

**AGGRESSIVE TAX PLANNING:
DIFFERENTIATING THOSE PLAYING
THE GAME FROM THOSE WHO DON'T**

Kristina Murphy and Yuka Sakurai



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Kristina Murphy and Yuka Sakurai

SERIES EDITOR

Tina Murphy

Centre for Tax System Integrity
Research School of Social Sciences
Australian National University
Canberra, ACT, 0200

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This series of working papers is designed to bring the research of the Centre for Tax System Integrity to as wide an audience as possible and to promote discussion among researchers, academics and practitioners both nationally and internationally on taxation compliance.

The working papers are selected with three criteria in mind: (1) to share knowledge, experience and preliminary findings from research projects; (2) to provide an outlet for policy focused research and discussion papers; and (3) to give ready access to previews of papers destined for publication in academic journals, edited collections, or research monographs.

Series Editor:
Tina Murphy

Abstract

The study reported in this paper examined a group of Australian taxpayers who have expressed a preference for an aggressive tax agent. The study attempted to understand how high-risk taxpayers and high-risk practitioners form their partnerships by examining aggressive taxpayers' attitudes and perceptions of the Australian tax system. Data were taken from the Community Hopes, Fears and Actions Survey, which tested a random sample of 2040 Australian taxpayers. Results from a series of independent sample t-tests revealed that there are a number of important differences between 'aggressive' and 'non-aggressive' taxpayers. Finally, a stepwise discriminant function analysis was used to determine which variables can most effectively differentiate aggressive taxpayers from other taxpayers. The best predictive model obtained from this analysis indicated that taxpayers involved in aggressive tax planning tend to have higher family incomes and are more status-oriented than other taxpayers. They are also more likely to blame the Australian Taxation Office (Tax Office) if caught for a tax offence, are more likely to be vindictive towards the Tax Office as a result, and are more likely to adopt a resistance posture towards the Tax Office. Not surprisingly, taxpayers with an aggressive tax agent are more likely to be game-players than other taxpayers. These findings are discussed in the regulatory context. Possible solutions for how tax authorities might deal with this high-risk group of taxpayers are suggested.

Aggressive tax planning: Differentiating those playing the game from those who don't

Kristina Murphy and Yuka Sakurai

Introduction

There are many reasons why taxpayers choose to use a tax agent. These reasons range from taxpayers wanting to file an accurate return, not having the knowledge to complete a complex return, wanting to minimise the tax they are required to pay, or simply not having enough time to complete their own return. Whatever the reason, taxpayer demand for tax agents has increased substantially over the past few decades, with approximately 70% of Australian taxpayers now choosing to use a tax practitioner (Braithwaite, 2000; Commissioner of Taxation, 1997).

The role that tax agents play in taxpayer compliance has received increasing attention over the past 15 years. Research in the United States has shown that professionally prepared returns tend to be more non-compliant than self-prepared returns and tax practitioners have stated that their clients demand such work (for example, Coyne, 1987; Erard, 1993; Helleloid, 1989; Klepper & Nagin, 1989a). In contrast, a number of studies have reported that taxpayers demand cautious behaviour and accurate returns from their tax agents (Hite & McGill, 1992; Sakurai & Braithwaite, 2001; Tan, 1999). This debate is far from being resolved. The aim of the study reported in this paper was to identify the factors that lead taxpayers to seek the services of an aggressive tax practitioner. It did this by examining a sub-sample of Australian taxpayers, namely, those believed to have an aggressive tax agent.

Theories of non-compliance

A number of theories have been proposed to explain non-compliant behaviour, both in the taxation context and in regulatory fields in general. The most dominant model of non-compliance in the regulatory field portrays the subject as an 'amoral profit-seeker whose actions are motivated wholly by rational calculation of costs and opportunities' (Kagan & Scholz, 1984, p. 69). In the taxation literature this assumption underlies the deterrence theory approach (Grasmick & Green, 1980). The central explanatory proposition is that a taxpayer is likely to break the law unless anticipated legal penalties exceed the additional earnings that could be made by evading tax.

One of the main limitations of the deterrence theory approach, however, is that it does not satisfactorily explain the high levels of observed compliance. Smith and Kinsey (1987) have shown that the majority of American taxpayers are compliant even when the possibility of detection and punishment for non-compliance is obviously slim. Australian research has also shown that taxpayers report being generally compliant even when they believe others are not (Braithwaite, 2000). These findings suggest that taxpayers' attitudes towards the tax system, rather than (or in addition to) purely economic calculations or fear of punishment, are important in explaining taxpayers' non-compliance. Wallschutzky (1984) also indicates that attitudes are more important than opportunities in determining taxpayers' behaviour. The incorporation of attitudes to the regulatory system into theoretical accounts of non-compliance is the basic contention of Kagan and Scholz's (1984) political citizen model.¹

Kagan and Scholz's political citizen model incorporates the idea that unreasonable behaviour by regulators generates resistance to compliance. Unreasonableness may involve disrespect for citizens, or arbitrary refusal to take their concerns into account in the enforcement process. Citizen response is likely to be weakened respect for compliance with the law. In the context of taxation, non-compliance could be interpreted as taxpayers' expressive rebellion against Tax Office enforcement actions, or laws that are perceived to be illegitimate. Smith and Kinsey (1987) have also argued that people's social networks and associations help shape their perceptions, norms and attitudes, which then influence their responses to imagined and actual sanctions. Recent research has highlighted the importance of using these socio-psychological factors to explain taxpayers' non-compliance, with some authors showing taxpayers' perceptions about evasion and fairness having a direct influence. For example, Porcano (1988) discussed how individuals who perceive evasion as prevalent, and/or to be an insignificant crime, tend to be less compliant. Taken together, the results of these studies suggest that taxpayers' attitudes towards the Tax Office and the tax system in general need to be taken into account when attempting to explain non-compliance.

¹ The basic idea of Kagan and Scholz's (1984) model is that when 'amoral calculators' fail to comply, it is because they calculate that the costs of compliance exceed the benefits, but for 'political citizens' non-compliance arises because they are not persuaded that compliance is a just obligation of citizenship.

The role of tax practitioners in taxpayer compliance

The effect that tax practitioners have on taxpayer compliance has also received substantial attention in recent years (for example, Ayres, Jackson & Hite, 1989; Jackson, Milliron & Toy, 1988; Klepper & Nagin, 1989a, 1989b; Reckers, Sanders & Wyndelts, 1991). Until recently, tax compliance research did not consider the potential impact of the tax agents on the compliance decision.

While tax practitioners alleviate many of the informational and computational barriers to tax compliance, they also possess the expertise to assist their clients in exploiting opportunities for tax non-compliance. In fact, Klepper, Mazur and Nagin (1991) suggest that tax agents have a dual role. Given that they have unique knowledge of tax law, tax agents can be both ‘exploiters’ and ‘enforcers’ of the law. Klepper et al. suggest that in unambiguous situations tax agents tend to be enforcers of the law. In these situations, they tend to ensure compliance by recommending cautious tax minimisation strategies. In contrast, when a tax agent is faced with an ambiguous situation, they tend to be exploiters of the law, in that they encourage tax avoidance.

Given that tax agents do have the knowledge and expertise to exploit the grey areas of tax law, a number of studies have examined whether professionally prepared returns are more non-compliant in nature than self-prepared returns. Findings from these studies have in fact suggested that professionally prepared returns are more non-compliant. For example, Smith and Kinsey (1987) found that audited tax returns prepared by Certified Public Accountants² and attorneys tended to have much higher dollar audit adjustments. Erard (1993) also found that paid-preparer returns exhibited greater non-compliance. Similar findings have been reported in many other studies (for example, Ayres, Jackson & Hite, 1989; Kaplan, Reckers, West & Boyd, 1988; McGill, 1988). Klepper and Nagin (1989a) reported that in the United States in 1979 about 44% of all tax returns were prepared by tax practitioners, yet these returns accounted for 74% of all non-compliance. Given the fact that 70% of Australians now choose to use a tax practitioners to prepare their tax return, the potential loss of tax revenue

² Also known as Certified Practising Accountants.

due to non-compliant reporting poses a serious problem for the Australian Taxation Office (Tax Office). The question of who instigates this non-compliant reporting – the tax agent or taxpayer – is therefore an important question and is discussed in the next section.

Aggressive tax reporting

In the Tax Office 1999–2000 annual report, the Commissioner of Taxation highlighted the importance of continuing to pursue the issue of aggressive tax planning. Despite the strategies that have been put in place to combat the rise of aggressive tax planning, the Tax Office is continuing to see intense activity among those who devise, promote, market and participate in such activities. In this paper, the term ‘aggressive tax reporting’ refers to the situation where there is a reasonable probability that a particular tax return stance will not be upheld by an audit and subsequent legal challenge. Thus ‘an aggressive position is a risky choice due to the uncertainty of its final disposition’ (Hite & McGill, 1992, p. 400).

While many in the aggressive tax planning industry argue that they are simply responding to the demands of their clients, there have been many situations where participants in aggressive tax planning schemes have been led to invest based on trust in the proposals marketed to them (Commissioner of Taxation, 2000). Thus the question of who instigates aggressive tax reporting – whether it is driven by demand or supply – is complex, albeit interesting and important. Studies exploring this question have yielded contradictory results.

Results from a number of surveys (Collins, Milliron & Toy, 1990; Hite & McGill, 1992; Sakurai & Braithwaite, 2001; Tan, 1999) indicate that the majority of taxpayers want their tax agent to assume an honest role and prepare an accurate return. Collins et al. (1990) concluded that approximately 70% of their sample used tax agents to file an accurate return, with only 25% indicating that minimising their tax liability was their primary objective. Hite and McGill (1992) and Tan (1999) found that taxpayers tend to agree with conservative advice offered by their tax agent, and to disagree with aggressive advice. Sakurai and Braithwaite (2001) also reported that taxpayers generally want an honest tax agent who files an accurate return.

In contrast, studies performed on tax agents themselves indicate that they view their clients as the initiators of aggressive tax reporting (Attwell & Sawyer, 2001; Klepper & Nagin, 1989a; Schisler, 1994; Tooley, 1992). This point of view is also supported by Sakurai and Braithwaite's (2001) research on a sample of 2040 Australian taxpayers. Sakurai and Braithwaite identified three types of tax adviser sought by taxpayers. The most popular type sought was one who was honest and risk-averse. The second most popular type was one who engaged in 'cautious minimisation of tax'. These practitioners avoid conflict, yet are sophisticated about identifying opportunities to minimise tax. The third type of tax practitioner sought by taxpayers was the 'creative accountant, aggressive tax planning type'. Here, the taxpayer wants a practitioner who is well networked and knows what issues the Tax Office is targeting at that time. Unlike the second type of practitioner, the creative accountant is not threatened by conflict. According to Sakurai and Braithwaite, this is by far the least popular preference among ordinary taxpayers, but identifies a niche market that is significant and of great concern to tax authorities.

Sakurai and Braithwaite (2001) also showed that taxpayers are likely to find tax practitioners who have the attributes they value most highly. This finding suggests that a small number of taxpayers do in fact look for, and ultimately find, an aggressive tax agent who will aggressively minimise the tax they are required to pay. The present study aimed to further examine this group of taxpayers in an attempt to identify which factors are important for predicting when a taxpayer will seek such advice.

The present study

The study reported here used data from the Community Hopes, Fears and Actions Survey (Braithwaite, 2000) to study those taxpayers who have expressed a preference for a creative accountant of the aggressive tax planning type and who actually have an aggressive tax agent. In other words, this group has found a tax agent who corresponds with their ideal. It is assumed that these taxpayers will pose a greater threat to the Tax Office than taxpayers who prefer to use an honest and risk-averse practitioner.

The study attempts to understand how high-risk taxpayers and high-risk practitioners form their partnerships by examining aggressive taxpayers' attitudes and perceptions of the Australian tax system. Specifically, it asks if the views of aggressive taxpayers differ from

those of others in the general population. Following the argument of Braithwaite (forthcoming) – taxpayers who distance themselves from the Tax Office tend to develop critical attitudes towards the Tax Office to justify their behaviour – it is hypothesised here that taxpayers who have an aggressive tax practitioner will be more critical of the Tax Office and of the tax system in general. By providing a psychological profile of this sub-sample of taxpayers, policy-makers will be able to develop more appropriate policies for dealing with taxpayers in this high-risk group.

Method

Using data from the Community Hopes, Fears and Actions Survey (Braithwaite, 2000), this study examined some of the psychological factors which differentiate taxpayers who have an aggressive tax agent from those who do not.

The Community Hopes, Fears and Actions Survey was mailed to 7754 Australians between June and October 2000. Participants were randomly selected from publicly available electoral rolls. The sample therefore included both taxpayers and non-taxpayers. Completed questionnaires were received from 2040 respondents, yielding a response rate of 29%. While 29% is low, such a response rate is not unusual in the tax context, with some arguing (for example, Wallschutzky, 1984) that tax surveys of the general population cannot be expected to yield higher than a 30 to 40% response rate. More importantly, however, the respondents to this survey were a representative sample of the general population (for details see Mearns & Braithwaite, 2001).

For the purposes of this study, two groups of taxpayers were of interest. The first was a group of taxpayers who reported that they preferred a creative accountant and who actually had an aggressive tax agent ($n = 539$). The second group of interest was taxpayers who did not prefer a creative accountant and did not have an aggressive tax agent ($n = 861$). See Appendix for details on how each of these two groups/variables were constructed.

Analyses and results

The data consisted of taxpayers' responses to a variety of variables designed to measure beliefs and attitudes towards the Tax Office and the Australian tax system. The group that want and have an aggressive tax agent was compared to the general taxpayer population in terms of the following constructs: their demographic profile, their world views; their motivational postures; their evaluation of the Tax Office and tax system; and their individual experiences (see Braithwaite, 2001, for a detailed description of these constructs). It should be noted here that only the variables that appeared to highlight important differences between the two groups of taxpayers were examined. Following an examination of the variables that showed differences between these two groups of taxpayers, a discriminant function analysis was used to identify the variables that had most predictive power in differentiating the two groups.

Demographics

A number of demographic variables have been shown to play a role in tax non-compliance (for a discussion see Jackson & Milliron, 1986). Based on the data collected in the Community Hopes, Fears and Actions Survey, taxpayers who reported that they want and have an aggressive tax agent were differentiated from taxpayers who do not have an aggressive tax agent on three demographic variables: age, education and family income (see Table 1). There were no other demographic differences between taxpayers who want and have an aggressive tax agent and other taxpayers.

Table 1: A comparison of demographic variables for taxpayers who want and have an aggressive tax agent (aggressive) and other taxpayers (others) (standard deviations are given in brackets)

<i>Variable</i>	<i>Aggressive</i>	<i>Others</i>	<i>t value</i>
Age	46.37 (14.24)	48.33 (14.07)	2.51**
Education	2.82 (1.61)	3.05 (1.69)	2.55**
Family income ('000s)	55.16 (43.94)	49.96 (32.47)	-2.27*

*p<0.05 **p<0.01

Findings show that taxpayers who want and have an aggressive tax agent tend to be slightly younger on average, tend to be less educated, and tend to have a family income significantly higher than those who do not have an aggressive tax agent.

World views

World views are a person's underlying beliefs about the world they live in and want to live in. The Community Hopes, Fears and Actions Survey operationalised this construct by measuring taxpayers' social and personal values in general, their values towards paying tax, and their priorities for tax reform. Table 2 compares the mean scores of taxpayers who want and have an aggressive tax agent with other taxpayers in terms of a number of world views.

Table 2: A comparison of taxpayers who want and have an aggressive tax agent (aggressive) and other taxpayers (others) on a number of variables designed to measure a person's world views (standard deviations are given in brackets)

Variable	Aggressive	Others	t value
<i>Social and personal values</i>			
Status	4.69 (0.95)	4.34 (1.02)	−6.42***
Propriety	5.65 (0.86)	5.54 (0.90)	−2.27*
Effectiveness	5.58 (0.81)	5.44 (0.83)	−2.99**
<i>Tax morality</i>			
Honesty in taxpaying	3.39 (0.70)	3.69 (0.69)	7.82***
Tax evasion admiration	2.83 (0.88)	2.51 (0.85)	−6.69***
<i>Priorities for tax reform</i>			
Making the rich pay	3.96 (0.84)	4.00 (0.87)	ns
Cutting tax and administration	3.90 (0.76)	3.71 (0.85)	−4.25***
Simplifying the tax system	3.10 (0.95)	2.89 (0.94)	−4.08***

*p<0.05 **p<0.01 ***p<0.001

Social and personal values. As can be seen in Table 2, those taxpayers who want and have an aggressive tax agent score significantly higher on the status variable than other taxpayers. The status variable measured the importance people placed on economic prosperity, power

and having high standing in their community. The results show that those involved in aggressive tax planning are more status-oriented in that they are more likely to view these attributes as important.

Propriety was designed to measure whether people thought it was important to do the right thing and follow the rules of correct conduct. Contrary to expectation, those involved in aggressive tax planning were more likely to view this attribute as more important than the general taxpayer. This is a particularly interesting finding as it suggests that taxpayers who are involved in aggressive tax planning do not believe that what they are doing is wrong. Additional results (see below) in fact suggest that they think minimising tax is the smart thing to do.

Effectiveness measured participants' resourcefulness and efficiency in using the best methods to get the best results. Results from the survey showed that those involved in aggressive tax planning thought this value was more important.

Tax morality. A number of variables were used in the Community Hopes, Fears and Actions Survey in an attempt to gauge the level of tax morality held by a taxpayer. Michael Wenzel of the Centre for Tax System Integrity developed a scale labelled 'a personal ethical norm of honesty in taxpaying' to measure whether taxpayers believed they should honestly declare all cash earnings and not overstate deductions on their tax returns. Results showed that taxpayers who want and have an aggressive tax agent are less likely to think one should honestly declare cash earnings, are more likely to think working for cash without paying tax is a trivial offence, and are more likely to think it acceptable to overstate tax deductions.

Friedrich Schneider³ designed a multi-item scale labelled 'admiration of cash economy tax evasion'. Again, this scale was designed to measure a taxpayer's overall level of morality towards paying tax. Specifically, this variable measured how a taxpayer would respond if they found out an acquaintance was working for cash payments without paying tax (that is, whether they would care, whether they thought it was wrong, and whether they thought the

³ Friedrich Schneider is a Visiting Fellow at the Centre for Tax System Integrity. He is a leading researcher on issues associated with the cash economy internationally.

acquaintance was clever). Results showed that taxpayers who want and have an aggressive tax agent are more likely to view this hypothetical acquaintance as smart for being involved in the cash economy and less likely to judge the behaviour as immoral.

Priorities for tax reform. A number of scales were developed for the Community Hopes, Fears and Actions Survey to measure taxpayers' priorities for tax reform. Not surprisingly, compared to the general taxpayer, those taxpayers who want and have an aggressive tax agent thought it more important that taxes be kept as low as possible and that the costs of administering the tax system should be minimised. Further, compared to the general taxpayer, they thought the tax system should be simplified. As can be seen in Table 2, taxpayers who want and have an aggressive tax agent do not differ from the general population in believing that the rich should pay more in tax.

Motivational postures

Motivational postures represent the ways in which individuals position themselves in relation to a regulatory authority, and are predispositions to compliant or non-compliant conduct (Braithwaite, 1995). Using items adapted from previous work, Braithwaite, Reinhart, Mearns & Graham (2001) showed that taxpayers adopt five different motivational postures in the taxation context. The posture that received the strongest endorsement was commitment, followed by capitulation, resistance, game-playing and disengagement. Table 3 compares the mean scores of taxpayers who want and have an aggressive tax agent with others on each of these motivational postures.

Table 3: A comparison of motivational postures adopted by taxpayers who want and have an aggressive tax agent (target) and other taxpayers (others) (standard deviations are given in brackets)

Variable	Aggressive	Others	t value
Commitment	3.76 (0.56)	3.91 (0.55)	5.19***
Capitulation	3.37 (0.53)	3.37 (0.54)	ns
Resistance	3.29 (0.51)	3.11 (0.55)	-6.24***
Game-playing	2.41 (0.53)	2.26 (0.52)	-5.37***
Disengagement	2.61 (0.58)	2.21 (0.57)	-12.60***

***p<0.001

As can be seen from Table 3, taxpayers involved in aggressive tax planning are less committed to the tax system than the general taxpayer. If a taxpayer adopts a commitment posture towards the tax system, it means they feel a sense of moral obligation to pay their taxes and pay their taxes with good will because they believe paying tax ultimately advantages everyone.

The posture of capitulation means that a taxpayer may not be happy with the Tax Office or tax system, but they acknowledge it is a part of life and they must accept that taxes need to be paid. Capitulation signals an intention to be cooperative with the Tax Office. The two groups of taxpayers did not differ significantly on this motivational posture.

Findings also showed that taxpayers involved in aggressive tax planning are significantly more resistant towards the tax system than the general taxpayer (see Table 3). Taxpayers who adopt a resistance posture are likely to view the Tax Office with antagonism because they feel the Tax Office pushes them around. Further, these taxpayers believe people should take a stand against the Tax Office.

A particularly interesting motivational posture to examine is game-playing. Taxpayers who adopt a game-playing posture enjoy the game of finding the grey areas of tax law and the challenge of minimising tax. In fact, they believe the Tax Office respects them for being creative in their tax affairs. As one might expect, findings from the survey showed that those involved in aggressive tax planning scored significantly higher on this posture than taxpayers in general. This result is hardly surprising, given that those involved in aggressive tax planning seek to minimise their tax by exploiting loopholes in the tax law.

The fifth motivational posture measured in the Community Hopes, Fears and Actions Survey was that of disengagement. Taxpayers who are disengaged from the tax system are those who do not care that they are not doing the right thing by the Tax Office and they believe the Tax Office cannot do anything to them if they choose not to pay their taxes. Further, they do not really want to know what the Tax Office expects from them. As can be seen in Table 3, those taxpayers who want and have an aggressive tax agent are more likely to be disengaged from the tax system than others.

Evaluation of the tax system

The results from a number of scales were analysed with the aim of gauging taxpayers' attitudes towards the tax system and the way in which the Tax Office operates. Table 4 presents the relevant variables which differentiated taxpayers who want and have an aggressive tax agent from others. Of interest was whether those involved in aggressive tax planning see themselves as receiving less favourable outcomes in relation to their tax affairs than taxpayers in general.

Table 4: A comparison of taxpayers who want and have an aggressive tax agent (aggressive) and other taxpayers (others) on their evaluation of the Tax Office (standard deviations are given in brackets)

Variable	Aggressive	Others	t value
Distributive justice	3.52 (1.00)	3.73 (1.02)	3.63**
Citizens being treated as trustworthy	3.12 (0.79)	3.22 (0.81)	2.22*
Material loss	3.25 (0.84)	3.00 (0.89)	-5.29***
Legitimacy	2.66 (0.64)	2.78 (0.70)	3.25**

*p<0.05 **p<0.01 ***p<0.001

Distributive justice (Tyler, 1997) refers to the perceived fairness of outcomes. In the taxation context, if a taxpayer were to view a decision made by the Tax Office as being unfair or unjust, then the distributive justice principles would not have been met. The index of distributive justice in the Community Hopes, Fears and Actions Survey was designed to ask taxpayers how often they agreed with decisions made by the Tax Office and how often the decisions had been favourable to them.

Of central importance in theories of procedural justice are issues of respect for citizens.

The citizen trustworthiness scale was developed by John Braithwaite and Toni Makkai (1994) and was designed to measure an aspect of procedural justice in the taxation context. This two-item scale asked survey respondents whether they thought the Tax Office treated taxpayers in a trustworthy manner.

Trevor Sutton's (1997) material loss index was also analysed. This index was designed to ask taxpayers how they felt about paying tax and whether they believed paying tax removed the incentive to earn more income.

A multi-item favourability scale, based on the work of Tyler (1997), proved useful in group comparisons. This scale was designed to test the perceived legitimacy of the Tax Office. According to Tyler (1997), having legitimacy influences the degree to which an authority is or is not effective.

Table 4 presents data from the Community Hopes, Fears and Actions Survey on each of these four scales. With respect to the distributive justice scale, taxpayers involved in aggressive tax planning are less likely to agree with Tax Office decisions than are other taxpayers. They are also less likely to think the Tax Office treats citizens as trustworthy. Taxpayers who wanted and had an aggressive tax agent are more likely to think they would be better off working less given the rate of tax they have to pay (as measured by the material loss index) and less likely to view the Tax Office as a legitimate institution. More specifically, they view the Tax Office as being too powerful and too influenced by political pressures.⁴

Individual experiences

According to some deterrence theorists, a number of factors other than the likelihood of getting caught need to be taken into account when investigating taxpayers' non-compliance (Grasmick & Bursik, 1990). Braithwaite et al. (2001) pointed out that one needs to consider people's perceptions of the probability of getting caught, the perceived probability of receiving particular punishments, and the psychological and social problems posed by being caught. The psychological and social facets of how the individual interprets punishment were measured in two ways. Respondents were first asked how big a problem it would be to them if different types of punishment were received. As can be seen in Table 5, taxpayers involved in aggressive tax planning are less likely to view receiving punishment as a problem.

⁴ These specific items in the scale accounted for most of the difference.

Table 5: A comparison of taxpayers who want and have an aggressive tax agent (aggressive) and other taxpayers (others) on their individual experiences (standard deviations are given in brackets)

Variable	Aggressive	Others	t value
Problem of punishment	3.46 (0.73)	3.55 (0.66)	2.19*
Shame acknowledgment	2.94 (0.84)	3.13 (0.81)	4.04***
Shame displacement	2.01 (0.70)	1.75 (0.61)	−6.99***

*p<0.05 ***p<0.001

Next, respondents were asked how they would react to a particular type of punishment (that is, a fine). Of interest was the extent to which they anticipated feeling shame when they were caught and punished for a tax offence. Braithwaite et al. (2001) hypothesised that if regulatory action does not result in reactions of shame acknowledgment (for example, feeling remorse, wanting to put things right), compliance is unlikely as an outcome. Findings revealed that taxpayers involved in aggressive tax planning are less likely to have reactions of shame acknowledgment. In other words, they appear not to feel remorse for evading their tax obligations. A reaction that is also known to undermine compliance is shame displacement. Shame displacement means that an individual does not accept responsibility for wrongdoing and they blame others for what has happened to them. This variable was measured in the survey by asking respondents whether they blame the Tax Office and feel unfairly treated by the Tax Office. Results showed that taxpayers who want and have an aggressive tax agent are more likely than others to blame the Tax Office and think their treatment is unfair. As a result of this, they are more likely to want to get even with the Tax Office. This could manifest itself in non-compliant behaviour.

Summary of findings

The study reported in this paper examined whether taxpayers involved in aggressive tax planning are different demographically, hold different world views, adopt different motivational postures, evaluate the Tax Office differently, or have different individual experiences than taxpayers not involved in aggressive tax planning. To summarise, it appears that taxpayers who seek and have an aggressive tax agent are slightly younger, earn more and are less educated than the general taxpayer. They are also more status-oriented, place value

on behaving with propriety more generally, and believe they are more resourceful and efficient in using the best method to get the best results. The overall level of morality towards paying tax is also much lower in taxpayers who have an aggressive tax agent. They appear to be more against the idea of paying tax and are less likely to think that nothing is wrong with evading tax. In fact, this group of taxpayers appears to think evading tax is the smart thing to do.

Taxpayers involved in aggressive tax planning are less committed to the tax system, are more resistant in their dealings with the Tax Office, and are more likely to feel disengaged from tax authorities. Not surprisingly, these taxpayers are more likely to adopt a game-playing posture, whereby they enjoy seeking out the grey areas of tax law.

Taxpayers who want and have an aggressive tax agent place less value on the tax system and Tax Office. Compared to taxpayers in general, they believe the tax system should be simplified and the costs of administering it should be minimised. They are less likely to view the Tax Office as a legitimate institution and are more likely to disagree with Tax Office decisions.

The findings suggest that deterrence is limited in its effect with this group of taxpayers. Taxpayers who want and have an aggressive tax agent are more likely to blame the Tax Office and feel unfairly treated under circumstances where they are caught and punished for a tax offence. Most importantly, taxpayers involved in aggressive tax planning are less likely to view punishment as a problem and are less likely to feel ashamed or responsible if caught and punished for a tax offence.

Discriminant function analysis

In the previous section, 20 variables were found to discriminate taxpayers who want and have an aggressive tax agent from those who do not.⁵ Stepwise discriminant function analysis was used to determine which variables were the most important in predicting whether a taxpayer would want and use an aggressive tax agent. Variables were entered and retained in the discriminant function if they were significant at the 0.05 level or less. Table 6 contains the

⁵ Twenty-one variables discriminated between the two groups if the age variable was considered.

standardised coefficients, with only the significant values presented. Those with the largest absolute values made the largest contribution to the function, and discussion will be limited to these variables.

As can be seen in Table 6, six variables made significant contributions to the discriminant function. The six selected variables were effective in discriminating groups, leading to a significant multivariate Wilks' Lambda, $\chi^2(6) = 0.86$, $p < 0.001$. Of the six significant variables, the game-playing posture contributed the most, followed by honesty in taxpaying, family income, shame displacement, status and resistance.⁶

Honesty in taxpaying was negatively related to the dependent variable, confirming that taxpayers who have an aggressive tax agent tend to have a lower level of honesty towards paying tax. The positive relationships between game-playing, resistance, family income, shame displacement and status and the dependent variable indicate that taxpayers who have an aggressive tax agent tend to have higher family incomes, enjoy seeking out the grey areas of tax law, are more likely to be 'resisters' in their motivational posture towards the tax system, are more status-oriented and are less likely to accept responsibility by blaming the Tax Office if they are caught and punished for a tax offence. Forty-five per cent of taxpayers who have an aggressive tax agent were correctly classified by the function. Of taxpayers who do not have an aggressive tax agent, 84% were accurately classified by the function. The overall correct classification rate was 69%.

⁶ The leave-one-out method was used for cross-validating the data. The same six variables were found to contribute to the discriminant function.

Table 6: Standardised coefficients for a stepwise discriminant function analysis for discriminating between taxpayers who have an aggressive tax agent and those who do not

Independent variable	Dependent variable
	Type of agent (aggr. versus not aggr.) Standardised function coefficient ^a
V ₁ Education	–
V ₂ Family income	0.258
V ₃ Status	0.184
V ₄ Propriety	–
V ₅ Effectiveness	–
V ₆ Honesty in taxpaying	–0.357
V ₇ Tax evasion admiration	–
V ₈ Cutting tax and administration	–
V ₉ Simplifying the tax system	–
V ₁₀ Commitment	–
V ₁₁ Resistance	0.181
V ₁₂ Game-playing	0.673
V ₁₃ Disengagement	–
V ₁₄ Distributive justice	–
V ₁₅ Citizens being treated as trustworthy	–
V ₁₆ Material loss	–
V ₁₇ Legitimacy	–
V ₁₈ Problem with punishment	–
V ₁₉ Shame acknowledgment	–
V ₂₀ Shame displacement	0.186
Canonical correlation	0.381
Wilks' Lambda	0.855
Chi-square	173.688
Significance level	0.000

^a Insignificant variables marked with –.

Discussion and implications

In previous studies, the debate over whether tax agents encourage taxpayers to take more risks by exploiting the grey areas of tax law, or whether taxpayers demand that tax agents explore these areas, is far from resolved. Findings have been reported to support both sides of the argument. While not directly addressing this question, the present study attempted to profile a group of Australian taxpayers who said they wanted and used an aggressive tax agent.

The results of the discriminant function analysis indicated that of the 20 variables that differentiated taxpayers at the bi-variate level, only six were important in a large multivariate analysis. The procedure of identifying these six important variables provides the Tax Office, and tax practitioners, with useful information for developing strategic policies aimed at reducing aggressive tax planning.

Taxpayers involved in aggressive tax planning tend to have higher family incomes and tend to be more status-oriented than general taxpayers. Given the importance that taxpayers involved in aggressive tax planning place on their standing in the community, it is not surprising that they may attempt to reduce their tax aggressively in order to have more disposable income. Given that taxpayers who earn more have more to gain by evading their taxes, it is hardly a surprise that interventions geared towards taxpayers at the upper end of the income scale are likely to be more effective in reducing aggressive tax planning.

How should we interpret the finding that taxpayers involved in aggressive tax planning are more likely to blame the Tax Office if asked to pay substantial fines or penalties for tax offences? They are also more likely to anticipate wanting to get even with the Tax Office if given such punishment. This is a particularly interesting result, as it has implications for the way the Tax Office deals with non-compliance within this group of taxpayers.

As noted earlier, motivational postures represent the ways individuals position themselves in relation to a regulatory authority, reflect the desire to cooperate or not, and are predispositions to compliant or non-compliant conduct (Braithwaite, 1995). The findings of the discriminant function analysis revealed that taxpayers involved in aggressive tax planning are more likely to adopt a resistant posture towards the Tax Office. They are more likely to view the Tax Office as pushing them around and, as a result, are more likely to believe that people should take a stand against the Tax Office. This finding, taken together with the results presented in the previous paragraph, suggests that bullying or issuing indiscriminate threats to those suspected of non-compliance may be ineffective, and may in fact lead to higher levels of non-compliance. This finding fits Brehm & Brehm's (1981) research into reactance, which has shown that the use of threat and coercion, particularly when perceived as illegitimate, can produce the opposite behaviour from that advocated. That does not mean, of course, that strict enforcement and legal sanctions are unnecessary or inappropriate. Punishment and deterrence of unjustifiable violations are essential even under a cooperative

enforcement strategy. Perhaps a more appropriate strategy would call for discriminating as opposed to legalistic rule enforcement (see Kagan & Scholz, 1984). This could be achieved by focusing on taxpayers (and their advisers) who are engaging purposefully in unusual manoeuvres. Twenty-five years ago, Grbich (1976, p. 238) forcefully made the point that tax authorities should be concentrating on taxpayers who are purposefully involved in ‘artificial tax avoidance devices’. Taxpayers with a legitimate excuse or with a mistaken interpretation of the law might view responsiveness from the Tax Office in a positive manner and, as a result, the gesture may act to bring this otherwise honest group of taxpayer back into the system voluntarily.

The game-playing posture was also found to discriminate between taxpayers who were involved in aggressive tax planning and those who were not. This variable was in fact the most important, with the aggressive tax planning group significantly more likely to report using the grey areas of tax law and enjoying the challenge of minimising tax. Taxpayers’ moral obligation towards paying tax was also found to differ between the two groups. Taxpayers with an aggressive tax agent are more likely to think it is acceptable to overstate tax deductions and not report cash income, suggesting that they do not view such behaviour as immoral. Together, these findings support the argument that taxpayers may be the instigators of aggressive tax reporting. Caution is needed, however, in generalising this conclusion to all taxpayers involved in tax minimisation.

Sakurai and Braithwaite (2001) discussed how taxpayers open to low-risk tax minimisation strategies often find themselves with tax agents who serve taxpayers open to high-risk minimisation strategies. Tax agents are usually expected to correctly interpret the level of risk their clients are willing to take and are also expected to judge what is acceptable minimisation behaviour. Often, however, this does not occur. Tax agents tend to be more adventurous than their clients in thinking a particular minimisation strategy will be upheld by a subsequent legal challenge (Hansen, Crosser & Laufer, 1992); so what is high risk for a taxpayer may be considered low risk to the agent.

Two possible solutions for dealing with these potential communication problems are apparent. First, eternal vigilance is obviously needed against the opening of tax loopholes. The integrity of overarching principles that aim to bring about compliance with the *spirit* of the law, as opposed to the letter of the law, needs to be defended (see McBarnet, 2001).

However, as discussed by McBarnet (p. 10), it is no easy matter to sustain overarching principles and prevent them from being converted or reduced to rules that can then be used once again as material to creatively avoid tax. John Braithwaite is working on this challenge as a current project of the Centre for Tax System Integrity.

Another approach for dealing with the issue of aggressive tax planning (or high-risk minimisation strategies) would be to develop formal guidelines and accreditation or registration procedures for the professional conduct of tax advisers and practitioners. Surprisingly, guidelines such as these have not yet been developed and only recently has the general area of professional ethics and responsibility received attention (for reviews see Cranston, 1995; Preston, 1996; Ross, 1998).

Woellner, Barkoczy, Murphy & Evans (2001, pp. 1771–1773) have recently put forth a proposal for the formulation of general guidelines for the ethical obligations of tax advisers in Australia. Their suggestion is to divide the tax adviser's role and ethical responsibilities into four areas: tax planning advice; preparation of tax returns and dealing with the Tax Office; 'the adviser as advocate'; and the adviser's obligation to society. Some of the specific ideas put forth in their proposed guidelines include: ensuring that advisers not recommend a course of action merely because the reality is that the client will probably get away with it; making sure that advisers have an obligation to their clients and community to ensure that a proposed 'scheme' not be a paper arrangement only, but have commercial and family reality; and, where a client intends to file a false return or statement, the adviser should attempt to dissuade them from doing so. It is proposed that if the client insists on proceeding, the adviser should cease to act for the client in that matter. Of course, guidelines are not enough. Moses did not come down from the mountain with the ten guidelines; he also led the development of accreditation, education, confession (shame acknowledgment as an alternative to shame displacement) and excommunication processes of the church. Tax integrity still awaits its Moses.

The development of guidelines such as those suggested by Woellner et al. would be a start in providing a safeguard for tax practitioners who feel pressured into developing clever strategies for minimising their clients' tax obligations, as well as protecting taxpayers from tax agents who (1) may misinterpret their clients' wishes or (2) lack the ability or integrity to prepare accurate and correct tax returns.

Conclusion

While there is no clear and easy solution to the problem of aggressive tax planning, this paper has attempted to provide the reader with a broader understanding of how taxpayers involved in aggressive tax planning think and operate in the tax system. The results are consistent with a number of the theories of non-compliance discussed in the introduction, including deterrence, reactance, procedural justice and shame management theory. The results suggest that the motivational drivers of aggressive tax planning may be multiple, with a number of interconnected theories each contributing a little to the explanatory power. The results have demonstrated that taxpayers who say they prefer high-risk advice, and who have actually sought out an aggressive tax agent, differ substantially from other taxpayers. Their tendency towards engaging in aggressive tax planning was seen as a reaction towards an organisation they perceived to be illegitimate.

While the findings of this study appear to support the notion that taxpayers with an interest in high-risk tax minimisation strategies instigate aggressive tax reporting, further work needs to be done on a sample of taxpayers who are actually known to be involved in high-risk tax-effective schemes to see how these taxpayers come to be involved in such activities. In addition, much remains to be done in the area of the relationship between taxpayers and their tax agents; specifically, a question of interest would be to identify how tax agents and their clients broach the idea of aggressive tax reporting. In order to more fully understand the intricacies of this interesting group of taxpayers, these and related strategies will be the topic of future research conducted by the Centre for Tax System Integrity.

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APPENDIX

Two groups of taxpayer were of interest for the present paper.

- taxpayers who reported that they preferred a creative accountant and who actually had an aggressive tax agent (target group), and
- taxpayers who did not prefer a creative accountant and did not have an aggressive tax agent.

How survey participants responded to various questions in the Community Hopes, Fears and Actions Survey determined to which group they belonged. This appendix describes the procedure used to determine inclusion in these two groups.

Scale construction

Survey participants were asked the following two sets of questions (see Braithwaite, 2001, for a full description of the Community Hopes, Fears and Actions Survey).

1. If you do generally use a tax agent or advisor to prepare your income tax return, how well do the following statements describe his/her approach to taxation matters?

	Strongly disagree	Disagree	Neither	Agree	Strongly agree
1. I have a tax agent who is clever in the way she/he arranges my affairs to minimize tax	1	2	3	4	5
2. My tax agent helps me interpret ambiguous or grey areas of the tax law in my favour	1	2	3	4	5
3. My tax agent has suggested complicated schemes I could get into to avoid tax.....	1	2	3	4	5

An aggressive tax planning scale (Scale 1) was constructed by combining responses to the three parts of Question 1. This particular scale determined if the taxpayer actually had an aggressive tax agent.

2. What priority would you place on the following qualities if you were to choose a tax agent or advisor?

	Priority			
1. Someone who knows their way around the system to minimize the tax I have to pay	Low (1)	Medium (2)	High (3)	Top (4)
2. Someone who will take advantage of grey areas of the law on my behalf.....	Low (1)	Medium (2)	High (3)	Top (4)
3. Someone who is well networked and knows what the Tax Office is checking on at any particular time.....	Low (1)	Medium (2)	High (3)	Top (4)
4. A creative accountant.....	Low (1)	Medium (2)	High (3)	Top (4)
5. Someone who can deliver on aggressive tax planning	Low (1)	Medium (2)	High (3)	Top (4)

In order to determine if a taxpayer wanted to have a creative accountant, two additional scales were constructed using parts of Question 2. The first scale (Scale 2) assessed the priority taxpayers would place on having a tax agent who has a cautious minimising and conflict avoidance style. This scale was measured by combining responses to parts 1 and 2 of Question 2. The second scale (Scale 3) assessed the priority taxpayers would place on having a creative accountant with an aggressive tax planning style. This scale was measured by combining responses to parts 3, 4 and 5 of Question 2.

Conditions for group inclusion

Taxpayers who want and have an aggressive tax agent. If a taxpayer scored *greater* than 2.5 on Scale 2 **or** scored *greater* than 2 on Scale 3, **and** also scored *greater* than 2.7 on Scale 1, they were classified as a taxpayer who reported that they preferred a creative accountant and who actually had an aggressive tax agent (target group). A total of 539 taxpayers were classified into this group.

Taxpayers who did not want and did not have an aggressive tax agent. If a taxpayer scored *less* than 2.5 on Scale 2 **and** scored *less* than 2 on Scale 3, **or** scored *less* than 2.7 on Scale 1, they were classified as a taxpayer who did not prefer a creative accountant and did not have an aggressive tax agent. A total of 861 taxpayers were classified into this group.

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