

AN EXPLORATORY STUDY OF THE FISCAL ILLUSION OF INDIVIDUAL TAXPAYERS IN SOUTH AFRICA

by

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It is so true, *“I can do all things through Christ who strengthens me”*. Philipians 4:13.

ABSTRACT

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Fiscal illusion is understood to be a concept that occurs where taxpayers do not always realize how much they contribute towards government revenue in the form of taxation, or how much they receive in the form of public goods and services (Dell' Anno & Mourao, 2011:2). The purpose of this study was to discover the originating causes of fiscal illusion amongst individual taxpayers in South Africa. To achieve this objective, available literature was reviewed, which revealed that complexity of the tax systems is argued to be one of the causes of fiscal illusion. A study conducted in South Africa suggested that taxpayer's perception toward tax affects their attitude (Oberholzer, 2007:45).

The hypothesis derived from the literature was then applied to a real life context by conducting interviews with a sample of individual taxpayers. Based on the analysis of data obtained, the study revealed that fiscal illusion of individual taxpayers in South Africa falls within four conceptual elements namely, hidden taxes, number of taxes, double taxation and, to a limited extent, tax shifting.

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

Taxpayers easily undervalue their tax burden arising from indirect taxes which are incorporated into consumption prices, as compared to direct taxes which are charged openly from the intended taxpayer (Sausgruber & Tyran, 2005:2). These authors refer to the “Mill hypothesis” which suggests that the tax burden from most consumption taxes is underestimated due to the fact that direct taxes are more visible when compared to indirect taxes (Mill, 1848:237). In a survey conducted on individual taxpayers in different countries, Fochmann *et al.* (2010:23) drew a generalised conclusion that individual taxpayers are unable to correctly estimate their own marginal tax rate. These findings reveal that the more complicated the tax rule or how it is presented; the worse is the taxpayer’s quality of tax judgement (Fochmann *et al.*, 2010:7).

Oates (1988:65) refers to fiscal illusion as an organized misrepresentation of crucial fiscal considerations which may considerably misrepresent the citizens’ monetary choices. The principle is that the design of the system may be the underestimation of cost of public spending, and this is resultant in the fact that the public is not fully informed of taxation’s total cost (Sanandaji & Wallace, 2011:237). The study on fiscal illusion is important because this concept is one of the sources of suspicion between the state and its tax paying citizens (Dell’ Anno & Mourao, 2011:2). The Katz Commission of tax reforms made a recommendation that there should be campaigns to raise consciousness of all kinds of taxes as imposed by the government (Katz Commission, 1996:4).

It should also be noted that expenditures and taxes are two of the major policies of government which are sometimes set to maximize political support (Downs, 1960:542).

Mourao (2010:268) concluded that it is up to the academics to examine public budgets and taxation schemes to avoid blaming each other as a result of the damages that may result from fiscal illusion. Sausgruber and Tyran (2005:40), in agreement with Downs (1960:542) state that fiscal illusion may have significant concerns resulting from its potential to misrepresent democratic choices on fiscal issues.

Over the past couple of years since 1994, the South African Revenue Services (SARS) has been commended for creating a series of new revenue collection systems which resulted in better compliance and improved enforcement of revenue laws (Oberholzer, 2007:3). This improvement has in turn resulted in revenues collected escalating year on year due to improvement in tax administration (Naidoo, 2005:13 in Oberholzer, 2007:3). The challenge is that tax morality among South African taxpayers is still low, reasons ranging from the fact that tax is unfair and burdensome, high levels of evasion and poor administration (The Katz commission, 1994:S5.1).

Fochmann *et al.* (2010:17), in agreement with some studies conducted in various countries, concluded that taxpayers have misperceptions of their individual tax burden. The main reason is identified to be the complexity of tax legislations of the countries. Dell' Anno and Mourao (2011:22) conducted a study on fiscal illusion around the world. Their study focused on analysing the magnitude of fiscal illusion. Dell' Anno and Mourao (2011:22) concluded that the more complex the tax system, the greater the fiscal illusion. The South African Revenue system is considered to be complicated and that only a minority of tax professionals can reasonably understand it (Oberholzer, 2007:5).

1.2 PROBLEM STATEMENT

The phenomenon of fiscal illusion has been studied from as far back as the nineteenth century. James Stuart Mill (in May, 1986:465) stated that individuals underestimate their tax burden because of lack of transparency in the system of taxation. Since then various elements and hypotheses were investigated and analysed, for instance May (1986:465) examined the competing assertions concerning the effects of citizen's perceptions of tax burden and tax benefits. The study revealed that the citizens tend to underestimate the tax benefits derived from the government expenditure, while they tend to overestimate the

related tax burden (May, 1986:468). Some studies focussed on taxpayers' perceptions, for instance, studies by Fochmann *et al.* (2010) and Oberholzer (2007). Fochmann *et al.* (2010), in a study conducted in Germany focused on the perception of taxpayers in relation to their own tax obligation. This study also made reference to the effect the perceptions might have on the monetary decisions the taxpayers make. The study concluded that respondents in some jurisdictions seldom give a correct estimation of their marginal tax rate (Fochmann *et al.*, 2010:23).

Oberholzer's (2007) study on taxpayers' perceptions in South Africa supported the view that perceptions of taxpayers influence their attitudes towards tax. This study indicated that SARS should focus on shifting taxpayer's awareness with regard to taxation (Oberholzer, 2007:216). In line with this objective, it is also important to investigate the originating causes of perceptions of individual taxpayers in South Africa, more specifically the causes of fiscal illusion amongst individual taxpayers in South Africa.

1.3 PURPOSE STATEMENT

The purpose of this study is to explore the originating causes of fiscal illusion amongst individual taxpayers in South Africa.

1.4 RESEARCH OBJECTIVES

- To analyse the literature in order to establish the theoretical constructs supporting the phenomenon of fiscal illusion.
- To apply these theoretical constructs in a real life context in order to explore the originating causes of fiscal illusion amongst individual taxpayers in South Africa.

1.5 IMPORTANCE AND BENEFITS OF THE STUDY

This study may contribute to the understanding of how South African individual taxpayers perceive their tax burden. The study explores the causes of fiscal illusion amongst the individual taxpayers and the results may contribute to an understanding of the aspects that

contribute to the perceptions that these taxpayers have about taxes in South Africa. The prevalence of technical aspects partly denies citizens of their democratic control over their government's fiscal policy (Dell' Anno & Mourao, 2011:22).

This study may also assist policy makers to be more aware of the taxpayer's understanding of the economic policy, and to propose or intensify initiatives of tax education to the taxpayer as recommended by the Katz commission (1996:35). Dell' Anno and Mourao, (2011:23) recommended that there should be initiatives intended to improve the level of participation of citizens in public decisions. This may allow them to be the paramount defenders of their country's fiscal procedures.

1.6 DEMARICATION OF STUDY

Demarcation of the study describes the boundaries of the study. The study has some limitations related to the context and theoretical perspective. The study only focuses on natural persons as taxpayers and excludes corporations, small medium enterprises and trusts. All non-residents as defined in the Income Tax Act 58 of 1962 are also excluded from the study.

The study is exploratory in nature and is not intended to take a broad view of the findings and conclusions to the entire population of South Africa. It only highlights the perceptions amongst a selected group of taxpayers.

1.7 ASSUMPTIONS

An assumption is defined as something that one thinks is probably true without checking it (Maskew Miller Longman, 2009:41). In research, an assumption is defined as a position that is taken for granted without which the research assignment would be futile (Leedy & Ormrod, 2010:5). The assumptions that underpin the current study are:

- Participants were selected based on the assumption that they are aware of or understand the basics of the South African tax system.

- Participants were willing to provide their honest and unbiased responses to all the questions asked.

1.8 DEFINITION OF KEY TERMS

The study involves a couple of key concepts. For the purpose of this study, the manner in which these key terms are used is clarified as follows:

Fiscal Illusion: is used as a concept that occurs where a taxpayer does not always realize how much he really contributes to government revenue in the form of taxation, or how much he receives in the form of public goods and services (Mourao, 2010:267).

Non-resident: Based on the definition of the term “resident” a person is a non-resident in the case of a natural person who is neither –

- ordinarily resident in South Africa; nor
- at any time during a relevant year of assessment physically present in South Africa in compliance with all three of the requirements of the physical presence test (Income Tax Act 58 of 1962:33).

Perceived tax burden: Fochmann *et al.* (2010:2) define perceived tax burden as, an estimated tax obligation made by the taxpayer when asked to or when in the processes of making an economic or political decision.

1.9 ABBREVIATIONS USED

Table 1: Abbreviations used in this document

Abbreviation	Meaning
FEDs	Fiscal extraction devices as explained by Wagner (1976:49)
SARS	South African Revenue Service
Stats SA	Statistics South African
VAT	Value added tax

1.10 RESEARCH DESIGN AND METHODOLOGY

Research design is a detailed plan by which the researcher outlines the strategy of how the specific research will be conducted (Cooper & Schindler, 2011:139). It outlines specific systems and actions for the gathering, measurement and scrutiny of data. The research design shows how the chosen strategy will address the specific goals and objectives of the current study. The current study followed the general research process which contains three major stages, namely, exploration of the situation, collection of data and analysis and interpretation of results (Cooper & Schindler, 2011:154).

The study adopted a qualitative research approach in order to explore insights about the causes of fiscal illusion, as explained by Leedy and Ormrod (2010:136). Both qualitative and quantitative research techniques can be used, but exploratory studies mostly follow a qualitative research approach. The current study followed a phenomenological research design. This design is appropriate when the research attempts to understand peoples' perceptions, views and understanding of a particular situation and depends exclusively on interviews (Leedy & Ormrod, 2010:141).

1.11 OVERVIEW OF CHAPTERS

Chapter 1: Introduction

Chapter 1 provides the background to the study and presents the problem and the purpose statements. A brief overview of the research objectives, importance and benefits of the study are summarised. Demarcation and assumptions used in the study are also presented. Next, a brief description of key terms and a table of abbreviations used. Finally a brief overview of research design and methodology is presented.

Chapter 2: Literature Review

The second chapter provides the literature review synthesised for the purpose of the study. The literature provides us with the understanding of previous studies conducted, and how to explain the fiscal illusion as a concept, and the perceptions of taxpayers. The literature addresses the causes and indicators of fiscal illusion. The chapter then

concludes based on the literature reviewed. Significant support on the existence of fiscal illusion is available.

Chapter 3: Research Design and Methodology

This chapter discusses the research design and methodology applied in the study. It provides a detailed outline of the research design, sampling method, collection of data and how it is analysed.

Chapter 4: Data Analysis

The fourth chapter presents the analysis of data collected.

Chapter 5: Conclusion

The final chapter briefly explains and links the purpose of the study to the findings obtained from the respondents to the research.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION

Theory of fiscal illusion has been recognized as early as the beginning of the twentieth century (Dell' Anno & Mourao, 2011:2). Tax complexity as directly related to the causes of fiscal illusion has been studied and accepted across the field of social science and public finance (Chetty *et al.*, 2008:37; Heyndels & Schmolders, 1995:127; Wagner, 1976:47). Further studies on causes and measurement of fiscal illusion have been conducted to illustrate the existence of fiscal illusion in most jurisdictions around the world (Dollery & Worthington, 1996:5-30, Oates, 1988:4-14). The purpose of this chapter is to review the literature in order to provide clarity on the construct of fiscal illusion. The chapter also provides an analysis of perceptions as viewed by previous researchers and scholars.

2.2 FISCAL ILLUSION AS A CONSTRUCT

Puviani is recorded to be amongst the first people to develop the theory of fiscal illusion in his book *Teoria dell'illusione finanziaria*, Mourao (2010:267). The theory of fiscal illusion suggests that the invisibility of government revenues to taxpayers, results in the public spending being seen not as costly as it really is (Mourao, 2010:267). In most instances, all taxpayers benefit from public expenditures through these unseen revenues. The constituencies' desire for government expenditure increases, consequently providing legislators with a motivation to grow the size of public spending. Puviani also suggested that fiscal illusion does not benefit citizens because it obscures government spending (Mourao, 2010:267).

Buchanan (1967:130) in developments to Puviani's theory, acknowledged the illusion in multiple ways of collecting and imposing taxes. Buchanan's study mentions that the authorities may take advantage of fiscal illusion by utilising a number of strategies to hide revenue collection. These strategies are not all necessarily important, especially in the

modern days (Buchanan, 1967:130). Some of these strategies are discussed in the next section, under the origins and causes of fiscal illusion.

Dollery and Worthington (1996:1) describe fiscal illusion is a theory centred on the idea that the segregation of taxing and spending powers distorts the taxpayer's estimation of the "true" costs and benefits from publicly provided goods and services within a given fiscal jurisdiction. Fiscal illusion is understood to be a concept that occurs where taxpayers do not always realize how much they contribute towards government revenue in the form of taxation, or how much they receive in the form of public goods and services (Mourao, 2011:2).

As early as 1846, James Stuart Mill stated that taxes are either direct or indirect. Direct tax is simply the tax which is required from a person whom it is intended should pay, namely personal income tax and corporate income tax (Mill, 1846:237). Contrary to direct taxes, Mill provided an example of a producer or importer of commodities from whom an excise or customs duty is levied, but to tax through the producer or importer - the final consumers of those commodities. The producer or importer will recover the amount by means of an escalation in price of the commodity which in turn is borne by the final consumer. Mill (1846:237) further argued that, with this kind of levying of tax, the exact liability connected with indirect taxes is always miscalculated in comparison to that of direct taxes. This phenomenon is referred to as the Mill hypothesis (Sausgruber & Tyran, 2005:39-40).

In line with the Mill hypothesis, fiscal illusion is evidenced in jurisdictions where there are more renters than property owners (Oates, 1988:72). For renters, property tax is invisible as it is hidden in rental bills and not a visible line item as it is to the property owner. The renter illusion theory argues that renters tend to undervalue their property tax cost and for that reason are in favour of excessive levels of government expenditure (Blom-Hansen, 2004:127). The notion of fiscal illusion revolves around the scheme that the real government spending and government revenues may be regularly misinterpreted by the public of a given monetary authority (Dollery & Worthingham, 1996:1).

A test of theory and evidence on the effects of invisibility of tax conducted by Chetty *et al.* (2008:1) confirmed the Mill hypothesis. Chetty *et al.* study intended to show

that consumers underreact to taxes that are not visible or salient. The main focus was on consumer conduct that optimally depends on total tax-inclusive prices rather than conducts that depend on the tax rate itself. The results revealed that commodity taxes that are included in displayed prices reduce demand significantly more than taxes that are not included in posted prices (Chetty *et al.*, 2008:36).

2.2.1 The origins and causes of fiscal illusion

Researchers who followed up on suggestions by Mill (1848:237) that the relative invisibility of indirect taxes compared to more visible direct taxes is the cause of fiscal illusion were also confirmed by Heyndels and Schmolders (1995:138). The Mill hypothesis suggests that fiscal illusion may lead to excessive public expenditure, which the taxpayers would not have agreed to, had they correctly perceived the resultant tax burden (Sausgruber & Tyran, 2005:40). A common phenomenon in the fiscal illusion literature is that increasing the share of revenue collected through indirect taxes is an indication of a greater manipulation of fiscal illusion policies by the policy makers (Dell' Anno & Mourao, 2011:10).

In most democratic countries, taxpayers are likely to be lacking information on which to base their decisions on public-sector activities. This is mainly because the motivation to obtain information on the benefits and costs of government programs is much less than that of private goods (Downs, 1960:541). Individuals determine their own preference in as far as the patterns and choices in relation to spending and consumption of private goods, and little time is spent learning about government programs. Fiscal illusion, mostly in democratic countries exists because of *ignorance of politics* (Downs, 1960:544-545).

This theory was later confirmed by Buchanan (1967:10) who stated that *fiscal ignorance* is necessary but not a sufficient condition for the existence of fiscal illusion. On its own it might lead to a rise of a random pattern to over and underestimation of tax liabilities. Fiscal illusion implies persistent and consistent behaviour which leads to recurring and predictable biases in budgetary decisions (Buchanan, 1967:158). Wagner (2001:1) stated that the term fiscal illusion derived its definition from the fact that legislators make taxes appear less heavy than they really are. The government is able to achieve this by imposing *many different types* of taxes in many different ways (Buchanan, 1967:130).

Fiscal illusion exists because the treasury and revenue authorities might consider and even decide to collect more taxes by escalating the existing tax rates on income, or by introducing additional consumption taxes (Buchanan, 1967:131). *Consumption tax* is usually an easier choice as it is perceived not to generate an obvious excess tax burden to the taxpayer (Buchanan, 1967:131). Consumption taxes do not always evoke hostility by the taxpayer towards the government and the taxpayer makes less total effort to avoid taxation (Wagner, 1976:59). The illusion is even more complete when the tax has been in existence for a while. The taxpayers feel the impact when the price of commodities are increased as a result of indirect tax imposed, but the longer the tax remains in the price of the product, the consumer ceases to sense opportunity cost (Buchanan, 1967:131).

A further argument on the existence of fiscal illusion is that a tax system can be characterised by what Wagner (1976:49) called Fiscal Extraction Device (FED's) which is a means by which resources from the citizens are transferred to the treasury. This can be done in different forms, either through direct or indirect taxes. Income tax results from claims which are placed directly to the taxpayer by the FEDs. These claims are imposed at the time the taxpayer receives income. Indirect taxes, which are extracted as consumption taxes, the tax component is in the form of price mark ups which the consumer is faced with at the time of payment (Wagner, 1976:50).

Most of these taxes are also *hidden* in the price of commodities or services being paid for. The direction on which fiscal illusion will direct the bias of public sector outcomes is not clear. In some earlier literature, Downs (1960:541) maintained that *inadequate information* would tend to reduce the public budget. In later literature the view shifted in that it suggested that significant elements of the tax system are largely hidden and under-perceived by the taxpayers (Heyndels & Schmolders, 1995:138). This stems partly from the deliberate effort by public agencies to mask the full costs of their programs and, where possible, to overstate the important elements like tax withholding and form taxation which will obscure patterns of incidence that conceal the real cost of public programmes (Buchanan, 1967:130).

Dell' Anno and Mourao's (2011:2) study on fiscal illusion around the world was conducted with the intention to analyse the magnitude of fiscal illusion between federal and unitary forms of governments. A comparative analysis based on the estimated index of fiscal

illusion reveals that fiscal illusion is more severe on average in developing and underdeveloped countries like Latin America, Asia and in Africa than it is in North America and Europe. In the said study Dell' Anno and Mourao, (2011:10) identified five causes of fiscal illusion. These causes are not directly connected to the policy makers of the country, but have been recognised to be the most common causes of fiscal illusion. Below is a brief discussion of these causes:

The first cause as referred to by Dell' Anno and Mourao (2011:11) is the *ratio of self-employed workers and the total employed population ratio*. The higher the ratio of self-employed workers, the more visible the tax burden because more “active” tax compliance is required for the self-employed than for employees. The higher self-employment rate is expected to increase the index of fiscal illusion in the form of tax burden because it increases the policy maker's motivations to misrepresent the perception of the tax burden (Dell' Anno & Mourao, 2011:12).

Wagner (1960:58) identified the second cause as the relationship between the *size of the tax burden and the tax structure of the system*. Dell' Anno and Mourao (2011:12) argue that the tax burden may be considered as a substitution by the policy maker's need to lessen the perception of tax burden. The greater the size of tax, the easier it is for the government to use economic policies aimed at increasing the size of the government.

Thirdly, *misperception of tax rates* is identified as the cause of fiscal illusion. Buchanan and Wagner (2000) in Dell' Anno and Mourao (2011:12) identified the existence of an inclination of taxpayers to think in terms of marginal tax rates instead of average tax rates. This illusion is accounted for by the index of top marginal income and payroll tax as published in the Index of Economic Freedom. At higher marginal income tax rates, the perception of tax burden is more visible (Buchanan, 1967:139). This hypothesis was also confirmed in a study conducted by Dell' Anno and Mourao (2011:12) and Fochmann *et. al.*, (2010:3).

The fourth and final cause is *the overall index of press freedom and the political pressures and controls on media content*. These are non-monetary indexes that may affect the perception of fiscal illusion (Dell' Anno & Mourao, 2011:13). These variables include issues

such as the editorial independence of both state-owned as well as privately owned media; access to information and their sources and intimidation of journalists by the state. Intuitively, the low index of press freedom will result in transparency of the information from the policy makers down to the citizens of the country. A need for many specialised skills from journalists and even citizens are required. These skills are essential to enable citizens and journalists to recognise strategies which are in favour of fiscal illusion, and be able to open a debate right at the beginning. This means lower understanding of proposed fiscal policies leads to reduced resistance against fiscal illusion strategies, lack of significant voter pressure on political parties and consequently, greater effective tax burdens and size of the public sector (Dell' Anno & Mourao, 2011:22).

2.2.2 Consequences of fiscal illusion

Mourao (2008:86) developed a model that predicts higher levels of fiscal illusion will *decrease national economic growth rates*. In this study Mourao (2008:86) makes reference to Puviani's (1903) argument that fiscal illusion can be used by politicians to *deceive voters* of the reality of the economic standing of the country. In these circumstances, fiscal illusion can be classified as a particular case of political illusion. Downs (1960:542) argued that since expenditures and taxes are two of the principal policies of government, they can be used by the ruling party to maximize political support. Lack of knowledge of monetary data has been shown to be a significant problem, and results in a constituency unable to judge the actions of politicians (Heyndels & Schmolders, 1995:133).

Buchanan and Wagner (1977:439) identified that higher levels of fiscal illusion promote *unnecessary growth in the size of the public sector*. This evidence may prove valid in developed countries. In contradiction, Mitchell (2009:38) argues that some taxes do more damage to the economic growth than others. Mitchell (2009:38) suggested three simple principles as a good guide to a good tax policy. Firstly, lower tax rates are better than higher tax rates. Secondly, extra taxes on savings and investments are very costly and finally, special tax loopholes reward economic inefficiency (Mitchell, 2009:39). Mitchell concluded that escalation of income taxes in the form indirect taxes might harm the economy instead to growing it.

Mitchell's argument is supported by Mourao (2008:88); he suggests that fiscal illusion may have a negative impact on economic growth. This negative growth rate can be mitigated by higher values of a productive public service. Mourao (2008:88) uses the assumption that whatever is collected in the form of taxes is used by a productive public service to stimulate economic growth. Mourao (2008:88) refers to the dangers of fiscal illusion, one of which is the fact that *politicians manipulate taxpayers'* obscure knowledge to achieve their own political gains. The downside of manipulation is also clear during the times of election and voting for the country's leadership. As a result of fiscal illusion, taxpayers will put up with larger budgets than otherwise, and will support a politician whom otherwise they might have opposed if they had a clear understanding of the economic policy (Wagner, 2001:2). This theory was initially revealed by Downs (1957:140) arguing that lack of information from the electorate has the potential to convert a democratic government into a representative government as it forces the central representative board to rely on the agents scattered around the country in informing them how the government performed and what it intends to do in the future if re-elected (Downs 1957:140).

2.2.3 Measurement of fiscal illusion

Oates (1988:66) identified five specific hypotheses relating to empirical analysis of fiscal illusion, namely, revenue complexity, revenue elasticity, the flypaper effect, renter illusion and debt illusion. A brief discussion of the measurement of fiscal illusion, using the five forms of fiscal illusion hypothesis, is briefly discussed below:

Firstly, fiscal illusion can be measured by observing the level of *complexity* of the jurisdiction's *revenue systems* (Oates, 1988:68). The simplest fiscal systems only have one or very few types of taxation and operate freely and clearly. In a composite tax system there are a number of taxes and are mostly hidden, and often operate under unclear economic conditions (Wagner, 1976:51). More complex revenue systems result in the taxpayers perceiving their burden to be lower than it really is (Dollery & Worthington, 1995:5). Wagner (1976:57) referred to this behaviour as a rationale to disguise the degree of incomes transferred from the individuals to government.

Secondly, the level of fiscal illusion can be measured by evaluating the level of *revenue elasticity*. Buchanan (1967:65) argued that revenue systems with relatively high income elasticity tend to be associated with rapid increase in public budget during periods of economic growth. The theory in this study suggests that there is a clear relationship between involuntary increase in government revenue established under income elastic revenue structure and increased government spending, other things being equal (Dollery & Worthington, 1996:10). Oates (1988:73) made reference to Wagner's argument that changes in tax rates are debated extensively by the government in consultation with relevant stakeholders, yet no similar debates take place in an automatic increase in tax rates. This argument suggests that the taxpayers are more concerned with increases in rates rather than their tax bill (Oates, 1988:73). The author further concluded that the income elasticity of the tax structure would put forth an optimistic effect, that is, the more elastic the forms of taxation, the higher the growth expected in the public budget.

The *Flypaper effect* is identified as the third form of fiscal illusion. This form is also referred to as intergovernmental funding by Wagner (1976:58). This refers to a theory where lump-sum payments in addition to public utility profits put forward a stimulatory effect on government spending. Budget maximising political agencies conceal the grant revenues by expanding the public budget (Oates, 1988:77). An increase in the level of dependence in grants leads to higher levels of fiscal illusion, which in turn will increase the level of government expenditure, other things being equal (Wagner, 1976:58). Results of a study conducted in South Africa revealed that the effects of municipal own-source returns on local expenditure are greater than those of interstate transferals. Conversely, these results do not provide any statistical suggestion in backing of the flypaper hypothesis within the context of municipal expenditures in South Africa (Amusa *et al.*, 2008:1). However, in a summary of studies conducted as compiled by Dollery and Worthington (1996:8), the majority of results supported the stimulatory effects of intergovernmental grants. On the other hand some of the studies that used a different methodology to analyse the flypaper illusionary hypothesis, found no systematic effect (Oates, 1988:78).

The fourth hypothesis is known as the *renter illusion* in which fiscal illusion is directly associated with the level of property possession in an economic jurisdiction (Oates, 1988:72). The renter illusion hypothesis holds that renters underestimate their

property tax burden and therefore support excessive levels of local expenditure. This form of theory is interpreted to imply that the property ownership and fiscal illusion have an adverse relationship (Oates, 1988:72).

However, evidence raises doubts about the renter illusion hypothesis. A range of studies on renter illusion reveal that renters desire more public services than home-owners. The illusion exists because, for property owners property tax is visible as it is paid directly by the property owner, while the renters do not necessarily see the property tax as it is hidden in the rental bill (Blom-Hansen, 2005:127).

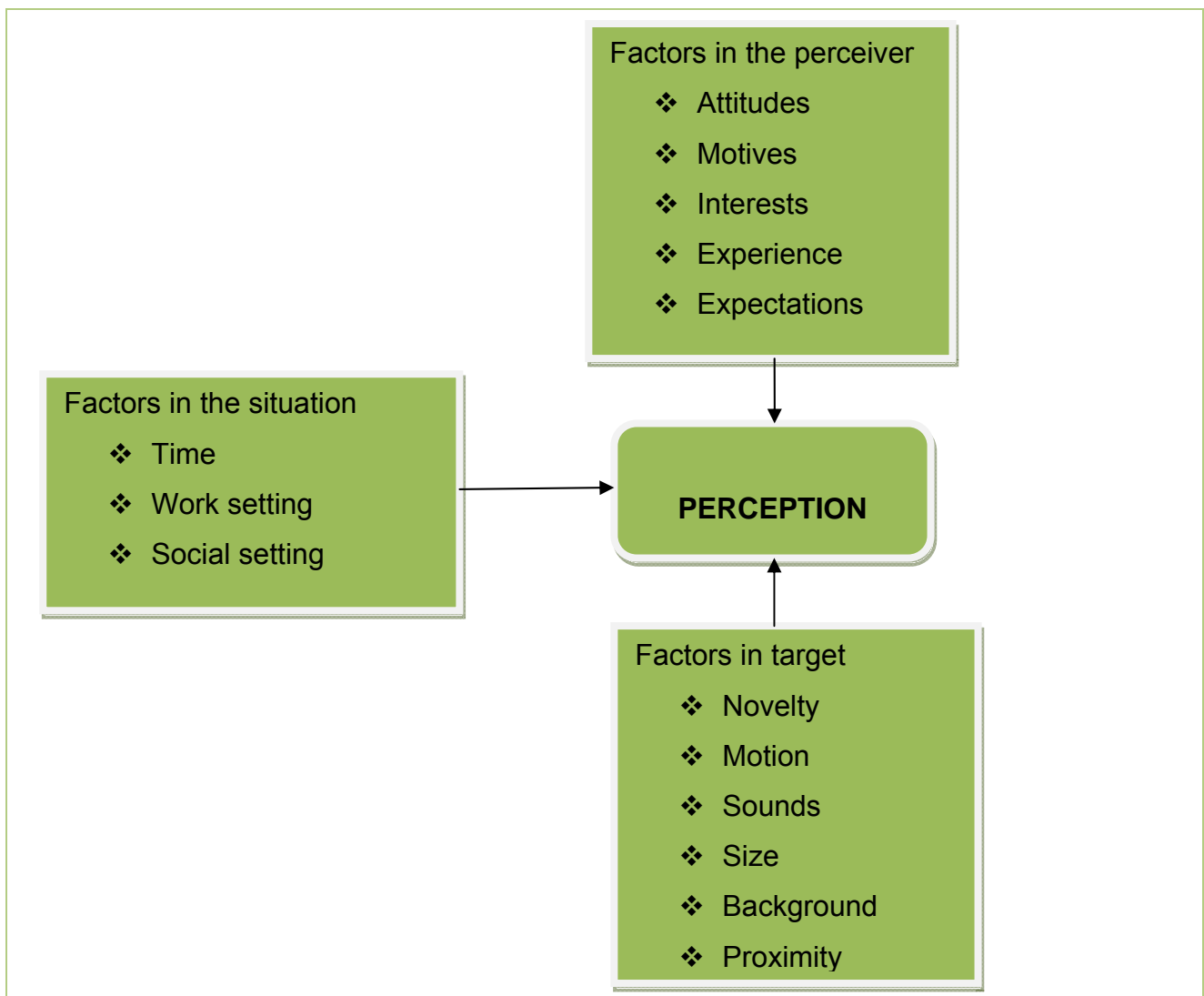
The fifth and final form of fiscal illusion that can be used as a measure is *debt illusion* which relates to a situation where provision of public goods funded through government debt provides an illusory effect on the taxpayers (Oates, 1988:76). In this form, an illusion exists when the taxpayer underestimates the present discounted value of future tax liabilities as well as the future benefits of tax assets on which the debt has been utilized (Buchanan, 1967:287). In a conceptual and empirical exploration of the theory of fiscal illusion developed by Wagner (1976:46), the author identified debt illusion as one of the aspects of fiscal illusion which assumes that debt finance is perceived to be less expensive when compared to direct tax finance, other things being equal. This assumption is based on the fact that citizens find it difficult to account for debt finance than it is to account for current tax finance. This results in the expansion of government spending as the debt has an effect of thinning out the financial burden to the future periods (Wagner, 1976:46).

2.3 TAXPAYER'S PERCEPTIONS

The Oxford English dictionary defines perception as "...the way in which something is regarded, understood, or interpreted". Though necessarily based on incomplete and unverified (or unreliable) information, perception is equated with reality for most practical purposes and guides human behaviour in general (businessdictionary.com). Robbins (2001:124) highlighted factors that may influence the perceptions of an individual. As in any other subject, people perceive taxation differently (Oberholzer, 2007:45).

People perceive what their backgrounds permit them to perceive. Perceptions are influenced by the individual's experiences; this includes culture, language, gender, and economic status. When individuals look at an object and attempt to interpret what they see, that interpretation will be influenced by that individual's personal experiences as mentioned earlier by Oberholzer (2007:45). It is true that individuals can look at the same thing and yet perceive it differently. Figure 1 below illustrates these factors that may influence the perceptions of individuals.

Figure 1: Factors that influence perceptions



Source: Oberholzer (2007:45) adapted from Robbins (2001:124)

It is concluded from the diagram above that various social, economic and other circumstances of a taxpayer may influence the perceptions of that person including that

individual's perceptions or misperceptions about tax (Oberholzer, 2007:45). Different population groups in South Africa may have very different perceptions of tax. The author also makes reference to a study conducted by De Villiers (1996), which states that South Africans have a very negative attitude towards tax. The perceptions stem from the fact that tax rates are too high, unfair and sometimes are perceived to be the product of apartheid. The other group perceives tax to be the means of taking from those who have and giving to the ones who have not. These perceptions have a strong relationship with the economic status of the individual and the population group being interviewed (Oberholzer, 2007:45).

Perception may also differ in how taxpayers perceive a certain type of tax and its burden. In Germany Seidl and Traub (2001) conducted a study on taxpayer's attitudes, behaviour and perceptions of fairness with respect to taxation using data drawn from a survey among German employees. The German income tax system is based on a household income rather than an individual one. Married couples enjoy a special tax benefit resulting from spouse tax splitting which is commonly known as *splitting boon*. The results on taxpayer's attitudes and behaviour were again contradicting within the same group of taxpayers. More than one-third of the participants perceived their taxation either as "too high" or "far too high". Surprisingly this group recommended fair tax burden which was still not lower than the current one. This means that they perceived the current tax to be high but still their perception was lower than the actual tax burden (Seidl & Traub, 2001:266).

Another study which analysed the perceptions of individual's marginal tax rates in liberal state revenues was conducted by Fochmann *et al.* (2010:3). They analysed studies conducted in different countries and findings in all countries are consistent as to the existence of misperceptions but with inconsistent results. It is possible that in the same country, different authors get results where the taxpayers are overstating and with another understating the marginal tax rate. Fochmann *et al.* argue that factors influencing the taxpayer's misperception are not yet adequately examined. In their study they make reference to a number of reasons leading to the inconsistencies in results. Table 2 below summarises a list of studies in various countries in which the results were inconsistent.

Table 2: Perceptions of individual marginal tax (survey data)

Author	Country	Results
Gensemer et al. (1965)	USA	Mixed valuation of marginal tax rates.
Morgan et al. (1977)	USA	
Lewis (1978)	UK	Tax rates are undervalued.
Fujii and Hawley (1988)	USA	Understated tax rates.
Rupert and Fischer (1995)	USA	Overstated marginal tax rates.
Hundsdoerfer & Sichtmann(2007)	Germany	Marginal tax rates are overvalued.

Source: Fochmann et al. (2010:3).

2.4 CONCLUSION

From as far back as the nineteenth century, the revenue authorities in different countries used invisible forms of taxation to collect government taxes, and the taxpayers often underestimated tax burden from indirect taxes compared to direct taxes. This was later known as the “Mill hypothesis” (Sausgruber & Tyran, 2005:4). This theory still applies in most jurisdictions including South Africa. The tax system is made up of many forms of taxation which are often complex for an ordinary taxpayer to comprehend (Oberholzer, 2007:5).

This chapter outlines the literature reviewed for the purpose of this study. The theoretical aspects that create fiscal illusion among individual taxpayers around the world were explored. The studies on South African taxpayers’ perception of their tax burden was also discussed with reference to factors affecting their perception, and reference was made to worldwide and local studies. An exploration of literature relating to forms of measuring fiscal illusion was discussed.

Theory reviewed indicated that fiscal illusion may be caused by perceptions that the taxpayers may have. This study aims to explore these causes that lead to these perceptions. Structured interviews will be conducted with a selection of individual taxpayers. The next chapter discusses the research methodology that will be followed to test the theoretical constructs discussed above in real lives of South African taxpayers.

CHAPTER 3

RESEARCH DESIGN AND METHODOLOGY

3.1 INTRODUCITON

The aim of this study is to explore the originating causes of fiscal illusion amongst South African taxpayers in relation to their perceptions of their tax burden. The theoretical constructs with regard to fiscal illusion and the perceptions of taxpayers were identified in the preceding chapter. The purpose of this chapter is to identify practices, processes and techniques that are used to attain knowledge of the causes of the fiscal illusion of the individual taxpayers (Krauss, 2005:759). The investigation is guided by the belief that there is no unitary reality apart from the perceptions that people may have (Krauss, 2005:760).

This chapter discusses the enquiry strategy and its general characteristics as adopted for the study. The sampling plan used in the study is described, highlighting how the respondents were selected for inclusion. The chapter further discusses how data was collected and briefly discusses the data collection tool.

3.2 RESEARCH DESIGN

The research design is the general plan of how the study can best answer the research question (Saunders *et al.*, 2009:136-137). The current study seeks to understand the originating causes of fiscal illusion amongst individual taxpayers in South Africa. The understanding can be consequent from the review of available literature on the proposed study and qualitative data collection process and analysis (Cooper & Schindler, 2011:145). Qualitative research is an umbrella term used to describe the number of research approaches that assist researchers to understand and explain the meaning of phenomena without or with little disruption in the natural settings of the respondents (Merriam, 1998:5).

A number of logical assumptions support the use of qualitative research. Firstly, qualitative research is naturally used to answer questions about the complex nature of phenomena, often focussing on describing and understanding a phenomenon from the point of view of participants (Leedy & Ormrod, 2005:94). Secondly, a qualitative approach allows the researcher to understand the point of view of the respondents or taxpayers without allowing social science to speak for or on behalf of the taxpayers (Krauss, 2005:764). Thirdly, qualitative research methods seek to come to terms with the meaning and not the frequency of a certain theory (Cooper & Schindler, 2011:183). Fourthly, research will involve direct encounters with the participants and will give meaning to how individual taxpayers perceive their tax burden (Gerson & Heorowits, 2002:199). Finally, it is designed to explain people and matters associated with them and does not depend on numerical data, words and/or pictures are used to convey what has been learnt (Fox & Bayat, 2007:7).

The current study is *exploratory* in nature as it seeks to provide the researcher with basic and preliminary understanding of the underlying causes of fiscal illusion amongst individual taxpayers (Saunders *et al.*, 2009:135). This implies that the research will be conducted with the goal of understanding the fiscal illusion from the respondent's perspective. An exploratory study is a valuable means of finding out what is happening; to seek new insights; to ask questions and to assess phenomena in a new light (Saunders *et al.*, 2009:135).

There are three principal ways of conducting exploratory research (Saunders *et al.*, 2009:136):

- A search of available literature.
- Interviewing "experts" in the subject. In this study the taxpayers were interviewed.
- Conducting focus group interviews.

This is a *cross-sectional* study making use of semi-structured questionnaires to collect data. Each respondent was interviewed once and the data collected represented a snapshot at one point in time (Cooper & Schindler, 2011:717). *Primary data* was collected and analysed specifically for this study. Primary data refers to data that is collected specifically

during the interviews with the taxpayers in order to address the research question (Saunders *et al.*, 2009:598).

Listed below are the general descriptors that reflect the features of research design for the current study:

- *Basic research* - This research is undertaken purely to understand what the individual taxpayer perceives as originating causes of fiscal illusion. The purpose of basic research according to Fox and Bayat (2007:10) is to increase the scientific knowledge. Results from this study may only determine the hypothetical constructs to be investigated in subsequent studies. It may yield no definitive answers to the study.
- *Cross-sectional research* – The participants are interviewed once and data collected represents a phenomenon at a specific moment in time (Saunders *et al.*, 2009:155).
- *Epistemology* – This is known as the philosophy of knowledge which will assist the researcher with what the taxpayer knows, and what the relationship is between what the taxpayer knows and the truth. This philosophy assists with the analysis of the scope of knowledge and how it relates to similar concepts such as the truth (Saunders *et al.*, 2009:112).
- *Exploratory study* - The current study may provide us with a basic and preliminary understanding of the taxpayer's perceptions of the fiscal illusion in the South African tax system. Therefore the study is considered to be inductive in nature (Saunders *et al.*, 2009:139).
- *Primary data* – Data is collected specifically for the current study to address the research question (Saunders *et al.*, 2009:598).
- *Qualitative research* – One-on-one interviews are conducted with the respondents and no numerical data is used,

- only non-numerical data is obtained and analysed from the participants (Saunders *et al.*, 2009:480).

The study focuses on theory generation rather than testing the existing theory.

3.3 SAMPLING

In the research field, sampling is commonly known as the procedure of deciding on units (e.g., people, organizations) from a population of importance or interest so that by studying the sample one may take a broad view of results back to the population from which they were chosen (Cooper & Schindler, 2011:727). Sampling procedures can be divided into two types, namely probability or representative and non-probability or judgemental sampling (Saunders *et al.*, 2009:213). For the purpose of this study, target population refers to individual taxpayers in South Africa.

There are four major types of non-probability sampling, namely availability, purposeful/purposive, quota and respondent-assisted sampling (Daniel, 2011:82). The current study will make use of a purposeful, self-selection technique as the intention of the study is to explore the hypothesis from a selected population (Saunders *et al.*, 2009:237). Purposeful sampling is a non-probability sampling technique in which respondents are carefully chosen from the target population on the basis of their fit with the purpose of the study and specific inclusion and exclusion criteria (Daniel, 2011:87). Purposeful sampling can be classified into several subtypes according to type of criteria to be used for including or excluding elements of the population. This criteria is inclined to fall into four main categories namely, central tendency, variability, theory/model development and based on judgement and reputation (Daniel, 2011:90).

A purposeful sampling method was used as the sampling technique. The advantages of this sampling procedure are that it provides more control over who is selected, and there is less unfairness due to under-representation and over-representation. It also limits the ability of the investigator to make valid generalities beyond the elements included in the sample (Daniel, 2011:88). Another advantage of this technique is that it assists in

answering the research question and meeting the research objectives (Saunders *et al.*, 2009:237). This sampling technique is based on the supposition that the researcher wishes to determine, comprehend and advance insights and consequently must choose a sample from which the most is likely to be learned (Merriam, 1998:61). The disadvantages of the selected technique are that it is prone to bias and influences that are beyond the researcher's control because the participants are only in the sample because of ease of access and existing relationships (Saunders *et al.*, 2009:241). The other consequence is that an unknown portion of the population is omitted (Saunders *et al.*, 2009:240). Listed below are five main steps followed in selecting a purposeful sample as outlined by Daniel (2011:88):

- Define the target population.
- Identify the inclusion and exclusion criteria for the sample.
- Plan to recruit respondents who conform to the inclusion criteria.
- Determine the sample size.
- Select the targeted number of population elements.

These steps were addressed as follows in the present study. Important to note is that the sample is not representative of the South African demographics. The unit of analysis for the study was individual taxpayers within the Gauteng area. The participants were specifically selected from colleagues, family and friends who are working and whom were expected to have a basic understanding of the South African tax system. This strategy was followed as the study was a limited exploratory study and constrained by time. Hence, the number of participants was also limited to twenty.

3.4 DATA COLLECTION

This study is categorized as qualitative as its intention is to refer to a state of affairs, phenomenon or a problem (Kumar, 1999:10). Primary data was gathered in the form of interviews using open-ended, semi-structured tested questionnaires as the study seeks to describe the originating causes of fiscal illusion in the taxpayer's perceptions (Leedy & Ormrod, 2007:148). Interviews may be formalised and structured, using standardised questions for each respondent. Informal and unstructured conversations may also be

followed depending on the respondent's views (Saunders *et al.*, 2009:318). This section will consider the methods of data collection and the design of the data collection instrument, which is the questionnaire.

3.4.1 The method of data collection

The initial data is collected from available literature and provides the basis for the understanding of fiscal illusion and perceptions of the taxpayers. The second section is to collect primary data that will assist the researcher to understand the perceptions of the individual taxpayers in relation to their tax burden. Data was collected through individual interviews by the researcher. In general an interview is a collaborating dialogue between two or more individuals (Saunders *et al.*, 2009:318). The main objective of the qualitative interview is to draw the attention of the interviewer or researcher to what the participants or taxpayer perceives as the tax burden. This type of interview asks general and open-ended questions to probe and record responses from the interviewee. The interviews are semi-structured, and a list of subjects and questions to be covered is available during the interview (Saunders *et al.*, 2009:320). These questions, designed and asked properly, will be able to give answers to the research question, namely what are the originating causes of fiscal illusion?

One of the benefits of a semi-structured qualitative technique is its adaptability, dependent on the flow of the dialogue. The interviewer is in a position to emphasise, change or even ask further probing questions from the participants. The participants can also seek clarity if the question is unclear; thereby giving responses they are confident with (Saunders *et al.*, 2009:320). There are also some disadvantages to this technique. One of which is possible bias and lack of honesty as the participants are personally known to the interviewer.

The researcher personally conducted the interviews. No training was required and guidelines as outlined by Leedy and Ormrod (2007:149-152) were taken into account. Areas of interviewing competence as recommended by Saunders *et al.* (2009:336-339) were also considered.

3.4.2 Questionnaire design

The questionnaire was divided into section A and section B (refer to Appendix A of the present study). The first section required the respondents to answer questions relating to their background. Firstly the respondent had to indicate if he or she had signed the consent form to participate in the interview. The following set of questions required the respondents to provide their demographic profiles in terms of their age group, gender, population group and the respondent's level of tax knowledge.

The second part of the questionnaire focused on obtaining the respondents' view about the perception of their tax burden. The section below described the individual questions included in the questionnaire, together with the literature reviewed that supports the inclusion of the question in the questionnaire.

In question 7 and question 8 of the questionnaire, the respondents were asked how much of the percentage of their household income is paid over to any sphere of government, and to explain the reasons for their estimation. Use of the estimated percentage when measuring fiscal illusion is in line with a study conducted by Fochmann *et al.* (2010:3) and Sausgruber and Tyran (2005:4). These questions will assist to obtain an understanding of whether this is the same case with South African individual taxpayers.

The questionnaire avoided personal or sensitive questions that are not relevant or will not add value to the study.

3.4.3 Pre-testing of questionnaire

The pilot testing of the questionnaire is carried out to detect any weaknesses in the design. The intention of the experimental testing is to improve the inquiry form so that the participants will not have problems understanding the questions. Pilot testing also assists the interviewer by limiting problems in recording and analysing responses (Saunders *et al.*, 2009:294).

Colleagues from the tax department of one of the major banks in South Africa were requested to review and give recommendations to the quality and clarity of the questionnaire (Saunders *et al.*, 2009:294). Another testing was done with four acquaintances with a minimum tax background, this was done to check if the questions are easily understandable by reviewing the responses provided, how long it took to respond, clarity and attractiveness of the layout (Saunders *et al.* 2009:294).

The benefits of pre-testing the questionnaire are numerous, according to Cooper and Schindler (2011:347). Pre-testing of questionnaire assists to determine ways to increase participants' interest and the possibility that participants will remain engaged to the end of the survey. It also assists with improving the question content, wording and sequencing of the questions. It also enhances the overall quality of the questionnaire (Cooper & Schindler, 2011:347).

No major problems were detected at this stage, grammar and issues with logical flow were corrected and the questionnaire amended accordingly.

3.5 DATA ANALYSIS

The main aim of this section is to describe the technique that was used to analyse data collected from the study. With qualitative studies the data analysis spiral is the most common. The process starts off by preparation of primary data collected in order to correct errors and any omissions that could compromise quality standards (Cooper & Schindler, 2011:421). This process could be referred to as the organisation of data and involves creating computer databases and breaking large units into smaller ones if applicable (Leedy & Ormrod, 2010:153).

The next step is the perusal of primary data to get a sense of what the responses from the respondents are likely to be. At this stage memorandums that suggest possible categories of interpretation are recorded and grouped together in order to get preliminary interpretations (Leedy & Ormrod, 2010:153). This stage may also assist with checking validity and credibility of data as responses are compared and contrasted with one another.

Data is then grouped into categories and subcategories and each piece of data is classified accordingly (Leedy & Ormrod, 2010:153).

The final stage of data analysis is to synthesise data for the readers and offer hypotheses or propositions that describe the relationships among different categories and subcategories (Leedy & Ormrod, 2010:153). A descriptive account of the finding is then given based on the data analysed. This study is exploratory and it moved beyond description into theory generation (Merriam, 1998:179).

3.6 ASSESSING AND DEMONSTRATING THE QUALITY AND RIGOUR OF THE PROPOSED RESEARCH DESIGN

A number of data quality issues can be recognised in relation to the use of semi-structured and in-depth interviews. The current study requires flexibility during the interview; this allows respondents the ability to open up about their perceptions without limitations. This flexibility, on the contrary, may result in the respondent not being *reliable* and may undermine the strength of this type of research. This shortcoming is overcome by making and retaining proper notes during the interview. These notes can be referred to at a later stage by other researchers for them to understand the process used (Saunders *et al.*, 2009:327).

The other important key to an effective interview is adequate *planning*. Participants were contacted to set up appointments before the interviews can be conducted. At this time the consent form is emailed for the participants to read and understand the terms of reference. An adequate amount of time was allocated for each respondent to allow enough time to sign the consent form and raise any questions relating to the interview where applicable. This proper planning of the sessions demonstrated the credibility and obtained confidence of the participants (Saunders *et al.*, 2009:328).

Thorough research on the subject cannot be overemphasised (Saunders *et al.*, 2009:328). The *level of knowledge* about the topic has been researched from the University's online library including external databases available to the University of Pretoria. Journal articles

relating to taxation in South Africa have been researched. The National Treasury and SARS websites were useful in providing valuable information relating to the need for tax education for the taxpayers and the impact of citizens' ignorance of fiscal policies (Saunders *et al.*, 2009:328).

The *locations* for the interviews were very convenient and appropriate for both the interviewee and the interviewer. All participants live or work in areas easily accessible to the interviewer. The participants were selected from colleagues, friends and family members living and working around Johannesburg (Saunders *et al.*, 2009:329).

3.7 RESEARCH ETHICS

The framework of research ethics refers to the suitability of one's conduct relative to the right of those who become the focus of one's study or are even affected by it (Saunders *et al.*, 2007:178). Research ethics therefore relates to questions about how the researchers put into words and make clear the research topic, design research and gain access, collect data, process, analyse and store data and how we write up our research finding in a moral and responsible way (Saunders *et al.*, 2007:178). Cooper and Schindler (2011:32) define ethics as the rules or standard of conduct that guide our ethical choices about our conduct and how we relate with others. The main purpose of ethics is to ensure that no one is hurt or suffers adverse consequences from one's research activities (Cooper & Schindler, 2011:32).

A number of key ethical issues are considered throughout the duration of the research project. The rights of participants have been safeguarded so that they do not suffer any harm as recommended by Cooper and Schindler (2011:32). The *benefits* of the study as outlined in section 1.5 of the current study are discussed with the participant (Cooper & Schindler, 2011:33). Each participant is provided with an informed consent form indicating that she or he has been informed about the nature of the study as well as his or her rights and protection. The consent form indicates that the respondent participates in the study on a voluntary basis. The participants are expected to read and sign the consent forms before participating. The consent form will be kept safe until the study has been completed (Cooper & Schindler, 2011:32).

The following general ethics issues were adhered to throughout the research project (Saunders *et al.*, 2007:181):

- Confidentiality of likely and actual participants.
- Voluntary nature of participation and the right to withdraw partially or completely from the process.
- Permission and likely dishonesty of participants.
- Maintenance of the confidentiality of data provided by individuals or identifiable participants and their anonymity.
- Reactions of participants to the way in which data is collected, including embarrassment, stress, discomfort, pain and harm.
- Effects on participants of the ways, in which data is used, analysed and reported, in particular the avoidance of stress, embarrassment, discomfort, pain and harm.
- Conduct and impartiality of the investigator (Saunders *et al.*, 2007:181).

CHAPTER 4

DATA ANALYSIS

4.1 INTRODUCTION

The objective of the study was to explore the perceptions of South African taxpayers in relation to their tax burden. This exploration was achieved by reviewing available literature and collecting primary data from a selected sample. For data collected to be useful, it needs to be analysed and the meaning understood. Qualitative research has an exclusive goal of enabling the meaning-making process (Krauss, 2005:763). The analysis will assist to develop theory from data collected. The analysis included the inductive methodology which comprises the development of a hypothesis as a result of the observation of empirical data. The analysis of the results was done to establish the variation in the situation without quantifying it. This approach is sometimes called the interpretative constructivist or postpositivist approach (Leedy & Ormrod, 2005:94).

This section of the study intends to analyse the qualitative data collected from twenty respondents. Merriam (2009:175) refers to data analysis as the process of making sense out of data collected and involves fusing, reducing and understanding what the respondents say and the researcher's observations. The primary task during data analysis was to identify common themes in the people's descriptions of their experiences. The first section of this chapter analysed the demographic background of respondents. The second part analysed the respondents' perceptions of fiscal illusion.

4.2 DEMOGRAPHIC BACKGROUND OF RESPONDENTS

This following section provides the demographic profile of the participants. The demographic information required and analysed included participant's age group, gender, population group, employment status and the level of tax knowledge. With the exception of employment status, this information is analysed and supported by the use of graphs and tables as presented below.

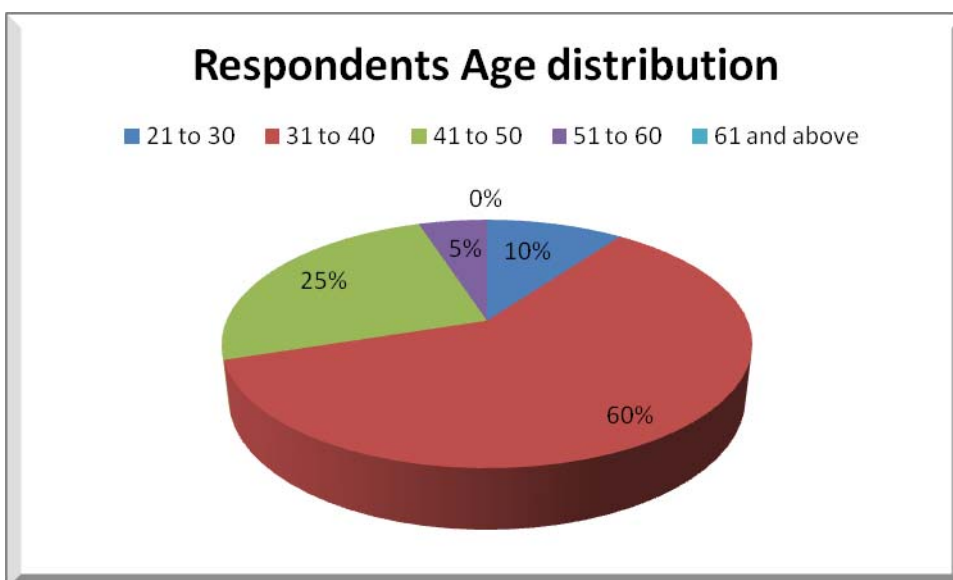
4.2.1 Respondent's age distribution

According to the information collected, the largest portion of the respondents, 60% comprised of people within the ages of 31 to 40 years. 25% of the sample is represented by respondents between the ages of 41 to 50 years, being the second largest portion. The youngest group was only 10% of the sample and the oldest was a mere 5% of the sample. No-one was interviewed above the age of 61 years. The table and the chart below illustrate the distribution of the respondent's ages.

Table 3: Respondents' age group

Age group	Percentage representation
21 - 30	10%
31 - 40	60%
41 - 50	25%
51 - 60	5%
61 and above	0%

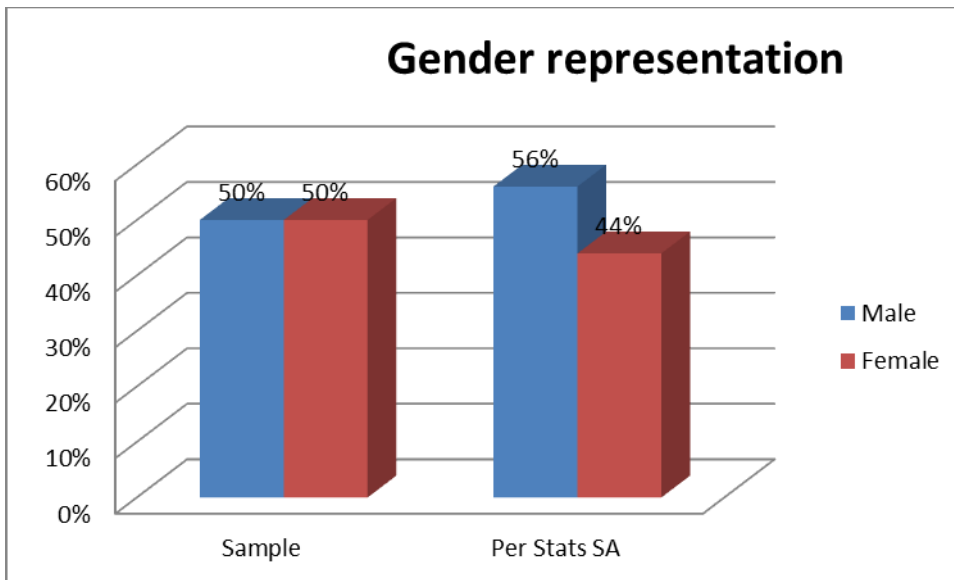
Figure 2: Age group of respondents



4.2.2 Respondent’s composition of gender

At the end of March 2012 employment was reported to be at 13 422 000, of which 5 902 000 (44%) were women and 7 520 000 (56%) were men. This figure represented all forms of employment nationwide (Statistics South Africa, 2012:s6.13). In the current study, representation of gender is equal, with ten males and ten females interviewed. Figure 3 below is a graphic representation of gender in the study, compared to the number of total employed population nationwide as presented by Stats SA.

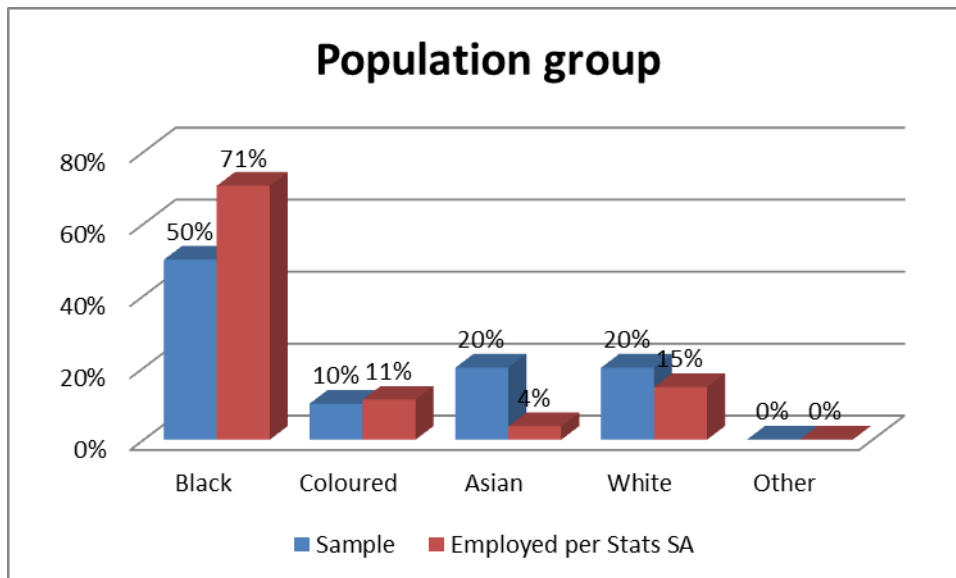
Figure 3: Composition of gender in the sample



4.2.3 Segregation according to the respondent’s population group

The population group represented Africans as half of the respondents in the sample and the other fifty per cent is split between Coloureds, Asians and Whites in ten: twenty: twenty proportions respectively. According to employment data provided by Statistics South Africa (Stats SA), in March 2012 there were 9 470 000 Africans, 1 488 000 Coloureds, 500 000 Asians/Indians and only 1 964 000 Whites employed nationally in all forms of employment (Statistics South Africa, 2012:s6.13). None of the respondents represented the “other” population group. The chart below illustrates the population groups that responded to the survey compared to the employment data nationally.

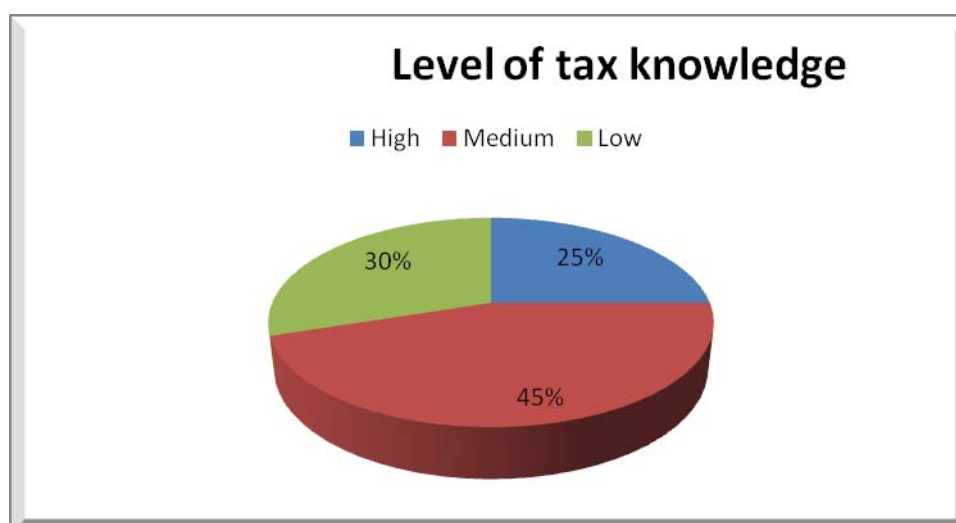
Figure 4: Population group as represented in the study



4.2.4 Level of the respondent's tax knowledge

The interviewees were asked to provide their level of tax understanding. This question intended to assess if the perceptions would be influenced by the level of tax knowledge. The majority of respondents have an average knowledge as this group represents 45% of the sample. What was of interest was that perceptions and estimations were not consistent even within the group with similar tax knowledge. Figure 5 below illustrates the level of tax knowledge among the participants.

Figure 5: Level of tax knowledge of the respondents



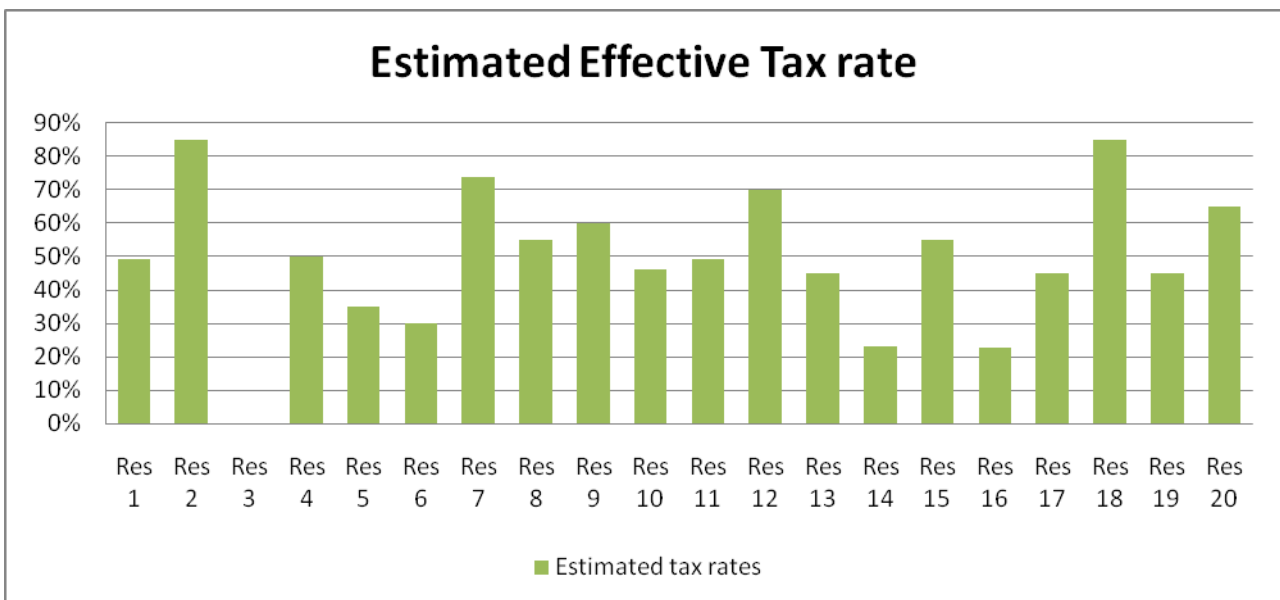
4.3 FISCAL ILLUSION OF THE PARTICIPANTS

This section analyses the fiscal illusion among individual taxpayers as shown in the responses from the interviewees. During the interview sessions, the respondents were requested to estimate the effective percentage of tax paid to any government sphere in proportion to their household income. The follow-up question intended to understand the basis of the respondents' estimation and they were requested to give detailed reasons for their estimates.

4.3.1 Estimated effective tax rate

The estimate ranged from zero to eighty five per cent of the household income paid to any sphere of government as taxes. The average estimate of the sample was forty nine per cent. Below is a graphic representation of the effective tax rates as provided by the respondents.

Figure 6: Respondents Estimated Effective Tax rates



4.3.2 Basis for the estimation of effective tax rate

The responses by interviewees were analysed into categories and the names of these categories are congruent with the orientation of the study, and are derived mostly from participant's responses (Merriam, 2009:184). The findings identified from the responses were grouped and categorised in four different codes. The process of relating categories and properties to each other was used and this is known as axial coding (Merriam, 2009:200). The codes used to summarise various elements contributing to fiscal illusion as derived from the participant's responses were adopted from Steyn (2012: 478). Table 4 below explains the codes and categories used to analyse the participants' responses.

Table 4: Coding of conceptual elements contributing to respondents' fiscal illusion.

Question #:	Category	Description	Code
8	Hidden taxes	Refers to any reference made to taxes that are not visible or are unknown to the general public.	HID
8	Number of taxes	Reference to a number of different taxes and levies in the South African tax law.	NTX
8	Double Taxation	Any mention of participants being taxed more than once on the same income.	DTX
8	Tax Shifting	Any references made by respondents to aspects such as paying tax on values that already have a tax component in them, where suppliers include taxes in the cost of the product being sold, including any other reference to shifting of taxes.	TSH

Source: Steyn (2012:478-479)

The study revealed that there are a number of reasons that lead to fiscal illusion. The responses were grouped according to four major categories as indicated above. Most respondents had more than one conceptual element contributing to their illusion. Of the responses analysed, 95% of responses by participants mentioned that the South African

tax system is not visible or taxes are hidden in the cost of consumption. This argument is supported by a number of studies such as “the Mill Hypothesis” as conducted by Sausgruber and Tyran (2005:39) and Chetty *et al.* (2008:1), when they conducted a study on the salience and taxation.

85% of responses mentioned that the tax system has too many different taxes especially indirect taxes. In most instances, the respondents were not even sure what the tax rate for some of the levies are. A further 30% mentioned that double taxation is another element that causes an illusion in computing their tax expense, in that some of the income is taxed more than once, while the other 30% of responses indicated that sometimes tax is charged on items that already have a tax component in it. Reference was made to customs duty that is tax charged to the importer of commodities but is borne by the final consumer. The table below shows the analysis of the responses from twenty respondents (Res), and is summarised into four categories described in table 4 above.

Table 5: Analysis of responses

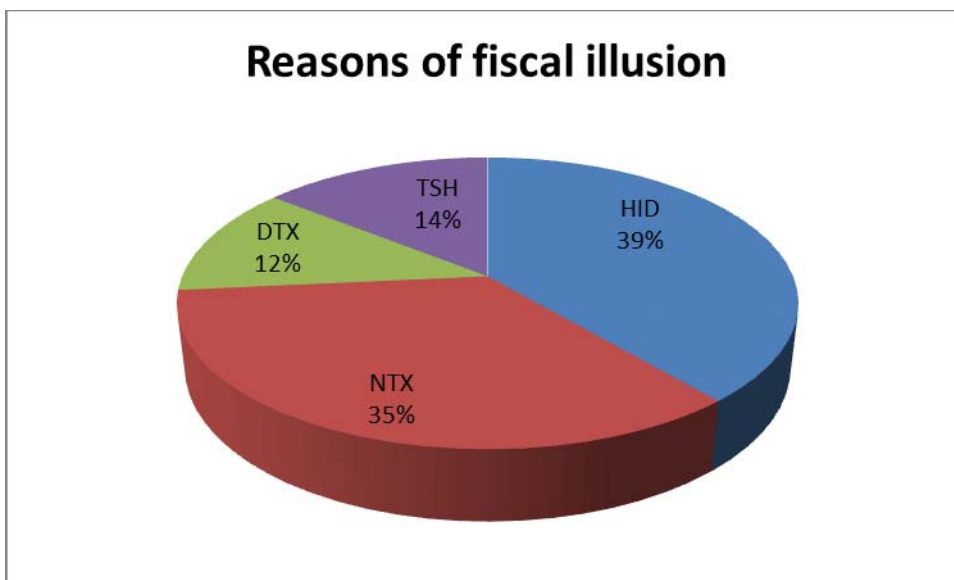
Respondent	Findings from the interviews	HID	NTX	DTX	TSH
Res 1	Estimates employee tax to be 40% of salary, remainder charged as VAT on consumption. In addition there are fuel levies, rates and taxes.	1	1		
Res 2	The biggest tax charge is via payroll taxes estimated at 40%. A number of additional taxes on consumption and investment is mentioned which escalates the effective tax rate up to 85%.	1	1	1	1
Res 3	Believes has no tax burden as this respondent’s salary is below the tax threshold.				
Res 4	Majority of the tax charge is from PAYE and consumption taxes as one pays tax every time they spend.	1	1		
Res 5	The major tax experienced is through PAYE and VAT.	1	1		
Res 6	The tax burden in addition to payroll taxes includes VAT on consumption, fuel levy and UIF.	1	1		
Res 7	The bigger portion of tax expense is deducted	1	1	1	1

	through PAYE, plus a long list of other taxes and levies at additional rates. There is also indirect additional tax as a result of children's private education, private health care and private security. This is deemed to be additional tax as these services are supposed to be the responsibility of the government.				
Res 8	In addition to PAYE, VAT and other rates on owned property, levies charged on consumption; the participant also views taxes withheld on behalf of domestic workers and <i>au pairs</i> as an additional burden.	1	1	1	1
Res 9	Personal income tax and consumption taxes, in addition we have fuel levies, rates, and airport taxes added to the tax burden.	1	1		1
Res 10	PAYE and other indirect taxes on consumption.	1	1		
Res 11	Personal Income Taxes, UIF and some consumption levies.	1	1		
Res 12	Forty per cent of this respondent's tax burden is as a result of personal income tax and the remainder to VAT, property rates, levies and more.	1	1		
Res 13	Consumption taxes especially through transport costs and fuel levies push the tax burden when added to the employee taxes.	1	1		
Res 14	Tax burden is based on the one charged per payslip.	1			
Res 15	Payroll taxes, property rates and taxes, car licencing and registration, toll fees, driver's licence renewal are also considered as taxes.	1	1		1
Res 16	Payroll taxes plus consumption taxes.	1	1		
Res 17	Estimate is based on PAYE and VAT on household expenditure.	1			
Res 18	PAYE and VAT are major contributors to the tax burden, in addition private education; medical	1	1	1	1

	aid and security costs that are supposed to be borne by the state are paid for by the citizens.				
Res 19	Personal Income Taxes and VAT on majority of services, including some municipal services and groceries and motor vehicle licences.	1	1	1	
Res 20	In addition to payroll taxes, there is a number of consumption taxes which are sometimes charged on values which have a tax component, like customs and excise duties are treated as base cost by suppliers then onto that escalated value retailers add on their mark-ups then add VAT. Tax on return on investments like, dividends tax, Capital Gains tax (CGT) is also considered to be an additional tax burden.	1	1	1	1
Total responses		19	17	6	7
Percentage of total responses		39%	35%	12%	14%

The data analysed above is further summarised in the form of a chart in the figure below:

Figure 7: Responses analysed into the four conceptual elements



4.4 SUMMARY

The purpose of this chapter was to analyse the data collected through the interviews with the respondents. The first section analysed the demographic background of the respondents, including race, age group, population group as well as the indication of the level of their tax knowledge.

The second section of this chapter analysed findings relating to the conceptual elements that contributed to the fiscal illusion of interviewees. These elements were divided into four main categories, namely hidden taxes, number of taxes, double taxation and tax shifting. The results of this study suggest that the majority of respondents view the use of multiple taxes as the common cause of fiscal illusion. These findings are supported by the Mill Hypotheses as investigated by Sausgruber and Tyrann (2005).

Perceptions also played a pivotal role as some of the respondents perceived private education, private health care and private security to be an additional tax burden. On the other hand some perceive tax as only the one deducted through payroll, and do not consider consumption taxes when calculating the estimated tax rate.

The final chapter summarises the significant findings of the study and discusses conclusions made as a result of the study. It also indicates the restrictions of the current study as well as makes reference to the possibility of future research that may be conducted to further explore the conceptual framework of fiscal illusion of taxpayers in South Africa.

CHAPTER 5

CONCLUSION

5.1 INTRODUCTION

South Africa, like most countries has a desire to grow the economy and provide essential services to its citizens, while reducing poverty and inequality (Oberholzer, 2007:207). It is the goal of each government to collect revenue at the lowest cost possible. With this in mind, various ways of collection are introduced to the extent that the system gets fragmented and complicated (Wagner, 1976:58). Fochmann *et al.* (2010:23) concluded that the complex tax rule results in poor quality of the taxpayer's judgement on some of their economic decisions.

The primary objective of this study was to explore the originating causes of fiscal illusion amongst individual taxpayers in South Africa. To achieve this objective literature from different sources was reviewed and synthesised. The theoretical constructs from the literature reviewed were applied in a real life context in order to explore the originating causes of fiscal illusion amongst individual taxpayers in South Africa. This was done by collecting primary data through interviews of a selected sample.

This chapter summarises findings of the research in order to present the conclusions in line with the primary objectives of the study.

5.2 SUMMARY OF FINDINGS AND CONCLUSIONS

Past and most recent studies conducted in South Africa and around the world give evidence that taxpayer's perception of their tax burden is largely distorted because of various reasons (Fochmann *et al.*, 2010:23; Amusa *et al.*, 2008:4). The literature reviewed revealed that fiscal illusion may be caused by the perceptions the taxpayers have about taxation (Oberholzer, 2007:6; Seidl & Traub, 2001:265-266). During the current study interviews were conducted to explore the taxpayers' perception of their tax burden. From

the sample selected, the interviews revealed a number of conceptual elements contributing to the fiscal illusion of respondents. These elements were further broken down into four categories and are discussed below.

5.2.1 Hidden taxes

The responses from at least nineteen interviewees revealed that it is very common for taxes to be imposed on the citizens by the South African tax system in the form of indirect taxes. They relayed this perception by attempting to list a number of taxes with which they are faced. These taxes are hidden in the price of consumption, also confirmed by Mill (1846:237). In most instances, the respondents were unsure of the exact rate charged for some of these taxes. These findings confirmed the theoretical framework in the literature which argues that certain kinds of taxes remain hidden while they extract a significant amount of personal income taxes (Oates, 1988:67). This argument was further strengthened by the perception of two respondents, who believe that cost of private education, private health care and private security increases the indirect tax burden on the citizens, as these services are expected to be subsidised or borne by the state.

5.2.2 Number of taxes

The respondents attempted to list a number of various taxes through which revenue is collected, most of which are hidden. The current tax system utilises different revenue extraction methods which have the ability to confuse the pattern of occurrence and have the effect of concealing the real cost of government revenue (Oates, 1988:67; Buchanan, 1967:130). In a number of instances some of the respondents were not able to remember the taxes and rates charged in each form of taxation. To the extent that the taxpayer is ignorant of the existence of a certain tax, the tendency is to be more accepting and submissive to its imposition. When it is brought to the taxpayer's attention they tend to overestimate its impact (Buchanan, 1967:188-189).

5.2.3 Double taxation

The results from the interviews also revealed that some of the respondents' income was taxed more than once. This argument is based on the tax on returns on investment. Some participants perceive tax on investment returns as double taxation and discourage the culture of investing among the citizens. Capital gains taxes, estate duty, property taxes and sometimes donations tax are perceived as other forms of double taxation and discourage the citizen's desire to accumulate wealth. The respondents commented that these assets were acquired using the taxpayer's after tax income.

5.2.4 Tax shifting

There was another observation by the respondents that VAT in most circumstances is added on values that already include a tax component, an example being customs and excise that is added on to cost of imported items. In addition to that, the supplier or retailer adds a mark-up and then VAT to the same amount. One of the respondents noted that this results in the importer of goods shifting their tax burden to the consumers. Another argument was that this result in double taxation, as one is not supposed to charge tax in the form of VAT on tax in the form of customs duty.

5.3 LIMITATIONS OF THE STUDY

The study had some limitations as it only focused on individual taxpayers who are employed. People who are economically inactive were excluded, even though they incur tax in the form of consumption taxes. Only natural persons were interviewed and corporate taxpayers were excluded from the study. The study further excluded taxpayers in the other sectors of employment, e.g. public servants and the self-employed. There is no comparison between the actual effective tax rates and those estimated by the respondents. These limitations could be addressed in future research.

5.4 CONCLUDING REMARKS

Payment of tax is generally not popular in most constituencies and only a distinctive minority are expected to say that they pay little tax (Lewis, 1982:41 in Oberholzer, 2007:246). Based on the outcomes of the study it can be concluded that one of the main causes of fiscal illusion among South African taxpayers is the number of taxes that are imposed on the citizens. This element complicates the tax system in that the taxpayer does not even know what some of these taxes are, and how much is the rate at which they are charged.

Reference to the complexity of tax systems was also argued as one of the causes of fiscal illusion by a number of studies as discussed in the literature review (Wagner, 2001:47; Oates, 1988:68). Second to this cause is double taxation. Taxpayers argue that some of their income is taxed more than once, especially returns on investment. The argument is that one invests from the after tax income, hence returns or growth thereof should not be subject to any form of taxation. The majority of respondents commented that it is difficult to accurately calculate or even estimate one's tax expense because of the complexity of the tax system. Their estimated tax rates were based on additional personal income tax rate per tax tables, without taking into account the fact that this tax is charged on a sliding scale. In most instances, Value Added Tax was reflected as if all expenditure is a VAT supply without considering the effect of exempt and zero rated supplies. This argument was endorsed by Fochmann *et al.* (2010:23) where the study concluded that taxpayers are unable to correctly estimate their marginal tax rate.

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LEGISLATION

Income Tax Act No. 58 of 1962.

APPENDIX A

- Data collection instrument-

INTERVIEW SCHEDULE

Respondent number

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- AN EXPLORATORY STUDY OF THE FISCAL ILLUSION OF INDIVIDUAL TAXPAYERS IN SOUTH AFRICA -

Dear respondent

Thank you for your willingness to complete this survey. The purpose of the survey is to explore your perceptions of the tax burden as imposed by the South African Revenue Services. The survey should not take more than 10 minutes to complete. This is an anonymous and confidential survey. You cannot be identified and the answers you provide will be used for research purposes only.

Please answer all questions. There are no right or wrong answers. We are interested in understanding your perceptions of your tax burden.

SECTION A – Background of respondent

Q1. Please indicate if consent to participate in the research has been signed:

Yes	
No	

Q2. Please select your age group:

21 to 30	
31 to 40	
41 to 50	
51 to 60	
61 and above	

Q3. Please select your gender:

Male	
Female	

Q4. Please select the population group you belong to:

African/Black	
Coloured	
Indian/Asian	
White	
Other, please specify_____	

Q5. Please select your employment status:

Salaried employee – Public sector	
Salaried employee – Private sector	
Self employed	
Unemployed	
Pensioner	

Q6. Please indicate your level of tax knowledge:

High	
Medium	
Low	

SECTION B

Q7. What percentage of your household's monthly income is paid over to any government spheres in the form of taxation (local/provincial/national)?

Estimated %: _____

Q8. Please explain in detail how you arrived at this estimation?

APPENDIX B



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

Faculty of Economic and
Management Sciences

Informed consent for participation in an academic research study

Dept. of Economics and Management Sciences

AN EXPLORATORY STUDY OF THE FISCAL ILLUSION OF INDIVIDUAL TAXPAYERS IN SOUTH AFRICA

Research conducted by:

Mrs L.L. Mhlungu (10615955)
Cell: 083 407 3440

Dear Respondent

You are invited to participate in an academic research study conducted by Lindelwa Mhlungu, a Masters student from the Department of Taxation at the University of Pretoria.

The purpose of the study is to **investigate South African taxpayer's perceptions of their tax burden. The study will address the degree of "burden illusion" of a South African individual taxpayer.**

Please note the following:

- This study involves an anonymous survey. Your name will not appear on the questionnaire and the answers you give will be treated as strictly confidential. You cannot be identified in person based on the answers you give.
- Your participation in this study is very important to us. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- Please answer the questions in the attached questionnaire as completely and honestly as possible. This should not take more than **10** minutes of your time.
- The results of the study will be used for academic purposes only and may be published in an academic journal. We will provide you with a summary of our findings on request.
 - Please contact my supervisor, Dr T. Steyn, Theuns.Steyn@up.ac.za if you have any questions or comments regarding the study.

Please sign the form to indicate that:

- You have read and understand the information provided above.
- You give your consent to participate in the study on a voluntary basis.

Respondent's signature

Date