

Agreement with Tax Practitioners' Advice under Tax Law Ambiguity

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Taxpayers who cannot cope with or understand the complexity of tax requirements engage the services of a tax practitioner to help them resolve uncertainties, and practitioners are known to exploit tax loopholes to the taxpayers' advantage. The present study posed an interesting question: if practitioners provide aggressive advice, will taxpayers agree with them and what influences their decision? A self-administered mail survey was used to elicit the perceptions and attitudes of a nationwide, random sample of New Zealand business taxpayers. One of the key issues emerging from the study is that for business taxpayers, their risk attitudes such as sanction risk perceptions, personal risk propensity, and risk expectations were important determinants of their tax decisions after their practitioners had given them advice. However, other factors such as personal tax ethics, business tax ethics, firm size, and audit experience have no impact on business taxpayers' agreement with advice.

1.0 INTRODUCTION

Improving taxpayers' voluntary compliance is certainly an important goal of tax authorities worldwide. However, this goal is not always easy to achieve as not all taxpayers respond to their tax obligations in the same way. Some taxpayers may voluntarily comply whereas others may not for various reasons. A significant amount of research contributed by a number of disciplines over at least three decades has provided evidence of multiple determinants of compliance. Psychologists and sociologists have aptly pointed out that the economic model (for example, likelihood of detection and penalties) does not fully capture all of the many factors that affect compliance behaviour; other non-economic factors are also important.¹

Amongst the various types of factors that influence taxpaying behaviour, the category of the "other" as coined by Braithwaite and Wenzel,² is identified as an important non-economic factor. The "other", to mention a few, includes tax practitioners, friends or family members of the taxpayer. As more taxpayers are seeking advice from practitioners due to the increasing complexity of tax laws, practitioners have indeed become important 'gatekeepers' to the tax system. Practitioners, therefore, play an important role as they can help to enhance tax compliance or exploit tax loopholes.

¹ See Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).

² Valerie Braithwaite and Michael Wenzel "Integrating explanations of tax evasion and avoidance" in Alan Lewis (ed) *The Cambridge Handbook of Psychology and Economic Behaviour* (Cambridge University Press, Cambridge, 2008) at 304-334.

Although there is a dearth of literature in which tax practitioners are considered, particularly outside the US, their importance is becoming more accepted and recent researchers have started to explore their roles in taxpaying behaviour,³ including factors influencing their tax decisions. Research findings suggest that tax practitioners' willingness to exploit the tax law may be driven by various factors, such as clients' preference for type of advice, clients' characteristics and practitioners' characteristics.⁴ For instance, tax practitioners were found to provide aggressive (or conservative) advice to aggressive (or conservative) clients.⁵ These insights, elicited from tax practitioners, suggest that taxpayers are the instigators of aggressive tax advice. It is interesting to note that in studies in which the views of taxpayers have been assessed, it is reported that they prefer conservative rather than aggressive advice.⁶ Preference for conservative advice appears to be consistent with the literature, which indicates that one of the main reasons taxpayers engage a tax practitioner is to file a correct tax return. Braithwaite⁷ interviewed tax promoters and advisers in Australia and the United States, and provides an explanation of how aggressive advice can at times be demand-driven and at times supply-driven. His data support the view that aggressive advice can be demand-driven for boutique shelter products (that is, those that are crafted in response to demand articulated by wealthier clients). However, when they are finessed to the point of being suitable as mass-marketed schemes, they have a roller-coaster history. Initially, they are supply-driven, and become demand-driven when other taxpayers come to know about these schemes and how well they work. Whether aggressive advice is demand or supply-driven, it further affirms the key role practitioners play in taxpaying behaviour.

An interesting question is: even if aggressive advice is supply-driven, will taxpayers take the aggressive tax position in accordance with the practitioners' advice and are such decisions influenced by other factors? If they do not accept such advice at all, then it is not really a concern for tax authorities. On the other hand, if their acceptance is influenced by certain factors, then perhaps tax authorities could look at ways to curb such influences. This study therefore examines taxpayers' acceptance of aggressive advice from the practitioner and the possible factors that may influence their decisions. It focused on one subset of taxpayers, business taxpayers, as they have more complex tax affairs and more scope for tax planning as compared to, for instance, salary or wage earners. Due to the nature of their business, they tend to have more ambiguous types of income or expense and, therefore, are more likely to engage a tax practitioner.

This study contributes on two fronts. First, it advances the current understanding of how practitioners and taxpayers influence each other by examining the factors that predict the taking of aggressive

³ Lin Mei Tan "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20 *Journal of Economic Psychology* 431; and Lin Mei Tan and Adrian Sawyer "A Synopsis of Taxpayer Compliance Studies: Overseas vis-à-vis New Zealand" (2003) 9 *New Zealand Journal of Taxation Law and Policy* 431.

⁴ Cheryl A Cruz, William E Shafer and Jerry R Strawser "A Multidimensional Analysis of Tax Practitioner's Ethical Judgments" (2000) 24 *Journal of Business Ethics* 223; and VC Milliron "A Conceptual Model of Factors Influencing Tax Preparers' Aggressiveness" in Shane Moriarity and Julie Collins (eds) *Contemporary Tax Research* (Center for Economic and Management Research, University of Oklahoma, Norman) 1.

⁵ D LaRue and PM Reckers "An Empirical Examination of the Influence of Selected Factors on Professional Tax Preparers' Decision Processes" (1989) 7 *Advances in Accounting* 37; and Dan L Schisler "An Experimental Examination of Tax Preparers' Aggressiveness - A Prospect Theory Approach" (1994) 16 *Journal of the American Taxation Association* 124.

⁶ Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45 *Nat'l Tax J* 389; Yuka Sakurai and Valerie Braithwaite "Taxpayers' Perceptions of the Ideal Tax Adviser: Playing Safe or Saving Dollars?" (Working Paper No 5, Centre for Tax System Integrity, Australian National University, Canberra, 2001); and Tan, above n 3.

⁷ John Braithwaite *Markets in Vice Markets in Virtue* (The Federation Press, New South Wales, 2005).

advice. Second, the tax jurisdiction of New Zealand offers a unique opportunity to look at practitioner-influence in a relatively unconstrained context. Most insights into the tax practitioner's role come from United States studies (and more recently from Australia). The generalisability of the results to other countries has been questioned.⁸ New Zealand is particularly interesting as a site for this research because there are relatively fewer institutional constraints on the practice of tax advising. Tax practitioners are not regulated by the Government and their services, unlike those offered in many other countries, are geared toward business returns, since many salary and wage earners now do not have to file tax returns.⁹

The remainder of the article is organised as follows. An overview of the literature and the development of hypotheses are provided in section 2. The next sections, 3 and 4, describe the research design and discuss the results, respectively. The last two sections present the conclusions and limitations of the study.

2.0 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 Taxpayers' Agreement with Aggressive Advice

Research findings leave little doubt that aggressive positions are common among tax practitioners.¹⁰ In various studies in which practitioners' willingness to advocate client positions in the grey area has been examined, a number of factors that could potentially influence practitioners' aggressiveness have been identified.¹¹ One consistent finding is that legal factors such as tax law ambiguity can influence a tax practitioner's actions or conduct.¹² Klepper and Nagin¹³ produced some evidence that tax practitioners contribute to compliance by enforcing legally clear requirements. However, in ambiguous situations, practitioners can advise clients on how to take advantage of ambiguous features of the tax law. With many aspects of the tax law not clear cut, there are indeed ample opportunities for practitioners to exploit them to their clients' advantage. This type of "creative compliance", if undetected, is considered to be even more destructive of the integrity of the law and, therefore, poses a

⁸ John Hasseldine, Peggy Hite, Simon James and Marika Toumi "Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors" (2007) 24 *Contemporary Accounting Research* 171; Lin Mei Tan "Research on the Role of Tax Practitioners in Taxpayer Compliance: Identifying Some of the Gaps" in Adrian Sawyers (ed) *Taxation Issues in the Twenty-First Century* (Centre for Commercial and Corporate Law Inc, University of Canterbury, Christchurch, 2006) 15; and Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).

⁹ Generally, one needs to file a return if the income earned is other than salary, wages, interest, dividends, and/or taxable Maori authority distributions.

¹⁰ Frances L Ayres, Betty R Jackson and Peggy S Hite "The Economic Benefits of Regulation: Evidence from Professional Tax Preparers" (1989) 24 *The Accounting Review* 300; Steven E Kaplan, Philip MJ Reckers, Stephen G West and James C Boyd "An Examination of Tax Reporting Recommendations of Professional Tax Preparers" (1988) 9 *Journal of Economic Psychology* 427; Michael L Roberts "Tax Accountants' Judgment/Decision-Making Research: A Review and Synthesis" (1998) 20 *Journal of the American Taxation Association* 78; William E Shafer and Richard S Simmons "Social responsibility, Machiavellianism and tax avoidance: A study of Hong Kong tax professionals" (2008) 21 *Accounting, Auditing & Accountability Journal* 695; and Braithwaite, above n 7.

¹¹ Cruz, Shafer and Strawser, above n 4; and Milliron, above n 4.

¹² Young-dahl Song and Tinsley E Yarbrough "Tax Ethics and Taxpayer Attitudes: A Survey" (1978) 38 *Public Administration Review* 442.

¹³ Steven Klepper and Daniel Nagin "The Criminal Deterrence Literature: Implications for Research on Taxpayer Compliance" in Jeffrey A Roth and John T Scholz (eds) *Taxpayer Compliance: A Social Science Perspective* (University of Pennsylvania Press, Philadelphia, 1989).

much larger problem than outright evasion.¹⁴ For these reasons, tax authorities are wary of aggressive advice provided by practitioners to their clients. As such, considerable enforcement resources are utilised by tax authorities to prevent an abusive expansion of questionable interpretation.¹⁵ Indeed, in 2009-10, the New Zealand Inland Revenue utilised about 1,075,000 hours in tax audits. Out of \$2,866 million in audit discrepancies,¹⁶ \$156 million related to aggressive tax issues.¹⁷ Aggressive tax advice therefore can be a threat to the sustainability of the tax system as the Government loses the tax revenue from undetected, blatant, creative tax schemes.

In addition, the knowledge that tax practitioners can reduce taxes for those who can afford their services may adversely affect the tax commitment of other taxpayers who cannot afford to pay for such services. Prior literature suggests that taxpayers' compliance behaviour may be influenced by their beliefs about the actions of other taxpayers, such as high-income taxpayers and corporations, who are perceived as not paying their fair share of taxes.¹⁸

Even if practitioners are to provide aggressive advice where the tax law is unclear, will taxpayers subscribe to it? Taxpayers may seek the advice of practitioners, but in the eyes of the law, they (and not the practitioners) bear the full responsibility of paying the correct amount of tax. Accordingly, when practitioners provide feedback on their recommendations, taxpayers will have to make a tax reporting decision as to whether to agree or disagree with them. Drawn from the tax compliance literature, this study sets out to examine the willingness of taxpayers to subscribe to practitioners' aggressive advice and the factors that could potentially influence their decisions. The factors explored in this study are: personal risk propensity, sanction risk perceptions, expectation of aggressive advice, personal tax ethics and business tax ethics. Accordingly, five hypotheses are developed and they are discussed below.

2.2 Personal Risk Propensity

The tax treatment of certain income and expenses is not always clear cut, and taxpayers who are confronted with such uncertainties will have to make a choice as to whether or not to accept their practitioner's advice. Decisions they make could be characterised as risky when they are faced with a high uncertainty "about whether potentially significant and/or disappointing outcomes of decisions will be realised".¹⁹ The decision-making behaviour literature identified risk propensity as having an impact

¹⁴ Valerie Braithwaite and John Braithwaite "An Evolving Compliance Model for Tax Enforcement" in Neal Shover and John Paul Wright *Crimes of Privilege: Readings in White-Collar Crime* (Oxford University Press, New York, 2001) 411; Doreen J McBarnet and Christopher J Whelan *Creative Accounting and the Cross-eyed Javelin Thrower* (Wiley, Chichester, 1999); and Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).

¹⁵ Jeffrey A Roth, John T Scholz and Ann Dryden Witte *Taxpayer Compliance* (University of Pennsylvania Press, Philadelphia, 1989) vol I.

¹⁶ Audit discrepancies refer to the difference between the tax ascertained as a result of audit activity and that previously returned or ascertained by the taxpayer, plus penalties and interest: *Inland Revenue Annual Report 2006* (B-23, Wellington, 2006) at 20.

¹⁷ *Inland Revenue Annual Report 2010* (B-23, Wellington, 2010) at 35.

¹⁸ High-wealth individuals, no doubt, are another group of taxpayers perceived by the public as not paying their share of tax; see Valerie Braithwaite, Monika Reinhart, Malcolm Mearns and Rachelle Graham "Preliminary Findings from the Community Hopes, Fears and Actions Survey" (Working Paper No 3, Centre for Tax System Integrity, Australian National University and Australian Taxation Office, 2001); Betty R Jackson and Valerie C Milliron "Tax Compliance Research: Findings, Problems, and Prospects" (1986) 5 *Journal of Accounting Literature* 125; and Roth, Scholz and Witte, above n 15.

¹⁹ Sim B Sitkin and Amy L Pablo "Reconceptualizing the Determinants of Risk Behavior" (1992) 17 *Academy of Management Review* 10.

on decision makers' behaviour.²⁰ Risk propensity refers to an individual's tendency, on average, to take or avoid risks. While there is some evidence that willingness to take risks is situationally determined (see, for example, the prospect theory), risk propensity is also seen as a personality trait. The psychological and criminological literature shows that there are people with a high and people with a low risk propensity.²¹ Compared to those with a propensity to avoid risks (risk averters), those who are willing to take risks (risk takers or risk seekers) are more likely to construe a relatively risky situation as one of low risk, and thus have a higher tendency to take risks.²²

The decision makers that fall under the category of business taxpayers would have experienced different types of risks. That said, individual differences in willingness to take risks are still likely to exist. For instance, some taxpayers may claim an expense only when they are very certain that the expense is deductible. This group may be considered as taxpayers with a low risk propensity, that is, they are risk averters. On the other hand, there may be taxpayers who do not require a very high level of certainty that an expense is deductible. This group of taxpayers have the characteristics of risk takers. Risk propensity is therefore a relevant factor that could affect willingness to accept practitioners' aggressive advice. In Tan's²³ study, which showed that taxpayers accepted whatever advice their practitioners gave, she did not consider the possible impact of individual taxpayers' risk propensity. Several studies suggest that risk propensity varies among taxpayers.²⁴ Accordingly, it was hypothesised that when practitioners offer aggressive advice, it is likely that those business taxpayers who are risk takers will be more willing to accept aggressive advice than will those who are risk averters. The hypothesis is stated as:

- H1: Taxpayers with a higher risk propensity will agree more with their practitioners' aggressive advice on an ambiguous tax situation than will those with a lower risk propensity.

2.3 Sanction Risk Perceptions

The effects of audit probability as compared to severity of penalty have consistently been shown to affect taxpaying behaviour.²⁵ These results support the economic model, in which the assumption is

²⁰ See Sim B Sitkin and Laurie R Weingart "Determinants of Risky Decision-making Behavior: A Test of the Mediating Role of Risk Perceptions and Propensity" (1995) 38 *Academy of Management Journal* 1573; and *ibid*.

²¹ See Sitkin and Pablo, above n 19.

²² Kin Fai Ellick Wong "The Role of Risk in Making Decisions under Escalation Situations" (2005) 54 *Applied Psychology: An International Review* 584.

²³ Lin Mei Tan "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20 *Journal of Economic Psychology* 431; and Lin Mei Tan and Adrian Sawyer "A Synopsis of Taxpayer Compliance Studies: Overseas vis-à-vis New Zealand" (2003) 9 *New Zealand Journal of Taxation Law and Policy* 431.

²⁴ Otto H Chang, Donald R Nichols and Joseph J Schultz "Taxpayer Attitudes Toward Tax Audit Risk" (1987) 8 *Journal of Economic Psychology* 299; Julie H Collins, Valerie C Milliron and Daniel R Toy "Factors Associated with Household Demand for Tax Preparers" (1990) 12 *Journal of the American Taxation Association* 9; Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45 *Nat'l Tax J* 389; and Yuka Sakurai and Valerie Braithwaite "Taxpayers' Perceptions of the Ideal Tax Adviser: Playing Safe or Saving Dollars?" (Working Paper No 5, Centre for Tax System Integrity, Australian National University, Canberra, 2001).

²⁵ See for example Ana de Juan, Miguel A Lasheras and Rafaela Mayo "Voluntary Tax Compliant Behavior of Spanish Income Tax Payers" (1994) 49 *Public Finance* 90; Karyl A Kinsey and Harold G Grasmick "Did the Tax Reform Act of 1986 Improve Compliance? Three Studies of Pre- and Post-TRA Compliance Attitudes" (1993) 15 *Law & Policy* 293; Steven Klepper and Daniel Nagin "The Role of Tax Preparers in Tax Compliance" (1989a) 22 *Policy Sciences* 167; R Mason and LD Calvin "A Study of Admitted Income Tax Evasion" (1978) 13 *Law and Society Review* 73; Richard D Schwartz and Sonya Orleans "On Legal Sanctions" (1967) 34 *University of Chicago Law Review* 274; and P Webley and S Halstead "Tax

that taxpayers are self-interested, and generally engage in tax evasion if it pays.²⁶ Studies have indicated that the probability of detection is the most significant factor to affect tax positions adopted on contentious tax issues, and tax evasion.²⁷ However, many researchers have argued that it is the perceived likelihood of detection rather than the actual probability of detection that has an impact on compliance behaviour.²⁸ Taxpayers' compliance is likely to be higher when they perceive a high probability of being caught and suffering severe consequences.²⁹ These views are in accord with the perceptual deterrence literature, which has shown that people differ in how likely they think it is that negative sanctions will impact on them in both economic and social domains.³⁰ Risk perception refers to a decision maker's assessment of the risk inherent in a situation, that is, how risky a situation is in terms of probability estimates of the degree of situational uncertainty.³¹ Those who perceive a situation as one in which the likelihood of detection and sanctioning is high tend to be more risk averse, and those who perceive a situation as one in which the likelihood is low tend to be more risk seeking.

Drawing from both of these literatures, taxpayers who are faced with a decision as to whether to agree or disagree with their practitioners' aggressive advice when the tax law is ambiguous may also be influenced by their own assessment of sanction risk, that is, the certainty and severity of punishment.³² This effect would operate above and beyond the overall risk-taking propensity discussed in the previous section. It is a situational measure of risk taking when an ambiguous tax issue is involved.³³ The following research hypothesis tests the effects of sanction risk perceptions as follows:

Evasion on the Micro: Significant Simulations or Expedient Experiments?" (1986) 1 *Journal of Interdisciplinary Economics* 87.

- ²⁶ See Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).
- ²⁷ See Silvia A Madeo, Albert Schepanski and Wilfred C Uecker "Modelling Judgments of Taxpayer Compliance" (1987) 62 *Accounting Review* 323; Paul Webley, Henry Robben, Henk Elffers and Dick Hessing *Tax evasion: An experimental approach* (Cambridge University Press, New York, 1991); and Steven E Kaplan, Philip MJ Reckers, Stephen G West and James C Boyd "An Examination of Tax Reporting Recommendations of Professional Tax Preparers" (1988) 9 *Journal of Economic Psychology* 427.
- ²⁸ See Anne L Christensen and Peggy A Hite "A Study of the Effect of Taxpayer Risk Perceptions on Ambiguous Compliance Decisions" (1997) 19 *Journal of the American Taxation Association* 1; Valerie Braithwaite, Monika Reinhart, Malcolm Mearns and Rachele Graham "Preliminary Findings from the Community Hopes, Fears and Actions Survey" (Working Paper No 3, Centre for Tax System Integrity, Australian National University and Australian Taxation Office, 2001); Betty R Jackson and Valerie C Milliron "Tax Compliance Research: Findings, Problems, and Prospects" (1986) 5 *Journal of Accounting Literature* 125; and Mason and Calvin, above n 25.
- ²⁹ Harold G Grasmick and George J Bryjak "The Deterrent Effect of Perceived Severity of Punishment" (1980) 59 *Social Forces* 471; Alan Lewis *The Psychology of Taxation* (Martin Robertson, Oxford, 1982); Maryann Richardson and Adrian Sawyer "A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects" (2001) 16 *ATF* 137; de Juan, Lasheris and Mayo, above n 25; Steven Klepper and Daniel Nagin "The Criminal Deterrence Literature: Implications for Research on Taxpayer Compliance" in Jeffrey A Roth and John T Scholz (eds) *Taxpayer Compliance: A Social Science Perspective* (University of Pennsylvania Press, Philadelphia, 1989); and Schwartz and Orleans, above n 25.
- ³⁰ Daniel S Nagin "Deterrence and Incapacitation" in Michael Tonry (ed) *The Handbook of Crime and Punishment* (Oxford University Press, New York, 2000) 345; and Tomasz Zaleskiewicz "Beyond Risk Seeking and Risk Aversion: Personality and the Dual Nature of Economic Risk Taking" (2001) 15 *European Journal of Personality* 105.
- ³¹ Sim B Sitkin and Laurie R Weingart "Determinants of Risky Decision-making Behavior: A Test of the Mediating Role of Risk Perceptions and Propensity" (1995) 38 *Academy of Management Journal* 1573.
- ³² See Nagin, above n 30.
- ³³ Christensen and Hite, above n 28.

- H2: Taxpayers with low sanction risk perceptions (perceived probability of detection and of severe tax penalties) will agree more with their practitioners' aggressive advice on an ambiguous tax situation than will those with high sanction risk perceptions.

2.4 Expectation of Aggressive Advice

Taxpayers have various expectations of their tax practitioners when they decide to resort to them for help with their tax affairs. An expectation is "an anticipation of future consequences",³⁴ and the content of these expectations may include preferences with respect to specific acts.³⁵ Studies have shown that taxpayers' preference for type of advice might influence their agreement with their practitioners' advice, and the literature indicates that taxpayers' preference for type of advice varies. Some taxpayers prefer conservative advice while others prefer aggressive advice.³⁶ However, in some studies no attempt has been made to examine whether or not taxpayers' preferences are dependent on the ambiguity of tax law. The literature which indicates that taxpayers' preference is to be on the safe side of the law³⁷ suggests that if the tax law is clear, taxpayers would prefer conservative advice; whereas if the tax law is ambiguous, they might prefer aggressive advice.

Therefore, drawing from the findings on taxpayers' preference for type of advice, together with practitioners' responses to tax law ambiguity, it was hypothesised that those who expect aggressive advice, where the tax law is ambiguous, will be more likely to agree with practitioners' recommended aggressive advice. The third hypothesis is stated as follows:

- H3: In an ambiguous tax situation, expectations of aggressive advice will be positively associated with taxpayers' agreement with practitioners' aggressive advice.

2.5 Personal and Business Tax Ethics

As a person's behavioural intentions to comply or not comply with tax law are posited to depend on the norm,³⁸ this factor has received considerable attention in tax research.³⁹ Personal norms or tax ethics

³⁴ Rajiv Grover and Marco Vriens *The Handbook of Marketing Research: Uses, Misuses, and Future Advances* (Sage Publications, Thousand Oaks, 2006) at 576.

³⁵ Robert L Kahn, Donald M Wolfe, Robert P Quinn and J Diedrich Snoek *Organizational Stress: Studies in Role Conflict and Ambiguity* (John Wiley & Sons Inc, New York, 1964) at 14.

³⁶ See, for example, Philomena Leung and Barry J Cooper "Accountants, Ethical Issues and the Corporate Governance Context" (2005) 15 *Australian Accounting Review* 79; CT Sandford and PN Dean "Accountants and the Tax System" (1972) *Winter Accounting and Business Research* 3; Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) *XLV Nat'l Tax J* 389; Lin Mei Tan "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20 *Journal of Economic Psychology* 431; and Lin Mei Tan and Adrian Sawyer "A Synopsis of Taxpayer Compliance Studies: Overseas vis-à-vis New Zealand" (2003) 9 *New Zealand Journal of Taxation Law and Policy* 431.

³⁷ See, for example, Yuka Sakurai and Valerie Braithwaite "Taxpayers' Perceptions of the Ideal Tax Adviser: Playing Safe or Saving Dollars?" (Working Paper No 5, Centre for Tax System Integrity, Australian National University, Canberra, 2001).

³⁸ Icek Ajzen "The Theory of Planned Behavior" (1991) 50 *Organizational Behavior and Human Decision Processes* 179; and Martin Fishbein and Icek Ajzen *Belief, Attitude, Intention, and Behavior: An Introduction to Theory and Research* (Addison-Wesley, Reading, 1975).

³⁹ Philip MJ Reckers, Debra L Sanders and Stephen J Roark "The Influence of Ethical Attitudes on Taxpayer Compliance" (1994) 47 *Nat'l Tax J* 825; Benno Torgler and Kristina Murphy "Tax Morale in Australia: What Shapes It and Has It Changed Over Time?" (2004) 7 *Journal of Australian Taxation* 298; Michael Wenzel "Misconceptions of Social Norms About Tax Compliance: From Theory to Intervention" (2005) 26 *Journal of Economic Psychology* 862; and Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).

refer to "privately held ethical and moral convictions"⁴⁰ and have been identified as an important determinant of taxpaying behaviour.⁴¹ Studies have also shown that taxpayer ethics play a mediating role between compliance variables such as opportunity, probability of detection,⁴² tax rate, taxpayer's withholding status,⁴³ and probability and severity of consequences.⁴⁴

A social norm represents "a pattern of behavior that is judged in a similar way by others and that is sustained in part by social approval or disapproval".⁴⁵ As pointed out by Spicer and Lundstedt,⁴⁶ human behaviour in the area of taxation can be affected by internalised norms of role expectations and these norms may be affected by the behaviour of an individual's reference groups (such as friends, relatives and work associates). Consequently, if taxpayers know that many people in groups important to them evade taxes, then their commitment to the social norm of tax compliance will be weaker.⁴⁷ Although some studies have shown that social norms indeed play a role in shaping taxpayers' behaviour,⁴⁸ their relevance appears less clear, at least compared to the effects of personal norms on tax compliance.⁴⁹ For instance, taxpayers who view tax evasion as immoral (personal norms) may not necessarily evade tax even if others do (social norms). The explanation for this behaviour offered by Wenzel⁵⁰ is that social norms can be effective only when taxpayers identify with the group to whom the norms are attributed. This reasoning perhaps explains why some taxpayers are affected by social norms,⁵¹ while others adhere to their own tax ethics.⁵²

The literature on the effect of taxpayers' personal and social norms on taxpayers' compliance behaviour suggests that these norms could also play a part in business taxpayers' reporting decisions. That is, the extent to which business taxpayers are willing to accept aggressive advice from practitioners could be influenced by their own personal norms (termed here as personal tax ethics). In

- ⁴⁰ Michael Wenzel "An Analysis of Norm Processes in Tax Compliance" (2004) 25 *Journal of Economic Psychology* 214.
- ⁴¹ James Alm, Isabel Sanchez and Ana de Juan "Economic and Noneconomic Factors in Tax Compliance" (1995) 48 *Kyklos* 3; and *ibid.*
- ⁴² Kent W Smith "Integrating Three Perspectives on Noncompliance: A Sequential Decision Model" (1990) 17 *Criminal Justice and Behavior* 350; and Michael Wenzel "The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers' Identity" (2002) 87 *Journal of Applied Psychology* 629.
- ⁴³ Philip MJ Reckers, Debra L Sanders and Stephen J Roark "The Influence of Ethical Attitudes on Taxpayer Compliance" (1994) 47 *Nat'l Tax J* 825.
- ⁴⁴ Wenzel, above n 42.
- ⁴⁵ Alm, Sanchez and de Juan, above n 41, at 6.
- ⁴⁶ Michael W Spicer and Soren B Lundstedt "Understanding Tax Evasion" (1976) 31 *Public Finance* 295.
- ⁴⁷ Alm, Sanchez and de Juan, above n 41.
- ⁴⁸ Alm, Sanchez and de Juan, above n 41; and Wenzel, above n 42.
- ⁴⁹ Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007); and Wenzel, above n 42.
- ⁵⁰ See n 42.
- ⁵¹ Joachim Vogel "Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey Data" (1974) 27 *Nat'l Tax J* 499.
- ⁵² Valerie Braithwaite *The Community Hopes, Fears and Actions Survey: Goals and Measures* (Centre for Tax System Integrity, Research School of Social Sciences, The Australian National University, Canberra, 2001); Harold G Grasmick and Robert J Bursik Jr "Conscience, Significant Others, and Rational Choice: Extending the Deterrence Model" (1990) 24 *Law & Society Review* 837; and Philip MJ Reckers, Debra L Sanders and Stephen J Roark "The Influence of Ethical Attitudes on Taxpayer Compliance" (1994) 47 *Nat'l Tax J* 825.

In addition, they could also be influenced by their perceptions of other businesses' social norms (termed here as business tax ethics). Accordingly, the following hypotheses posit that:

- H4: In an ambiguous tax situation, personal tax ethics will influence taxpayers' agreement with practitioners' aggressive advice.
- H5: In an ambiguous tax situation, perceived business tax ethics will influence taxpayers' agreement with practitioners' aggressive advice.

2.6 Control Variables

2.6.1 Taxpayers' firm size

One factor that has a marked influence on the taxpaying of business taxpayers is firm size. In particular, small businesses have been identified as major contributors to the United States income tax gap.⁵³ To some extent, such findings imply that small businesses are more aggressive than large corporations, but other studies call into question this inference. This aggressive characteristic of small businesses in some ways appears inconsistent with results from studies indicating that a small business organisation's (SBO's) most important aim is to file an accurate tax return.⁵⁴ Other researchers⁵⁵ adopt the view that creative compliance is more pervasive in large corporate practice. Tax practitioners also indicated that, compared to small clients, large clients expected them to be more aggressive.⁵⁶ Possibly, evasion is the method of reducing tax that is more commonly identified in small businesses, especially those involved in the cash economy.⁵⁷ Large businesses are more likely to use avoidance measures effectively to reduce their tax.

Apart from these inconsistent findings, there are very few research studies focusing on the effect of firm size on agreement with practitioners' advice. Tan's⁵⁸ sample consisted of mainly small businesses and her results suggest that small businesses tend to have a preference for conservative rather than aggressive advice. Hite et al's⁵⁹ findings showed that a huge majority of SBOs were risk averse as they would claim a deduction only if they were 70 per cent certain that it would be allowed. Although this study points towards the conservativeness of small firms, no comparisons could be made with large

⁵³ Joel Slemrod "Small Business and the Tax System" in Henry J Aaron and Joel Slemrod (eds) *Crisis in Tax Administration* (Brookings Institution Press, Washington DC, 2004) 69; and Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45 *Nat'l Tax J* 389.

⁵⁴ Roman Tomasic and Brendan Pentony "Taxation Law Compliance and the Role of Professional Tax Advisers" (1991) 24 *Australian & New Zealand Journal of Criminology* 241; Julie H Collins, Valerie C Milliron and Daniel R Toy "Factors Associated with Household Demand for Tax Preparers" (1990) 12 *Journal of the American Taxation Association* 9; and Hite and McGill, *ibid*.

⁵⁵ For example, Doreen McBarnet "When Compliance is not the Solution but the Problem: From Changes in Law to Changes in Attitude" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing Ltd, Aldershot, 2003) ch 11.

⁵⁶ Tomasic and Pentony, above n 54.

⁵⁷ Susan Cleary Morse, Stewart Karlinsky and Joseph Bankman "Cash Businesses and Tax Evasion" (2009) 20 *Stan L & Pol'y Rev* 37.

⁵⁸ Lin Mei Tan "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20 *Journal of Economic Psychology* 431; and Lin Mei Tan and Adrian Sawyer "A Synopsis of Taxpayer Compliance Studies: Overseas vis-à-vis New Zealand" (2003) 9 *New Zealand Journal of Taxation Law and Policy* 431.

⁵⁹ Peggy A Hite, Toby Stock and C Bryan Cloyd "Reasons for Preparer Usage by Small Business Owners: How Compliant are They?" (1992) 37(2) *The National Public Accountant* 20.

firms as they were not included in the study sample. It is interesting that a recent study by Ahmed and Braithwaite⁶⁰ showed that small businesses prefer a tax practitioner who is creative and knowledgeable about aggressive tax planning, and that small businesses admit a greater tax evasion than those employed in the nonprofit sector. Taking into consideration the literature on the potential relation between size of business and decision making, firm size was used as a control variable in this study.

2.6.2 Taxpayers' audit experience

It has been further suggested in the literature on decision making that decision makers' experience or familiarity with a situation can have an impact on their subsequent behaviour.⁶¹ In a tax context, it is possible that taxpayers' audit experiences may have an effect on their tax decisions. However, taxpayers who have been audited before could experience either a negative (sanctions imposed) or a positive (no sanctions imposed) outcome. As Tittle⁶² suggested, the type of outcome experienced before could affect future tax compliance behaviour. A positive (or negative) audit experience may encourage (or discourage) future tax compliance. For instance, strategic tax evaders exposed to tax audits may learn to develop more effective noncompliance strategies.⁶³ As a result, they might be more willing to undertake risks that less experienced individuals would usually avoid. Other researchers have argued that taxpayers who have been audited before might not necessarily react in this manner.⁶⁴ It is possible that taxpayers whose audits failed to detect noncompliance may conclude that they may not be so lucky next time.⁶⁵ Drawing on this literature, those who are deciding on whether or not to accept their practitioner's aggressive advice may also reflect on their audit experience. Therefore, audit experience was used as a control variable in this study.

3.0 RESEARCH DESIGN

3.1 Sample

A self-administered mail survey was used to elicit the perceptions and attitudes of a nationwide random sample of 1,400 New Zealand business taxpayers obtained from the New Zealand Yellow Pages™ business search service. Since a huge majority (96 per cent) of businesses in New Zealand are small and medium enterprises (SMEs), another 100 companies were randomly selected from the New Zealand Exchange Market (NZX) to represent larger enterprises.

Of the 1,500 questionnaires⁶⁶ sent out, 262 respondents returned completed questionnaires, and 204 were identified as out of frame (that is, no longer in business, or not known at the address, or for other reasons). This gave an effective sample size of 1,296, with a response rate of 20 per cent. The response

⁶⁰ Eliza Ahmed and Valerie Braithwaite "Understanding Small Business Taxpayers: Issues of Deterrence, Tax Morale, Fairness and Work Practice" (2005) 23 *International Small Business Journal* 539.

⁶¹ Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).

⁶² Charles R. Tittle *Sanctions and Social Deviance: The Question of Deterrence* (Praeger, New York, 1980).

⁶³ Brian Erard "The Influence of Tax Audits on Reporting Behaviour" in Joel Slemrod (ed) *Why People Pay Taxes: Tax Compliance and Enforcement* (University of Michigan Press, Ann Arbor, 1992) 95.

⁶⁴ James Andreoni, Brian Erard and Jonathan Feinstein "Tax Compliance" (1998) 36 *Journal of Economic Literature* 818.

⁶⁵ Steven Klepper and Daniel Nagin "Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution" (1989a) 23 *Law and Society Review* 131.

⁶⁶ Copies of the questionnaire can be obtained from the first author upon request. Some data collected in this questionnaire was used for other studies.

rate, although not high, is comparable to many other tax surveys carried out in Australia and New Zealand.

The majority of the business taxpayers were from firms that employed not more than 20 full-time employees. About 70 per cent of taxpayers were from SMEs (fewer than 20 employees). As firm size was used as a control variable, the firms were dichotomised in accordance with the national statistics classification of SME-sized enterprises. Those with fewer than 20 employees were coded as 1 to represent SME and those with 20 or more employees were coded as 2 to represent large firms. Accordingly, the SMEs comprised 70 per cent (n=181) and the large businesses comprised 30 per cent (n=81) of the sample. The majority of the respondents (63 per cent) were either company directors or owners/managers of the firm. Overall, the questionnaires were completed by either the owner of the business or the person who made or helped to make tax decisions for the business organisations. Furthermore, about two-thirds of the respondents' firms employed a local or regional Chartered Accountant (CA) firm to help them with their tax work and about 29 per cent (most likely the large firms) used a Big 4 CA firm. There was variation in the sample in terms of experience with Inland Revenue audit. Slightly more than half (54 per cent) of the respondents' firms had been audited at least once by Inland Revenue. As this is a control variable, the results were dichotomised so that 1 represented those who had not been audited before (46 per cent), and 2 represented those who had been audited (54 per cent).

3.2 Research Measures

3.2.1 Agreement with aggressive advice

Interpretations of 'aggressiveness' offered by researchers⁶⁷ tend to reflect a consideration of the tax authorities' stance on the position taken, for example, whether there is a reasonable probability that a claim made will be upheld by the tax authorities, or whether it will be easily defended upon a tax audit. It also means that a pro-taxpayers' position is taken on a questionable item. To overcome the different interpretations of aggressiveness used in various studies, Carnes, Harwood and Sawyers⁶⁸ define aggressiveness in a relative fashion, that is, those "being more likely than other tax professionals to take pro-taxpayer positions for the same situation" are more aggressive. In this study, the meaning of aggressive which has been adopted is "taking a pro-taxpayer position on a questionable item" where that position is not justified clearly by the facts and relevant professional literature.⁶⁹

Although legal ambiguity is an important factor in tax reporting decisions, it is not feasible to consider all types of ambiguous tax issues in one questionnaire. As a result, two generic hypothetical scenarios, one concerning deductions and the other concerning classification of income, were provided to examine taxpayers' tax reporting decisions. The scenarios were used as an indirect measure of taxpayers' tendency toward aggressive tax reporting decisions.

The first scenario that involved an ambiguous area in tax deduction was stated as follows:

⁶⁷ Such as Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45 *Nat'l Tax J* 389, and Dan L Schisler "An Experimental Examination of Tax Preparers' Aggressiveness - A Prospect Theory Approach" (1994) 16 *Journal of the American Taxation Association* 124.

⁶⁸ G Carnes, G Harwood and R Sawyers "The Determinants of Tax Professionals' Aggressiveness in Ambiguous Situations" (1996) 8 *Advances in Taxation* 1.

⁶⁹ Andrew D Cuccia, Karl Hackenbrack and Mark W Nelson "The Ability of Professional Standards to Mitigate Aggressive Reporting" (1995) 70 *Accounting Review* 227; and Hite and McGill, above n 67.

Say your firm has incurred an expense of a **considerable** sum and you seek your tax practitioner's advice as to whether the expense is deductible. Your practitioner tells you that the tax law relating to this expense is **rather ambiguous** but thinks that it should be deductible. However, if the deduction is challenged by the IRD, your practitioner tells you that there is a 50% chance that it may not be upheld by the court in your favour. If your practitioner advises you **to claim** the deduction in your firm's tax return, will you agree with his/her advice?

The second scenario mirrored that of the first scenario but it involved an ambiguous area in the classification of income. These two scenarios were adapted from Braithwaite,⁷⁰ Christensen and Hite,⁷¹ Hite and McGill,⁷² and Tan.⁷³ The chance that it will not be upheld by the court was stated as 50 per cent to depict an element of uncertainty. Since both scenarios are ambiguous and the practitioner's advice is pro-taxpayers, the advice given is considered of the aggressive type.

The amount under consideration could also have an impact on taxpayers' tax reporting decisions. When amounts are trivial, taxpayers may not be too concerned about the consequences of their decisions. However, if the amount is considerable, other factors may come to bear on the taxpayers' decisions as they are likely to consider more carefully the consequences. In both scenarios above, therefore, it was stated that the amount of expense and income is considerable.

A rating scale from 1 = "definitely no" to 5 = "definitely yes" was used to measure the extent of taxpayers' agreement with their practitioner's aggressive advice. Their agreement or disagreement with their practitioner's advice in the hypothetical scenarios represented the dependent variable.

Table 1: Descriptive Statistics (Means, Standard Deviations (SD)) for the Business Taxpayer Variables

Business taxpayer variables	Mean	SD
Agreement with aggressive advice		
– on ambiguous deduction item	3.48	1.02
– on ambiguous income item	3.52	0.94

⁷⁰ Valerie Braithwaite *The Community Hopes, Fears and Actions Survey: Goals and Measures* (Centre for Tax System Integrity, Research School of Social Sciences, The Australian National University, Canberra, 2001); Harold G Grasmick and Robert J Bursik Jr "Conscience, Significant Others, and Rational Choice: Extending the Deterrence Model" (1990) 24 *Law & Society Review* 837; and Philip MJ Reckers, Debra L Sanders and Stephen J Roark "The Influence of Ethical Attitudes on Taxpayer Compliance" (1994) 47 *Nat'l Tax J* 825.

⁷¹ See Anne L Christensen and Peggy A Hite "A Study of the Effect of Taxpayer Risk Perceptions on Ambiguous Compliance Decisions" (1997) 19 *Journal of the American Taxation Association* 1; Valerie Braithwaite, Monika Reinhart, Malcolm Mearns and Rachelle Graham "Preliminary Findings from the Community Hopes, Fears and Actions Survey" (Working Paper No 3, Centre for Tax System Integrity, Australian National University and Australian Taxation Office, 2001); Betty R Jackson and Valerie C Milliron "Tax Compliance Research: Findings, Problems, and Prospects" (1986) 5 *Journal of Accounting Literature* 125; and R Mason and LD Calvin "A Study of Admitted Income Tax Evasion" (1978) 13 *Law and Society Review* 73.

⁷² Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45 *Nat'l Tax J* 389; Yuka Sakurai and Valerie Braithwaite "Taxpayers' Perceptions of the Ideal Tax Adviser: Playing Safe or Saving Dollars?" (Working Paper No 5, Centre for Tax System Integrity, Australian National University, Canberra, 2001); Lin Mei Tan "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20 *Journal of Economic Psychology* 431; and Lin Mei Tan and Adrian Sawyer "A Synopsis of Taxpayer Compliance Studies: Overseas vis-à-vis New Zealand" (2003) 9 *New Zealand Journal of Taxation Law and Policy* 431.

⁷³ See Tan, *ibid*, and Tan and Sawyer, *ibid*.

Sanction risk perceptions		
– chance of audit	55	26
– chance of penalty	52	29
Personal risk propensity		
– immaterial amount	63	23
– material amount	69	22
Expectation of aggressive advice	3.75	0.79
Personal tax ethics	4.26	0.72
Business tax ethics		
– inflate expenditure	2.48	.72
– understate income	2.37	.71
– manipulate accounts payable	2.26	.71
– manipulate accounts receivable	2.23	.72
– manipulate inventory figures	2.44	.75
– claim private expenses as business	2.69	.85
– claim capital expenditure as revenue	2.53	.76
– manipulate work in progress	2.49	.75

As displayed in Table 1, the mean scores show a greater tendency to agree than disagree with practitioners, with both means above the midpoint. There appears to be a higher agreement with practitioners' aggressive income advice than with their deduction recommendation. However, the result of a paired samples *t* test shows that there was no significant difference in taxpayers' responses to the deduction and income situation ($t = -0.851, p = .396$, 2-tailed).

About 21 per cent ($n = 55$) of the respondents indicated that they had experienced such a deduction situation and about 15 per cent ($n = 40$) of the respondents had experienced such an income situation. Given that the scenarios were hypothetical and were deliberately stripped of specificity, these percentages were interpreted as satisfactory for concluding that the scenarios were sufficiently realistic as to be credible to the respondents.

The association between the deduction situation and the income situation, as indicated by the Pearson correlation coefficient, was strongly significant and positive ($r = .67, p < .001$). Accordingly, the responses to the two scenarios were summed and averaged to produce a single scale representing agreement with aggressive advice ($M = 3.56; SD = .856; \alpha = 0.797$).

3.2.2 Personal risk propensity

Risk propensity is a person's general tendency to take or avoid risk or the likelihood that he or she will engage in a particular activity. This concept (adapted from Hite et al's study⁷⁴) was measured by asking taxpayers the following question:

Say your firm has incurred an expense of \$300, and the tax law on the deductibility of this expense is rather ambiguous. How certain will you have to be (on a scale of 0% to 100%) that the IRD will allow the deduction before you will make a claim?

A similar question was asked but the amount indicated was increased from \$300 to \$3,000 to provide an indication of the extent of risk they were willing to take. The two different amounts used were to test whether materiality had any impact on their decisions.

Percentage scores were averaged and a standard deviation was calculated. The mean scores for the immaterial and material amounts were 63 and 69 (on a 1 to 100 per cent scale) respectively, with standard deviations of 23 and 22. These statistics are comparable to the findings of Hite et al,⁷⁵ which showed that small business taxpayers required 70 per cent certainty before they would claim a deduction. About 57 per cent of the respondents indicated that they needed to be more than 50 per cent certain before they would make the \$300 claim. As a higher percentage of certainty denotes a lower level of risk propensity, this indicates that slightly less than a majority (43 per cent) of the respondents were the more risk-taking type. When the amount of expense was material, that is, \$3,000, about 66 per cent of the respondents indicated that they required more than a 50 per cent level of certainty before they would claim the expense as recommended by their practitioner. While the sum of money had some effect in the expected direction, it was not a major factor in taxpayers' calculations.

The bivariate Pearson correlation between the ratings for certainty for the \$300 and \$3000 expense claims showed a moderately strong positive relationship ($r = .56$; $p < .001$). Since the Cronbach's alpha is .72, the 2-item measures were considered reliable measures of propensity.

Accordingly, the taxpayers' responses to the two items were averaged to derive a single scale for risk propensity ($M = 65.6$; $SD = 20.1$).

3.2.3 Sanction risk perceptions

Perception of sanctioning risk was measured by using a hypothetical scenario and asking respondents two questions to assess audit probability and the likelihood of severe penalties:

Say your firm **claimed** an ambiguous deduction of a considerable sum following your practitioner's advice, what do you think are the chances (on a scale of 0% to 100%) that your firm (a) will be **audited** and (b) will face **severe penalties** if the amount is ruled as not deductible?

Table 2 shows that the mean score for audit and that for penalties were 55 ($SD = 26$) and 52 ($SD = 29$) respectively. Perceptions of audit risk and severe penalty risk were also positively correlated ($r = .47$; $p < .001$). Since the Cronbach's alpha is .70, the two items were combined through averaging scores, thereby producing a reliable measure of the perception of sanction risk ($M = 53.5$; $SD = 24.5$).

⁷⁴ See n 72.

⁷⁵ Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45 Nat'l Tax J 389; Yuka Sakurai and Valerie Braithwaite "Taxpayers' Perceptions of the Ideal Tax Adviser: Playing Safe or Saving Dollars?" (Working Paper No 5, Centre for Tax System Integrity, Australian National University, Canberra, 2001); Lin Mei Tan "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20 Journal of Economic Psychology 431; and Lin Mei Tan and Adrian Sawyer "A Synopsis of Taxpayer Compliance Studies: Overseas vis-à-vis New Zealand" (2003) 9 New Zealand Journal of Taxation Law and Policy 431.

It is interesting to note that about 44 per cent of the respondents perceived that there would be a more than 50 per cent chance of audit. About 39 per cent of the respondents perceived that there would be a more than 50 per cent chance of severe penalties being imposed. This indicates that there is a mixture of taxpayers who have high and low risk perceptions in this study.⁷⁶

3.2.4 *Expectation of aggressive advice*

As taxpayers may have different expectations of their practitioners, respondents were asked to indicate the extent of their agreement or disagreement on a 5-point Likert scale (1=strongly disagree to 5=strongly agree) to a list of 17 expectation statements relating to tax services.⁷⁷ The list of expectation statements was drawn up from a review of the literature and they are as follows:

- Help my firm file an accurate return;
- Help my firm minimise tax;
- Help my firm avoid serious penalties;
- Explain the tax law and regulations using words that I/we understand;
- Know many ways to save taxes;
- Be able to exploit tax loopholes to the advantage of my firm;
- Be creative in dealing with my firm's tax matters;
- Reduce uncertainties in tax matters that concern my firm;
- Be up-to-date with the latest changes in tax law;
- Save my firm considerable time in dealing with tax matters;
- Advise my firm not to take deductions that fall within any grey areas of the tax law;
- Be clear about the risks associated with the recommended advice;
- Provide my firm with conservative advice in areas where the tax law is not ambiguous;
- Provide my firm with aggressive advice in areas where the tax law is ambiguous;
- Promote any tax-effective schemes to my firm so that I/we don't have to pay too much tax;
- Assist my firm to make claims only when they are clearly legitimate;
- Just deal with my firm's tax matters with minimum fuss and without bothering us too much with it.

⁷⁶ For the above questions, personal risk propensity and sanction risk perceptions were focused on the deduction of expenses and not income. The reason for focusing only on deduction was to prevent the questionnaire from becoming too lengthy, which may discourage people from responding.

⁷⁷ The information collected was also used for another research paper on taxpayers' expectations of and experiences with their tax practitioners.

A factor analysis of the list of taxpayers' expectations of their practitioners showed that one of the dimensions of expectations related to aggressive advice.⁷⁸ The expectations were: exploit tax loopholes to my firm's advantage; creative in dealing with my firm's tax matters; provide my firm with aggressive advice in areas where the tax law is ambiguous; and promote any tax-effective schemes to me first so that we don't have to pay too much tax. This factor was therefore used as the measure for expectation of aggressive advice. The mean (SD) for this scale is 3.75 (.79) and the Cronbach alpha is .78, denoting the reliability of the 4-item scale.

3.2.5 Personal and business tax ethics

Because of concerns that some business taxpayers may want to present an artificially pro-social image of their personal ethics,⁷⁹ an attempt was made in this study to measure personal ethics by eliciting the information in a more indirect manner. The question asked was whether the taxpayers think that their firm should declare all taxable income in the tax return. This measure was adapted from Wenzel's⁸⁰ work and was used to test whether personal tax ethics had any influence on their agreement with practitioners' aggressive advice. The rating scale from 1="definitely no" to 5="definitely yes" was used to measure this norm.

As shown in Table 2, the mean was 4.26 and a huge majority (91 per cent) responded affirmatively. In comparison, Braithwaite et al's⁸¹ results showed that 72 per cent of taxpayers agreed that they should honestly declare their cash earnings. Hite et al⁸² had 75 per cent who indicated that they never knowingly failed to report income. This group of respondents therefore saw themselves as highly ethical although there is a possibility of socially desirable responding. It is possible that personal ethics have quite a narrow meaning among business taxpayers preferring to strictly follow the letter of the law.

Business tax ethics were measured by asking taxpayers their perceptions of what they thought other business firms would ask their practitioners to do to help them minimise taxes. An 8-item scale comprised the following: exaggerate deductible expenditure; underreport taxable income; manipulate accounts receivable; manipulate accounts payable; manipulate inventory figures; claim private expenses as business expenses; and claim capital expenses as revenue expenses; manipulate work in progress figures.

⁷⁸ The other two dimensions relate to technical proficiency and cautious advice with eigenvalues of 5.4 (alpha = 0.86) and 1.2 (alpha = 0.61) respectively. The eigenvalue and alpha for aggressiveness was 2.0 and 0.78 respectively. They all accounted for 57 per cent of the variance in the item set.

⁷⁹ Peggy A Hite, Toby Stock and C Bryan Cloyd "Reasons for Preparer Usage by Small Business Owners: How Compliant are They?" (1992) 37(2) *The National Public Accountant* 20.

⁸⁰ Kent W Smith "Integrating Three Perspectives on Noncompliance: A Sequential Decision Model" (1990) 17 *Criminal Justice and Behavior* 350; and Michael Wenzel "The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers' Identity" (2002) 87 *Journal of Applied Psychology* 629.

⁸¹ John Braithwaite, Yvonne Pittelkow and Robert Williams "Tax Compliance by the Very Wealthy: Red Flags of Risk" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing Ltd, Aldershot, 2003) ch 10.

⁸² See n 59.

Some of these items were adapted from Attwell and Sawyer.⁸³ The requests generally depict unethical or aggressive types of requests. The rating scale used for these measures of business tax ethics ranged from 1 = "never" to 4 = "frequently".

The results in Table 1 show that while all eight requests appeared to occur, the mean scores suggest that they were thought to be made occasionally but not frequently. A Cronbach's alpha of .90 was calculated for the eight types of requests, indicating consistency in the way that business taxpayers recognised them as opportunities to minimise taxes. Accordingly, the mean scores for the eight requests were averaged to derive a single scale for business tax ethics ($M = 2.45$, $SD = .57$).

As a particular practitioner will serve a range of clients, and competing firms may have other practitioners, it is important to examine the views of respondents regarding the kinds of requests likely to be accommodated. If they perceive that most practitioners would not help other firms with such requests, then they may conclude that a social norm of honesty or caution is operating. Tax practitioners may be seen as gatekeepers preventing tax abuses. To examine this further, taxpayers were asked whether they thought that the practitioners serving other firms would help them with any one of the eight requests to reduce tax. They were also asked whether they thought their own practitioners would do the same. The results show that taxpayers perceived that their practitioners were more unlikely to help them with those requests and their perception of the likelihood of assistance from other firms' practitioners was also low. Taxpayers appeared to perceive practitioners as having integrity to prevent abuse of the tax system. This insight of taxpayers that other tax practitioners would be like their own and not give in to their clients is interesting.

4.0 HYPOTHESES TESTING RESULTS

Relationships among the dependent variable (agreement with aggressive advice) and the five independent variables (personal risk propensity, sanction risk perceptions, expectation of aggressive advice, personal and business tax ethics) were examined by using the Pearson product-moment correlation coefficient. The results showed that risk perceptions and risk propensity had a negative relationship with agreement with aggressive advice ($r = -.305$ and $-.234$ respectively; $p < .001$), whereas expectation of aggressive advice had a positive relationship ($r = .162$; $p < .01$). Personal and business tax ethics had no significant relationship with agreement with aggressive advice. Based on the bivariate analyses, the first, second and third hypotheses are supported. The above bivariate analyses indicate whether or not the independent variables are related to agreement with aggressive advice individually. This analysis does not tell us the predictive power of the variables as a set or their importance relative to each other. To ascertain the best predictors of accepting aggressive advice, a multivariate regression analysis was conducted as it allows the examination of the effect of several independent variables on a dependent variable. The model is expressed as follows:

$$\text{Aggressive Advice} = \alpha_0 + \beta_1 \text{Size} + \beta_2 \text{Audit} + \beta_3 \text{Sanctionrisk} + \beta_4 \text{Personalrisk} + \beta_5 \text{Expectation} + \beta_6 \text{Personalethics} + \beta_7 \text{Businessethics} + \epsilon$$

Where:

Aggressive Advice = Agreement with aggressive advice

Size = Business size, which assumes a value of 1 for SMEs and 2 for large firms

⁸³ Rebecca Attwell and Adrian Sawyer "The Ethical Attitudes of New Zealand Tax Practitioners – Still 'Barely Passing'?" (2001) 7 New Zealand Journal of Taxation Law and Policy 111.

Audit	=	Audit experience, which assumes a value of 1 for those not audited and 2 for those who had been audited.
Sanctionrisk	=	Sanction risk perceptions (chance of audit and penalty)
Personrisk	=	Personal risk propensity,
Expectation	=	Expectation of aggressive advice
Personaethics	=	Personal tax ethics
Businessethics	=	Business tax ethics

A hierarchical multiple regression analysis with agreement with aggressive advice as the dependent variable was then performed.⁸⁴ When the control variables, that is, size of business and audit experience, were entered into the equation, the squared multiple correlation was statistically significant but accounted for only .8 per cent of the variance in agreement with aggressive advice. At the level of individual variables, neither size⁸⁵ nor audit experience had any significant impact on agreement with aggressive advice in this New Zealand sample. When the predictor variables were added to the equation, a change in R squared of 14 per cent was statistically significant with three variables making a significant contribution to explaining agreement with a practitioner's aggressive advice (see Table 2). Risk perception contributed most to the variance explained by the regression model. The higher the perceived risk of audit and sanctioning, the less likely business taxpayers were to accept the aggressive advice they were given. Also significant in contributing to explaining acceptance of a practitioner's aggressive advice was the taxpayers' risk propensity and aggressive advice expectation. Those who were risk takers rather than risk averse and those who expected aggressive advice were more likely to agree with a practitioner giving aggressive advice.⁸⁶ Hypotheses 1, 2 and 3 were therefore supported whereas hypotheses 4 and 5 were not.

Table 2: Results of a Multiple Regression Analysis Predicting Agreement with Aggressive Tax Practitioner Advice

Predictors	B	SE	β
Control variables			
Business size	.063	.128	.035
Audit experience	-.164	.121	-.096
Business taxpayer variables			
Business size	.043	.127	.024
Audit experience	-.081	.116	-.047

⁸⁴ It is of note that none of the tolerance statistics was below .2; therefore, multicollinearity in the data was not a concern; see Andy P Field *Discovering Statistics Using SPSS* (Sage, Los Angeles, 2005).

⁸⁵ When the control for firm size was used as a categorical variable (instead of dichotomous) and converted to a set of dummy variables, there was no change in the results.

⁸⁶ The model explained 15 per cent of the variance in accepting aggressive tax advice. The relatively low R^2 value suggests that other factors not considered in this study could have influenced taxpayers' reporting decisions.

Sanction risk perception	-.092	.023	-.256**
Personal risk propensity	-.072	.029	-.168*
Business tax ethics	-.109	.096	-.072
Personal tax ethics	.003	.080	.002
Expectation of aggressive advice	.181	.071	.166*
Constant	3.728	.214	

* $p < 0.05$ ** $p < 0.001$

β = standardised regression coefficients

5.0 DISCUSSION AND CONCLUSION

This article examines the extent to which taxpayers agree with practitioners' aggressive advice and what drives taxpayers to agree or disagree with such advice. When faced with uncertainty about an intended tax position proposed by their practitioner, risk attitudes, as shown in this study, were the main predictors of agreement with the practitioner's aggressive advice. That is, taxpayers' aggressive advice expectations, their risk propensity and perception of sanction risk were significant factors in predicting their decisions.

Sanction risk perception was the most important factor. Those who perceived less chance of being caught and penalised severely were more likely to accept aggressive advice. These results are generally consistent with those in the literature⁸⁷ suggesting that there are clients who not only use practitioners to help them comply with the law but also use practitioners as "gamesters" and "adversarialists". Where there is an element of uncertainty in tax law, the degree of exploitation boils down to how far the practitioner is willing to stretch them and how much sanction risk the taxpayers are willing to take. Those with a higher risk propensity were also more willing to accept aggressive advice than were those who were risk averse. This is a personal characteristic of taxpayers; different taxpayers have different risk levels and they shape taxpayers' willingness to accept aggressive advice. Aggressive advice expectation emerged as the other important factor, a finding that is consistent with the literature on taxpayers' preference for aggressive advice. Taxpayers generally would accept practitioners' aggressive advice if they have such expectations. This finding implies that taxpayers might have communicated with practitioners in such a way as to initiate a pattern of aggressive advice. Therefore, aggressive advice can be demand-driven by aggressive taxpayers – there is indeed a market for aggressive tax planning of which tax practitioners are very much aware.

The results further showed that other businesses' tax ethics and personal tax ethics did not have an impact on taxpayers' decisions. This result appeared less consistent with the literature. Prior research, however, has focused predominantly on taxpayers in general rather than a subset (that is, business taxpayers) as used in this study. It is possible that social norms could be more influential on non-business taxpayers, who tend to have less knowledge of tax or who do not engage a tax practitioner. Wenzel's⁸⁸ research on norms suggests that taxpayers need to identify with the group to whom the

⁸⁷ For example, see Harold G Grasmick and George J Bryjak "The Deterrent Effect of Perceived Severity of Punishment" (1980) 59 *Social Forces* 471, and Anne L Christensen and Peggy A Hite "A Study of the Effect of Taxpayer Risk Perceptions on Ambiguous Compliance Decisions" (1997) 19 *Journal of the American Taxation Association* 1.

⁸⁸ Philip MJ Reckers, Debra L Sanders and Stephen J Roark "The Influence of Ethical Attitudes on Taxpayer Compliance" (1994) 47 *Nat'l Tax J* 825; Benno Torgler and Kristina Murphy "Tax Morale in Australia: What Shapes It and Has It

norms are attributed for social norms to be effective. One would expect business taxpayers to identify with other business taxpayers' attitudes. However, the respondents' perception that it is very unlikely that other businesses' tax practitioners would assist with unethical requests perhaps rules out business tax ethics as a relevant consideration. This result suggests that an examination of the effects of social norms on taxpaying behaviour needs to be considered carefully in context.

Unlike numerous studies which have shown that personal tax ethics have a role to play in taxpayers' compliance, this study did not reveal a significant impact on taxpayers' decision to accept aggressive advice from the practitioner. Possibly, the single item measure of personal tax ethics, 'Should your firm declare all taxable income?', lacked sufficient nuance or sophistication to capture adequately the personal tax ethics construct. It is highly probable that the item is not well-suited to measuring personal ethics in relation to ambiguous tax law. A multi-item index that looks at respect for the spirit of the law as well as belief in adherence to the letter of the law might have provided a more robust test of the personal tax ethics hypothesis. Perhaps most importantly, prior studies generally have focused on individual taxpayers, not taxpayers consulting with their tax practitioners. It is possible that factors affecting a taxpayer who does not use a tax practitioner are different from factors affecting a taxpayer who uses one. Once a taxpayer engages the services of a practitioner, the practitioner is interposed between him or her and the tax authorities. At this point, responsibility for ethical judgement may be passed on to the practitioner.⁸⁹ Tax practitioners, in a sense, may become the ethics gatekeeper in the minds of taxpayers. Practitioners can influence their clients' tax decisions by educating them about what 'can' and 'cannot' be done. As a result, variables that were once important when taxpayers made decisions alone are not salient when taxpayers are advised by a practitioner.

Finally, there is no evidence to support the view that taxpayers from SMEs or larger firms are more likely to accept aggressive decisions than are others. Results from past studies on the effects of firm size on tax compliance have been inconsistent, suggesting that context and opportunity may affect outcome. This study, for instance, concerned aggressive reporting whereas many studies on tax compliance have been focused on tax evasion. Firms that operate in the cash economy have more opportunities to evade tax and tend to belong to the SME category. In contrast, firms adopting aggressive avoidance measures tend to belong to large businesses.⁹⁰ Certainly large corporations, especially those with international interests, have more opportunities for and encounter less risk in minimising their tax aggressively. The business sample used in this study was dominated by SMEs and was less able to capture large international conglomerates.

Audit experience also had no impact on taxpayers' decisions. In contrast, Chang et al's⁹¹ results showed that those who were more experienced with Inland Revenue audits adopted a more contentious

Changed Over Time?" (2004) 7 *Journal of Australian Taxation* 298; Michael Wenzel "Misconceptions of Social Norms About Tax Compliance: From Theory to Intervention" (2005) 26 *Journal of Economic Psychology* 862; and Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).

⁸⁹ Valerie Braithwaite *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy* (Edward Elgar, Cheltenham, 2009).

⁹⁰ John Braithwaite *Markets in Vice Markets in Virtue* (The Federation Press, New South Wales, 2005); and Susan Cleary Morse, Stewart Karlinsky and Joseph Bankman "Cash Businesses and Tax Evasion" (2009) 20 *Stan L & Pol'y Rev* 37.

⁹¹ Otto H Chang, Donald R Nichols and Joseph J Schultz "Taxpayer Attitudes Toward Tax Audit Risk" (1987) 8 *Journal of Economic Psychology* 299; Julie H Collins, Valerie C Milliron and Daniel R Toy "Factors Associated with Household Demand for Tax Preparers" (1990) 12 *Journal of the American Taxation Association* 9; Peggy A Hite and Gary A McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45 *Nat'l Tax J* 389; and Yuka Sakurai and Valerie Braithwaite "Taxpayers' Perceptions of the Ideal Tax Adviser: Playing Safe or Saving Dollars?" (Working Paper No 5, Centre for Tax System Integrity, Australian National University, Canberra, 2001).

return position. Other researchers who found no significant effects have noted that the quality of the audit outcome may have a role to play. In this study, the quality of the audit was not elicited directly from the respondents. Their profile also shows that most respondents who had experienced an audit before did not suffer severe consequences with respect to penalties imposed on their firms. The fact that most did not have a 'bad' audit experience perhaps explains why audit did not serve as a deterrent and rein in acceptance of aggressive advice.

Apart from the variables identified in this study, there could be other factors that explain when business taxpayers accept aggressive advice from their practitioner. The low R^2 from the multiple regression analysis suggests the need to look further for explanatory variables. Contextual constructs associated with the taxpayer-tax practitioner dyads were not tested in this model. Furthermore, the practitioner-client relationship is not a static but a dynamic one. There is certainly more interaction and communication between them which creates opportunities for each to influence the other's decisions. The ongoing interactions are not easy to capture with data collected from samples of taxpayers using a cross-sectional study design.

The above findings generally support the variant of classic economic theory that emphasizes individual perceptions of costs and benefits. Taxpayers maximise their tax outcome by weighing what they perceive to be the uncertain benefits of successful avoidance against the risk of sanctions should the act be judged evasive.⁹² Although other studies have found noneconomic factors to be influential on taxpaying behaviour, it appears that for business taxpayers working in partnership with their practitioners, their risk attitudes and risk perceptions dominate their choice of tax reporting decisions in an ambiguous tax context. This finding is in line with Kirchler's⁹³ views of the self-employed, who tends to perceive taxation in a narrow economic self-interested frame as limiting their freedom to invest their money in their businesses. In contrast are other white-collar workers and civil servants who tend to consider taxation in terms of collective interests, fairness and norms.

An implication of the findings of this study is that tax penalties are an important deterrent for business taxpayers, but they need to be salient in their minds.⁹⁴ The tax authorities can raise business taxpayers' perceptions of sanction risk by improving their communication about their audit activities and the severity of the penalty structure for taxpayers found to be noncompliant. As pointed out by Webley et al,⁹⁵ people's estimate of the chance of successfully evading taxes are influenced more by media coverage of cases prosecuted for evasion than by actual changes in auditing procedures. Some studies have shown that educational communication directed at taxpayers can successfully strengthen compliance.⁹⁶

⁹² See Erich Kirchler *The Economic Psychology of Tax Behaviour* (Cambridge University Press, New York, 2007).

⁹³ Ibid.

⁹⁴ See KW Smith and KA Kinsey "Understanding Taxpayer Behavior: A Conceptual Framework with Implications for Research" (1987) 21 *Law and Society Review* 639; and John Braithwaite *Markets in Vice Markets in Virtue* (The Federation Press, New South Wales, 2005).

⁹⁵ See Silvia A Madeo, Albert Schepanski and Wilfred C Uecker "Modelling Judgments of Taxpayer Compliance" (1987) 62 *Accounting Review* 323; Paul Webley, Henry Robben, Henk Elffers and Dick Hessing *Tax evasion: An experimental approach* (Cambridge University Press, New York, 1991); and Steven E Kaplan, Philip MJ Reckers, Stephen G West and James C Boyd "An Examination of Tax Reporting Recommendations of Professional Tax Preparers" (1988) 9 *Journal of Economic Psychology* 427.

⁹⁶ D John Hasseldine and Steven E Kaplan "The Effect of Different Sanction Communications on Hypothetical Taxpayer Compliance: Policy Implications from New Zealand" (1992) 47 *Public Finance* 45; John Hasseldine, Peggy Hite, Simon James and Marika Toumi "Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors"

Furthermore, taxpayers may not perceive anything wrong or unethical about aggressive advice when the tax law is ambiguous. Rather, they may perceive it as the government's fault for not legislating clearly; hence, they feel they have every right to save the maximum amount of tax the law allows. Although it is impossible to legislate for every eventuality, the challenge of clarifying the tax law through better drafting of legislation should not be ignored. In addition, incorporating principles to frame a set of rules and provide guidance for interpretation and closing loopholes appears to be not just a desirable option,⁹⁷ but an urgent first step toward protecting the integrity of the tax system.⁹⁸

Findings elicited from the mail survey, however, should be viewed with some caution, due to the possibility of selection bias in the sample. It is not known for certain whether those who responded were different from those who did not. A comparison of late and early respondents suggested no serious response-related problems, but it remains possible that those who participated represent a less aggressive and more ethical group. A second problem that should be acknowledged is social desirability bias and the misunderstanding of questions that are always possible with a self-administered mail questionnaire. Attempts were made to mitigate these problems by pilot-testing the questions and assuring the subjects of the confidentiality and anonymity of their responses, but the possibility of such a bias remains. Third, as in all experimental studies, any vignette used is a hypothetical decision context. It assumes that responses will reflect how the participants would behave in real life. Efforts were made to develop a realistic case by pilot-testing with practitioners and business taxpayers. Finally, static self-administered questionnaires cannot capture the decision-making process and how the interaction between taxpayer and tax practitioner might affect the outcome. The dynamics of the interaction process could perhaps be explored by observing the parties' interactions or by interviewing the two parties after their meeting. Whichever method is followed, the most pressing questions on tax practitioner-taxpayer influence are best answered through placing the dyad under the microscope. The conversation between the two parties, interpretations of each other's needs and the shared construction of the best way forward for managing the client's tax affairs, hold the key to how each party shapes the risk-taking and ethicality of the other.

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⁹⁷ Judith Freedman "Defining Taxpayer Responsibility: In Support of a General Anti Avoidance Principle" (2004) 4 BTR 332; and Sol Picciotto "Constructing Compliance: Game Playing, Tax Law, and the Regulatory State" (2007) 29 Law & Policy 11.

⁹⁸ See John Braithwaite *Markets in Vice Markets in Virtue* (The Federation Press, New South Wales, 2005).

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