

**SMALL BUSINESS INDIVIDUALS:
WHAT DO WE KNOW AND
WHAT DO WE NEED TO KNOW?**

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The Australian National University
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Abstract

This study investigates the reasons why Small Business Individuals (SBI) have a poor reputation on questions of tax compliance. Tax related attributes of SBI were compared with private sector employees (PRI), employees in non-profit or government organisations (NPO), and non-working individuals (NWR). Data were taken from the *Community Hopes, Fears and Actions Survey* based on a random sample of 2040 individuals. A comparison of group means using one-way analyses of variance revealed that while there are numerous similarities in the responses of these groups, there were also critical differences. A stepwise discriminant function analysis was used to determine which variables could most efficiently differentiate SBI from others. The best predictive model obtained from this analysis indicated that SBI were more likely to owe money to the Tax Office and to perceive that they were unfairly treated by the Tax Office when compared with big business. At the same time, they acknowledged paying less than their fair share of tax. In addition, SBI viewed others as having lower social-ethical norms in relation to paying tax and were more opposed to the government spending tax dollars on welfare issues. Although they placed high importance on personal values of efficiency, SBI acknowledged having inadequate tax knowledge. These findings are discussed in the regulatory context: *talking softly with a big stick* is likely to work some of the time and be the best starting point. *Taking the stick out and being tough*, however, is likely to be necessary as a back-up strategy to signal that a credible sanctioning process is in place, and will be used to elicit compliance when necessary.

Small business individuals: What do we know and what do we need to know?

Eliza Ahmed and Yuka Sakurai¹

Introduction

The small business sector makes a major contribution to the Australian economy, accounting for about 51% of all private sector employment and 97% of all private sector businesses (Australian Bureau of Statistics, 1995). The small business sector is also seen as a high-risk segment of the economy as far as voluntary tax compliance is concerned (Boucher, 2001; Joulfaian & Rider, 1998; Wallschutzky, 1984). In order to better understand why individuals earning their living in this sector have a poor reputation for tax compliance, it has been suggested that small business individuals (SBI) are likely to have more opportunities to participate in cash business compared to taxpayers with wages and salaries (Coleman & Freeman, 1994; Joulfaian & Rider, 1998; see Vogel, 1974). However, there has also been a strong voice in defence of SBI. They consider themselves to be surrounded by an inefficient and unsupportive tax system, and an often unnecessarily confrontational bureaucracy (Coleman & Freeman, 1994). Given reports of antagonism between the Tax Office and SBI, it is desirable to better understand how these taxpayers come to hold such opinions and attitudes, and importantly, how they are likely to act and react in relation to taxation demands. This paper is a contribution to improving the relationship between the small business sector and the Tax Office, and simultaneously strengthening a culture of voluntary compliance.

We begin with a brief review of the small business literature with a particular emphasis on tax compliance. A snapshot of these studies is presented in Table 1. However, studies that have explored socio-demographic and personality characteristics of the sector are also cited at the beginning of the paper to provide a more complete picture of the background against which compliance behaviour takes place. In reviewing empirical studies on small business, emphasis was given to those relating to the management of compliance. Only 14 studies met our inclusion criteria and are reviewed in this paper. Reasons for exclusion of other articles are: (1) reports do not deal directly with tax compliance; (2) reports are published only as abstracts without sufficient substantiating details; (3) reports appeared to be lacking reliable and valid data; and (4) access to reports was prohibited due to commercial sensitivities.

¹ We would like to thank Dr Valerie Braithwaite for her helpful comments at various stages of the development of this paper.

Following such a review of past studies, we point out the gaps in the literature, and describe variables that are incorporated in the current study. The review also emphasises that individuals from this sector bring to the tax compliance situation a set of beliefs and values that are fundamental to who they are and to their business success. We represent this as the 'Protestant work ethic' (Weber, 1958), and through this lens, we generate hypotheses about SBI approaches to taxation and the democracy. Finally, we describe the data from the *Community Hopes, Fears and Actions Survey* (Braithwaite, 2000) as they relate to SBI, and discuss the findings.

What does past research tell us?

A number of studies on SBI have examined socio-demographic factors (Roffey, Stanger, Forsaith, McInnes, Petrone, Symes, & Xydias, 1996; Wiegand & Rothengatter, 1999), and personality correlates (Moran, 1997; Roffey et al., 1996). The socio-demographic profiles alert the reader to the diversity of this group. For instance, approximately one-third of the self-employed are women who are aged between 30 and 45, married with children, and who have a tertiary education not necessarily related to business administration (Roffey et al., 1996). Male proprietors, on the other hand, tend to have vocational training with marketing, managerial knowledge and experience to support them in their endeavours.

There has also been some research on ethnic entrepreneurs focusing on the stereotype of their being unskilled and non-compliant. Although immigrants face barriers in operating their businesses (Roffey et al., 1996) and are interested in obtaining training and advice (Marlow, 1992), they do not seek official sources of information either because they are unaware of its availability or because they mistrust authorities (Dornstein, 1976; Kermond et al., 1991).

Research that has looked at the personality traits of SBI has characterised them as seeking autonomy, independence and rewards for achievement in their business operations (for example, Rosa, Hamilton, Carter, & Burns, 1994). These characteristics portray SBI in a way that seems consistent with Weber's (1958) notion of the Protestant work ethic. Weber described the Protestant ethic as a code of morals based on the principles of thrift, discipline, hard work, individualism, and commitment to occupation. In describing such a view, he postulated a close relationship between the Protestant ethic and the rise of entrepreneurship. A tendency to associate SBI with a Protestant ethic outlook is echoed in some research that

has focused on taxpaying behaviour. In Brown's (1985) study, SBI rated themselves as ethical and decent. In rating the determinants of their moral and ethical positions, they highlighted the importance of social and religious standards, in-group harmony, fear of punishment, and an internalised commitment to following the law. Therefore it comes as a surprise that voluntary compliance is considered to be lower among small business taxpayers than among other taxpayers with wages and salaries (see Joulfaian & Rider, 1998). If SBI are constrained by a strict moral code, what are the factors that lead to the view by the Tax Office that SBI are high risk for tax avoidance and evasion?

A number of studies have attempted to solve such a paradox, and explored whether small business individuals' compliance behaviour is shaped by a set of cultural and social norms (ATO, 1996; Coleman & Freeman, 1997; Wiegand & Rothengatter, 1999). For example, the Australian study by Coleman and Freeman pointed out that while a segment of small businesses (for example, professionals) view tax minimisation as game-playing with the Tax Office, another segment (for example, blue collar workers) do it for their own survival. It has also been found that non-immigrant business owners claim that immigrant business owners are non-compliant in terms of proper invoicing, record keeping and laundering cash (Wiegand & Rothengatter, 1999). The importance of the Tax Office having an educational curriculum to increase compliance among ethnic business owners has been recommended by these researchers.

The importance of having a clear understanding of the tax system in business has been emphasised in a number of studies (ATO, 1990; McKercher, 1995; Sigala, Burgoyne & Webley, 1999). The Australian study by McKercher has shown that a lack of tax knowledge contributes to non-compliance among SBI. It has been noted that these taxpayers do not have adequate knowledge in relation to tax law which may have caused unintentional non-compliance. SBI not only lack a precise understanding in tax matters, but also lack confidence in keeping financial records, and importantly, do not view taxation as a priority (ATO, 1996). In order to overcome such problems with non-compliance, there have been suggestions that tax knowledge can be gained through informal information exchanges among taxpayers (Sigala et al., 1999). In the UK, Sigala et al. (1999) reported that SBI were more likely to communicate among themselves about their own tax situation (for example,

seek information on what they should do), compared to other taxpayers. A cautionary note is expressed by these authors. Frequent communication among SBI may or may not improve tax compliance as it depends on the goals and objectives of the communication.

Wallschutzky & Gibson's (1993) study of Australian SBI revealed that their primary concern is having cash flow which affects their taxpaying behaviour, particularly paying tax on time. They are also more likely to seek advice from tax advisers (if they can afford to) instead of contacting the Tax Office (Coleman & Freeman, 1994). Importantly, they prefer to use these advisers as a primary source of information and remain independent of the Tax Office (Coleman & Freeman, 1994).

If SBI rely more on tax advisers than on the Tax Office, an interesting question arises as to how much influence tax advisers have on small business individuals' compliance? One US study (Hite et al., 1992) explored the motivations of SBI for using tax advisers. Findings demonstrated that preparing tax returns correctly and reducing the likelihood of penalties were the most important reasons for using tax advisers. By the same token, SBI were in favour of being in control of their own tax situations and making decisions for final reporting.

The US study by Hite et al. (1992) also addressed the issue of tax compliance among SBI. Using data on compliance from the Internal Revenue Service (IRS), the authors reported that one in every five SBI was either under-reporting income or over-reporting deductions. The most commonly addressed factors associated with such non-compliance were an absence of third party reporting of their income, and a perceived lower probability of detection. Both factors are thought to increase participation in cash economy activities (Coleman & Freeman, 1994; Joulfaian & Rider, 1998; Noble, 2000; Vogel, 1974).

Capacity of the tax authority to check the accuracy of the taxpayers' information has been explored by Dornstein (1976) in Israel. Findings reveal that in a situation where non-compliance is highly detectable and the tax authority has high control in detecting non-compliance, tax compliance tends to be higher. Dornstein's study has emphasised the importance of the taxation control system in detecting non-compliance, specifically when the declared income was lower than the actual income. Interestingly, there is an 'occupational norm' among certain occupational and industrial groups (for example, trades persons) that favours non-compliance by not reporting cash-in-hand (Noble, 2000; Sigala et al., 1999).

Although SBI regard themselves as honest (Coleman & Freeman, 1994) and recognise cash business as illegal (ATO, 1996; Noble, 2000), bartering and cash jobs are often considered by them to be normal business practice (Coleman & Freeman, 1994).

In an Austrian study of small business individuals' attitudes to paying tax, Kirchler (1999) highlighted the fact that SBI were more likely to perceive taxpaying as limiting their freedom to make financial decisions about their own income. These individuals also perceived that their freedom had been threatened. Perceived restriction of freedom was positively related to favourable attitudes towards tax evasion, lower tax morale and a tendency to act in ways to avoid paying taxes (Kirchler, 1999). The author concluded that reducing and avoiding tax was a way of escaping the perceived loss of freedom.

Studies have also explored small business individuals' perceptions of the Tax Office (Coleman & Freeman, 1994; Wallschutzky & Gibson, 1993). These Australian studies attributed small business individuals' non-compliance to the unavailability of the necessary information from tax authorities (Wallschutzky & Gibson, 1993). Despite their willingness to establish a cooperative relationship with the Tax Office (Coleman & Freeman, 1994), findings highlight the fact that inaccessibility of the Tax Office is at least partly responsible for failure to instil an appropriate business ethic among SBI. The Tax Office is seen as being neither sympathetic nor cooperative in their dealings with small business individuals' concerns and problems (Coleman & Freeman, 1994). Such a lack of good communication and support from the Tax Office is likely to lead to bitterness in SBI as time goes by. Other studies report that SBI regard their relationship with tax authorities as adversarial and feel an urge to win against 'the taxman' (Noble, 2000). It has also been found that SBI express strong resentment against the tax system (ATO, 1996), and view the tax system as unfair (Noble, 2000).

Past research has contributed substantially to our knowledge about SBI. Nevertheless, our understanding of the behaviour of SBI remains incomplete in that the documented tensions over taxpaying have not been linked back to their worldviews and aspirations, and experiences with tax officials. We also know little about how small business individuals' motivations are different from those of other taxpayers. As can be seen from Table 1, empirical results of the previous studies are primarily oriented to addressing three broad issues: (a) showing SBI as honest and committed to their work (Coleman & Freeman, 1994;

Hite et al., 1992); (b) indicating an adversarial relationship between SBI and tax officials (ATO, 1996; Coleman & Freeman, 1994; Noble, 2000); (c) documenting that SBI perceive the tax system as unfair (Noble, 2001).

Research is needed with SBI to find out the broader factors that are likely to trigger the adversarial relationship between SBI and the tax authority. As evident from Table 1, most studies have been limited to interviews and focus group discussions to gather information about tax matters from SBI. Only a few studies (for example, Hite et al., 1992; Kirchler, 1999; McKerchar, 1995) have used larger samples with a self-report survey methodology. In addition, studies (for example, Coleman & Freeman, 1994; Hite et al., 1992; Kirchler, 1999; McKerchar, 1995; Wallschutzky & Gibson, 1993) have generally been restricted to a highly selected population, such as SBI. While this may control outside variation, and enable better prediction of who among SBI is not compliant, the methodology does not help understand why SBI as a group are often reported as being resistant to paying tax. Only a few studies (for example, Noble, 2000; Sigala et al., 1999; Wallschutzky, 1984) have used a mix of respondents (for example, SBI and individuals who work in other organisational contexts) to enable comparisons on a broader set of compliance triggers. In these cases, the validity of the findings has been limited by the small sample size (for example, Sigala et al., 1999). With a few notable exceptions (for example, Hite et al., 1992; Joulfaian & Rider, 1998), most of this research consists predominantly of qualitative analytic explorations (for example, Wallschutzky & Gibson, 1993; Wiegand & Rothengatter, 1999).

Table 1: Summaries of studies on tax compliance among small business individuals (SBI)

Authors / Organisation (Year)	Participant	Method (analytical tools)	Issues explored	Major Findings
ATO (1990)	502 small business owners in Australia	Telephone interviews (descriptive statistics)	Attitudes towards tax payment and the Tax Office, and level of tax knowledge.	Non-compliance within the small business sector is attributed to a lack of knowledge of their tax obligations. SBI favoured any attempts by the ATO to reduce their administrative burden.
ATO (1996)	Small business owners and managers in Australia	Focus group sessions (qualitative analyses)	Nature of the business, size, dealings with tax advisers, perceptions towards the tax system and the Tax Office.	Non-compliance within small business sector is attributed to a lack of confidence in record keeping, a lack of knowledge in tax matters, strong emotional resentment against the tax system and the Tax Office.
Coleman & Freeman (1994)	Small business owners in Australia	Interviews & focus group session (qualitative analyses)	Attitudes towards tax payment and the Tax Office.	Small businesses tend to see their relationships with the Tax Office as adversarial and use their accountant as a primary source of information. They regard themselves as honest, but accept barter and cash payment as business practices.
Coleman & Freeman (1997)	Four types of small business (professionals, blue collars, retailers & rural) in Australia	Interviews & focus group session (qualitative analyses)	Attitudes towards tax payment and the Tax Office, influence of social norm on such attitudes.	Most respondents support the idea of paying tax, and voluntary compliance is related to the individual's cultural background. Motives and forms of non-compliance activities (for example, game-playing /survival) vary across the four groups.
Dornstein (1976)	2500 small business taxpayers in Israel	Data were gathered from the file in the Income tax Division	Effect of the control system of the tax authority and detection ability on compliance.	High efficiency of the tax authority and low opportunity to cheat tax are major determinants of compliance.

Authors / Organisation (Year)	Participant	Method (analytical tools)	Issues explored	Major Findings
Hite, Stock, & Cloyd (1992)	300 small businesses in the USA	Self-report survey questionnaire (descriptive statistics, correlation and chi-square)	Motivation behind the use of a tax practitioner, and personal variables, such as age, gender.	Motivations for small business individuals to use a tax practitioner are to have the tax return prepared correctly and to reduce the likelihood of penalties.
Joulfaian & Rider (1998)	8,341 small business taxpayers from proprietorship, farm, or rental real estate in the USA	1985 & 1988 IRS taxpayers' compliance measurement program data (Tobit estimate)	Effect of differential taxation on voluntary compliance.	The tax liability on proprietorship income under US tax law is higher than the tax liability on the same level income from rental real estate. This differential taxation treatment is found to affect the voluntary reporting compliance by small businesses.
Kirchler (1999)	117 small / medium sized firms in Austria	Survey questionnaires (correlations)	Perceived loss of freedom, attitudes towards tax evasion, moral beliefs, and tax avoidance.	Perceived restriction of freedom was related to favourable attitude towards tax evasion, low tax morale and a tendency to reduce / avoid tax.
McKerchar (1995)	200 small businesses in Australia	Self-report survey questionnaires (descriptive statistics)	Sources of tax information, level of tax knowledge, education, age, length of time in business, turnover range & industry.	An accountant is seen as their primary source of information, non-compliance may be unintentional - resulting from their lack of awareness of taxation matters.
Noble (2001)	Small and medium business proprietors (n=41), the general public (n=24), key influences (n=19), revenue officials (n=19) in New Zealand	Interviews & focus group sessions (qualitative analyses)	Perceptions of the tax system, tax evasion, and motivations for tax evasion.	Small-medium businesses perceive the tax system as unfair, and tax & tax compliance costs as too high. Cash jobs are generally seen as socially acceptable and encouraged from industry peers.

Authors / Organisation (Year)	Participant	Method (analytical tools)	Issues explored	Major Findings
Sigala, Burgoyne, & Webley (1999)	23 taxpayers (both self-employed and employed at organisations) in the UK	Interviews (qualitative analyses)	Tax communication with others in the same occupation, social norms within occupational groups.	A social norm is evident which favours cash payments in particular occupational groups, such as small business taxpayers. Compared to others, these taxpayers tend to communicate more with each other about their tax situations, mainly to seek opportunities to reduce income tax and/or to find correct information.
Wallschutzky (1984)	1000 individuals (500 non-evaders and 500 convicted evaders) in Australia	Questionnaire survey (descriptive statistics)	Employment status and tax evasion.	Evaders tend to be small business individuals.
Wallschutzky & Gibson (1993)	12 small businesses in Australia	Interviews (qualitative analyses)	Concerns and problems of small business, and perceptions towards Tax Office.	The main concern for small business is cash-flow, instead of tax compliance. Cash-flow problems affect the payment of their taxes on time. Small business individuals have negative perceptions towards the Tax Office.
Wiegand & Rothengatter (1999)	Five small business network groups (non-immigrant & immigrant) in Australia	Focus group sessions (qualitative analyses)	The effects of small business trading networks (for example, ethnic culture) on tax compliance.	The non-immigrant business owners perceived the immigrant business owners as non-compliant. Findings revealed that the ethnic owners were more engaged in transnational networks, such as laundering cash.

One exception that has used a quantitative approach was the US study by Joulfaian and Rider (1998). This study used a large sample pooled from the Internal Revenue Service, and focused on the effects of differential taxation treatments on voluntary compliance among SBI. The authors concluded that the way in which tax obligations are framed through law and administrative practices are important in shaping compliance. Joulfaian and Rider's (1998) study, however, does not identify the mechanisms through which differential taxation has an effect (for example, reasonableness and justice). A recent study by Kirchler (1999) suggests that one key to effective design in a tax system may lie in limiting perceived restrictions on freedom by SBI. Although this may not be a problem isolated to this group of taxpayers. The Kirchler study did not provide any comparison with other groups of taxpayers on perceived loss of freedom in paying tax.

The present study attempts to understand small business individuals' taxpaying behaviour through focusing on perceptions of taxpaying and the tax system. It compares small business individuals' worldviews, demands and experiences with those of other groups of people. Through this process, the following question can be answered: Do SBI see their relationship with the Tax Office differently from other groups of people, and if so, what is special about this relationship?

The present study

The present study assumes that tax compliance and its management are influenced by (and also possibly influence) how individuals view the world and evaluate the tax system. Individuals are constantly interpreting their environment to give meaning to their own actions and the actions of others. Tajfel (1974) maintained that we need to see order in our surroundings as a way of organising cognitions about the self and the social world. In the present context, worldviews represent our beliefs about the kind of world we live in and also the kind of world we would like to live in (see Braithwaite, 2001). Worldviews are based on the social realms in which one interacts. These views are formed through the way in which we summarise and remember our experiences and observations, and through the assumptions we make about how things work. The *Community Hopes, Fears and Actions Survey* operationalised worldviews in terms of an individual's social and personal values, attitudes to

democracy and power, and beliefs about government expenditure and tax priorities in our society. According to Braithwaite (2001), worldviews are important to the ways in which individuals align themselves with social policy.

The importance of a taxpayer's evaluation of the tax system as a determinant of tax compliance has also received much attention in the literature. A number of studies have emphasised the role of perceived fairness of the tax system and have demonstrated that taxpayers are less likely to comply with a tax system they consider unfair (for example, Alm, Jackson, & McKee, 1993; Cowell, 1992; Falkinger, 1995; Kinsey, Grasmick, & Smith, 1991; Roberts & Hite, 1994). Tax compliance is also likely to depend on institutional demands, individual knowledge and experiences. There is some evidence that tax compliance increases with higher penalty rates set out by the tax authority (Friedland, Maital, & Rutenberg, 1978). However, other studies have shown that tax compliance increases with a lower penalty rate (Spicer & Lundstedt, 1976; Varma & Doob, 1998). Past research on tax compliance also produces conflicting results on whether outside groups pressure taxpayers in making their decisions. Some studies have indicated that tax advisers can shape an individual's taxpaying decisions by defining the accepted and legal options available (Cruz, Shafer, & Strawser, 2000). Others have shown that taxpayers themselves are the instigators of aggressive tax planning (Attwell & Sawyer, 2001; Murphy & Sakurai, 2001; for discussion on this, see Sakurai & Braithwaite, 2001).

Whether individuals comply or not is also likely to depend on the individual's attitude about whether the Tax Office is an authority with which they want to cooperate. Willingness to cooperate is represented by the social distance taxpayers place between themselves and the Tax Office. Sets of interconnected beliefs and attitudes that explain and justify how individuals see their relationship with the Tax Office are called motivational postures. There are five such postures: commitment, capitulation, resistance, disengagement, and game-playing. Research has shown that individuals who take a resistant and/or a disengaged stance are more likely to distance themselves from the authority, and therefore less likely to comply with rules and obligations (Braithwaite, Braithwaite, Gibson, & Makkai, 1994). Game-playing is also postulated as a risk factor for avoidance behaviour, if not non-compliant behaviour.

Having discussed the relevance of a range of factors to tax compliance, the next question is whether they can be used to differentiate SBI from other groups of people, such as employees in private organisations, employees in non-profit or government organisations, and non-working individuals². Recent research (see Collins, Milliron & Toy, 1992) has called into question the wisdom of an approach that seeks a universalistic model to explain compliance. Instead, a contingency approach to tax compliance research is recommended (Collins et al., 1992). This approach begins with the assumption that relationships among a set of compliance relevant variables will interact and affect compliance differently for different segments of taxpayers, such as small business taxpayers, rural taxpayers, young taxpayers, taxpayers who participate aggressively in tax avoidance schemes and so on. Therefore the current work is a first attempt to find out what is distinctive about SBI in their compliance related attitudes and behaviours. How do they differ from private sector employees (PRI), employees in non-profit or government organisations (NPO), and non-working individuals (NWR)? The variables examined in this study can be grouped under the following headings:

- Worldviews, such as social and personal values, attitudes to Australian democracy, appropriateness of expenditure of tax monies, material loss through taxation, and priorities for tax reform;
- Evaluation of the tax system in terms of procedural justice, fairness in the tax system, and the perceived power of the Tax Office;
- Institutional demands, experiences and sources of influence, such as deterrence factors and shame management factors in the context of non-compliance (for example, exaggerating deductions and under-reporting of extra income); tax knowledge; tax priority; conflict between the respondent and the Tax Office, and perceptions of self and significant others; and
- Motivational postures, such as commitment, capitulation, resistance, game-playing and disengagement.

On the basis of the earlier literature review, four overarching hypotheses are analysed in the remainder of this paper.

² For the purpose of simplifying the text, employees in the private sector are referred to as PRI taxpayers, employees in non-profit organisations as NPO taxpayers, and non-working individuals as NWR individuals.

First, if there is a strong Protestant work ethic evident for SBI, one would expect to find higher scores on personal values of competence and effectiveness, status and recognition, propriety, and on having an orderly prosperous society. Additionally, SBI should also have higher scores on establishing national security and freedom, and an independent economy. As for spending tax dollars, they would be more supportive of expenditure on security related activities (for example, policing and defence) than welfare services (for example, education and employment) and would oppose affirmative action initiatives and support for minorities. In accord with the Protestant ethic approach, they can also be expected to view taxpaying as a monetary loss as they are likely to see personal wealth as a major goal in life. However, they are expected to be similar to others on attitudes (quality and satisfaction) towards the democracy, reform for building a cooperative taxpaying culture, social values of harmony, and personal values such as concern for others. This set of predictions will be referred to collectively as the **Worldviews Hypothesis**.

Given that SBI place importance on moral decency and are committed to their occupation (see Brown, 1985; Coleman & Freeman, 1994), it would also be expected that they would place greater importance on feeling obligated to obey the law, taking the demands of authority seriously, and wanting to be treated with respect by the authority (for example, to have an honest taxpayer's identity, a personal ethical norm of paying tax, to place priority on doing one's tax, to feel obligated to accept Tax Office decisions, and to receive trustworthy and respectful treatment from the Tax Office). This set of predictions will be referred to collectively as the **Obligation and Respect Hypothesis**.

Additionally, SBI would be expected to manifest task-oriented work practices, such as saving time, being business focused, and being well networked for support on business matters. One would therefore expect SBI to prefer a tax system which would minimise paper work and be open to seeking help in sorting out their tax matters (perhaps, ideally having an aggressive tax adviser). This set of predictions will be referred to collectively as the **Work Practices Hypothesis**.

Finally, past research has shown that SBI are at risk of being non-compliant (Boucher, 2001; Joulfaian & Rider, 1998). We would therefore expect that these individuals would be more likely to face sanctions from the Tax Office. They would also be more likely to perceive the Tax Office as 'picking on them' (for example, power imbalance exerted by the Tax Office

upon small and big businesses), and would claim that others also pay less tax than they should (others' social-ethical norm in paying tax). A tendency may arise to act against paying tax. SBI can therefore be expected to distance themselves from the Tax Office (for example, resistant posture). They can also be expected to pay less than their fair share of tax. This set of predictions will be referred to collectively as the **Social Influence and Reactance Hypothesis**.

Method

Participants

The data used in this paper are collected from 2040 randomly sampled Australian taxpayers who completed the *Community Hopes, Fears and Actions Survey* (Braithwaite, 2000). The sample was stratified on each state and territory (for details, see Mearns & Braithwaite, 2001). Of the 7754 questionnaires distributed, 2040 were returned after several reminders, giving a response rate of 29% (after allowing for undelivered questionnaires and ineligible respondents). The response rate is comparable with other Australian mail surveys on tax issues (Bragg, 2000; Leonard, Wearing, & Baldwin, 2000; Wallschutzky, 1984). Wallschutzky (1996) has argued that tax surveys of the general population cannot be expected to yield a higher than 30 to 40% response rate. Bragg's Australian survey yielded the lower response rate of 18% whereas the Austrian study by Kirchler (1999) showed a response rate of 28%.

Procedure

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

Measures

The *Worldviews Hypothesis* is tested using questions about social and personal values, attitudes to Australian democracy, appropriateness of expenditure of tax monies, material loss through taxation, and priorities for tax reform. The *Obligation and Respect Hypothesis* is tested using questions on having an honest taxpayer identity, a personal ethical norm of paying tax, prioritising tax matters, an obligation to accept Tax Office decisions, and having respectful and trustworthy treatment from the Tax Office. The *Work Practices Hypothesis* is tested through questions on wanting to minimise paper work, having competent tax knowledge in doing tax returns, ideally having an aggressive tax adviser, seeking help in doing tax returns, the likelihood of getting caught and facing sanctions for tax evasion, and the problems created by sanctions including shame management. Finally, the *Social Influence and Reactance Hypothesis* is tested through questions about the Tax Office's power over small and big businesses, others' social-ethical norm in paying tax, conflict with the Tax Office, and motivational postures (for example, commitment, capitulation, resistance, game-playing and disengagement).

Altogether 43 independent variables (including a respondent's age and personal income) were used in this research. Only those measures which appeared as significant at the final stage of our analyses (stepwise Discriminant Function Analysis) are described in the Appendix, if interested in other measures refer to Braithwaite (2001).

Two questions were used to classify respondents into four different categories:

- (1) Following the question '*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*', respondents were asked: Is that job for (i) a private company or business; (ii) non-profit organization eg university; (iii) commonwealth, state or local government; or (iv) are you self-employed, in a business partnership, or do you own a business?
- (2) ...Last week were you (i) working full-time for pay; (ii) working part-time for pay; (iii) unemployed; (iv) retired from paid work; (v) full-time student; or (vi) keeping house.

Categorising participants into groups

For the present purpose, we recoded both questions. For the first question, 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 or self-employed) were not changed. For the second question, we grouped respondents who worked either full-time or part-time into one category, and collapsed all other respondents into a second category. Using the recoded questions, we formed the following four groups:

- (1) self-employed, in partnership, or owning business (SBI) working either full-time or part-time (n = 177);
- (2) those employed by a private company / business (PRI) working either full-time or part-time (n = 608);
- (3) those employed by a non-profit or government organisation (NPO) working either full-time or part-time (n = 391);
- (4) those not working (NWR) such as retirees, students, the unemployed and those involved in home duties (n = 799).

Results

Data Analyses

The data analyses were performed in two steps. The first step used a set of univariate analyses to compare the above four groups on all sets of variables. The second step involved the use of discriminant function analysis to identify the variables that were primarily responsible for differentiating SBI from other groups.

Analyses of variance

The specific aim of the analyses of variance was to explore the extent to which SBI were similar to, and different from other taxpayers (that is, private company taxpayers, non-profit or government organisation taxpayers, and non-working individuals). Comparisons are made in terms of the variables listed above as indicators of the Worldviews Hypothesis, the Obligation and Respect Hypothesis, the Work Practices Hypothesis, and the Social Influence

and Reactance Hypothesis. The mean scores for each indicator variable are compared for these four groups of taxpayers. The means and standard deviations of the variables on which SBI differ from other groups are shown in Table 2. Table 3 presents the variables on which SBI showed similarities with other groups. A series of one-way analyses of variance with post hoc tests (Scheffés) were performed to ascertain which pairs of means were significantly different among the four categories of taxpayers. Scheffé's comparisons with the target group, that is SBI, were conducted and are reported in Table 2. Table 2 uses the symbol of the comparison group (that is, PRI for private organisation taxpayers, NPO for non-profit or government organisation taxpayers, and NWR for non-working individuals) to indicate which specific group(s) is significantly different from SBI. Because our interest concentrates on small business taxpayers, findings are discussed with a particular focus on them.

Table 2: Means and standard deviations of the variables for each group with F values

Variables	SBI (n = 177)	PRI (n = 608)	NPO (n = 391)	NWR (n = 799)	F - value
Worldviews					
Social values of security	5.85 NPO (0.85)	5.66 (0.91)	5.40 (0.97)	5.68 (1.02)	11.35***
Personal values of competence and effectiveness	5.70 NPO, NWR (0.72)	5.53 (0.80)	5.42 (0.77)	5.47 (0.87)	5.48***
Personal values of status and recognition	4.58 NPO (0.90)	4.62 (0.93)	4.27 (1.05)	4.48 (1.03)	10.30***
Personal values of propriety	5.69 NPO (0.84)	5.60 (0.78)	5.38 (0.91)	5.71 (0.87)	13.88***
Opposition to Government support for minorities	3.87 PRI, NPO (0.75)	3.69 (0.75)	3.50 (0.84)	3.72 (0.75)	11.47***
Support for free market society	3.23 NPO (3.23)	3.07 (0.76)	2.83 (0.77)	3.30 (0.79)	31.58***
Support for spending more tax dollars on welfare	3.57 NPO, NWR (0.56)	3.65 (0.58)	3.73 (0.58)	3.83 (0.60)	15.68***
Support for spending more tax dollars on security	3.72 NPO (0.66)	3.66 (0.71)	3.55 (0.75)	3.83 (0.72)	15.29***
Obligation and respect					
Receiving respect from Tax Office	3.17 NWR (0.91)	3.17 (0.82)	3.19 (0.80)	3.39 (0.79)	10.61***
Trustworthy treatment from Tax Office	3.07 NPO, NWR (0.92)	3.15 (0.77)	3.17 (0.78)	3.30 (0.76)	6.61***

Variables	SBI (n = 177)	PRI (n = 608)	NPO (n = 391)	NWR (n = 799)	F - value
Trust in the Tax Office to be fair	2.98 NWR (0.76)	2.97 (0.74)	2.97 (0.75)	3.19 (0.76)	12.69***
Consultation (being consulted by the Tax Office)	2.63 NWR (0.76)	2.64 (0.69)	2.61 (0.69)	2.80 (0.70)	8.84***
Work practices					
Incompetence in doing tax return	3.09 NPO, NWR (1.00)	2.87 (1.05)	2.74 (1.04)	2.86 (1.05)	4.61**
Ideally having an aggressive tax adviser	2.27 NPO (0.74)	2.24 (0.80)	1.98 (0.76)	2.29 (0.78)	14.77***
Reform for minimising paper work for tax return	3.96 PRI, NPO (0.74)	3.78 (0.80)	3.70 (0.88)	3.82 (0.77)	4.48**
Instances of help sought for doing tax return	1.31 PRI, NPO, NWR (0.72)	1.03 (0.64)	1.04 (0.61)	.98 (0.80)	6.87***
Social influence and reactance					
Tax Office's power over small business	4.26 PRI, NWR (0.57)	4.09 (0.65)	4.12 (0.68)	4.09 (0.70)	3.41*
Tax Office's power over big business	3.01 PRI, NWR (1.17)	3.20 (1.15)	2.97 (1.28)	3.27 (1.21)	6.56***
Others' social-ethical norm in paying tax	2.56 PRI, NWR (0.64)	2.64 (0.61)	2.56 (0.60)	2.70 (0.59)	6.15***
Self paying less than fair amount of tax	2.68 NPO (0.64)	2.56 (0.74)	2.46 (0.72)	2.78 (0.62)	21.31***

Variables	SBI (n = 177)	PRI (n = 608)	NPO (n = 391)	NWR (n = 799)	F - value
Experiencing sanctions from Tax Office	.15 PRI, NWR (0.71)	.00 (0.66)	.00 (0.72)	.00 (0.63)	6.34***
Owing money to Tax Office (last 4 years)	2.11 PRI, NPO, NWR (0.90)	1.41 (0.73)	1.39 (0.75)	2.45 (1.27)	59.87***
Capitulation posture	3.36 NPO, NWR (0.60)	3.34 (0.51)	3.27 (0.53)	3.51 (.053)	21.06***
Resistant posture	3.25 NPO, NWR (0.57)	3.22 (0.51)	3.15 (0.52)	3.12 (0.55)	5.65***
Game-playing posture	2.41 NPO (0.68)	2.44 (0.56)	2.24 (0.62)	2.49 (0.63)	14.46***

* p<0.05** p<0.01

*** p<0.001

Table 3: Variables on which small business individuals showed similar responses to others (private sector taxpayers, non-profit or government organisation taxpayers, and non-working individuals)

Worldviews

Social values of harmony
Personal values of concern for others
Disillusionment with democracy
Satisfaction with democracy
Reform for building a cooperative taxpaying culture
Material loss through taxation

Obligation and respect

Honest taxpayers' identity
Personal ethical norm in taxpaying
Making tax a priority
Obligation to accept Tax Office decisions

Work practices

Deterrence factors (Likelihood of getting caught, facing sanction, and the problems created by sanctions following tax evasion)
Shame management

Social influence and reactance

Commitment posture
Disengagement posture

Findings about the Worldviews Hypothesis

The Worldviews Hypothesis was tested by using scales on social and personal values, attitudes towards Australian democracy, government spending priorities, priorities for tax reform, and material loss through taxation. Where significant differences emerged, they involved SBI and individuals who worked in non-profit or government organisations. SBI were remarkably similar to those working in the private sector.

As can be seen from Table 2, SBI scored higher on security values emphasising the importance of law and protecting the resources within one's group, such as: national greatness, national security and freedom. Furthermore, they scored higher on personal values of competence and effectiveness, were concerned about conventional standards of behaviour (propriety), and displayed a desire for economic and social success (status and recognition). In summary, SBI seek protection and security through rules, and the acquisition of social and material status.

A between-group comparison on another variable – ‘government’s support for minority groups’ revealed that SBI resisted the influence of minorities in decision-making, reflecting a lack of interest in social cohesion and inclusiveness. Consistent with these findings, SBI showed less interest in spending tax dollars on state welfare services. In response to the question about how the Australian government should spend taxpayers’ money, it was found that SBI are more in favour of promoting security (for example, defence and policing) and less supportive of helping others develop their potential (for example, education and health care).

When asked about their views on Australian democracy, SBI showed a great deal of interest in building a free market by empowering individual business entities, which indicates that SBI favour a hands-off economic policy in terms of government intervention. However, no significant differences were found for attitudes towards Australian democracy and the quality of this democracy. All groups expressed similar cynicism and disillusionment with democracy while embracing the idea of establishing a democracy that would support individuals. Notable similarities were also found for social values of harmony, personal values of concern for others, and reform for building a cooperative taxpaying culture. Although group differences on the variable of material loss did not reach statistical significance, SBI scored higher on this variable as expected: they tended to resent the way in which the tax system prevented them from getting ahead. All these findings provide strong support for the Worldviews Hypothesis, although it is worthy of note that these views were shared with employers in the private sector. Small business individuals’ views contrasted with those working in the non-profit or government sector, and those outside the workforce.

Findings about the Obligation and Respect Hypothesis

The Obligation and Respect Hypothesis was tested with six scales: having an honest taxpayer identity, holding a personal ethical norm in favour of paying tax, making tax a priority, having an obligation to accept Tax Office decisions, and having respectful and trustworthy treatment from the Tax Office. This hypothesis argues that SBI, compared to others, would score higher on feeling obligated to taxpaying and also on the need to feel respected by the Tax Office. No group differences were found on honest taxpayer identity, personal ethical norm of honesty, obligation to accept Tax Office decisions, and tax priority. Small business individuals’ scores on these variables were much like those of other groups.

The absence of significant differences in relation to the Obligation and Respect Hypothesis was surprising. The next question is whether SBI feel respected and trusted by the Tax Office. We have hypothesised that SBI need to feel respected by tax authorities because they value law and legitimate institutions. If they don't feel this respect, they may withdraw and become adversarial in their dealings with the Tax Office. The data show that SBI feel less trusted and respected by the Tax Office than some segments of the population. However, they do not differ significantly from taxpayers employed in the private sector.

Findings about the Work Practices Hypothesis

The Work Practices Hypothesis was tested by using scales on wanting to minimise paper work, having competent tax knowledge in doing tax returns, ideally having an aggressive tax adviser, seeking help in doing tax returns, the likelihood of getting caught and facing sanctions for tax evasion, and perceiving problems with being sanctioned for evasion. Findings are given in Table 2.

From Table 2, it can be seen that SBI were more likely to experience difficulty in preparing their own income tax return. They acknowledged that they were less competent in completing their tax return, and hence, sought assistance in preparing it³. In addition, SBI wanted a less complex tax system for record keeping that would minimise the administrative costs of tax preparation. When asked about their ideal tax adviser, SBI were likely to place a high priority on having a tax adviser who had good networks, and was creative and knowledgeable about aggressive tax planning. These findings suggest that SBI have not fully integrated tax obligations into their normal business operations. Tax is of secondary importance to them. While the problems they face are no greater than those of others in the private sector, their work practices are less accommodating of tax than those in the non-profit or government sector. It goes without saying that the consequences of feeling less confident about tax matters might be more serious from the point of view of revenue collection when the individual concerned is self-employed rather than a PAYG (Pay As You Go) wage and salary earner.

³ In a further analysis, it was found that SBI are most likely to seek help from tax advisers ($F = 14.30$; $p < 0.001$) and business partners ($F = 24.58$; $p < 0.001$) in preparing their tax returns. Although statistically not significant, SBI are the least likely to seek assistance from the Tax Office.

Findings about the Social Influence and Reactance Hypothesis

The Social Influence and Reactance Hypothesis argues that small business individuals' perceptions will be affected by their own experiences with the Tax Office and perceptions of others' experiences. This hypothesis was tested by using scales on the Tax Office's power over small and big businesses, others' social-ethical norm in paying tax, conflict with the Tax Office, and motivational postures.

Findings relevant to the Work Practices Hypothesis emphasised that the small business individuals' incompetence and need for help with tax matters was likely to act as obstacles for them in meeting institutional demands. It would not be surprising to find from this that they have a record of incomplete taxation dealings (such as record keeping). Consequently, they find themselves owing money to the Tax Office and facing sanctions, such as the prospect of undergoing an audit or investigation, and being penalised. These expectations are confirmed in Table 2. SBI experienced sanctions from and owed money to the Tax Office more than those employed in other sectors.

In terms of perceptions of others, SBI were like the non-profit or government sectors, in that they perceived that the Tax Office lacked power over big business and high wealth individuals. By contrast, SBI expressed the view that the Tax Office had considerable power that they used when faced with defiance from the self-employed, and wage and salary earners.

At the same time, SBI viewed others as failing to abide by a social ethical norm to pay tax. This is another attitude which they share with workers in the non-profit or government sectors, but which sets them apart from other private sector employees. Perceiving others as defying tax laws is likely to make them think that they are entitled to do the same, thereby shaking their tax morality. Being sanctioned by the Tax Office and seeing others getting away with non-compliance may have acted as a trigger for SBI to take the worst pathway, that of resistance towards the Tax Office. Adopting such a stance represents a defence against perceived injustice and readiness for non-compliant activities. Indeed, SBI say that they pay less than their fair share of tax, as do those working in the private sector. They are also less willing to capitulate to the tax authority than those in the non-profit or government sector, and are more willing to game-play with the tax authority.

These findings support the Social Influence and Reactance Hypothesis. SBI have placed social distance between themselves and the Tax Office. Their defiance is expressed in the acknowledgment of lower compliance and receiving negative sanctions for non-compliance. At the same time, they see others behaving as they do, but not being penalised for the behaviour, particularly big businesses and high wealth individuals.

The above findings show that the defiance of SBI is greater than that of workers in the non-profit or government sectors, and those who are not working. SBI, however, are very similar to those working in the private sector. The difference between individuals working in the private sector and small business sector seems to be that SBI regard themselves as the ones most likely to be caught and punished by the Tax Office. In short, SBI see themselves as the victims of a tax system in which 'rorting' is not uncommon in the community.

The next section aims to build a model of how we can best discriminate SBI from others (PRI, NPO, and NWR).

Discriminant function analysis

This section describes findings from a stepwise discriminant function analysis⁴ (Porcano, 1988; Tabachnick & Fidell, 1996). We used this analytical technique to identify which combination of the variables⁵ would differentiate SBI most effectively from all others⁶.

A conventional stepwise Wilk's Lambda⁷ algorithm is used, which selects the independent variables in order of importance in the final discriminant analysis. Although a large number

⁴ Inspection of data with regard to evaluation of assumptions, outliers, normality and multicollinearity revealed no problems for stepwise discriminant function analysis.

⁵ Only variables that significantly differentiated SBI from others using ANOVAs (25 variables) were included for the stepwise discriminant function analysis. However, one variable (instances of help sought in preparing tax returns) was not included in this analysis in order to minimise missing data. Respondents had been asked to skip all questions relevant to tax returns (including this item) if they had not lodged their tax return in that particular year.

⁶ All groups (PRI taxpayers, NPO taxpayers and NWR individuals) other than SBI are collapsed into one group as our main concern was to discriminate SBI from others.

⁷ Wilk's Lambda was used as a stepwise criterion for evaluating the statistical significance of the variables (Norusis, 1993). A small value for Wilk's Lambda indicates a difference in group means. Eight variables passed this statistical test.

of variables appeared significant in the ANOVAs, only eight variables⁸ achieved significance in the stepwise Discriminant Function Analysis and were used to correctly discriminate SBI from others. These are as follows –

- having strong personal values of competence and effectiveness;
- having a low preference for spending more tax dollars on welfare issues;
- perceiving that the Tax Office exercises power over small business when small business decides to defy it;
- perceiving that the Tax Office exercises power less effectively with big business when big business decides to defy it;
- perceiving most taxpayers as lacking social-ethical norms in paying tax;
- acknowledging that SBI pay less than their fair share of tax;
- acknowledging owing money to the Tax Office; and
- lacking competence in preparing their own income tax returns.

The results of the discriminant function analysis are presented in Table 4. Because there were only two groups (SBI and others), it was only possible to have one discriminant function in this study⁹ which has been calculated by using a combination of the eight measures that have high sensitivity and specificity for profiling SBI against others. This function accounted for 11% of the total variance (Wilk's Lambda = 0.90, Canonical correlation = 0.31, Chi-square = 135.39, $p < 0.001$) (see Table 4).

⁸ It is important to note that fourteen variables (excluding instances of help sought in preparing tax returns) which were significant in the ANOVA are no longer significant in this stepwise Discriminant Function Analysis, as their importance was diminished by their intercorrelations with the dominant eight variables. For example, seven variables ('social values of security', 'personal values of propriety', 'personal values of status and recognition', 'support for spending more tax dollars on security', 'support for free market society', 'ideally having an aggressive tax adviser', and 'reform for minimising paper work for tax returns') are no longer significant because of their significant links with 'personal values of competence and effectiveness'. The importance of six variables ('resistance posture', 'capitulation posture', 'wanting respect from Tax Office', 'trustworthy treatment from Tax Office', 'trust in the Tax Office to be fair', and 'consultation') is diminished due to the intercorrelations with 'Tax Office's power over big business'. Again, two variables ('age' and 'experiencing sanctions from Tax Office') did not emerge as significant as they were significantly correlated with 'owing money to Tax Office'. Three variables ('Opposition to government support for minorities', 'personal income', and 'game-playing posture') did not emerge as important predictors as they were significantly correlated with 'support for spending more tax dollars on welfare' and 'Tax Office's power over small business', respectively.

⁹ If k is the number of groups and p is the number of dependent variables, then the number of possible discriminant functions is $k-p$ (see Stevens, 1986, p. 263).

Table 4: Standardised Canonical Discriminant Function Coefficients, Wilk's Lambda and F-values with their level of significance from a stepwise Discriminant Function Analysis

Predictor variables	Standardised Canonical Discriminant Function Coefficients	Wilk's Lambda	F value with significance
Owing money to Tax Office	0.81	0.934	98.61***
Support for spending more tax dollars on welfare	-0.32	0.928	54.00***
Tax Office's power over small business	0.25	0.929	38.89***
Incompetence in doing tax return	0.24	0.923	30.97***
Paying less than one's fair share of tax	0.21	0.919	26.06***
Tax Office's power over big business	-0.20	0.915	22.52***
Others' social-ethical norms in paying tax	-0.20	0.906	20.02***
Personal values of competence and effectiveness	0.19	0.902	18.09***
Canonical R	0.31		
Eigenvalue	0.11		
Chi-Square	135.39		
Significance	p<0.001		

*** p<0.001

Table 4 presents the correlation coefficients¹⁰ between the variables and the discriminant function in ascending order of the absolute size of the correlation within the function. These are: owing money to the Tax Office (0.81), support for spending more tax dollars on welfare (-0.32), the Tax Office's power over small business (0.25), incompetence in doing tax returns (0.24), paying less than one's fair share of tax (0.21), the Tax Office's power over big business (-0.20), others' social-ethical norms of taxpaying (-0.20), and finally, personal values of competence and effectiveness (0.19). It is evident that owing money to the Tax Office primarily defines this function, however other variables also play an important part in discriminating SBI from others. Other measures in the bottom part of Table 4 show the overall degree of fit of the discriminant analysis. The overall canonical correlations suggest a moderate association between this set of eight variables and group membership. The eigenvalue, chi-square, and Wilk's Lambda suggest that the variables utilised give moderate discriminatory power in separating SBI from others. One limitation of our study is that we

¹⁰ 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).

can not be sure that our sample is truly representative of all SBI. A further cautionary note is that the variables identified as risk factors are not necessarily causal factors; they may mediate or moderate risk or may represent non-causal indicators of risk of tax non-compliance. All in all, however, the results obtained from the discriminant function analysis are generally useful and suggestive as discussed in the next section.

Summary and conclusion

This study provides in-depth information on how SBI are similar to and different from others in terms of their worldviews, evaluation of the tax system, demands and experiences with the Tax Office, and motivational postures. This section discusses the obtained findings within the compliance-oriented regulatory framework (see Ayres & Braithwaite, 1992; Braithwaite, 1985, 2000; Grabosky, 1985; Kagan & Scholz, 1984). Scholars working within this framework have attempted to map the dynamics of regulatory strategies in relation to corporate misconduct (Braithwaite & Braithwaite, 2000; 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. Which model is used depends on whether non-compliance is due to the corporation being amoral, a political citizen, or organisationally incompetent. This section takes on the challenge of understanding reasons for non-compliance among SBI, and provides some recommendations on how to build a culture of voluntary tax compliance.

The findings of this study identify a number of attributes that are useful in profiling SBI against others. At first glance, our results seem to be suggestive of *amoral and rational calculation* among SBI which is also in accord with community stigma. As evident in our analyses, SBI are more likely to owe money to the Tax Office and to face sanctions. In addition, they are found just as likely to be incompetent corporate taxpayers whose misconduct is driven by lack of expertise. Complex administrative requirements together with a lack of expertise are likely to be linked with their non-compliance (for example, owing money to the Tax Office). Supposing that this is the case, imposing a legal sanction is unlikely to be effective as a corrective tool. The Tax Office should initially rely on education

and persuasion just in case there is a desire to be a good citizen which may have been hindered by *organisational incompetence*. A priority can be placed upon exploring the needs and expectations of SBI. Based upon such practical information, establishing a small business advisory committee (independent of the Tax Office but able to provide tax advice) would be a good way of providing informal but professional support. Consideration may also be given to studying the feasibility of a peer-review approach. Reviewing each other's tax matters can reduce the tensions between the Tax Office and SBI, with the appropriate outcome for evaluation of the initiative being improvement in compliance (for example, money owing the Tax Office).

Data also suggest that SBI regard big businesses and the wealthy as being in a privileged position in the regulatory system. Such negative views of the tax system and beliefs that others are dishonest in paying tax increase the likelihood of non-compliance. But it would be hasty to resort to deterrence to influence SBI to comply since sanctions communicate an 'amoral name tag'. As can be seen from our data, SBI show no less a concern for honest and lawful taxpaying behaviour than other groups. Yet they feel as if they are treated more harshly. This is an argument for treating SBI initially within a 'regulator as politician' framework and not within that of 'regulator as policeman' (for details, see Kagan & Scholz, 1984).

In recommending the Tax Office's role as 'politician' rather than 'policeman', we are arguing that tax authorities should take a dialogic approach that may create a genuine change of beliefs in SBI about the tax system, what it represents and what it provides the community. 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 tax collection. If an approach of explaining such benefits to taxpayers is taken, some SBI may favour compliance¹¹. However, not everyone will be swayed by argument and reason. Once education, persuasion and negotiation have failed, a more defensive model can be pursued through an enforcement approach. The tax authority can choose from a number of approaches ranging from verbal and written warnings to penalties of different strengths. But we need to

¹¹ It should be remembered that SBI are as concerned about paying tax as anyone else and expressed concerns about feeling ashamed if caught for tax evasion. SBI do not lack a conscience, but they are disillusioned with the system.

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 persuasion and cooperation for inspections and penalties. It is a holistic approach toward regulation in which mixes of regulatory strategies appeal to the complexity and variety of motivations underlying compliance’ (Parker, 2000).

What would happen if a defensive enforcement model 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. Perceiving a discriminatory approach in the way the tax authority uses power to regulate small business compared with big business, SBI feel they are being unfairly treated by the Tax Office. At the same time, perceiving others as having lower social-ethical norms acts as an excuse for following the same path. Such thinking is likely to be strengthened by 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 advisers may have been asked to offer tips on how corporate-tax loopholes can be used to make up their expenditure, precisely because of prior application of sanctions. It could be that SBI would be less likely to consider aggressive tax planning if they judged the system as fairer. If this is so, then tax compliance may have less to do with deterrence than with dialogue and restorative justice¹².

In summary, the primary long-term goal of the tax officer is to ensure that taxpayers demonstrate responsible taxpaying behaviour. If there is reason to believe taxpayers are *incompetent*, persuasion and education should be given priority. If persuasion and education fail, negotiation becomes the key regulatory strategy. After this point, enforcement will be necessary. Tax officers need to be cautious at this point, however. Due to the lack of problem identification and in-depth analyses (Parker, 2000), regulators can escalate inappropriately and punish ‘*good apples*’ to the point where future cooperation is seriously jeopardised. If non-compliance is unintentional and a heavy penalty is imposed, the taxpayer may respond with a hardened and offensive strategy of non-compliance, because of their anger at being treated as a ‘*bad apple*’. Facing sanctions with no apparent good reason may create

¹² For a detailed discussion on dialogue and restorative justice, see Parker (2000).

reactance¹³ in SBI, and encourage them to seek an aggressive tax adviser as a means of surviving in an unfair tax world. Adopting the strategy of persuasion and negotiation over deterrence minimises long term damage to the Tax Office – taxpayer relationship.

Given the complexity of the world and ourselves, we need a combination of approaches to understand and respond legitimately to SBI (Kagan & Scholz, 1984; Parker, 2000), such as persuasion, institutional reform, and deterrence. Regulators need to talk softly while carrying a big stick (see Ayres & Braithwaite, 1992, p.19). Whether the big stick is likely to be used effectively or not depends on context. Sometimes, the use of the big stick can point to failures in the justice and legitimacy of the institution. Deterrence, however, will be a poor substitute when a significant proportion of the population regards institutionalised reform as the primary means of restoring justice to the tax system.

¹³ For details about reactance, see Brehm (1966).

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APPENDIX

Descriptions of the measures used in the stepwise discriminant function analysis

Personal values of competence and effectiveness

Measured through five items instructed as: 'Below is another list, this time made up of personal goals and ways of living that different people use as guiding principles in their daily lives. Please indicate the extent to which you accept or reject each of these goals *as principles that you try to live by*. Do this by circling the numbers as you did before. Before you start, quickly read through the entire list to get a feel for how to score your answers.'

There were seven response categories: 1 = reject, 2 = inclined to reject, 3 = neither reject nor accept, 4 = inclined to accept, 5 = accept as important, 6 = accept as very important, 7 = accept as of utmost importance. Items are:

- (1) Efficient (always using the best method to get the best results);
- (2) Showing Foresight (thinking and seeing ahead);
- (3) Resourceful (being clever at finding ways to achieve a goal);
- (4) Knowledgeable (being well-informed); and
- (5) Logical (being rational).

Support for spending more tax dollars on welfare

Measured by five items instructed as: 'The government spends taxpayers' money in many different areas. Below are just a few of these areas. For each area, do you think the government should be spending less money, keeping things as they are, or spending more money?'

There were five response categories: 1 = much less, 2 = less, 3 = same, 4 = more, 5 = much more. Items are:

- (1) Education;
- (2) Health care;
- (3) Law courts and legal aid;
- (4) Welfare; and
- (5) Employment.

Tax Office's power over small business, wage and salary earners

Measured by three items instructed as: 'The following questions relate to the power that you perceive the Tax Office as having. To what extent do you disagree or agree with the following:'

There were five response categories which were reverse scored: 1 = strongly disagree, 2 = disagree, 3 = neither, 4 = agree, 5 = strongly agree. Items are:

- (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.

Tax Office's power over big business and high wealth individuals

Measured by two items instructed as: 'The following questions relate to the power that you perceive the Tax Office as having. To what extent do you disagree or agree with the following:'

There were five response categories which were reverse scored: 1 = strongly disagree, 2 = disagree, 3 = neither, 4 = agree, 5 = strongly agree. Items are:

- (1) The Tax Office can't do much if a large company decides to defy it; and
- (2) The Tax Office can't do much if a wealthy individual decides to defy it.

Owing money to Tax Office

Measured by one item instructed as: '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?' There were four response categories: 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 returns¹⁴.

Paying less than one's fair share of tax

Measured through two questions instructed as: 'In your opinion, do the following groups pay their fair share of tax?' There were five response categories: 1 = much more!, 2 = a bit more, 3 = OK, 4 = a bit less, and 5 = much less. Items are:

- (1) you, yourself; and
- (2) your industry/occupation group.

¹⁴ Anyone who scored a '4' was not included in the analysis.

Incompetence in doing tax return

Measured by one item: 'I feel competent to do my own income tax return'. There were four response categories: 1 = not at all, 2 = a little bit, 3 = a fair bit, and 4 = very much. This item was recoded (reverse scored) into 4, 3, 2, and 1, respectively, so that a higher score indicates an incompetency in doing tax return.

Others' social-ethical norms of taxpaying

Measured by four items instructed as: '...we would like to know what you think MOST PEOPLE think.' There were five response categories: 1 = no!!, 2 = no, 3 = don't know, 4 = yes, and 5 = yes!!. Items are:

- (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 deductions on their tax return?¹⁵;
- (3) Do MOST PEOPLE think working for cash-in-hand payments without paying tax is a trivial offence?; and
- (4) Do MOST PEOPLE think the government should actively discourage participation in the cash economy?

¹⁵ This item was recoded (reverse scored) into 5, 4, 3, 2, and 1 in order to make it consistent with other items in this measure.

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