

**Understanding small business taxpayers:  
Issues of deterrence, tax morale, fairness and work practice**

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**ABSTRACT**

This study investigates how the self-employed define themselves and their businesses in relation to taxation issues, and whether there is evidence that this segment engages with taxation in ways that are different from other segments of the population. Data are collected from a random sample of 2040 Australians. Four domains are chosen for comparison: perceived deterrence for non-compliance, tax morale, perceived fairness; and work practice. As evident in the discriminant function analysis, the self-employed are distinguished by not receiving an annual tax refund, perceiving themselves as paying less than their fair share of tax, having less tax competence and independence, perceiving greater power in the tax office to elicit compliance, favouring small government and minimum government interference, and opposing tax expenditure for redistributive programs such as health, welfare and education. Findings are discussed in a regulatory context.

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## INTRODUCTION

In the last two decades of the 20th century, the small business sector grew rapidly in most OECD<sup>1</sup> economies (Meager et al., 1992; OECD, 2000) and became vitally important to these countries' economic and social prosperity (Australian Bureau of Statistics, 2002; Freeman, 2003; United States Small Business Administration, 1998). At the same time, the poor performance of the small business sector in complying with tax obligations has been identified as a significant problem (Australian Taxation Office, 1996; Boucher, 2001; Hite et al., 1992; IRS<sup>2</sup>, 1988; Joulfaian and Rider, 1998; Wallschutzky, 1984). The present study uses data from a large population survey to ask the question of whether the small business segment can be differentiated from the rest of the population in terms of their psychological and social disposition to taxation. We also consider some general work practice variables with the intention of asking whether the reasons for greater non-compliance in the small business sector have more to do with the nature of the work than with the way in which small business owners approach the tax system and its officials.

The paper is structured around three issues that have dominated the tax compliance literature: perceptions of deterrence, tax morale and fairness. The questions addressed in this paper are as follows: (a) Is there any evidence that small business owners as a group are less concerned about sanctioning for non-compliance? (b) Do small business owners have lower levels of tax morale than other taxpayers? (c) Are small business owners more likely to feel that the tax authority deals with them in a way that is unfair compared to others in the system? Finally, the issue of workplace

practice is examined. While opportunity to conceal income and over-state deductions is generally accepted as being greater among small business owners (Joulfaian and Rider, 1998), industry groups and researchers alike point to the high costs of compliance for small business taxpayers (Noble, 2000; Pope et al., 1993; Webley et al., 2002). This study does not purport to represent these costs because clearly they will not only be greater than the compliance costs incurred by wage and salary earners but they will be of a very different kind, and the purpose of this paper is to compare small business owners with the general population on a set of common variables. But we do include capacity variables to test the hypothesis that compliance may be more onerous for small business taxpayers than others. Finally, we review the regulatory strategy (the Compliance Model; for details see Cash Economy Task Force Report, 1998) that has been officially adopted by the Australian Taxation Office and ask if it is a suitable approach given the findings of this research.

*Tax compliance: What the research tells us*

Deterrence

Traditionally, tax compliance has been understood in terms of the benefits of successful evasion weighed against the risk of detection and punishment (Allingham and Sandmo, 1972). Thus, as perceptions of deterrence activity by the tax authority spread through the community and as fears of being caught are aroused, tax evasion is expected to go down in the population as a whole. A degree of support has been found for the hypothesis that compliance is likely to be higher when taxpayers perceive there to be a higher probability of *being caught* along with anticipated *adverse consequences* (Grasmick and Bursik, 1990; Lewis, 1982; Richardson and Sawyer, 2001).

In the small business context, opportunities for evasion are high and resources are often scarce for field auditing (Joulfaian and Rider, 1998). Even when high investments are made in auditing, uncovering 'hidden cash' is never going to be an easy task without an adequate audit trail (Cash Economy Task Force Report, 1998; Dornstein, 1976). Thus, the first hypothesis for investigation in this study of small business owners is that they are *more dismissive of tax authority presence and interest in their activities than others in the community; and are less worried about being caught, both in terms of likelihood and consequences.*

### Tax morale

While deterrence theory continues to be popular as a framework for understanding tax compliance, the notion of voluntary taxpaying and "intrinsic motivation to pay taxes" (Torgler, 2003: 5) has attracted considerable attention (Alm et al., 1995; Andreoni et al., 1998; Lewis, 1982). The term used for this intrinsic motivation is tax morale (Frey, 1997). Others refer to a similar phenomenon when they state that people pay tax because they believe it is the right thing to do (McGraw and Scholz, 1991; Richardson and Sawyer, 2001; Schwartz and Orleans, 1967).

Most work using the concept of tax morale has adopted a unidimensional conceptualisation. In this paper, we explicitly envisage tax morale as multidimensional. While not claiming to provide an exhaustive delineation of its dimensions, two are singled out for analysis in this study. The intrinsic motivation to pay tax may come from the desire to be a good citizen or from the desire to contribute to the common good. The first represents duty or obligation to the state, and is a genuinely felt desire to do the right thing as a citizen. The second represents duty or obligation to one's fellow human beings, and is a genuinely felt desire to share resources with those who do not have them, to make sure that the basic needs of all are met, and to protect the

rights of the most vulnerable. In general, a positive correlation would be expected between these different facets of tax morale since most tax systems in modern democracies are based on the premise that we should be willing to support a progressive tax system voluntarily, and that tax law signals the democracy's commitment to protect the 'common good' and serve all citizens. But there is some evidence to suggest that for small business owners, these two kinds of obligations – the obligation to do the right thing and the obligation to contribute to wealth redistribution – may be more distinctive.

A number of studies have described small business taxpayers as law abiding, responsible and ethical, taking their tax obligations seriously (Brown, 1985; Cunningham and Lishercon, 1991). From this reading, the tax morale of small business, conceived as a citizen's obligation to the state, should be as high, if not higher than that of the general population.

Another facet of the life of small business owners emerges from research that reminds us of the location of small business in a capitalist economy. Studies on personal values have portrayed small business taxpayers as ambitious, hard-working, courageous, individualistic, and as seeking social and economic status (DeCarlo and Lyons, 1980). Other research has highlighted personal attributes such as seeking autonomy, independence and rewards for achievement in their business operations (e.g., Rosa et al., 1994). The findings of Kirchler (1999) need to be interpreted from this perspective. Kirchler found that small business taxpayers were more likely to perceive taxpaying as limiting and threatening their freedom to make financial decisions about their own income. Perceived restriction of freedom was positively related to favourable attitudes toward tax evasion, lower tax morale and a tendency to act in ways to avoid paying taxes. In view of these findings, one would not expect to

find small business owners being more willing than others in the community to contribute their earnings to the communal pot for purposes of income and wealth redistribution and the creation of a more equal society. Thus, tax morale gives rise to two different hypotheses in the context of understanding small business views of taxation. *Tax morale associated with citizenship is expected to be as high, if not higher, than that of the community. Tax morale associated with the redistribution of wealth is expected to be lower than that found in the community.*

Related to the issue of the individual business owner's tax morale is the issue of the perceived tax morale of the community, that is, the perception that others are meeting their taxpaying obligations and are doing so willingly. Community norms about how one should behave are likely to constrain taxpayers as they review their taxpaying options (Cullis and Lewis, 1997; Smith and Kinsey, 1987; Weigel et al., 1987). In the case of small business owners, it could be argued that as a group, they are more likely to be exposed to tax evasion than most members of the community because they move in circles where opportunity to evade is high and cash economy activity is most prevalent (Noble, 2000; Vogel, 1974; Wallschutzky, 1984). It is therefore hypothesised that *perceptions of community tax morale will be more negative among small business owners than among the broader community.*

### Fairness

Within the tax compliance literature, perceived fairness has emerged as an important consideration (Wenzel, 2002). For some authors, justice concerns have focused on whether or not citizens receive the goods and services they believe they deserve given the taxes that they pay (Kinsey and Grasmick, 1993; Kinsey et al., 1991; Mason and Calvin, 1984; Scholz and Lubell, 1998; Thurman et al., 1984; Richardson and Sawyer, 2000). Perceptions of the fairness of the exchange, however, are likely to be influenced

by the expectations of government and the purposes for which people believe taxes should be used (the redistribution of wealth for example), which we have incorporated in this paper under the concept of tax morale. Thus, fairness is conceptualised in this section in relative terms, that is, the extent to which individuals believe they are paying their fair share compared to others (Kinsey and Grasmick, 1993; Wenzel, 2004); and procedural terms (Tyler, 1997; Wenzel, 2002), that is, the degree to which people believe that the tax authority treated them in a respectful, impartial and responsive way (Braithwaite and Reinhart, 2000).

Perceptions of unfair treatment (procedural unfairness) were reputed to be rife among the small business community at the time this research was conducted in Australia. The Australian Taxation Office was seen as being neither sympathetic nor cooperative in their dealings with small business taxpayers' concerns and problems (Coleman and Freeman, 1994; Coleman et al., 2001). Furthermore, small business taxpayers expressed strong resentment against the tax system (Australian Taxation Office, 1996). Feelings of being poorly treated by the tax authority and the tax system are not confined to Australia. New Zealand research (Noble, 2000; Tan and Veal, 2003) has raised fairness issues in relation to administration and tax levels, and Webley, Adams and Elffers (2002) have summarised European findings which suggest a heightened sense of unfairness about taxation among small business groups.

On the basis of these findings, it is hypothesised that as a group, *small business taxpayers will be more critical of the levels of procedural justice offered by the tax authority*. With regard to their contributions to the tax system relative to others, a question is posed rather than an hypothesis: *Do small business taxpayers feel that they are contributing the right amount, more than, or less than their fair share of personal income tax to the government?* Some studies have reported small business concerns

about the range of taxes that they are required to pay (Joulfaian and Rider, 1998; Noble, 2000; Webley et al., 2002). The focus in the research reported herein, however, is income tax – do small business owners believe they pay more, the right amount, or less than their fair share of income tax?

### Work practice

Although small business taxpayers regard themselves as honest (Coleman & Freeman, 1994) and recognise cash business as illegal (Australian Taxation Office, 1996; Noble, 2000), bartering and cash jobs are often considered by them to be normal business practice (Coleman and Freeman, 1994). The ‘occupational norm’ is to engage in these activities to a certain degree, regardless of protest from the tax authority (Coleman and Freeman, 1997; Noble, 2000; Sigala et al., 1999). A number of studies have attempted to resolve this paradox, and explored whether small business taxpayers’ compliance behaviour is shaped by their work practices (Australian Taxation Office, 1990; McKerchar, 1995; Sigala et al., 1999).

Wallschutzky and Gibson’s (1993) study with Australian small business owners identified their primary concern as cash flow that affected their taxpaying behaviour, particularly paying tax on time. Business owners aim at maximising earnings from business resources and are prepared to use any resources including debt to accomplish this goal (Vickery, 1987). Paying tax thereby becomes a casualty of business pressures, a trade-off that becomes increasingly easy when there is no third party reporting of income and chances of detection are low (Coleman and Freeman, 1994; Joulfaian and Rider, 1998; Noble, 2000; Vogel, 1974).

Temptation and ease may be one explanation, but both can be self-regulated by small business when a commitment is made to invest in business plans and good record

keeping. Understanding and keeping up with tax obligations is part of this process, but tax complexity befuddles many (James et al., 1987; Webley et al., 2002).

In the Australian context, McKerchar (1995) found that small business taxpayers did not have adequate knowledge of tax law to meet their obligations. Coleman and Freeman (1994, 1997) argue that not only do they not understand what is required to meet their obligations, they are insufficiently aware of what they need to do to effectively minimise their tax. In Australia, a high proportion of taxpayers (75%), including wage and salary earners, rely on a tax adviser or tax agent to complete their yearly tax returns (Australian Taxation Office, 2002). In most cases, the reason given for seeking their assistance is to be able to do their tax honestly and without fuss (Sakurai and Braithwaite, 2003).

For small business owners in Australia, the role of the tax advisor appears to be one of giving advice (Coleman and Freeman, 1994). In a study in the United States, Hite et al. (1992) explored the motivations of small business taxpayers for using tax advisors. The most important reasons given were preparing tax returns correctly and reducing the likelihood of penalties. Yet, these authors, citing data from the Internal Revenue Service, note that one in every five small business taxpayers was either under-reporting income or over-reporting deductions. For small businesses, there is often no third party who is witness to the transactions and can hold the small business owner accountable on tax related matters. Moreover, if one needs to divulge illegal behaviour, it is best to seek out the kind of tax adviser that will be sympathetic and supportive. Kalinsky and Bankman's (2002) research in the United States has shown how tax advisers are chosen on the basis of their reputation. Sakurai and Braithwaite (2003) and Tan (1999) have also suggested that tax agents and taxpayers are well placed to choose each other to suit their financial interests and ethical stance.

In this respect, it is of note that Coleman and Freeman (1994) observe that small business taxpayers rely more on tax advisors than on tax officers. The explanation for this state of affairs, however, is not simply the desire to evade. Two Australian studies have explored small business taxpayers' perceptions of the tax office and the tax system (Coleman and Freeman, 1994; Wallschutzky and Gibson, 1993). The willingness of small business taxpayers to establish a cooperative relationship with the Australian Taxation Office has not always been reciprocated in the past (Coleman and Freeman, 1994). Complaints of tax office inaccessibility have been widespread (Coleman and Freeman, 1994, 1997). Other studies elsewhere report small business taxpayers as regarding themselves as having an adversarial relationship with tax authorities and as wanting to win against "the taxman" (Noble, 2000). Interestingly, the Australian study by Coleman and Freeman (1997) pointed out that professional small business taxpayers view tax non-compliance as game-playing with the tax office. Game-playing seems to be a norm that is becoming increasingly prevalent in many countries, particularly among businesses which have incorporated tax planning into their overall business strategy (McBarnet and Whelan, 1999; Rossignol, 2001).

Internationally, tax administrations have also been undergoing change, adopting proactive strategies to build cooperation and improve compliance. Across the developed democracies, there has been an emphasis on improving taxpayer services (Barton, 2001; James et al., 1987; Prebble, 2001), seeing opportunities through electronic technology for creating better compliance systems (Gilbert et al., 2001), and entering the business of private rulings to clarify the application of tax law (Grbich, 2001; James and Alley, 1999).

In the midst of change in the way small business and tax administrations are functioning, it is difficult to formulate hypotheses relating to work practices and small

business's tax orientation. Tentatively, the following hypotheses are offered for exploration with these data. First, because of the complexity of their tax obligations, *small business owners are expected to express less self-reliance and capacity to manage their tax affairs themselves.* Second, because small business owners do not have tax withheld at source as wage and salary earners do, *they are less likely to be in the situation in which the government owes them money and they receive a personal income tax refund.* Third, because of their greater opportunity to effectively minimise their tax, *small business owners will be more likely to seek the services of a tax agent skilled in aggressive tax planning.* Fourth, for reasons relating both to the nature of their work as well as their views of government, *small business owners will be more likely to dissociate from the tax system, transcending notions of deference to authority, and preferring to game play with or disengage from tax requests.*

#### *The context of the present study*

In the past, most small business studies have been limited to interviews and focus group discussions to gather information about tax matters. Only a few studies have used larger samples with a self-report survey methodology (e.g., Hite et al., 1992; Kirchler, 1999; McKerchar, 1995). In addition, studies have generally been restricted to the population of small business taxpayers (e.g., Coleman and Freeman, 1994; Hite et al., 1992; Kirchler, 1999; McKerchar, 1995; Wallschutzky & Gibson, 1993). While this strategy is methodologically ideal for predicting who among small business taxpayers is non-compliant, and for picking up on the special issues of small business taxpayers (for example, compliance costs, other taxes that affect small business), the methodology does not allow a picture to be painted of how small business owners differ from other members of the community with regard to tax matters. Only a few

studies have used a heterogeneous sample comprising small business taxpayers and taxpayers who work in other organisational contexts (e.g., Noble, 2000; Sigala et al., 1999; Wallschutzky, 1984). In these cases, the sample size has at times been small, and the breadth of the psychological and social domain of enquiry has not been large (e.g., Sigala et al., 1999). With a few notable exceptions (e.g., Hite et al., 1992; Joulfaian and Rider, 1998), most of this research consists predominantly of qualitative analytic explorations (e.g., Wallschutzky and Gibson, 1993; Wiegand and Rothengatter, 1999).

The present study provides a large data set, collected through randomly sampling the Australian population with an omnibus tax survey. The survey provides an extensive list of questions relating to the psychological and social factors that may differentiate different types of taxpayers. In short, the survey provides highly distinctive quantitative data which supplements the rich base of qualitative research that has tended to dominate this field.

## METHOD

### *Sample and Data*

The hypotheses were tested on the basis of data from the *Community Hopes, Fears and Actions Survey* (Braithwaite, 2000). Of the 7754 questionnaires distributed, 2040 were returned after several reminders, giving a response rate of 29 per cent (after allowing for undelivered questionnaires and ineligible respondents). This response rate, while low in absolute terms, compares favourably with rates reported for other tax surveys (Pope et al., 1993; Kirchler, 1999; Wallschutzky, 1996; Webley et al., 2002). Citizens seem less interested in filling out questionnaires related to tax than they are with most other topics. A series of diagnostic analyses (see Mearns and Braithwaite, 2001) suggested that the sample provided a relatively representative cross-section of the

views of Australians about their tax system. Furthermore, the sample was relatively representative of the population with regard to sex, ethnicity, education, age, occupation, and marital status.

### *Procedure*

The survey instrument was developed by Valerie Braithwaite at the Centre for Tax System Integrity at the Australian National University (Braithwaite, 2001)<sup>3</sup>. A professional social research company, Datacol, selected the sample and administered the survey on behalf of the researchers.

Each respondent was mailed three items: an accompanying letter signed by the director of the research centre, a questionnaire, and a postage-paid return envelope. The accompanying letter briefly described the intent of the survey, guaranteed strict confidentiality of responses, and encouraged respondents to complete and return the completed questionnaire in a sealed envelope. An identification number appeared in the questionnaire to allow follow-up reminders of non-respondents (for details, see Mearns and Braithwaite, 2001) asking them to complete and mail the survey if they had not already done so.

### *Design*

One item was used to classify respondents into different categories in relation to their employment.

Respondents were asked “What kind of work do you do? Please give your full job title and as much detail as you can. If you are retired or unemployed, please describe your last regular paid job”. Next, respondents were asked: “Is that job for (i) a private company or business; (ii) non-profit organisation e.g. university; (iii) commonwealth,

state or local government; or (iv) are you self-employed, in a business partnership, or do you own a business?

For the present purpose, we recoded the responses. We grouped respondents who worked in a non-profit organisation and the commonwealth, state or local government into one category. The other two categories (private company and self-employed) were not changed. Using the recoded item, we formed the following three groups:

- (1) self-employed, in partnership, or owning business (SBT) (n = 244);
- (2) those employed by a non-profit or government organisation (NPT) (n = 534);
- (3) those employed by a private company / business (PCT) (n = 785).

It is of note that those categorised as self-employed, in partnerships, or owning a business could be: (a) sole proprietorships and partnerships without employees; (b) a micro business (defined by the Australian Bureau of Statistics (2002) as businesses employing less than 5 people); (c) a small business (defined by the Australian Bureau of Statistics (2002) as businesses employing between 5 and 19 people); (d) a medium business (defined by the Australian Bureau of Statistics (2002) as businesses employing between 20 and 199 people); and (e) a large business (defined by the Australian Bureau of Statistics (2002) as businesses employing 200 or more people). Because 97% of businesses in the private sector in Australia involve less than 20 employees (Australian Council of Trade Unions, 2004), we use the term small business to refer to the sample selected for study in this paper. We have not been able to distinguish micro from small business, referring instead to the combined group as small business.

### *Measures*

The *Deterrence Hypothesis* was tested using four measures: (a) probability of getting caught; (b) general deterrence, that is, probability of getting caught multiplied by probability of receiving sanctions multiplied by the severity of the consequences; (c) a three item scale measuring the perceived power of the tax office over small business, self-employed, and ordinary people to elicit compliance; and (d) a four item scale measuring the degree to which the respondent had experienced an audit, a check, a penalty, or conflict over a tax transaction (experience with sanctions and conflict scale).

The *Tax Morale Hypothesis* was tested through eight measures. Belief in doing the right thing was measured through (a) the obligation to accept tax authority decisions scale and (b) the personal norm of tax honesty scale. Those who believe in being law abiding themselves are also likely to express values that promote propriety and respect for law and order in society. Such values were measured through the (c) security value orientation scale. Support for tax money being used to support law and order was measured through ratings of (d) relative preference for security institutions expenditure (ie policing). These four measures were used as indicators of the kind of tax morale reflected in internalised law abidingness.

Of the remaining four measures, three represented tax morale as an internalised commitment to redistribute resources. The first was the desire to use tax money for education, health, welfare, employment and legal aid and reflected a (a) relative preference for enabling institutions expenditure. The second measured values advocating a more equal and caring society and was called the harmony value orientation scale. The third scale measured opposition to big government and social justice programs that undermined competition and gave concessions to the marginalised groups, and was called small government and minimum interference.

The final measure included in the tax morale set of variables is how individual respondents perceived the tax morale of others, that is, the perceived social norm surrounding tax paying.

*The Fairness Hypothesis* was tested using three measures. Procedural justice was assessed through asking respondents to rate the Australian Taxation Office in terms of its performance on the 12 items comprising the Taxpayers' Charter. Two other measures were used to assess the degree to which taxpayers believed that they were paying less than, the right amount, or more than their fair share compared to others (a) on the same income and (b) Australians as a whole.

*The Work Practice Hypothesis* was tested through the following three measures: (a) a tax competence and independence index; (b) likelihood of getting a tax refund; and (c) preference for a tax agent who was an aggressive tax planner.

In addition, respondents were asked about their overall relationship with the Australian Taxation Office. The cooperation-resistance scale reflected the degree to which taxpayers approved or disapproved of tax office actions within a shared understanding that the tax office had the status of a legitimate authority. The dissociation scale measured the degree to which respondents challenged tax office authority either through ignoring its requests completely (disengagement) or game playing with the law. Small business owners have both greater opportunity to disengage and game-play than wage and salary earners who have income tax extracted at source. These scales or general approaches to the tax authority have been described elsewhere as motivational postures (Braithwaite, 2003).

Finally, one of the assumptions that underlies this paper is that tax evasion is more likely to be found in the small business sector than in other sectors. Thus, a measure

was also taken of tax evasion, defined as under-reporting income, engaging in the cash economy, and exaggerating deductions.

Details about the sources of the above measures are provided in the Appendix.

## RESULTS

### *Data Analyses*

The data analyses were performed in two steps. The first step was a univariate set of analyses using One-way Analyses of Variance. The second step involved a multivariate procedure, Discriminant Function Analysis.

### *Analyses of Variance*

The specific aim of the Analyses of Variance was to explore the extent to which small business taxpayers were similar to and different from the other two groups of taxpayers, those employed in the private sector and those working for non-profit or government organisations. Comparisons were made in terms of the above mentioned indicators of deterrence, tax morale, fairness, and work practice. Post hoc tests (Scheffés) were performed to ascertain which pairs of means were significantly different among the three groups of taxpayers. Scheffé's comparisons with the target group (small business taxpayers) are reported in Table 1 through Table 4.

In order to indicate which specific group(s) was significantly different from small business taxpayers (SBT), notations appear in the SBT column (that is, NPT if SBT is significantly different from non-profit or government organisation taxpayers, and PCT if SBT is significantly different from private sector taxpayers).

### **TAKE IN TABLE 1**

#### Findings in relation to the Deterrence Hypothesis

As can be seen from Table 1, the three groups do not show significant differences on two of the four deterrence variables: (a) probability of getting caught for tax evasion; and (b) general deterrence. However, findings with regard to perceived power of the tax office to elicit compliance and experience of conflict and sanctions in relation to the tax office are higher for the SBT group. Small business taxpayers see the tax office as having the power to gain their compliance and they report more experiences of contested assessment, audit, and sanctions. Statistically, these differences are significant between the SBT group and private sector taxpayers, but not between the SBT group and non-profit and government sector taxpayers. Overall, there appears to be only limited support for the Deterrence Hypothesis.

## **TAKE IN TABLE 2**

### Findings in relation to the Tax Morale Hypothesis

Table 2 presents findings for each scale used to test the Tax Morale Hypothesis. Small business taxpayers do not differ significantly from other groups in terms of their personal norm of tax honesty or in terms of their feelings of obligation to obey the law. Their tax morale, defined in terms of legal obligation, is comparable to that found elsewhere in the community. Their mean scores sit between non-profit and government sector taxpayers and private sector taxpayers.

Interestingly, small business commitment to values associated with security for the community and nation is higher than that found among those who work in the non-profit and government sector, as is their preference for spending their tax dollars on defense, policing and the like. In terms of tax morale for redistributing wealth through regulation and social justice initiatives, and through using tax dollars for education, health, welfare, legal aid and employment, small business taxpayers appear to be less

supportive than those who work in the non-profit and government sectors. In terms of their overall value orientation, however, small business owners were as concerned about equity issues as other groups.

Finally, no differences were found among the groups in terms of their perceptions of the tax paying ethic of others. Small business taxpayers were no more likely than others to see themselves as operating in a world where people did not value being an honest taxpayer.

### **TAKE IN TABLE 3**

#### Findings in relation to the Fairness Hypothesis

From Table 3, two of the three fairness variables show significant group differences, but in the opposite direction to that predicted. When the focus was on those earning about the same, small business taxpayers were more likely than those who worked in the non-profit and government sector to admit that they paid less than their fair share of tax. When asked to compare themselves with all Australians, small business taxpayers believed they paid less than their fair share, more so than either of the other two groups. In terms of procedural justice, small business rated their treatment at the hands of the tax office in the same way as other groups.

### **TAKE IN TABLE 4**

#### Findings in relation to the Work Practice Hypothesis

As can be seen from Table 4, small business taxpayers differ significantly from both non-profit or government organisation taxpayers and private sector taxpayers in relation to two variables: (a) competence and independence in preparing their own income tax returns; and (b) likelihood of receiving a tax refund. Small business

taxpayers admitted to having lower levels of competence and independence in dealing with tax matters; and, as expected, were less likely to receive a tax refund. The small business sector also differed significantly from taxpayers in non-profit and government organisations in their heightened attraction to an aggressive tax planner. They liked the idea of having a tax agent who was creative and knowledgeable about aggressive tax planning, but in this respect they were no different from others employed in the private sector.

In terms of their general working relationship with the tax office, small business taxpayers were much like other groups in terms of their levels of cooperation and resistance. They differed significantly from non-profit and government taxpayers in being more dissociated from the tax system, being able to cut themselves off from the demands of the tax authority and successfully challenge the authority. It is of note that no difference emerged on dissociation between small business owners and others who worked in the private sector.

Last, but not least, small business taxpayers admitted to greater tax evasion, but they were significantly different from only one group, non-profit and government employees. The levels of reported evasion among those employed in the private sector were comparable.

#### *Discriminant function analysis*

In the previous section, 13 variables appear to discriminate small business taxpayers from non-profit or government organisation taxpayers and/or private sector taxpayers. The purpose of the discriminant function analysis is to identify which combination of these 13 variables would differentiate most effectively small business taxpayers from

others<sup>4</sup>. Findings from a discriminant function analysis (Porcano, 1988; Tabachnick and Fidell, 1996) are reported below.

A conventional stepwise Wilk's Lambda (Norusis, 1993) algorithm was used, which selects the predictor variables in order of importance in the final discriminant classification. Because there were only two groups (small business taxpayers versus others), one discriminant function emerged in this study, accounting for 14% of the total variance (Wilk's Lambda = 0.88, Canonical correlation = 0.35, Chi-square = 137.44,  $p < .001$ ) (see Table 5). In addition, results show that 66% of the small business taxpayers and 70% of the taxpayers from other groups were correctly placed in their respective group which is well above the 50% chance of correct classification rate. The leave-one-out method was used for cross-validation of the result which revealed a drop in classification accuracy of .5% only (65.5% of the small business taxpayers and 70% of the taxpayers from other groups). Most importantly, the same six variables were found to contribute to the discriminant function, regardless of the method used.

#### **TAKE IN TABLE 5**

Table 5 presents the correlation coefficients between the variables and the discriminant function in descending order of the absolute size of the correlation coefficient<sup>5</sup>. The coefficients reflect the importance of each variable in distinguishing the groups. A positive coefficient reveals the extent to which the private, non-profit and government sector groups (in combination) score more favourably on the variable of interest. A negative coefficient shows the variables on which small business score more favourably. Thus, from Table 5, small business taxpayers can be distinguished by their having less likelihood of getting a tax refund (.79), paying less than their fair share of tax compared to all Australians (.30), having less tax competence and independence in completing tax returns (.28), perceiving greater power in the tax office to elicit

compliance with small business, the self-employed, and ordinary taxpayers (-.24), favouring small government and minimum interference (-.24), and opposing tax expenditure for redistributive programs such as health, welfare and education (.20). It is evident that the likelihood of getting a tax refund primarily defines the function; however, in addition, there are other variables that play a part in discriminating small business taxpayers from others.

Other measures in the bottom part of Table 5 show the overall degree of fit of the discriminant classification. The overall canonical correlations suggest a moderate association between this set of six variables and group membership. The eigenvalue, chi-square, and Wilk's Lambda suggest that the variables utilised give moderate discriminatory power in separating small business taxpayers from others.

## DISCUSSION AND CONCLUSION

This study tests a number of hypotheses on the distinctiveness of small business taxpayers in terms of their tax compliance related attitudes and behaviours. While making a number of contributions, there are also limitations that should be addressed in future research. First, the study is Australian based so that the generalisability to other tax regimes in different countries needs to be tested. Second, the definition of small business is based on survey self-reports without the collection of additional data such as number of employees and annual turnover. Most tax jurisdictions break down the business sector into micro, small, medium and large businesses. In this study, we are unable to make such distinctions, although with 97% of private companies being at the smaller end of the market (Australian Council of Trade Unions, 2004), it is appropriate to identify our findings with small business taxpayers as distinct from those who own

medium and large businesses. Nonetheless, the point needs to be made that through treating the self-employed and owners of businesses as a homogenous group, we may have glossed over some important distinctions among small business taxpayers. A final note of caution that affects the interpretation of results is that the variables identified as possible risk factors are not necessarily causal factors. This paper identifies attitudinal and psychological factors that may be linked with taxation non-compliance in the small business group. Further work is required to tease out the nature of any possible linkages.

Among the most important findings of this paper is that on a vast number of attitudinal variables, small business taxpayers are much the same as other taxpayers. They have a great deal in common with wage and salary earners in the private sector, and even share many views with wage and salary earners in the public sector. The major differences that were found relate to tax related activities, work practices and tax morale.

Those taxpayers who had their own business were more likely to acknowledge that they evaded tax, as well as expressing a keen interest in tax avoidance and tax effective planning. They were more likely to have experienced conflict with or sanctioning from the tax office, and they admitted to paying less than their fair share of tax. It was this last variable that dominated the discriminant function analysis. The picture emerging from these findings is that at the time of the study, small business was not suffering unduly at 'the hands of the taxman', at least not in terms of income tax payments<sup>6</sup>.

Yet in other respects, small business taxpayers clearly feel disgruntled. Small business taxpayers are less often in the situation where they receive a tax refund on submitting their annual income tax return, and they feel less competent and less independent in preparing their income tax return. One inference that can be drawn from

these findings is that the work practices of small business do not sit well alongside the self-assessment income tax system under which Australia operates. It seems reasonable and consistent with past research to assert that there is little joy in doing one's tax if one runs a small business. Even the "compulsory saving" that 85% (Australian Taxation Office Compliance Program, 2002-2003) of Australians look forward to each year when they receive their tax refund is not a reality for most small business owners. 65% of small business taxpayers report that they owe the tax office money, or at best, they break even.

The findings in relation to tax morale were of interest in the sense that they unravelled a mystery. In terms of law abidingness and respect for authority, small business taxpayers were no different from anyone else. Indeed, small business owners were more aware than others of the tax office and the authority that it could exert to elicit compliance. Thus, previous findings that small business owners take their responsibilities to obey the law seriously are supported by this study. Differences in tax morale, however, become evident when the focus shifted from paying tax as an obligation under the law to paying tax as a social obligation to society. The argument for paying tax in western democracies is to contribute to the government's communal pot so that services can be universally provided as well as extra support as a safety net for those in need. Ideologically, small business owners are less comfortable with this arrangement than others. They are more supportive of government that does not interfere in the economic and social order, adopting values of independence and self-sufficiency. This conclusion is consistent with the findings of Coleman and colleagues (2001).

Implications for compliance management

So what are the implications of these findings for regulating the small business sector as far as their tax obligations are concerned? Scholars working within a regulatory framework have attempted to map the dynamics of regulatory strategies in relation to corporate misconduct (Grabosky and Braithwaite, 1986; Kagan and Scholz, 1984; Reiss, 1984). This literature often distinguishes between a deterrence model and a bargaining model of enforcement (see Hutter, 1989; Reiss, 1984). A deterrence model seeks to punish regulated firms for corporate misconduct whereas a bargaining model seeks to persuade regulated firms to improve their corporate performance. In describing why regulatory violations occur, Kagan and Scholz (1984) argue that both models have their place depending on whether non-compliance is due to the corporation being amoral, a political citizen, or organisationally incompetent.

The findings of the present study possibly reflect all three of Kagan and Scholz's (1984) organisational motives for non-compliance. Certainly there is evidence to support the incompetent actor interpretation of non-compliance. Small business taxpayers feel less competent to do their own tax return and are more likely to consult others – business associates, friends, tax advisers, and less often the tax office. The non-compliance of Kagan and Scholtz's political citizen is also reflected in the findings. Small business owners are less convinced that contributing to the communal pot is a desirable way for them to spend their money. The admission of not paying one's fair share may be an extension of the political citizen role, or it may reflect a tendency to not pay if one can get away with it – a reflection of the position of amoral calculator in the Kagan and Scholz typology.

The approach that has been adopted by the Australian Taxation Office to manage the complexity of reasons that underlie non-compliance is set out in the ATO Compliance Model (Cash Economy Task Force Report, 1998). According to this model (see

Braithwaite, 2003 for a full description and detailed analysis), tax administrators should deal with non-compliance in a responsive fashion. Responsive regulation (Ayres and Braithwaite, 1992; Braithwaite and Braithwaite, 2000) involves the tax authority in engaging more actively with their taxpayers than is traditionally the case. The automatic issuing of notification of adjustments and sanctions is accompanied by a genuine effort to understand why such instances of non-compliance are occurring and by interventions that are designed to improve compliance in the future. The approach is incremental. The first step is to ensure that all taxpayers have the information required to comply and the support and education that small business appears to need to understand what the tax office is expecting of them. Involved in the education process may be information on why it is worthwhile to contribute to the society through paying tax. This may be a point of conjecture with small business taxpayers who want small government but, more than most, have a vested interest in the preservation of a range of state-provided or subsidised amenities<sup>7</sup>, not least of which are those that deliver an educated, healthy, skilled, and self-regulating population from which they draw their workforce and with whom they transact business (Avi-Yonah, 2002).

It is only after education and persuasion fail, that the sanctioning of non-compliant individuals should proceed. With varying levels of severity of sanctions at their disposal, tax administrators begin a gradual campaign of applying external pressure to elicit compliance. Fundamental to the ATO Compliance Model is the knowledge that non-compliance will trigger a response from the tax authority, and that this response will be tougher than the one applied before. The rationale for introducing sanctioning gently and incrementally is to signal to the taxpayer that the preferred option for settling tax disputes, from the perspective of both the taxpayer and the tax office, is at the bottom of the regulatory pyramid.

The findings of the present study are supportive of the relevance of responsive regulation to the taxation setting. As to the feasibility of implementing the ATO Compliance Model with the nuanced understanding of non-compliance that it demands, only time will tell. But at a minimal level, changes in tax administration that engage more positively with small business taxpayers seem to be unavoidable. In Kagan and Scholz's (1984) terms, this means that tax authorities need to adopt the role of 'educator' and 'politician' before they adopt the role of 'policeman'. In other words, tax administrators should be taking a far more dialogic approach to non-compliance, aiming to create a genuine change of beliefs in small business taxpayers about the tax system, what it represents and what it provides the community.

What would happen if an aggressive enforcement program was set in place before persuasion, education and negotiation had run their course? To answer this, we need to look more closely at the social-psychological dynamics of such a situation. The realisation that one's own tax incompetence, possibly linked to complex paper work demands, resulted in receiving sanctions from the tax authority. Perceptions of unjust punishment and victimisation can be the reason for taking up harmful and aggressive tax practices. Tax advisors may be sought after to exploit tax loopholes precisely because of prior application of sanctions (Murphy, 2003; for a recent example of how sanctions can backfire and elicit greater resistance, see Murphy, 2004).

The above discussion is not to suggest that everyone will be swayed by argument and reason, or that an authority should give up if education and persuasion fail to deliver the desired outcome. Once education, persuasion and negotiation have failed, an enforcement approach needs to be followed, not only from the point of view of the credibility of the system, but also because rational actors may decide to comply when the costs of sanctions exceed the personal benefits derived from non-compliance. The

tax authority can choose from a number of approaches ranging from verbal and written warnings to penalties of different strengths, but always with education and persuasion standing by to turn non-compliant actions into compliant ones. As Christine Parker (2000) warns, we need to be aware of the fact that "... this is not a simple matter of abandoning the quest for compliance and switching to deterrent sanctions as soon as persuasion fails. Compliance-oriented regulation is not a matter of substituting ... It is a holistic approach ... which mixes of regulatory strategies ... .. compliance" (Parker, 2000: 534).

Given the complexity of our world, and ourselves, we need a combination of approaches to understand and respond legitimately to small business taxpayers (Kagan and Scholz, 1984; Parker, 2000), such as persuasion, institutional reform, and deterrence. Regulators need to walk softly while carrying a big stick (see Ayres and Braithwaite, 1992: 19). Whether the big stick is likely to be used effectively or not depends very much on the regulatory context in which it is wielded. Sometimes, particularly in times of rapid social change when law struggles to keep abreast of the times, the use of the big stick can point to failures in the justice system and bring into disrepute the legitimacy of institutions such as that of taxation. In such circumstances, deterrence will be a poor substitute when institutionalised reform is regarded by a significant proportion of the population as the primary means of restoring justice to the tax system.

## ENDNOTES

<sup>1</sup> Organization for Economic Co-operation and Development.

<sup>2</sup> According to the Internal Revenue Service (IRS, 1988), the voluntary reporting compliance among wage and salary earners is over 99% whereas for self-employment income, it ranges from 41% to 84%.

<sup>3</sup> The Centre for Tax System Integrity is a collaborative research partnership between the Australian Taxation Office and the Australian National University. However, the views contained in this article are representative of the authors only, and are not representative of the Australian Taxation Office.

<sup>4</sup> Both PCT taxpayers and NPT taxpayers are collapsed into one group as our focal concern was to discriminate SB taxpayers against others.

<sup>5</sup> These are standardised canonical function coefficients which are derived weights applied to each of the variables in a given set to obtain the composite variate used in the canonical correlation analysis. As such, standardised canonical function coefficients are analogous to factor pattern coefficients in factor analysis or to beta coefficients in a regression analysis (see Arnold, 1996).

<sup>6</sup> The experiences of small business with the introduction of the goods-and-services tax 18 months after this survey is the subject of another paper.

<sup>7</sup> For example, with the recent collapse of the HIH insurance company in Australia, the government was able to step in and offer some security to small businesses and small business taxpayers precisely because government could draw on the revenue provided by taxpayers.

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**APPENDIX** (Readers are referred to Braithwaite (2001) for all source materials and for actual questionnaire)

The *Deterrence Hypothesis* was tested using four measures.

1. Probability of getting caught:

Based on Varma and Doob (1998), and Braithwaite and Makkai (1991), probability of getting caught was measured by a single question posed across two scenarios representing not declaring income (Scenario 1) and falsely claiming work deductions (Scenario 2). The scenarios are:

1. Imagine yourself in this situation. You have been paid \$5000 in cash for work that you have done outside your regular job. You don't declare it on your income tax return.
2. Imagine yourself in this situation. You have claimed \$5000 as work deductions when the expenses have nothing to do with work.

Respondents were then asked to answer the question using a five-point rating scale: "What do you think the chances are that you will get caught?" (1 = about zero [0%], 2 = about 25%, 3 = about 50%, 4 = about 75%, 5 = almost certain [100%]).

To compute a score on this measure, responses across the two scenarios were averaged (M = 3.42; SD = 1.05; alpha = .67).

2. General deterrence:

General deterrence was measured by using the following deterrence term which combines information about probability of getting caught, probability of receiving sanctions, and probability of seriousness of the consequences (see Braithwaite and Makkai, 1991; Varma and Doob, 1998):

$$\text{Deterrence} = \alpha + (C * P_t * S_t) + (C * P_p * S_p) + (C * P_{ct} * S_{ct}) + (C * P_{cp} * S_{cp}) + \varepsilon$$

where  $\alpha$  = constant

$C$  = likelihood of being caught

$P_t$  = likelihood of having to pay tax with interest

$S_t$  = severity of the problem created by having to pay tax with interest

$P_p$  = likelihood of having to pay tax with interest + penalty

$S_p$  = severity of the problem created by having to pay tax with interest + penalty

$P_{ct}$  = likelihood of being taken to court and having to pay tax with interest

$S_{ct}$  = severity of the problem created by being taken to court and having to pay tax with interest

$P_{cp}$  = likelihood of being taken to court and having to pay tax with interest + penalty

$S_{cp}$  = severity of the problem created by being taken to court and having to pay tax with interest + penalty

$\varepsilon$  = disturbance (error term)

The term was calculated for each scenario described above and then scores on the two scenarios were averaged (M = 189.6891; SD = 104.72). For specific questions used to

measure probability of being caught, probability of being sanctioned, and probability of seriousness of consequences, see Braithwaite (2001).

3. Perceived power of tax office over small business, self-employed, and ordinary people:

A three-item scale was used to capture perceived power of the tax office to elicit compliance from small business, self-employed, and ordinary people (see Braithwaite, 2001). Respondents were asked: “To what extent do you disagree or agree with the following” on a five-point strongly disagree to strongly agree rating scale: (1) The Tax Office can’t do much if a small business decides to defy it; (2) The Tax Office can’t do much if an ordinary wage and salary earner decides to defy it; and (3) The Tax Office can’t do much if a self-employed taxpayer decides to defy it.

Responses were reverse scored so a higher score indicated high perceived power of the tax office. To compute a score on this measure, the above 3 items were averaged ( $M = .4.10$ ;  $SD = .69$ ;  $\alpha = .82$ ).

4. Experience of sanctions and conflict over tax:

A four-item scale measured the degree to which the respondent had experienced conflict and received sanctions from the tax office (see Braithwaite, 2001). Respondents were asked: (1) Have you ever had an audit or other investigation by the Tax Office (1 = no, 2 = once, 3 = more than once); (2) Have you ever contested an assessment given by the Tax Office (1 = no, 2 = once, 3 = more than once); (3) Has the Tax Office ever asked questions to check the accuracy of your tax return? (scored as 1 = no, 2 = yes); and (4) Have you ever been fined or penalised in some way by the Tax Office? (scored as 1 = no, 2 = yes).

Because response categories were different for these three items, the items were standardised (where scores have a mean of zero and standard deviation of one) before being averaged to form a composite measure ( $M = .00$ ;  $SD = .68$ ;  $\alpha = .61$ ).

The *Tax morale Hypothesis* was tested using eight measures:

1. Obligation to accept tax authority decisions:

Two items taken from Tyler (1997) were used to assess respondents’ obligatory feelings in relation to what the tax office decides (see Braithwaite, 2001): (1) People should follow the decisions of the Tax Office even if they go against what they think is right; and (2) I should accept decisions made by the Tax Office even when I disagree with them. Responses were made on a five-point strongly disagree to strongly agree rating scale and were averaged to produce the scale score ( $M = 2.69$ ;  $SD = .84$ ;  $\alpha = .60$ ).

2. Personal norm of tax honesty:

A three-item scale to measure the personal norm of tax honesty was developed by Wenzel (in press) and asked respondents to indicate how strongly they rejected or accepted the following using a five-point scale: (1) Do YOU think you should honestly declare cash earnings on your tax return; (2) Do YOU think it is acceptable to overstate tax deductions on your tax return (reverse score); and (3) Do YOU think working for cash-in-hand payments without paying tax is a trivial offence (reverse score).

Responses were averaged to produce scale scores for each individual ( $M = 3.65$ ,  $SD = .73$ ,  $\alpha = .56$ ).

### 3. Security value orientation:

This scale was measured using Braithwaite and Law's (1985) Goal, Mode and Social Values Inventories (see Braithwaite, 2001). To compute the security value orientation scale, social (national strength and order) and personal (status, propriety, and effectiveness) values scales were combined ( $M = 5.32$ ;  $SD = .75$ ;  $\alpha = .84$ ).

### 4. Support for law and order (security) spending:

This scale was measured by three items asking: Should the government be spending much less money (1), less money (2), keeping things as they are (3), spending more money (4), and much more money (5) on: (1) Defence; (2) Policing; and (3) Preventing illegal immigration.

Responses were averaged to produce the scale scores for each individual ( $M = 3.72$ ;  $SD = .73$ ;  $\alpha$  reliability coefficient = .62).

### 5. Support for health, welfare, education (redistribution) spending:

This scale was measured using the same format as above with the following items: (1) Education; (2) Health care; (3) Law courts and legal aid; (4) Welfare; and (5) Employment. Responses were averaged to produce the scale scores for each individual ( $M = 3.73$ ;  $SD = .60$ ;  $\alpha = .70$ ).

### 6. Harmony value orientation:

This scale was measured using Braithwaite and Law's (1985) Goal, Mode and Social Values Inventories (see Braithwaite, 2001). To compute the harmony value orientation scale, both social (international harmony and equity) and personal (other and inner harmony) values scales were combined ( $M = 5.65$ ;  $SD = .72$ ;  $\alpha = .81$ ).

### 7. Small government and minimum interference:

This scale was measured by combining two measures from Braithwaite (2001): opposition to minority influences in decision making and support for small government, free markets ( $M = 3.41$ ;  $SD = .63$ ;  $\alpha = .64$ ).

### 8. Perceived social norm surrounding tax paying:

A three-item scale to measure perceptions of others' ethical norm in paying tax was developed by Wenzel (in press), and asked respondents to indicate how strongly they rejected or accepted the following items using a five-point scale: (1) Do MOST PEOPLE think they should honestly declare cash earnings on their tax return; (2) Do MOST PEOPLE think it is acceptable to overstate tax deductions on their tax return (reverse score); and (3) Do MOST PEOPLE think working for cash-in-hand payments without paying tax is a trivial offence (reverse score). Responses were averaged to produce scale scores for each individual ( $M = 2.57$ ;  $SD = .69$ ;  $\alpha = .57$ ).

The *Fairness Hypothesis* was tested using three measures:

#### 1. Procedural justice:

Twelve items were used to measure respondents' views on how often the Tax Office acts in accordance with the standards set out in the Taxpayers' Charter (Braithwaite, 2001). A five-point 'almost never' to 'almost always' rating scale was used with the following items: (1) Being accountable for what they do; (2) Treating you fairly and reasonably; (3) Treating you as honest in your tax affairs unless you act otherwise; (4) Respecting your privacy; (5) Keeping the information they hold about you confidential, in accordance with the law; (6) Offering you professional service and assistance to help you understand and meet your tax obligations; (7) Giving you access to information they hold about you, in accordance with the law; (8) Explaining to you the decisions they make about your tax affairs; (9) Giving you advice and information that you can rely on; (10) Helping you to minimise your costs in complying with the tax laws; (11) Giving you the right to an independent review from outside the Tax Office; and (12) Accepting that you have the right to be represented by and get advice from a person of your choice regarding your tax affairs.

Responses on these items were averaged to produce scale scores for each individual ( $M = 3.55$ ;  $SD = .86$ ,  $\alpha = .93$ ).

## 2. Fair share compared to others on same income:

Respondents answered the following question: Think of people in Australia who earn about the same as you. Would you say that you pay ... 'Much more tax than they do' (1), 'A bit more tax than they do' (2), 'About the same amount of tax as they do' (3), 'A bit less tax than they do' (4), and 'Much less tax than they do' (5). Responses were reverse scored so a higher score indicates believing that one pays much more than other Australians who earn about the same. Responses were averaged to produce the scores for each individual ( $M = 3.15$ ;  $SD = .60$ ).

## 3. Fair share compared to all Australians:

The same format was used to answer the more open question: "In your opinion, do the following groups pay their fair share of tax?" Responses were made in relation to two items: (1) you, yourself; and (2) your industry/occupation group. Responses were reverse scored so a higher score indicates believing that the above groups pay much more than their fair share of tax. Responses on these two items were averaged to produce scale scores for each individual ( $M = 3.36$ ;  $SD = .70$ ,  $\alpha = .76$ ).

The *Work practices Hypothesis* was tested using five measures:

### 1. Tax competence and independence:

Competence in preparing one's own income tax returns was measured by one single item, "I feel competent to do my own income tax return", rated on a four-point scale from 'not at all' (1) to very much (4).

Independence in preparing one's own income tax returns was measured by counting the number of people on whom respondents relied in preparing their 1998-99 income tax return, selecting from the following list: (1) Family member or close friend; (2) Tax agent or advisor (tax accountant or lawyer); (3) Business partner; (4) Someone from the Tax Office; (5) Someone from your industry association; and (6) One of your employees.

Because response categories of competence and independence items were different, the items were standardized (where scores have a mean of zero and standard deviations of one) before forming an index indicating competence and independence in preparing one's own income tax returns.

## 2. Likelihood of getting a tax refund:

In order to measure the extent to which respondents are in receipt of a tax refund, they were asked: "Think about the past four years. On most occasions, has the Tax Office owed you money when you filed your income tax return or have you owed the Tax Office money?" (1 = Tax Office owed me most times, 2 = Half and half, 3 = I owed the Tax Office most times, 4 = I don't file income tax returns). Respondents who scored a '4' were not included in the analysis. Responses of '2' and '3' were re-coded as '0' so that the higher score of 1 indicates that respondents were more than likely to receive a tax refund (M = .64; SD = .48).

## 3. Ideal tax adviser is aggressive planner:

A three-item scale was used to capture whether respondents ideally preferred to have an aggressive tax advisor (see Braithwaite, 2001). Using a rating scale from 1 (low) to 4 (high), respondents indicated preference for a tax agent or advisor who (1) is well networked and knows what the Tax Office is checking on at any particular time; (2) is a creative accountant; and (3) can deliver on aggressive tax planning. Responses on these three items were averaged to produce scale scores for each individual (M = 2.22; SD = .79, alpha = .79).

## 4. Quality of relationships:

Quality of relationships was measured through Braithwaite's motivational posture scales (see Braithwaite, 1995, 2001). Cooperation with tax office was measured through combining three motivational posture scales that represent taxpayers' cooperation with the demands of the tax office. The scales are commitment, capitulation, and resistance (reverse scored). Dissociation from the tax office was measured through two motivational posture scales that represent dissociation from the authority of the tax office. The scales are disengagement and game playing.

### *Tax evasion measure:*

Self-confessed tax evasion was a composite of three scales<sup>1</sup> developed from the Community Hopes, Fears and Actions Survey (see Braithwaite 2001, 2003). The scales are: under-reporting income, engaging in the cash economy, and exaggerating deductions. Scores on these three evasion measures correlated positively with each other, ranging from .11 ( $p < .001$ ) to .35 ( $p < .001$ ). Following Braithwaite (2003) they were combined into one composite *tax evasion* measure (Ahmed & Braithwaite, 2004).

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<sup>1</sup> These scales were standardized where scores have a mean of zero and standard deviation of one.

**Table 1. Means and standard deviations (in parenthesis) of “deterrence” variables for each group with F values**

Variables	SBT (n = 244)	NPT (n = 534)	PCT (n = 785)	F - value
Probability of getting caught for tax evasion	3.38 (1.07)	3.36 (1.01)	3.36 (1.06)	.04 (ns)
General deterrence (probability of getting caught * probability of receiving sanctions * probability of seriousness of the consequences)	194.25 (103.36)	182.48 (100.08)	186.62 (104.34)	.94 (ns)
Perceived power of tax office over small business, self-employed, and ordinary people	4.26 PCT (.55)	4.15 (.66)	4.11 (.65)	5.17**
Experience of sanctions and conflict over tax	.14 PCT (0.70)	.07 (0.73)	-.01 (0.66)	4.89**

\*\* < .01

**Table 2. Means and standard deviations (in parenthesis) of “tax morale” variables for each group with F values**

Variables	SBT (n = 244)	NPT (n = 534)	PCT (n = 785)	F - value
Obligation to accept tax authority decisions	2.65 (.89)	2.59 (.83)	2.74 (.82)	4.98** <sup>a</sup>
Personal norm of tax honesty	3.70 (.73)	3.76 (.72)	3.60 (.73)	8.05*** <sup>a</sup>
Security value orientation	5.44 NPT (0.64)	5.20 (0.76)	5.35 (0.71)	11.44***
Support for law and order (security) spending	3.75 NPT (.68)	3.61 (.73)	3.72 (.72)	4.91**
Support for health, welfare, education (redistribution) spending	3.61 NPT (.58)	3.75 (.58)	3.68 (.59)	5.09**
Harmony value orientation	5.63 (.64)	5.70 (.76)	5.61 (.71)	2.60 (ns)
Small government and minimum interference	3.54 NPT (.59)	3.27 (.68)	3.43 (.60)	18.35***
Perception of others' tax morale	2.58 (.65)	2.61 (.60)	2.67 (.61)	2.82 (ns)

\*\* < .01      \*\*\* < .001

<sup>a</sup> Although the overall F statistic was significant, the small business group (scoring between NPT and PCT) was not significantly different from either of them. NPT and PCT were significantly different from each other however.

**Table 3. Means and standard deviations (in parenthesis) of “fairness” variables for each group with F values**

<b>Variables</b>	<b>SBT</b> <b>(n = 244)</b>	<b>NPT</b> <b>(n = 534)</b>	<b>PCT</b> <b>(n = 785)</b>	<b>F - value</b>
Procedural justice	3.50 (.92)	3.51 (.86)	3.51 (.82)	.03 (ns)
Fair share compared to others on same income	3.10 NPT (.62)	3.24 (.64)	3.17 (.59)	4.36**
Fair share compared to all Australians	3.28 PCT NPT (.64)	3.45 (.71)	3.40 (.72)	4.96**

\*\* < .01

**Table 4. Means and standard deviations (in parenthesis) of “work practice” and other tax-related variables for each group with F values**

Variables	SBT (n = 244)	NPT (n = 534)	PCT (n = 785)	F - value
Tax competence and independence	-.21 NPT PCT (.52)	-.01 (.37)	-.04 (.44)	12.16***
Likelihood of getting a tax refund	.32 NPT PCT (.47)	.66 (.48)	.66 (.48)	47.70***
Ideal tax adviser is aggressive planner	2.34 NPT (.76)	2.04 (.78)	2.25 (.80)	15.78***
Cooperation with tax office	3.36 (.44)	3.38 (.40)	3.34 (.41)	2.21 (ns)
Dissociation from tax office	2.36 NPT (.48)	2.28 (.46)	2.41 (.43)	14.95***
Self-confessed tax evasion	.06 NPT (.68)	-.07 (.50)	.00 (.53)	3.74*

\* < .05    \*\*\* < .001

**Table 5. Standardised Canonical Discriminant Function Coefficients, Wilk's Lambda and F-values with their level of significance from a Discriminant Function Analysis**

Predictor variables	Standardised Canonical Discriminant Function Coefficients	Wilk's Lambda	F value with significance
Likelihood of getting a tax refund	0.79	0.914	102.73***
Fair share compared to all Australians	0.30	0.994	6.43**
Tax competence and independence	0.28	0.985	16.59***
Perceived power of tax office over small business, self-employed, and ordinary people	-0.24	0.992	31.53***
Small government and minimum interference	-0.24	0.989	8.89**
Support for health, welfare, education (redistribution) spending	0.20	0.990	10.51***
Canonical R	0.35		
Eigenvalue	0.14		
Chi-Square	137.44		
Significance	p<0.001		

\*\*\* p < 0.001