closing loopholes, based on a shared set of values, and this common understanding is the root of the mutually supportive collaboration. So revenue collection can be positively affected by an active political role, but only where the political authority shares the revenue-raising agency's interest in compliance. This raises serious doubts about the model which proposes independence from politics as the key to revenue-raising agencies' success: where the political leadership is not committed to the aims of the revenue collecting institution, independence is unlikely to be respected – where it does, mutual support, not independence, is the key to effectiveness.

That said, the evidence does suggest that the overall improvement in SARS's performance has offered significant political gains for the government, enabling it to

make some progress towards its stated commitment to greater equity while not compromising its concern for fiscal discipline.”(Smith, 2003)

### **3.7 SUMMARY**

In assessing the behaviour of South African taxpayers within the tax gap, a number of issues must be examined:

1. Is the tax burden that South Africans have to bear large in comparison with other comparable countries?
2. Has the root or originating cause for tax avoidance and tax evasion been addressed?
3. What are the solutions?

Tax is not unique to South Africa, it is paid in every democratic country in the world. Principles of all tax systems are the same. Taxes on personal income, companies pay taxes on profits and taxes on goods purchased like GST or VAT. Individual tax rates will differ from country to country. South Africa does not have the highest tax rates in the world, neither the lowest. However, as a developing country we need money for social and development projects.

The root cause of tax evasion is the lack of taxpaying culture in South Africa. Taxpayer education is going to endeavour to correct this situation. Taxpayer education alone will not stop tax evasion but severe action from enforcement together with taxpayer education will drop our rate of tax evasion.

In the United States, taxes are an obligation that all citizens are required to pay. If the citizens fail to make their statutory return, the Inland Revenue Service (IRS) will be on their door-steps. The IRS does not 'ramp nor skin up' when it comes to their taxes and they pardon no man. This has resulted in a positive tax culture in the United States, where despite the grumbling of some citizens, their taxes are returned to the state and on a timely basis.

## **CHAPTER 4**

### **THE INFORMAL SECTOR**

#### **4.1 BLACK ECONOMIC EMPOWERMENT**

With the new dispensation after the elections in 1994 a new type of middle class business men and professionals as well as wealth was created. These people are all high profile, educated individuals, with extensive business as well as marketing skills, but no tax culture (education). This has raised issues surrounding tax matters of businessmen who as a consequence of past discrimination barrier to the opportunities afforded by the South African economy are not fully integrated into the tax system and modern economy.

BEE is a significant feature of the South African economy and in recent months we have seen transactions effecting transfers of equity worth billions of rands. Although the number of these transactions has exploded in the last year or so, BEE is not a recent idea. It has been discussed for as long as South Africa has been a democracy and, as a core principal of our Constitution, is a fundamental part of our society and economy.

There is a great deal of confusion about the tax implications for both the shareholders of a company and the company itself in a black economic empowerment (BEE) deal. 2004 began with the signing of the Broad-Based Black Economic Empowerment Act by the President.

To acquire the benefits presented by BEE ownership, it is imperative that taxpayers have adequate knowledge of the various tax implications of BEE deals. This is important to ensure that BEE can be implemented in such a manner that it is efficient to all parties involved.

## 4.2 THE SECOND ECONOMY

“The gains made to date have predominantly focused on the formal economy. The challenge remains for SARS to take its investigative techniques into the informal areas of the economy in order to understand the possibilities and limits of expanding the state’s extractive capacity. This has been the area least explored by SARS, and is illustrated by the lack of new VAT registrants over the last four years - the most likely area for SARS to gain an insight into informal sector activities. One of the difficulties SARS may encounter in trying to understand informal economic activities is that the benefits for a participant in the informal economy in choosing not to comply might far outweigh the incentives for complying. This is a problem that faces revenue-raising authorities in most if not all sub-Saharan countries, and in this area – if not in any others – SARS’s performance is characterised far more by its similarities with other countries on the continent than by the differences.

If revenue-raising is to begin to penetrate those vast reaches of South African economic life beyond the formal economy, SARS has much work to do, both in understanding this complex and vital sector of the economy, and in learning how to ensure that those who operate within it join the tax-paying citizenry.”(Smith, 2003)

The problem arising from the awarding of Government municipal contract tenders is that the small businessman, probably from a rural area, has an understanding about the functionality of the job, but is clueless about his tax obligations. Many of these businessmen have low literacy levels and poor accounting skills if any, transactions are normally cash, he receives his funds expends it, and the rest goes into his pockets. The next step is that SARS appears at his door and wants the taxes due, but he has already spent all his money. This issue which is unique to our country has posed a dilemma, not only does his business face closure but this businessman’s story spreads throughout the community and impacts negatively on the tax culture.

### **4.3 SUMMARY**

This scenario alone is where the greatest challenge lies in taxpayer education. The SETA's have made initiatives in passing on skills to this market, but that in isolation does not resolve the problem. The solution is to work together to educate and provide an infrastructure to reduce the tax burden in terms of the legal requirements placed on the informal sector. Small business is the driving force behind our future economy; they require assistance in dealing with their tax obligations.

## **CHAPTER 5**

### **INVESTING IN THE NEXT GENERATION OF TAXPAYERS**

#### **5.1 OUR FUTURE TAXPAYERS**

Although, the education of taxpayers is a key issue in a tax system based on self-assessment, we have to give special attention to the new generation of future taxpayers. For younger people special programs are required to explain to them why paying taxes are important, and deliver the message, that a modern society is based on the abidance by laws and in this, compliance of tax code is no exception.

All economies in transition are facing the issue that changing the legal, social environment is relatively easy; to change the people's way of thinking, their attitude is much more difficult. In bringing about this change, education of the young plays a key role.

The South African Revenue Service needs to be more proactive in educating our citizens. Taxpayer education initiatives need to be driven towards encouraging SARS employees to visit schools to talk about the history of our tax system as well as taxpayer rights and responsibilities, as a short term goal. The long term issue can be projected by introducing awareness of our tax obligations and responsibilities via the life skills course. Thus inculcating a firm tax culture at an early age, in the premise that the youth are the countries future taxpayers.

#### **5.2 IRS EDUCATION PROGRAMS**

The IRS has year-round education programs designed to help the youth understand the tax laws and IRS procedures. Volunteers trained by the IRS are an important part of these programs.

## **Understanding Taxes Program for Students**

Understanding Taxes consists of four separate tax education courses designed to teach students about their federal tax rights and responsibilities and the economics and history on which our tax system is based.

The eighth grade program, Taxes in U.S. History, details the roles that taxes have played in our nation's history. It is designed for U.S. history classes. Students learn how tax policies of the past have contributed to tax policies in effect today. Teachers can integrate the program into standard curricula.

The high school program, Understanding Taxes, explains how to prepare and file a simple tax return and teaches about the history, politics, and economics of our tax system. The variety of topics covered in a modular format allows the course to be used in a number of different classes, such as history, economics, consumer education, social studies, government, civics, and business education.

TAX Interactive (TAXi) is an online learning lab designed for high school student and teacher use. TAX Interactive provides an educational and entertaining way to learn about tax rights and responsibilities.

The post-secondary program, Taxes and You, is designed to assist adult learners in becoming responsible participants in the tax system. Students will learn how taxes affect people and the economy and how to interpret and prepare tax forms. By learning how to pay only what is owed, managing personal finances will become a lot easier.

Scholars require an introduction to taxation and to understand our social responsibility as citizens of South Africa to pay taxes. The strategy to target this market entails the implementation of a tax education programme in schools as part of the curriculum within the life skills course and entrepreneurial endeavours.

The unemployed encompass students, pensioners and job seekers. This segment needs to attend taxation training pertaining to entrepreneurs. Awareness needs to be

created to the unemployed to gain an understanding on how taxes affect even the unemployed.

Facilitate the implementation of a programme for all final year students in tertiary institutions so that they are able to enter the job market as compliant taxpayers.



## CHAPTER 6

### THE INTERNATIONAL PERSPECTIVE ON TAXPAYER EDUCATION

The IRS created Taxpayer Education and Communication in response to concern that the IRS should better balance such services with its enforcement efforts. SB/SE was formed to address various issues affecting small business and self-employed taxpayers, such as filing tax returns and paying taxes. SB/SE's strategic goals include increasing compliance and also reducing burden among SB/SE taxpayers. A part of SB/SE is to use various strategies, including providing education, outreach assistance, and other services, to support SB/SE taxpayers in understanding and complying with tax laws.

In serving, Taxpayer Education and Communications is to partner with government agencies, small business groups, tax practitioner groups, and other stakeholders that could advance its education and outreach efforts. To meet an overall goal of increasing voluntary compliance. Taxpayer Education and Communications four program goals are to combat abusive tax schemes, reduce taxpayer burden, promote electronic filing, and negotiate agreements with SB/SE taxpayers on specific ways to voluntarily comply with tax laws.

The Internal Revenue Manual, documents the following issues regarding the operations of Taxpayer Education and Assistance, Taxpayer Education and Communication (TEC).

#### **"6.1 OPERATIONAL PRIORITIES**

The Office of Compliance Pre-Filing Activities supports the following specific operational priorities:

- Abusive Tax Schemes (Example: Abusive Trust/Offshore Credit Cards)

- Voluntary Agreements (Example: Tip Rate Determination and Education Program (TRD/EP))
- E-Submissions (Example: E-Filing and E-Payment )
- Burden Reduction

The Office of Compliance Pre-Filing Activities will strive to build the SB/SE network by targeting specific types of stakeholders, and developing and coordinating pre-filing policies, programs and procedures nationwide. Focus will be on:

- Developing and implementing an E-Commerce strategy to promote compliance and target non-compliance
- Partnering with the states to identify best practice E-Commerce initiatives
- Assessing the applicability of activities to IRS compliance and taxpayer education
- Increasing partnerships with local stakeholders to market E-File/E-Pay
- Identifying burden reduction opportunities
- Addressing targeted compliance issues

## **6.2 OFFICE OF PRE-FILING AGREEMENTS**

The Office of Pre-Filing Agreements will work with SB/SE Compliance, TEC field components and SB/SE Counsel to explore and consider new areas for the use of voluntary agreements at the pre-filing stage, which prevents the need for downstream enforcement activity.

- TEC will identify potential noncompliance among specific customer segments within common areas.
- Through educational, outreach products, services and activities, TEC will design, develop, negotiate and maintain program opportunities with various industry and partner groups.
- Supports the Compliance program goals by leveraging resources through partners and associations to educate the public. The education methods and techniques are not all-inclusive. Tax Specialists should adapt the procedures developed for each education plan based on the needs of the targeted audience.

### **6.3 EARNED INCOME TAX CREDIT (EITC) PREPARER OUTREACH PROGRAM**

The EITC Preparer Outreach Program is an alternative method of providing information and education to preparers to increase accuracy of EITC returns they prepare, and ensure taxpayers receive the proper EITC. TEC will conduct outreach to educate preparers before the returns are prepared instead of identifying errors through Compliance efforts later.

This program involves contacting a sample of paid preparers who are responsible for the highest number of EITC returns with errors and who prepared 75 or more returns where EITC was also claimed during the previous filing season.

During the outreach, Tax Specialists provide relevant information to help preparers avoid making the same EITC errors in the future and discuss due diligence requirements of preparers. The outreach does not constitute an examination and participation is voluntary on the part of the preparers.

## **Objectives - EITC Preparer Outreach Program**

In recognizing that not all errors are intentional, the objectives of the EITC Preparer Outreach Program include:

- A. Reducing burden on taxpayers, paid preparers, and the Service;
- B. Increasing compliance with EITC rules;
- C. Minimizing the use of enforcement resources; and
- D. Reducing the number of errors that negatively impact paper and electronic filed documents,

## **6.4 EITC TAX PROFESSIONAL GUIDE**

Communications & Liaison has developed an EITC Tax Professional Guide as part of the educational outreach to the preparer community. The Guide is intended to assist preparers in preparing accurate and complete returns for taxpayers claiming the EITC and includes the following:

- Letter from the Commissioner
- When the EITC is Disallowed
- What to do about Due Diligence
- Frequently Asked Questions about the EITC

## **6.5 VOLUNTARY AGREEMENTS**

Co-ordination will take place with Compliance on the identification of opportunities for new Voluntary Agreements and the identification of other Voluntary Agreement outreach endeavours.

A Voluntary Agreement is defined as a way to favourably resolve certain tax issues. The IRS offers a taxpayer the opportunity and an incentive to enter into an agreement to take a specific action in return for the IRS taking (or not taking) specific actions, such as penalty abatement, examination or enforced collection action. This mutually beneficial agreement positively impacts voluntary compliance, saves enforcement resources and reduces taxpayer burden by resolving the issue quickly.

## **6.6 BUSINESS INITIATIVE PROCESS**

Business Initiative proposals are recorded on a web based tracking system. Research capabilities are also planned and will be a tool in pursuing additional initiatives and facilitate the sharing of TEC efforts to

- Provide small businesses with information and education products and services to assist them in understanding and complying with their tax obligations.
- Develop and deliver products, services and programs targeted towards specific compliance problems and/or SB/SE groups.
- Leverage external stakeholder resources to deliver TEC objectives rather than direct one-on-one contact with taxpayers.
- Identify ideas that lead to proposed product development, partnership relations, burden reduction and alternative treatments from field contacts during filing season taxpayer contacts.

The intent for the initiative proposal process is centered on developing alternative methods to address compliance or burden reduction issues.

The best source for ideas to accomplish our goals and objectives come from the field component of TEC. The ideas associated with the initiative proposals may cover a broad range of program areas, from Business Marketing Services and Partnership Outreach to proposed pre-filing agreements.

The Business Initiative process is not intended to provide additional administrative burden or to stifle creativity but to provide a uniform process with defined information requirements and a common filtering or review criteria.

This process and the related reporting vehicles will allow IRS to share experiences and efforts to identify and expand those initiatives that most effectively and efficiently address any strategic objectives for possible National rollout.

## **6.7 CONCEPT DEVELOPMENT**

1. Concept development evolves around a basic idea that is developed into a coherent proposal.
2. There are three primary components that are incorporated into Concept Development. These components should be addressed to the extent applicable and that data is available. The components and the criteria are:

- Issue Identification:

Describe the issue and/or problem that the initiative is going to address. Ensure that this narrative completely covers the following items:

1. Extent of the issue: Does it have national implications or is it limited in scope?
2. Targeted Audience or Market Segment: What is the size of the population the initiative will impact? Also, describe the demographics

of this population (who they are, where are they located, etc.) and how the issue specifically impacts them.

3. Strategic Business Plan: How does the initiative relate to the SB/SE priorities and strategic objectives? Include a statement relative to how the proposal impacts and or supports the SB/SE program priorities & strategic objectives.

- Issue Background:

Describe the background of the issue/problem and any historical information relevant to the proposed business initiative. Include information on the following:

1. Similar Projects: Have any similar projects or activities addressed this particular area? If so, is there a written report or other documentation that should be included with this proposal? Is anyone else working on this issue at the present time? Research should be done to review other initiatives to assist in avoiding duplication and determining if similar projects have been approved/disapproved, ect.
2. Data Exists: What data exists which helps describe the nature of the issue/problem?
3. Data Necessary: What additional-data would be necessary during the Business Initiative review and what is the source of this data? Does research already exist that can be of use?

- Issue Resolution:

Provide a narrative describing how the initiative addresses the issue/problem. What specific actions need to be taken? Include information on the following:

1. Partners: Who would have to help complete the initiative? (both internal and external stakeholders) Ensure proper coordination takes place with the affected parties early in the process.
2. Timeframe: How long will the initiative take (estimate) and when can results be expected?
3. Resources: How much, in terms of staff time and related expenses, will it cost? (estimate)
4. Benefit Evaluation: How will the initiative be evaluated to gauge success?

## **6.8 OFFICE OF FIELD OPERATIONS**

- Assisting SB/SE Compliance regarding the promotion of voluntary agreements through outreach efforts.
- Ensuring the successful transition of the Tip Rate Determination and Education Program (TRD/EP) Voluntary Agreement Program from Compliance to TEC.
- Conducting independent reviews of TEC field activities.
- Integrates short and long range strategies and objectives for SB/SE Cross Unit Support for Wage and Investment Operating Division (W&I) programs during the filing and non-filing seasons.
- Provides continuous oversight and coordination of SB/SE cross unit Support activities.



- Coordinates with W&I and serves as the liaison for SB/SE Compliance and CAS for cross unit support to ensure readiness plans are in place.
- Develops and coordinates a TEC quality review program for cross unit support.
- Works with Compliance Policy to identify joint initiatives to address SB/SE taxpayer concerns/needs.
- Administers the voluntary agreement program, specifically the Tip Outreach Program (TRD/EP) that is being migrated from Compliance to SB/SE TEC.

## **6.9 KEY INTERDEPENDENCIES OF FIELD OPERATIONS**

1. Interact at the National level with Compliance, Large Mid-Size Business (LMSB), Tax Exempt/Government Entities (TE/GE) and Criminal Investigation (CI) to deliver consistent education/outreach materials, identify stakeholders and identify issues and trends.
2. Works with Partnership Relations, Product Development, and Business Marketing Services to deliver and evaluate products and services.
3. Interacts with Criminal Investigation (CI), Counsel, and Communications and Liaison (C & L).

## **6.10 CROSS UNIT SUPPORT**

1. Field Operations is responsible for the SB/SE TEC cross unit Support.
2. This support includes:
  - R-Mail
  - ETLA and

- Field Assistance
3. Analysts, TEC Area Coordinators and R-Mail/ETLA Coordinators will work in conjunction with the Field Operations to reduce the need for Compliance support.

### **6.11 R-MAIL**

1. The Referral Mail System (R-Mail) is used to record taxpayer questions that have been received telephonically but have not been answered "live" when initiated. R-Mail is managed by designated Area coordinators through the filing season with some Area SB/SE Coordinator (ASC) direct involvement.
2. Inventories are recorded on the R-Mail database and are considered aged if not closed within the prescribed timeframe. Taxpayers are to be contacted telephonically with responses to their inquiries but letters of explanation are an option when telephone contact attempts are not successful.

### **6.12 ETLA**

1. Electronic Tax Law Assistance (ETLA) for TEC is directed by the Office of Field Operations.
2. ETLA is an internet based system whereby the taxpayer has the capability through the Digital Daily website ([www.irs.gov](http://www.irs.gov)) to ask a tax question. Responses are made electronically to the E-mail address provided.
3. Inventories are aged if not responded to within 2 work days.

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### **6.13 TIP RATE DETERMINATION AND EDUCATION PROGRAM (TRD/EP)**

1. TRD/EP is a "fast track" voluntary agreement program whose primary source of authority is being migrated from Compliance to SB/SE TEC.
2. The Tip Outreach Program serves as the foundation of addressing consistent administration of the program by the TEC Area offices.
3. The pre-filing aspects of the Tip Outreach Program Mission within TEC will emphasize the organizational goal to improve voluntary compliance among all tipped workers.
4. TEC's focus is on the desired outcome of changing behaviour to accomplish:
  - More accurate returns filed
  - More income reported and
  - Correct tax paid

### **6.14 RESPONSIBILITIES FOR TIP OUTREACH PROGRAM**

1. TEC Headquarters, Area, and Territory Offices are responsible for administering the Tip Outreach Program activities.
2. The TEC Headquarters Office responsibilities are:
  - A. Ensure consistent program delivery within TEC.
  - B. Communicate with TEC executives, Area Directors and Headquarters analysts to ensure program effectiveness and consistency.

- C. Expand the Tip Program to other tipped industries (currently focusing on the food and beverage industry) and to include self-employed individuals who are in professions where tipping is customary. Example: Gaming, Cosmetology, Taxi Drivers.
- D. Partner with external stakeholders at the National level, focusing on pre-filing issues.
- E. Schedule and conduct program reviews for all TEC Areas on pre-filing activities.
- F. Develop innovative approaches to reducing taxpayer burden while improving the accuracy of the returns filed.
- G. Coordinate and communicate program results with TEC Headquarters Executives, Area Directors and Field Staff as well as other Operating Divisions.
- H. Collaborate with internal stakeholders on referrals of post-filing issues.
- I. Coordinate activities and program issues with national industry leaders.
- J. Prepare congressional responses and reports on pre-filing issues.
- K. Provide program guidance to internal and external stakeholders.
- L. Prepare and update the pre-filing tip initiative guidelines for the IRM.
- M. Coordinate with Learning and Education in the development of pre-filing Tip Program training.

- N. Review various studies and analyses of tipped individuals to determine where TEC needs to focus or renew its efforts for maximum impact.
  - O. Oversee operations of a Centralized Data Unit (CDU) which monitors agreements and generates Tip Program leads.
  - P. Maintain national stakeholder relationships with practitioners, trade and professional organizations.
3. The TEC Area Office is responsible for all Area Tip Outreach Program activities.
  4. The TEC Area Director is responsible for the overall planning and administration of the Tip Outreach Program activity. The TEC Area Directors should:
    - A. Ensure the delivery of the Tip Program as part of the Area work plan.
    - B. Assist with national broad-based outreach efforts within their area.
    - C. Maintain current external stakeholder relationships and build new external stakeholder relationships.
    - D. Serve as the focal point for information and concerns between the territories and Headquarters office.
    - E. Share area best practices to address systemic problems.
    - F. Participate in area meetings with Compliance and other internal stakeholders in operating and functional divisions.
    - G. Analyze data regarding program impact in their area.
  5. The Territory Office is responsible for all local Tip Outreach Program activities.

6. In conjunction with the Area Director, the TEC Territory Manager has the responsibility to implement the Area work plan with respect to the Tip Outreach Program activities. The TEC Territory Manager should:
  - A. Coordinate and assign tip leads and CDU referrals to designated TEC Tax Specialists.
  - B. Ensure the quality and consistency of broad-based and focused outreach efforts.
  - C. Establish and expand partnership relationships with local and regional external stakeholders.
  - D. Participate in cross-functional meetings with Compliance and other internal stakeholders to ensure their understanding of program goals.
  - E. Review and approve secured Tip Program agreements and insure their input into the agreement database.
  - F. Analyze data regarding program impact in their Territory.
7. The Area Directors designated TEC Territory Tax Specialist will deliver the program to stakeholder partners, business establishments and tipped workers. The TEC Tax Specialist will be responsible for the following duties:
  - A. Keeping the Area Director informed of all program activities.
  - B. Serve as primary contact and explain tip agreement options to local business owners.

- C. Establish new partner relationships with tipped workers, trade school administrators, and business owners in their Territory.
- D. Establish local partnering relationships with internal and external stakeholders.
- E. Prepare referrals to Compliance when facts and circumstances warrant such action.
- F. Conduct broad-based outreach that includes speeches, seminars and workshops.
- G. Order materials, organize and staff booths at local trade shows.
- H. Review leads to prioritize contact.
- I. Understand and explain tip laws, reporting requirements, Employer's Annual Information Return of Tip Income and Allocated Tips, (its use, common errors) to owners of food and beverage establishments and practitioner groups.
- J. Solicit and secure TRAC, TRDA and EmTRAC agreements.
- K. Prepare and forward the closed case file to their Territory Manager on all businesses contacted personally. The file should include significant activities performed, resolution of the contact and tip agreements if secured.
- L. Conduct employer/employee education meetings to discuss tip laws and reporting requirements.

- M. Share presentation techniques and provide shadowing opportunities for other TEC Tax Specialists.
8. The Centralized Data Unit (CDU) is a new organizational component within TEC. The CDU will provide support to TEC functions and work streams. With respect to the Tip Program, the CDU will provide pre-filing leads and monitor existing tip agreements. It will generate reports that track and measure the effectiveness of the program and:
- A. Work with various internal and external databases to build informational files (leads) of establishments to be contacted by the TEC Tip Tax Specialists.
  - B. Provide each TEC Area with leads based on the business demographics.
  - C. Monitor existing voluntary agreements and issue pattern letters.
  - D. Input voluntary agreement information to a database and generate reports from the database.
  - E. Gather data to measure the impact of TEC broad-based and focused outreach. The measures would rely on external data such as state licenses and internal measures.
  - F. Analyze Form(s) 8027 for accuracy and identify Form 8027 non-filers.

### **6.15 TRDA/TRAC/EMTRAC AGREEMENTS**

- 1. The Tip Rate Determination and Education Program was initiated by the Internal Revenue Service to improve voluntary compliance by employers and employees in industries where tipping is customary. Under this program,



employers can agree to voluntarily enter into one of two arrangements, the Tip Rate Determination Agreement (TRDA) or the Tip Reporting Alternative Commitment (TRAC).

2. Section 3414 of the Internal Revenue Service Restructuring and Reform Act of 1998 prohibits the threat of an audit to coerce taxpayers into signing a Tip Reporting Alternative Commitment (TRAC) Agreement or a Tip Rate Determination Agreement (TRDA). IRS employees will under no circumstances use or imply the threat of an audit when soliciting participants to sign up for either a TRDA or a TRAC agreement.
3. Employers will find one arrangement more beneficial, some will prefer the other arrangement, and others will choose not to participate in the program. As this is a voluntary program, employers do not have to participate. Those who choose may participate in one arrangement.
4. Under the TRDA, the Service will work with the employer to arrive at a tip rate for the various occupations in the industries where tipping is customary. Tip rates are determined using historical tip data and the McQuatter's Formula. At least 75 percent of tipped employees must sign a participation agreement agreeing to participate. Participating employees report tips at or above the rate determined in the agreement.
5. Under the TRAC agreement, the employer agrees to institute and maintain a quarterly educational training program that trains newly hired employees and periodically updates existing employees as to their reporting obligations with respect to tips. The employer also agrees to:
  - A. Establish a procedure for monitoring the reporting of charged tips by both directly and indirectly tipped employees.

- B. Establish a procedure to ensure the accurate reporting of tips by all employees.
  - C. Comply with all federal tax requirements regarding the filing of returns, paying and depositing taxes, and maintaining records.
6. Service agrees that while under a TRDA or TRAC, prior periods will not be examined if both employer and employee comply with the agreement. This procedure will not apply to those tax periods where examinations are already in process prior to entering into the agreement.
7. EmTRAC is a program initiated in December 2000 and allows any tipped industry the opportunity to develop their own tip compliance program. The EmTRAC program maintains the same filing, reporting, and educational requirements as the IRS administered TRAC agreement. Employers must apply, in writing, for approval of their program to receive the same benefits and protections afforded under TRAC. To date very few EmTRACs have been submitted and approved.

#### **6.16 TEC TIP OUTREACH PROGRAM ACTIVITIES**

1. Tip Program broad-based outreach activities will occur at the TEC Headquarters, Area, and Territory Offices. TEC Headquarters will partner with national organizations to promote the Tip Program. They will also participate with the Area and Territory offices at national trade shows or conventions.
2. TEC Tax Specialists will engage in broad based outreach to promote the Tip Program's TRDA/TRAC agreements.  
Tax Specialists will:
  - A. Participate in trade shows,

- B. Conduct seminars, and
- C. Perform public speaking engagements as part of their broad-based outreach activities.

### **6.17 ABUSIVE SCHEMES AND FLOW-THRU OVERVIEW**

1. The program enables the TEC Tax Specialist to educate the public on abusive schemes and flow-thru entities.
2. A description of abusive schemes and the tax law can be found on the SB/SE Compliance website under "Abusive Tax Shelters/Flow Through Entities" and also the CI website.
3. Abusive Schemes is a priority program and Flow Thru entities is a strategy tied to the Business Plan.

### **6.18 PROGRAM GOALS**

Support the Compliance Abusive Schemes and flow-thru program goals by developing products to be used by Partnership Outreach and TEC Tax Specialists in the field to leverage resources through partners and associations to educate the public.

Design, develop, negotiate, and maintain program opportunities with various industries and partner groups to foster compliance through development of outreach products and services.

Coordinate the educational efforts of the Areas to ensure these are conducted in accordance with National guidelines.

## 6.19 TYPES OF SCHEMES

There are many types of schemes. Some categories are:

- **Anti-tax Movement:** Frivolous tax arguments, claiming the income tax is illegal or immoral. Frequently they are quite open about their resistance to paying taxes, file frivolous returns, or fail to file tax returns. Tax arguments are usually constitutional, common law, religious, or depend on a frayed interpretation of the tax law. "Zero Tax", Frivolous Filer Program, and Questionable W-4 Program cases fall into this category.
- **Domestic Tax Shelters:** Usually file a complicated return, have multiple levels of entities (tiering), contain a bogus legal theory, and usually have a functionally tax-exempt component. Current favored entities include trusts, partnerships, Limited Liability Companies (LLC), charitable remainder trusts, and private foundations. These shelters can include leasing, financial products, and hobby losses. Several of the corporate tax shelter schemes (Company Owned Life Insurance (COLI), Lease-in/ Lease-Out (LILO), and Lease Strips) are being modified for use by small business and individual taxpayers. These types of schemes would include cattle shelters, oil and gas shelters, Section 302 basis shifting, cafeteria plans, etc.
- **Abusive Domestic Trusts:** Usually file a Form 1041 return, have multiple levels of entities (tiering), contain a bogus legal theory, and usually have a functionally tax-exempt component. Current favored titles include Business Trusts, Constitutional Trusts, Pure Trusts, Dynasty Trusts, Guam Trusts, and Fortress Trusts. Often these trusts are paired with other entities such as partnerships, Limited Liability Companies (LLC), foreign trusts, charitable remainder trusts, and private foundations to complicate, tier, and disguise their true nature.

- Offshore: May originate on virtually any tax return, have multiple levels of entities (tiering), use of the Form 1041 is common within the tiers, contain a bogus legal theory, and usually have a functionally tax-exempt component. These are frequently the same structure as the "Domestic Tax Shelter" described above. The difference is that the bottom 2 or 3 tiers are offshore, to further their goal of obscuring or hiding the true control and ownership of the assets and income – or the entire structure is offshore to accomplish the same purpose. Current favored titles include Business Trusts, Constitutional Trusts, Pure Trusts, Dynasty Trusts, Guam Trusts, and Fortress Trusts. Often these trusts are paired with other entities such as partnerships, Limited Liability Companies (LLC), foreign trusts, charitable remainder trusts, and private foundations to complicate, tier, and disguise their true nature.

### **Specific Issue Abusive Tax Schemes:**

Misuse of Disabled Access Credit: The disabled access credit is used to sell investments in such things as ATM machines, Internet availability, audio yellow pages, and pay phones. The marketers violate the intent of the credit by selling it to investors not operating a business, selling the equipment at prices far in excess of its value and using non-recourse financing. Even if the equipment is purchased with cash or recourse loans, the promoter generally includes a repurchase clause that allows the buyer to return the equipment at a guaranteed price – usually the acquisition price. Promoters generally sell investments, which are represented as qualifying the purchaser for the disabled access credit. Although there are variations in the promotions, they generally require a down payment or enrollment fee, which is combined with a creative financing package. Thus, according to the promoters, the purchasing taxpayers have incurred "eligible access expenditures" which qualify for the credit.

- Abusive Business and Deduction Schemes: These are a potpourri of dubious expense and income avoidance schemes which include schemes to misrepresent. These can include schemes to misrepresent self-employment

income, and to avoid self-employment taxes. These generally have a promoter or tax preparer that is instrumental in setting up the scheme. Their customer base is wage earners, self-employed, and small businesses. The home-based business scam is an example of a scheme in this area.

- **Credit and Refund Schemes:** These abusive tax credit schemes involve creation of credits to substantially reduce tax or create refunds. Examples include Earned Income Tax Credit, refund of FICA paid credit, Disabled Access credit, foreign earned income credit, and reparations for slavery credit.
- **Exempt Organization Schemes:** More and more information is being obtained indicating a growing use of charitable remainder trusts, private foundations, corporate soles, and Voluntary Employees' Beneficiary Associations (VEBAs) in abusive tax schemes designed to misrepresent deductions, offset gains, or disguise income. The return of phoney church schemes has also been observed.

## **6.20 PARTNERSHIP OUTREACH**

### **Roles and Responsibilities**

Partnership Outreach is a component of Small Business/Self-Employed (SB/SE), Taxpayer Education and Communication (TEC) business unit. Its name describes its two primary functions: establishing partnerships and conducting outreach efforts to stakeholders with the objective of helping small business taxpayers. These activities support TEC's mission to develop and deliver top quality educational and informational programs, products and services aimed at increasing voluntary compliance and reducing taxpayer burden. This pre-filing focus results from the recognition that increasing voluntary compliance decreases the need for more costly enforcement procedures.

TEC Partnership Outreach, with the field organization, engages partners who can expand TEC's outreach to small businesses. By leveraging relationships with partners such as professional and trade associations, practitioners, small business organizations, e-businesses, and other government agencies, TEC expands its ability to target and reach small business taxpayers. Using existing distribution channels of these partners allows TEC to reach significantly more taxpayers than it could through traditional face-to-face outreach activities.

An added benefit of strategic partnering is the opportunity to hear from small business taxpayers address issues of concern to them, and then seek remedies to reduce burden or clarify regulations. Reinforcing a mutually beneficial relationship is a guiding principle of Partnership Outreach.

The role of Partnership Outreach goes beyond maintaining good relationships and leveraging resources. For a partnership to be strategic, it should contribute to the on-going programs in TEC and advance TEC's strategic initiatives.

Partnership Outreach is organized into Partnership Relations, with five component parts, and Product Development.

Partnership Relations establishes and maintains mutually beneficial relationships between Service executives and leaders of partner groups. There are five segments of Partnership Relations, each managed by a Chief.

- E-Business/E-Commerce
- Government Agencies and Educational Institutions
- Practitioner and Payroll Groups
- Professional, Trade, and Service Organizations
- Small Business Organizations and Financial Institutions



## **6.21 PARTNERSHIP RELATIONS- GOVERNMENT AGENCIES AND EDUCATIONAL INSTITUTIONS**

### **Functional Statement**

Government Agencies and Educational Institutions establishes relationships and leverages channel partnership opportunities with government agencies, educational institutions and related associations to educate and communicate with small business taxpayers in order to help them meet their tax filling responsibilities.

The Chief of Partnership Relations for Government Agencies and Educational Institutions serves as the main point of contact with national channel partners to:

- Influence, formulate and evaluate policy and procedures;
- Provide guidance and support to field activities; and
- Develop key messages.

### **Business Objectives**

The following are the business objectives for Government Agencies and Educational Institutions:

- Improve our service to customers through enhanced education and outreach activities.
- Increase compliance among small business taxpayers particularly with respect to abusive schemes and participating in voluntary agreements.
- Reduce burden on small business taxpayers.
- Increase the use of e-submissions options.

## **6.22 PARTNERSHIP RELATIONS- PAYROLL AND PRACTITIONER GROUPS**

### **Mission**



Partnership Relations, Payroll and Practitioner Group's (PR:PP) mission is to communicate, educate, and deliver educational products and services focused on Small Business/Self Employed (SB/SE) customer needs to tax professionals. In addition, Partnership Product and Partnership Relations leverages partnerships with National Payroll and Practitioner Organizations to assist in the delivery of these products and services. The primary focus is to proactively identify emerging trends and common errors within the framework of TEC Operational Priorities and deliver services and programs to address these issues.

### **Roles/Responsibilities**

The Payroll and Practitioner Group works closely with national payroll and practitioner organizations to improve the delivery of service to small business taxpayers. The Chief of Payroll and Practitioner Groups is responsible for:

- Developing and maintaining mutually beneficial relationships between IRS and national payroll and practitioner organizations;
- Developing "Key messages for tax professionals" for TEC field personnel to use for their local liaison meetings;
- Distributing communication vehicles such as Headliners to national payroll and practitioner organizations and TEC field personnel;
- Serving as the SB/SE point of contact for both the national payroll and practitioner organizations;
- Influencing, formulating and evaluating SB/SE policies, procedures, and programs impacting national payroll and practitioner organizations;
- Providing guidance and support to TEC field activities with respect to payroll and practitioner issues.

## 6.23 TAX PROFESSIONAL EDUCATION PROGRAM OVERVIEW

Tax Practitioner Institutes (TPI) are conducted in cooperation with a college, university, state bureau of revenue, or professional accounting group. These institutes have been ongoing for as many as 60 years in some parts of the country. They began as schools to teach farmers and preparers on how to handle tax issues surrounding the preparation of farm tax returns. Over the years, the institutes have evolved into forums that deal with a large variety of income tax issues of interest to the entire tax practitioner community. Generally, the major state universities have sponsored these events. However, in some states, community colleges, practitioner organizations and volunteer organizations sponsor these institutes. All participants are eligible to receive CPE credit. Today, the Tax Practitioner Institutes provide a much-needed venue for delivering IRS messages to approximately 25,000 tax preparers.

We also believe that the Tax Practitioner Institute serves as part of an overall practitioner education curriculum, which includes Tax Talk Today, the Nationwide Tax Forums, local liaison meetings, etc. IRS covers all travel expenses for IRS instructors and speakers. There is no reimbursable program. All TPI text material is tied to IRS strategic goals and SB/SE operational priorities and objectives.

**Tax Talk Today** is a monthly program about current tax issues and policies sponsored in part by the IRS. It provides unbiased insight and information about current tax and business issues critical to tax professionals. All of the programs feature a panel discussion, questions and answers from viewers, current tax news stories, and tax teasers. The format allows viewers to ask questions via e-mail, fax or telephone. Viewers can earn one CPE credit by watching each Tax Talk Today via live webcast or archived webcast. All State Boards that accept National Association of State Boards of Accountancy (NASBA) sponsors of continuing professional education accept credit for the live webcast. NASBA has also approved credit for viewing the archived webcast or VHS videotape which qualifies as a Non-Interactive Self-Study program.

**The IRS Nationwide Tax Forums** originally started as an effort to bring together three essential elements of electronic filing in a manner that would encourage the exchange of information and ideas for encouraging electronic filing among taxpayers. The three essential elements are:

- The tax professional community that includes tax preparers, financial institutions and others involved in tax preparation;
- The vendors who provide the software and other services necessary for electronic filing;
- The IRS personnel responsible for the various programs affecting electronic filing.

Recognizing the opportunity to advance Internal Revenue Service (IRS) policies and programs in addition to electronic filing, the forums have expanded their scope to include seminars on compliance initiatives and IRS services. Tax professionals who attend these forums are eligible to receive Continuing Professional Education (CPE) credit.

**SB/SE Stakeholder Meetings** are generally held on a monthly, bi-monthly or quarterly basis:

The SB/SE Payroll and Practitioner Forum is an extension of the National Public Liaison (NPL) Forum. The focus of the bi-monthly forum is to discuss SB/SE related issues which impact our national payroll and practitioner organizations. The forum also provides an opportunity for SB/SE and other business operating unit subject matter experts (SMEs) to share, address and work through important SB/SE issues. Representatives from the national payroll and practitioner organizations attend the forum.

The Reporting Agent Forum is held on a quarterly basis. These quarterly working group sessions are conducted with representatives from the payroll community. The working group sessions address account management, customer service, and burden related issues.

TEC Field Liaison Meeting is an information sharing process between TEC field and headquarters personnel in relation to the payroll and practitioner communities. These meetings are conducted in the form of monthly conference calls.

## **6.24 PARTNERSHIP RELATIONS- SMALL BUSINESS AND FINANCIAL ORGANIZATIONS FUNCTIONAL STATEMENT**

Small Business and Financial Organizations establishes relationships and leverages partnership opportunities with small business and financial organizations to educate and communicate with small business taxpayers in order to resolve issues, reduce burden, and increase compliance.

### **Business Objectives**

The following are the business objectives for Small Business and Financial Organizations:

- Increase compliance among small business taxpayers.
- Improve our service to customers through enhanced education and outreach activities.
- Reduce burden on small business taxpayers.

## **Target Audiences**

Small Business and Financial Organizations targets the following audiences:

- Small Business Organizations/Associations
- Financial Organizations/Associations
- Minority Business Organizations/Associations
- Office Supply Distributors and Copy Centers

### **6.25 PARTNERSHIP RELATIONS- PROFESSIONAL, TRADE AND SERVICE ORGANIZATIONS BUSINESS MISSION AND OBJECTIVES**

Professional, Trade and Service Organizations (PTSO) is responsible for fulfilling TEC's mission of serving the small business/self employed taxpayer by establishing partnerships with professional, trade and service organizations to:

- Increase compliance among SB/SE taxpayers through relationships with national professional, trade and service organizations.
- Improve our service to customers through enhanced education and outreach activities based on the needs of professional, trade and service organization stakeholders.
- Reduce burden on SB/SE taxpayers through their memberships with national professional, trade and service organizations.

## **Functional Statement**

To accomplish the mission, the Chief of Partnership Relations for Professional, Trade and Service Organizations is responsible for:

Working with other IRS functions to identify opportunities for outreach activities to the small business community.

Arranging industry specific meetings to deliver key messages specifically targeted to that industry. These meetings are arranged on an as-needed basis.

Developing measures to determine the effectiveness of PTSO outreach efforts.

Consistently working to identify new groups and associations in which to partner.

Ensuring key messages are delivered timely to our external stakeholders.

Holding regular meetings with small business stakeholders to provide an avenue for them to identify and address their concerns.

Coordinating program activities with other IRS functions, to prepare Service-wide policies, address cross-functional issues, develop strategies and ensure consistent messages.

Maintaining established partnerships with external stakeholders.

Working with other IRS functions to market specific programs.

Working with TEC Area Directors, Territory Managers, Chiefs within Partnership Outreach, and Chief Counsel to ensure consistent messages are delivered to all small business customer segments.

Ensuring that all messages meet stakeholder needs.

Forwarding feedback received from customers to the appropriate IRS function for necessary action.

Coordinating all IRS presence at external events with small business Professional, Trade and Service Organizations.

Actively soliciting feedback from stakeholders for input into the IRS Business Plan.

Significantly contributing to stakeholder newsletters, magazines and web sites by creating RIS articles on a wide array of topics.

## **6.26 PARTNERING STRATEGY**

In keeping with TEC's commitment to "partner with a purpose", Professional, Trade and Service Organizations (PTSO) evaluates each partnership and ensures it falls within one or more of the following categories. This enables the evaluation of new and existing partnerships to be mutually beneficial, and achieves the goal of educating small business owners on their tax responsibilities. By categorizing the benefits of a potential relationship, we can determine whether or not we are "partnering with a purpose".

## **6.27 PARTNERSHIP RELATIONS- ELECTRONIC BUSINESS**

### **Electronic Business Overview**

Electronic Business is one of six sections located within Headquarters, Small Business and Self Employed, Taxpayer Education and Communication, Partnership Outreach.

Electronic Business was created primarily to establish relationships and partner with Electronic businesses (E-Business) and Electronic Commerce (E-Commerce) stakeholders with direct channels to the small business community.

The goal of Electronic Business is to develop and provide educational products and services based on the needs of the E-Business/E-Commerce stakeholders.

## **6.28 E-COMMERCE**

U.S. Bureau of the Census found it useful to think of the electronic or Internet economy as having three primary components:

- Electronic commerce
- Electronic business supporting infrastructure
- Electronic business processes

Electronic Commerce (E-Commerce) is defined by the U.S. Census Bureau as: any transaction completed over a computer-mediated network that transfers ownership of or rights to use goods or services. The value of goods and services sold on-line. The term "on-line" includes the use of the Internet, Intranet, and Extranet, as well as proprietary information that runs over systems such as Electronic Data Interchanges (EDI networks).

Electronic Business (E-Business) supporting infrastructure refers to the economic infrastructure that is used to support electronic business processes and conduct electronic commerce transactions. It includes hardware, software, telecommunication networks, support services, and human capital used in electronic business and commerce.

Electronic Business (E-Business) processes are processes that a business organization conducts over a computer-mediated network. Business organizations include any for-profit, government, or non-profit entity. Examples of on-line e-business processes include:

- Purchasing
- Selling



- Vendor-managed inventory
- Production management
- Logistics
- Communication and Support Services such as on-line training and recruiting

**Currently, Census measures four industries:**

- Manufacturing
- Merchant Wholesale
- Selected Service Industries
- Retail Trade

E-Business is redefining the business marketplace, allowing new global competitors to commence business daily. The terms "E-Business" and "E-Commerce" have evolved from the traditional definition of electronic shopping to a redefined representation of business and market processes enabled by the Internet and other digital technologies.

**E-Business Partnership Outreach Strategy and Goals**

E-Business strategy is based primarily on the needs of the stakeholders. In order to achieve success and meet the established goals of E-Business Partnership Outreach, it is imperative that a proactive approach is utilized to assist small business customers in meeting their tax obligations. This is accomplished through the following strategic goals:

- Establishing leveraged relationships with E-Business stakeholders in order to provide assistance to small business owners in meeting their business and individual tax obligations.

- Developing and providing educational products and services based on the current stakeholder needs.
- Providing stakeholders with news releases and other communication data that may impact their client's ability to meet their tax obligations.

E-Business will provide quality outreach through its commitment to gain a comprehensive knowledge and understanding of E-Business and E-Commerce issues.

E-Business has the responsibility for ensuring that a positive working relationship exists with SB/SE Compliance. To accomplish this, it is essential that E-Business be cognizant of the needs of SB/SE Compliance.

E-Business is responsible for keeping an open line of communication with SB/SE Compliance Policy, TEC Territory Offices, and other areas within IRS. Through this effort, E-Business encourages and supports innovative outreach efforts from all areas within the IRS.

## **6.29 ISSUE RESOLUTION TRACKING SYSTEM (IRTS) - GUIDELINES**

The Issue Resolution Tracking System (IRTS) was developed to track SB/SE issues identified by stakeholders and to ensure that stakeholders receive a response to their concerns or suggestions. In addition, the IRTS system provides TEC Headquarters Office with trend information to identify when local issues are widespread and may need TEC Headquarters intervention. Finally, this system provides a means to elevate appropriate issues to TEC Headquarters Office for resolution.

The IRTS is housed on the IRS Intranet site. The Area Director's review and approval is required for all issues elevated to TEC Headquarters Office for resolution.

Once an issue is entered into IRTS, the Field Territory Manager e-mails the Area Director for concurrence. The Area Director or his/her representative forwards the approved issue to TEC Headquarters Office.

## **6.30 PRODUCT DEVELOPMENT**

### **Mission**

The goal of Product Development is to ensure the delivery of products and services while meeting the needs of customers and anticipating newly emerging issues. Product Development is primarily responsible for designing, developing, and maintaining educational programs, products and services for Partnership Outreach programs, Small Business/Self-Employed customers and other stakeholders.

### **Process Design, Development and Delivery Procedures**

The goal of Product Development is to ensure the delivery of products and services while meeting the needs of customers and anticipating newly emerging issues. Product Development is primarily responsible for designing, developing, and maintaining educational programs, products and services for Partnership Outreach programs, Small Business/Self-Employed customers and stakeholders.

### **Product Development and Management Process**

The field serves as one of the primary sources in identifying the need for new and revised products and services, and assisting in their development. Product Development and Management acts as "publisher" by developing the new product, making suggestions on design and format, coordinating with multimedia and other offices, and creating/finalizing a prototype. All efforts to create new products should be closely coordinated through the Chief, Product Development and Management. This insures corporate quality standards are maintained and duplication of effort is avoided.

## **Products on the Web**

### **SB/SE Website**

The Product Development staff within Partnership Outreach in Taxpayer Education and Communication is responsible for publishing, maintenance and management of the SB/SE public website on IRS.gov.

The Product Development Staff serves as the point of contact for web issues on the SB/SE public website on IRS.gov. The website is used for education and communication in order to increase customer compliance and reduce customer burden. This includes, but is not limited to, incorporating educational projects into video streaming products and online ordering for educational CD's from the SB/SE public intranet site.

### **Web Strategy**

The SB/SE Division recognizes the importance of serving millions of small businesses, including corporations and partnerships with assets of \$10 million or less. While many face the same tax issues as large corporations, they often do not have tax professionals on staff. Tax compliance issues often stem from a lack of understanding of tax law requirements, inadequate accounting practices and resources and cash flow problems.

The Internet allows SB/SE Division the ability to effectively communicate with internal and external stakeholders. Use of the Internet offers tremendous benefits to users in terms of increased access to information sources relevant to tax laws, regulations and a host of other items.

The objective of the web site is to enhance customer service and outreach to 45 million small businesses and self-employed customers, provide industry specific

information and use the internet as a tool to gain information about the needs of our customers.

### **6.31 TAXPAYER BURDEN REDUCTION STRATEGY**

A Taxpayer Burden Reduction Strategy and supporting operational priorities and actions are reflected in IRS' Annual Performance Plan and SB/SE's Business Plan. As part of the Taxpayer Burden Reduction Strategy, the Office of Taxpayer Burden Reduction (OTBR) was established in SB/SE - TEC in January 2002.

The mission of this office is to achieve a significant reduction in unnecessary burden for all taxpayers by developing proposals that foster burden reduction; by coordinating and championing burden reduction efforts throughout the IRS; and by working with others in IRS, Congress, state and other federal agencies, and the small business community to develop, coordinate and implement meaningful burden reduction efforts that are consistent with IRS customer service and compliance goals.

#### **Roles and Responsibilities of the Director, Office of Taxpayer Burden Reduction**

The Director, Office of Taxpayer Burden Reduction reports directly to the Director, TEC. The Director, OTBR will provide direction and leadership for burden reduction efforts. These efforts will focus on six Major areas:

- Simplifying forms, publications and notices;
- Streamlining internal policies, processes and procedures;
- Promoting less burdensome rulings, regulations and law;

- Assisting in the development of a burden reduction measurement methodology;
- Partnering with internal and external stakeholders to more effectively and efficiently identify and address burden reduction initiatives; and
- Chairing the Taxpayer Burden Reduction Council, which develops cross-divisional proposals for burden reduction and coordinates and sponsors burden reduction efforts throughout the Service

### **Measuring Taxpayer Burden**

The ability to demonstrate the tangible results of burden reduction initiatives, through a reliable measurement system, is important for the IRS. Taxpayer burden is defined as the time or money expended by taxpayers to fulfil their responsibilities. It is currently only measured as it relates to the amount of time that is expended to complete the required tax forms and to maintain the necessary records/information. OTBR is currently assisting in the development of a Service wide micro-simulation model that will provide a more robust and accurate burden measurement methodology. Using "what if" scenarios, this model will also provide the capability of gauging the burden impact of various proposed legislative, policy and form changes, as well as prioritizing various proposals both in terms of time spent and costs incurred.

The model measures the cost of having employees or third parties fulfil taxpayers' pre-filing tax responsibilities. This measure is especially significant for SB/SE taxpayers since an estimated 80% of them use the services of a practitioner.

Efficiency and effectiveness may be used as a secondary measure to gauge the impact of burden reduction initiatives. This measure focuses on IRS cost savings, including staff costs, and reflects the savings realized by the elimination of

"downstream" work, such as data entry, adjustments, notices/correspondence and compliance activities. Often these resources can be redirected to more productive efforts.

In keeping with the balanced measures concept, taxpayer burden reduction is not looked at in isolation. It is viewed as a component of customer service/satisfaction and is balanced with compliance as part of a cost benefit analysis. By weighing these two components and the number of taxpayers impacted, we can ensure that unnecessary taxpayer burden is addressed and that tax compliance is not jeopardized.

## **6.32 OUTREACH PROCEDURES**

### **Overview**

Outreach includes all activities involving voluntary participation by the customer that have the intention of providing educational information to help customers comply with the tax laws. This voluntary assistance is provided in two basic forms:

- A. Direct Outreach, and
- B. Indirect Outreach.
- C. Outreach also includes customer assistance.

### **Indirect Outreach**

Indirect Outreach is defined as contact with external partners with the intention of establishing cooperative efforts to identify ways to increase compliance of customers. Examples of Indirect Outreach include meetings with the State Social Security Administrator, the Social Security Administration, practitioner groups or government agencies responsible for administering related laws.

One goal of Indirect Outreach is to provide opportunities to establish new partnership relationships and expand existing partnerships. This type of outreach can be used as a tool to remedy systemic or regional non-compliance.

Meetings are considered Indirect Outreach only if they involve individuals and organizations who are working to promote compliance, rather than meeting to address their own filing responsibilities. For example, a meeting with a league of municipalities would normally be considered Direct Outreach because the purpose of the meeting is to educate the participants, not to plan educational activities with them.



If the Specialist receives an inquiry from an authority for state and local government concerning the development of joint or partnership tax administration efforts with IRS, he or she should consult with the Office of Governmental Liaison and Disclosure (GLD).

## **Direct Outreach**

Direct Outreach is defined as outreach activity that provides educational information to a group of customers. Examples of Direct Outreach include conducting workshops, seminars, and attending or participating in customer association conferences and meetings. Meeting with other agencies who are the customers or direct representatives of the entities responsible for tax responsibilities is defined as Direct Outreach.

Direct Outreach is a preferred compliance tool when there is an opportunity to educate and interact with large numbers of customers at once. This type of outreach is a very useful and effective preventive and remedial tool for systemic and regional non-compliance.

Direct Outreach activity maximizes the opportunity for customer education but can also be a costly compliance remedy due to time involved with the activity and travel costs. Therefore, it is necessary to consider the following factors when planning this type of activity.

- Market segment impact,
- Expected number of attendees,
- Size and scope of the organization,
- Costs such as booth rental, promotional items, and travel expense
- Impact on potential compliance issues
- Opportunity to establish or expand partnerships, etc.

Depending on the resources available, each market segment within each state should be provided outreach over a reasonable period of time. The primary approach for providing this outreach should be to work cooperatively with the customers, government associations, government practitioners, and IRS stakeholders, participating in conferences, seminars, workshops, and other events.

The first step in conducting pre-filing and filing activities is to establish a plan of action for the area for which the Specialist is responsible. Each manager will have a plan or schedule for each state in his or her area.

### **Outreach Planning**

The first step in conducting outreach is to develop a plan of action that includes identifying customers that would benefit from Direct Outreach and establishing priorities for the use of resources. This action is necessary to document the reasons customers were selected in particular market segments. The plan should also include any trends, issues and problems that have been identified within each market segment.

Within a state, Direct and Indirect Outreach and customer assistance may be conducted simultaneously. The plan of action developed by the Specialist should include all these activities, with resources allocated based on the determined needs within the state.

### **Indian Tribal Governments Outreach**

#### **Mission of Indian Tribal Governments**

The mission of the Indian Tribal Governments (ITG) office is to provide Indian tribal governments top quality service by helping them understand and comply with

applicable tax laws, and to protect the public interest by applying the tax law with integrity and fairness to all.

The ITG office will be guided by principles of respect for Indian tribal self-government and sovereignty.

ITG will develop a functional and interactive government-to-government relationship between the IRS and ITG as envisioned by the President's Executive Orders.

## **Education**

ITG is committed to working with tribes on a collaborative basis to ensure that the interests and needs of both governments are met in the least intrusive manner. To fulfil our mission to the tribes, we will hold educational sessions that provide the information that is needed to satisfy the Federal tax laws applicable to their situations.

ITG provided educational sessions will cover a variety of topics based on the needs of the tribe that we are working with at the time.

Some tribes may have topics that are of special interest to them and we will develop sessions that would meet their needs. We will work with tribes to minimize any intrusion.

While the IRS has enforcement authority, it is our objective to work with tribes to minimize the need for enforcement. We believe that, through mutual respect and cooperation, the needs of both governments can be met.

The following is a brief list of ITG educational topics:

- Anti Money laundering

- Deposit of taxes
- Employment taxes
- Excise tax
- Information reporting
- Distributions to tribal members
- Tips
- The Collection Process”

The department of Taxpayer Education and Communication within the IRS, is a well developed fully functional department. In South Africa we have not even conceived the notion of how we are to operate our department. Examining the detail laid out in the procedure manual it is apparent that if we in South Africa were to follow the model as developed in the IRS and design it to fit in the South African context we can successfully launch taxpayer education.

## **CHAPTER 7**

### **IMPLEMENTATION OF TAXPAYER EDUCATION INITIATIVES**

The South African revenue collection system relies on taxpayers assessing their own tax liabilities and paying the correct amount of tax to the government.

Fundamental to this system of self-assessment is that taxpayers must have sufficient knowledge in the tax laws and procedures - and a confidence that we will act fairly and treat taxpayers according to their individual circumstances.

Building up a trust in the tax system by good work, education and promoting compliance against its competitor, non-compliance, is our leverage. We have two interlinked devices to help us achieve self-compliance - trust and differentiated treatment.

Public trust is achieved through a contract with the community, called the Taxpayers' Charter, which sets out a taxpayer's rights and responsibilities, and the service standards they can expect and how their views can be considered.

To let the people know of their tax liabilities we have a number of sources to inform them based on an electronic way or through channels that are more traditional.

Taxpayer Education is responsible for education of taxpayers through publications, news letters, media, seminars, workshops & educational/ professional institutions and facilitation for taxpayers by simplifying the laws, rules and business processes and providing one window operation in a taxpayer friendly environment for greater taxpayer satisfaction.

Taxpayer Education being a new concept introduced in the South African market will have to transform the ignorance in our country of taxpayers' obligations into compliance. The Commissioner has submitted that close attention to taxpayer education has been a key feature of tax administration reforms in many countries in recent years, partly in response to taxpayer needs associated with the increasing complexity of tax structures and rising level of tax burdens. The Commissioner recommends that customer service units should be established in all regional offices, and that a deliberate campaign of taxpayer education should be launched nationally. However, if the IRS Taxpayer Education and Communication model is examined taxpayer education functions are merged in that of enforcement. This should be our focus rather than viewing the function of taxpayer education as a taxpayer service function. It has more relevance as having functionality in both taxpayer service centre and enforcement in that you are providing taxpayer service at the same time providing feedback to enforcement that voluntary compliance has failed.

The SARS Taxpayer Education division is a reactive unit in terms of, performing functions at the request of the taxpayer. Our international counterparts have identified key issues and target issues at which they direct their resources to. The following international practices can be implemented in the SARS Taxpayer Education strategy.

### **Business Tax Workshops**

The Business Tax Workshops offered are designed with several types of business needs in mind.

### **New Businesses**

For a new business or an individual thinking about setting up a business in Oklahoma, the workshop offers information on formation, business structures, and steps for formation types such as incorporation steps, a step-by-step guide to

business registration, bookkeeping techniques, and a line-by-line explanation of the primary business tax forms.

The workshop participant will learn the keys to sales tax registration and collection, along with helpful tips on rate tables, reporting formats and exemptions. While questions are allowed and welcomed during the workshop, time is also allotted following each workshop for individual questions with the workshop instructor(s).

### **Existing Businesses**

For an existing business, the workshop offers information on the keys to sales tax registration and collection, along with helpful tips on rate tables, reporting formats and exemptions. Participants will also learn the steps to filling out the various business tax forms and which forms and tax laws have changed based on the latest legislative decisions. While questions are allowed and welcomed during the workshop, time is also allotted following each workshop for individual questions with the workshop instructor(s).

### **Volunteer Income Tax Assistance and Tax Counselling for the Elderly**

The Volunteer Income Tax Assistance (VITA) and Tax Counselling for the Elderly (TCE) are cooperative programs to provide a free service to taxpayers. These volunteers work in public places like libraries and community centres to assist taxpayers with the filling out of state and federal income tax forms during key tax season months.

### **The Volunteers**

The volunteers in the VITA program are specially trained by IRS personnel to handle both federal and state forms. Before beginning their public service as a volunteer, they must pass an exam covering all basic tax form areas.

The VITA volunteers spend January and part of February in training and then go on the road to work with the public February through April.

### **How They Can Help**

The assistance the VITA team members can give a taxpayer is free. Trained on state and federal taxes, these volunteers provide the best source of tax preparation knowledge available at no cost to you.

These volunteers are trained in tax forms, tax law changes, tax tables, exactly which forms you really need to use, what is deductible and what is not.

### **Interpreter Services**

Recognizing the importance of helping all taxpayers comply with the law, the Board provides services in languages other than English.

### **Tax Education Days**

Taxpayer service and information days are unique all-day educational conferences designed to assist the businessperson. Your government, at all levels joins together in one location to provide a full free day of counseling in areas that businesses need most. These conferences benefit everyone: established businesses, those just getting started, individuals anticipating going into business, and those who participate in the accounting/taxation industry. You can obtain publications and answers to your questions at information booths or take classes from our tax experts. The Board announces the events with tax return inserts mailed to area businesses, with posters and fliers in public places (including libraries and government offices), and through the local print and broadcast media.

The Board provides periodic industry-specific seminars to help particular types of businesses better understand how to apply the law. Before the seminars are held, the



Board meets with representatives of the industry group to determine the best ways to help businesses and to resolve areas of confusion. If you are a registered taxpayer, the Board will let you know if a seminar is scheduled for your industry group.

The Centre for Tax Education provides up-to-date courses for registered tax professionals, CPAs and enrolled agents. Each course is accredited by the California Tax Education Council and School of Business Administration, California State University, Sacramento. Course credits may be applied towards continuing professional Continuing Education (CE) credit requirements.

### **The Policy**

The size of the group is irrelevant. We'll meet with one person or hundreds of people.

The department shall develop and implement a taxpayer education and information program directed at, but not limited to, all of the following groups:

1. taxpayers newly registered with the department;
2. taxpayer or industry groups identified by the department;
3. department employees.

Implementation of taxpayer education and information program to be carried out;

1. a program of written communication with newly registered taxpayers explaining in simplified terms their duties and responsibilities and the most common areas of non-compliance encountered by participants in their business or industry;
2. participation in small business seminars and similar programs organized by state and local agencies;

3. revision of taxpayer education materials currently produced by the department which explain the most common areas of taxpayers' non-conformance in simplified terms;
4. implementation of a continuing education program for the preparers of tax return to include the application of new legislation.

Taxpayer education has been a sorely neglected department. The current status of the situation is that there are numerous problems each equally necessitating attention. However, all these issues cannot be addressed at once.

The international scenario exhibits the structure that the local department can resume. Interaction needs to take place at a national level with enforcement, large business, tax exemption unit, government entities and criminal investigation to identify issues and trends, identify stakeholders and deliver consistent education.

Using a broad range of business principles, technical-knowledge, and statistical analysis techniques, determines the feasibility of the plan and direct major studies to identify our business customers, gain an understanding of their business, define their needs, and evaluate their products and services.

Analyse program areas for trends in program delivery. Analyse report data to measure effectiveness to which program plans and achievements support strategic initiatives.

Develop various techniques and methods to assess costs and benefits of the program and to evaluate the effectiveness of current programs.

Collect, analyse and consolidate data and status reports to determine impact on resource effectiveness and compliance with established goals and objectives. Prepares required narrative, statistical reports and recommends corrective action.

Assess the impact of new programs and legislative changes on existing programs and resources.

Present findings through reports, memorandums, oral presentations, and other documents as required. Participate in the preparation and coordination of the program long and short range business plans.

Review and evaluate the effectiveness of operating procedures, work flow, inter-functional coordination, and organizational operation through observation, conferences, status reports and data. Prepare resulting documents from these reviews, reporting on progress towards achievement of program initiatives. Evaluate the implementation of new procedures affecting program operations and maintains adequate controls to ensure compliance with procedures and deadlines.

Following from the international review and their focus on the small business, in the South African context, emphasis can be placed on the Small, Medium, Micro Enterprise (SMME). This approach is in line with SARS goals of revenue collection, as this segment has the highest rates of non-compliance comparative to the other segments.

## 7.1 KEY RECOMMENDATIONS

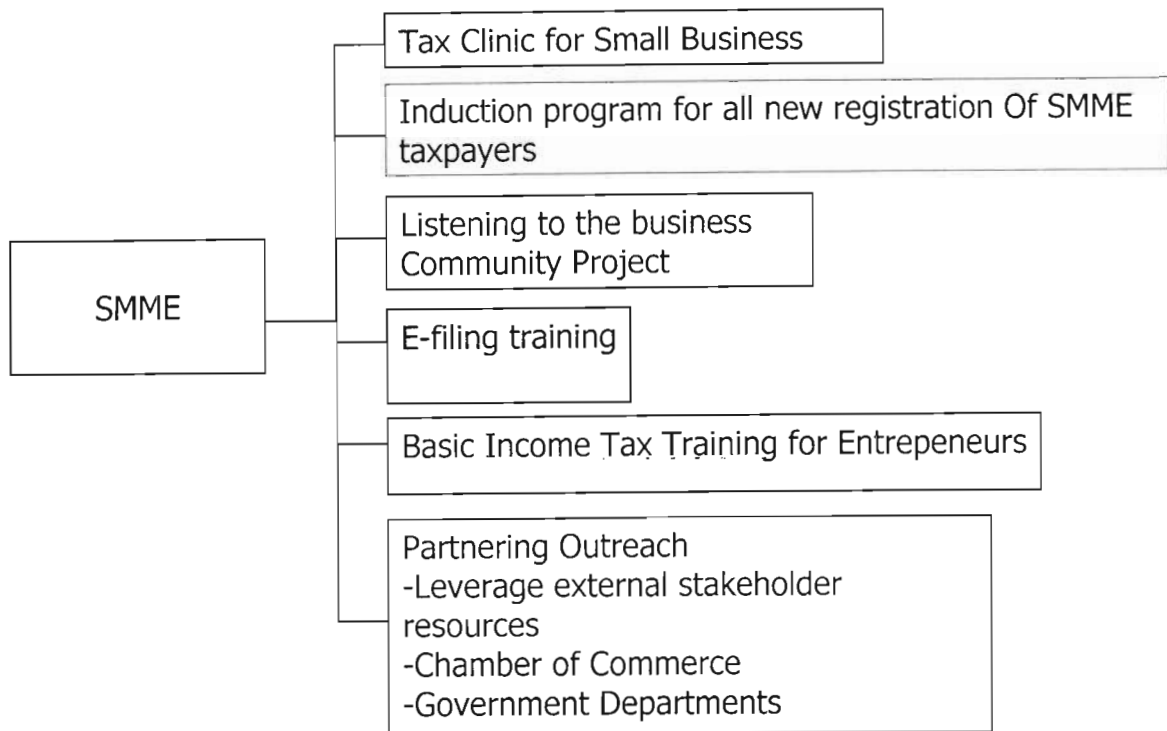


Illustration 6, The Way Forward for Taxpayer Education in South Africa

The tax clinic for small business is aimed at achieving voluntary compliance, by offering a personalized service to non-compliant businesses. The message highlighted is that you have a choice of coming forward and voluntarily complying or face the wrath of Enforcement.

Listening to business project will be launched via the Chambers of Commerce. The initiative seeks to achieve a database upon which training interventions can be based. The project encourages the business community to inform us how we could improve their revenue experience and reduce the tax burden on them.

E-filing training can now be marketed to the SMME.

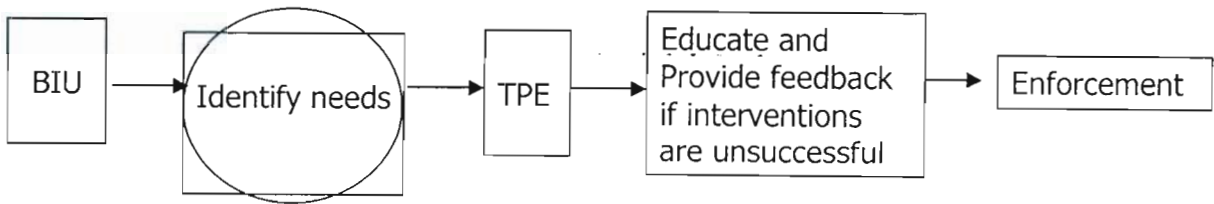
E-filing did not identify SMME as a target market, as they did not have the infrastructure to file electronically. With the introduction of an in-house e-filing training venue, the SMME can be encouraged to utilise SARS facilities.

Basic Income Tax training for entrepreneurs will take place on a voluntary basis. Sessions will be held on a weekly basis covering the range of taxes, applicable to an emerging business.

Work with executives from national industry and trade associations and Compliance to identify external stakeholder groups and to analyse and recommend products and services to meet customer needs.

Induction programme for new registrations seeks to be proactive in ensuring the taxpayer is empowered in terms of the obligations imposed on him by the Act at the inception of his relationship as a taxpaying citizen.

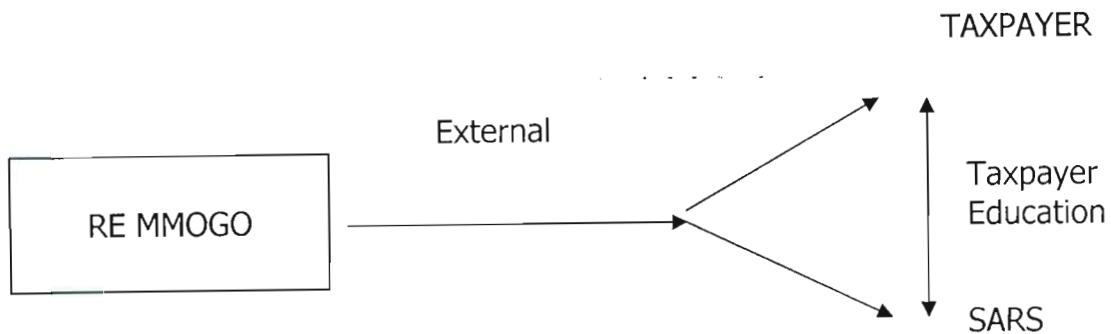
## 7.2 INTERDEPENDENCIES BETWEEN DEPARTMENTS



Business Intelligent Unit is responsible for investigating specific industries within the economy and profiling the inherent risks. In moving forward, the Business Intelligent Unit has the database to extract cases that need to go into audit and cases that can be handed over to Taxpayer Education.

Taxpayer education is conducted and feedback carried through to Enforcement if education has not lead to voluntary compliance. This methodology is aimed at targeting industry segments and ensuring compliance via either Taxpayer Education or Enforcement. The model is based on the premise that Taxpayer Education and Enforcement are inextricably linked. Taxpayer Education alone does not generate compliance but fear of non-compliance from Enforcement work hand-in-hand to ensure voluntary compliance.

### 7.3 FOSTERING A TAX CULTURE



The concept of Re Mmogo which means “we are together” is a concept which is internal to staff. Taxpayer Education endeavours to launch that concept externally, in that the only way in which the tax system can work effectively and efficiently is if the taxpayer and SARS can be brought together. The taxpayer needs to fully understand and conceptualize his tax obligations and SARS has to offer an excellent service. The responsibility of educating the taxpayer exists in every department not only Taxpayer Education. There has to be a move away from continually dismissing the taxpayer for being wrong. Rather the concept of educating the taxpayer as to the correct procedures needs to be implemented. These corrections need to be feed into a database where research can be conducted and issues identified. Educational products can be designed around these issues in response to taxpayer behaviour.

## CHAPTER 8

### ENGENDERING A TAX CULTURE

The effectiveness and efficiency of a tax administration in fulfilling its primary role is of paramount importance. The government's ability to fulfil its role is largely dependent on a variety of factors including the state of the economy, the public's support of the government's priorities, its views of the legitimacy of the governing regime to govern, and the willingness of the citizens to comply with the rules of the tax system.

The citizens' willingness to abide by the rules of the tax system is, to a large extent, affected by the public's perception as to whether the system is comprehensible, fair, responsible and reliable.

A tax administration, while not necessarily responsible for the formulation of such policies, is accountable for putting in place the required education, service of taxpayers. Consequently, tax administrations play a very significant role in the ability of a government to govern effectively and to realize its social and economic goals. In many ways, the tax system is a form of social contract between governments and their citizens and the tax administration has to do everything in its power to communicate this to the taxpayers. Of course not forgetting in the meantime to operate the checks and balances to ensure that these policies are carried out as formulated.

With the tax administration more involved in "income support", the public's expectations take on a new meaning - the public begins to rely on the tax administration for their social and financial well-being.

The South African tax administration has now laid the foundation for steady improvements in the effectiveness and efficiency with which it carries out its mission.

It is a long haul effort for a revenue authority to be valued and respected by the community it serves. However, we are on that road and we are making - albeit a slow - progress. That road is taking us from the traditional place of a tax collector to a place where the tax office/taxpayer relationship is more supportive. We may never reach that goal, but it is the process of undertaking it that is really important.

At the simplest level, it would be helpful to foster wider community understanding that evasion and avoidance are not victimless activities - that the tax system belongs to the people and that the whole community suffers when some members wrongfully or artfully dodge making their fair contribution to the upkeep of a decent, civilised society. The notion that it is perfectly acceptable to dodge tax so long as it can be done legally is contrary to notions of "good citizenship" and to the values that ought to prevail in our society. Regrettably, we cannot rely on duties of good citizenship alone.

Taxpayer Education is the future! It will enlighten our taxpayers and empower them with the ability to make the correct decisions in life. Taxpayer education is a stepping stone to engendering a tax culture.

## **8.1 SIMPLER TAX LAWS WILL IMPROVE TAX MORALITY**

"BOTH the Margo commission (1986) and the Katz commission (1994) dealt with tax morality and the tax gap. The tax gap is defined as the difference between the taxes that the law seeks to collect and those in fact collected. Both studies quoted estimates by the International Monetary Fund that the tax gap in industrialised countries was in the order of 10% and in the developing world the average was 33%. The Katz commission went so far as to estimate that in SA the tax gap was 20%, which represented at that time an amount of R 21bn.



Both studies alluded to the effect of a declining level of tax morality in the country and ascribe this to various factors including:

- Resentment over what is regarded as unfair or burdensome taxation;
- Deficiencies in administration, including collection;
- Problems relating to recognition of income and expenditure;
- Ineffective countering of avoidance; and
- A higher scale of evasion.

Both commissions recommended various actions to eliminate the tax gap. Although many of the recommendations of the commissions were not accepted, by and large the recommendations to deal with the tax gap were implemented.

The Katz commission identified problems with the tax gap - it invariably drives up tax rates and undermines the morale of taxpayers, discouraging compliance. How do we look 10 years down the line?

Undoubtedly the South African Revenue Services (SARS) has made significant strides in improving the administration of taxes. It has become more efficient and has increased its staff numbers and staff quality. SARS is now a far more effective tax-gathering machine than 10 years ago. Laws have been tightened, and in fact in the past 10 years there have been such a significant number of changes to the tax laws that they are now so complex only a handful of tax experts can understand them. This, obviously, creates additional problems for compliance by taxpayers who do not have access to sophisticated tax specialists.

There have been high-profile instances where SARS has been successful in collecting taxes from those who have tried to avoid or evade their responsibilities. Honest taxpayers have applauded these efforts because, if everyone pays their fair share, the burden would be lessened and honest taxpayers would not be shouldering the entire load.

Despite all the efforts at revenue collection, there still seems to be a perception that there is a significant tax gap in SA. A figure of R30bn is bandied about in the press as the extent of the gap. This figure does not seem to change despite all the efforts of SARS to reduce the gap, nor does it change from year to year. Whether this number is scientifically calculated is not known. It can be safely assumed, however, that the tax gap is not as large as it was 10 years ago.

What is clear is that the problem is not with the informal sector, nor with the taxi drivers or micro business. The collective income earned by the street vendors and micro businesses is so small that they probably do not exceed the threshold level for tax payable and, even if they did, the amounts collected would be negligible. The problem, if indeed there is one, lies with medium and large businesses that choose to remain outside the law.

Most taxpayers want to do the right thing and pay their fair share of tax. They do not, however, want to pay more than is necessary. What they seek from SARS (with justification, in my view) is certainty, equity and efficiency. These were the tenets of taxation that were identified by the Katz commission. Those who diligently pay their taxes and comply to their best ability with the tax laws want to be treated with respect by the revenue authorities.

Unfortunately this is not always the case and taxpayers, including our own clients, often feel that they are being treated as criminals and do not appreciate a heavy-handed approach from SARS with threats for non-compliance, often based on technicalities. These are also factors that affect tax morality. To have taxpayers who are willing to contribute and comply with the laws and seek every possible way of avoiding tax requires some give and take from both parties. While there is a general perception that it is just "take" on the part of SARS, I believe tax morality will not improve.

While SARS has reached out to some clients on issues, I believe more should be done in order to build the trust and mutual respect between the taxpayer and SARS.

If SARS sets the rules for the application of the tax law, it seems only fair that taxpayers take advantage of those rules if they are deficient.

Many of the problems with tax legislation arise as a result of hastily implemented legislation which requires numerous changes, often backdated, which just adds to the confusion. The implementation of new and complex laws needs to be implemented on a different basis and there needs to be proper thought and consultation before rushing in to change the laws. For instance, the changes to the residence basis of taxation and capital gains tax and its subsequent changes and variety of effective dates have made the interpretation of transactions extremely difficult. Ironically the implementation of VAT was smooth and virtually trouble-free. VAT legislation has also required very few changes since it was implemented, so we know it can be done.

Tax legislation in general is now so complex that the ordinary man in the street has difficulty understanding it. This in turn provides a compliance challenge. This, despite that fact that the Margo commission, way back in 1986, complained that the system was too complicated.

Since then there have been so many changes and additional taxes that only dedicated tax professionals are capable of understanding the intricacies. The danger here is that individuals and small businesses may not comply with the tax laws, not because they do not want to but because they do not have and cannot afford the knowledge necessary to fulfil their obligations.

We solidly support SARS's continued efforts to bring tax dodgers to book, but it also could do its cause some good by lightening up on honest taxpayers and simplifying the taxation process for individuals and small business.

At the end of the day, it is in our national interest to ensure we all pay our fair taxes within the spirit and framework of our tax laws and regulations. It might be useful for SARS to say to taxpayers: "Let us deal with the history and get a starting point going forward that embraces tax morality, national interest and the spirit of the law applied to both the taxpayer and SARS."

Ultimately, if we all pay our taxes, tax rates should drop and this might make us more competitive as a country for foreign direct investment and, hopefully, more jobs will be created."(Naidoo,2005)

## 8.2 CONCLUSION

"In the old SA, ramshackle tax legislation and ineffective tax collection allowed people to divert large chunks of income to tax shelters and tax havens.

Some of the tactics employed were legal and some were not. But in both cases the taxman was frustrated and relatively powerless. And the shortfall was made up by lower-income taxpayers who were not in a position to make smart tax arrangements.

In the new SA, a series of legislative changes and the creation of a new revenue-collection system has created a tax dispensation in which there is better compliance and improved enforcement.

Using state-of-the-art technology and 113 qualified forensic investigators at the Woodmead office in Sandton, SA Revenue Services (SARS) Commissioner Pravin Gordhan is closing the tax gap. But the gap still exists.

There are two parts to the tax gap, says Edward Nathan and Friedland's Beric Croome. He estimates about 4m economically active people are not registered for tax purposes. In some cases, failure to register is due to ignorance.

"Many people believe that because pay as you earn (PAYE) is being deducted monthly from their salary, they are automatically registered for tax purposes. This is not the case and individuals have a statutory duty to register personally."

The second part of the tax gap is created by the many registered taxpayers who are not declaring their full income, says Croome.

SARS is using its legislative powers and administrative reach to track the funds that have, so far, escaped its net. This includes asking banks for details of client

accounts and getting records of property transactions to check against individuals' tax returns.

For the average taxpayer, the steady broadening of the tax base has meant substantial relief. Since 2000 the minimum tax threshold had risen more than 50% for people younger than 65 and 40% for those older than 65.

Higher-income earners benefit less from the restructuring of the brackets. But Hazell says they have reason to be grateful. "I think we have forgotten where we came from. In 1990, we were paying top marginal rates of 45% at a level of R80 000 for married people and 45% on R54 000 for unmarried people. Finance minister Trevor Manuel has been more than fair in sharing the spoils of his fiscal policy with all, including the 'rich'. This has gained him considerable credibility among taxpayers, something few previous finance ministers could claim."

Another area where there has been relief is on domestic interest income.

The concessions give people more discretionary income to spend and to save. The results will be beneficial to the economy.

KPMG tax consultant Pierre du Toit points to another, equally important spin-off. The steady improvement in tax collection is building credibility for government and creating a new ethos among taxpayers. It's called tax morality, something that was virtually unknown 10 years ago."(Hazelhurst, 2003)

Voluntary compliance amongst taxpayers is heightened when taxpayer education and enforcement functions are balanced to achieved the desired output in tax compliance.

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