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# Tax Practitioner Compliance

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## Abstract

This chapter aims to review prior literature on tax practitioner and provides insights into tax practitioner behavior that affects taxpayer compliance. For the end, I attempt to distinguish tax practitioner compliance from taxpayer compliance for a better understanding of tax compliance process. I maintain that tax practitioner compliance can be assessed in the light of tax compliance, bringing about new perspective on tax compliance literature. In order for them to ensure compliance, the tax practitioners continue to develop their professional skills. Furthermore, the tax practitioner should be responsive to the environment in terms of both what clients want and what tax laws allow. However, their ethical judgments based on professional proficiency should not be affected by client pressure. Being a constituent of tax compliance dynamics, tax practitioner compliance may as well be construed in their decisions as well as underlying attitudes toward clients, colleagues, and the tax system. As a service provider, the tax practitioner must strive to reduce inconsistencies between expectations and experiences. As a member of the professions, the tax practitioner refrains from abusive tax schemes that can stimulate institutional corruptions. As a professional, the tax practitioner should safeguard the integrity of the tax system.

**Keywords:** tax compliance, tax avoidance, tax practitioners, self-assessment tax system

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## 1. Introduction

This chapter aims to review prior literature on tax practitioner and provide insights into tax practitioner behavior that affects taxpayer compliance. For the last four decades, tax compliance has been a subject matter of considerable interest to many researchers from a variety of academic disciplines including accounting, economics, history, law, psychology, political science, and sociology [1]. A great deal of studies has already contributed to the tax literature

discovering factors that shape taxpayer compliance behavior. However, most of them focus on taxpayer's behavioral responses to the tax system and fiscal policy.

Taxation is a highly structured process of institutionalized entities like taxpayers, tax practitioners, tax administration, and up to government and tax lawmakers [2]. Besides, tax compliance is a complex phenomenon in the actors in the field, and their interactions have a great impact on individual taxpayers' behavior [3]. Hence, lack of research on important entities can undermine our understanding of tax compliance behavior that is intimately intertwined [4].

In the real world, professional tax practices are highly relevant to determine taxpayer compliance. Tax practitioner can exert considerable influence on taxpayers in the tax compliance process by either helping them to enforce or exploit the tax law [5]. Many taxpayers, being helpless of overwhelming volumes and mysterious jargons in the tax laws, resort to the assistance from tax professionals who are well-informed of the complex tax rules. Moreover, having limited resources to run their business, taxpayers often defer to tax practitioners for the important decisions about their own tax matters. Therefore, it is essential to understand what makes the practitioners compliant and how they achieve compliance in taxpayer compliance process. However, scientific studies on tax practice in relation to taxpayer compliance are scarce. Furthermore, there is not a widely accepted definition of tax practitioner compliance.

The main objective of the chapter is to provide tax scholars, tax practitioners, and tax authorities with a better understanding of tax practitioner compliance in connection with taxpayers' choice of their tax position. Toward this end, I glean useful knowledge from research findings and synthesize them in order to clarify the meaning of tax compliance in relation to taxpayer and tax practitioner and their interactions. Herein, I refer to tax practitioners as private sector tax professionals who help taxpayers to prepare their tax returns and/or provide advice on tax matters including accountants, paid preparers, lawyers, etc.

Tax practitioner behavior is of great concern to taxpayers, as well as tax authorities. Shafer and Simmons [6] maintain tax advisors have abandoned concern for the public interests in favor of commercialism. The dilemma mainly arises from their dual role as a client advocate and gatekeeper safeguarding the fairness of the tax system. In other words, an aspect of tax practitioner compliance relates to the conflict of client advocacy and professional responsibilities [7]. Mason and Garrett Levy [8], p. 127, defines client advocacy as "a state of mind in which one feels one's primary loyalty belongs to the taxpayer. It is exhibited by a desire to represent the taxpayer zealously within the bounds of the law and by a desire to be a fighter on behalf of the taxpayer."

For example, a noncompliant practitioner is willing to accept overly aggressive or, in its extreme, a fraudulent tax reporting if the probability of detection and punishment is perceived to be relatively low. However, an important question still remains unresolved. Should tax practitioner aggressiveness in terms of recommending tax treatment be deemed noncompliant without any consideration whatsoever? Is tax practitioner compliance achieved if the practitioner takes too conservative a tax position in favor of the government which, arguably, represents public interests?

This chapter attempts to discover the key to understand the puzzling concept of tax practitioner compliance by illuminating the role of tax practitioners in the self-assessment system ("SAS") in regard to income tax return reporting positions. Since most of prior studies predominantly investigate tax compliance in the frame of individual taxpayers' evasion decision under detection risk, the term tax compliance and taxpayer compliance are often used interchangeably. For the purpose of the article, however, tax compliance should be carefully distinguished from taxpayer compliance. I presume that the tax compliance refers to *ex-ante* process, rather than *ex-post* consequence of the declaration of tax liabilities, in which all the actors in the field are involved to maintain. In a similar vein, Boll [9] argues that tax compliance is a socio-material assemblage, and complying is a distributed action among actors in the tax system.

## 2. The conceptualization of tax compliances

Taxpayer noncompliance refers to any failure to meet tax obligations, and it does not necessarily require intention to pay less tax than the law demands. It may result from deliberate underreporting, inadvertent misreporting, or nonfiling of tax return. The tax gap, which is a popular measure of noncompliance in an aggregate level, is defined as the difference between actual tax collected and the potential tax collection under full compliance [10]. It consists of nonfiling, underreporting, and underpayment of tax [11], which represent filing noncompliance, reporting noncompliance, and payment noncompliance, respectively.

Tax evasion and tax avoidance consist in deliberate act of noncompliance. While tax evasion refers to intentional underpayment of taxes by deliberate nondisclosure of taxable resources [12], tax avoidance is widely considered a legal way of reducing tax dues. Tax avoidance, however, is often against the spirit of the laws, thereby has a chance to be challenged by tax authorities, which eventually falls under the category of noncompliance.

The majority of scientific studies on tax compliance address the problem of individuals' tax evasion decision in the form of underreporting taxable income or overclaiming unwarranted deductions. In particular, most of them are concerned with SAS, in which taxpayers are given opportunities to underreport, and their initial tax liabilities are determined by self-declaration, while the true income will not be observable by tax authorities unless a tax audit is conducted. Thus, tax noncompliance, in the narrowest sense, refers to taxpayers' dishonesty in their tax reporting.

However, it should be noted that, from the viewpoint of taxpayers, noncompliance problem lies not only in undercompliance but also in overcompliance: noncompliance can result not only from underreporting or underpayment but also from overreporting or overpayment. Inadvertent noncompliance may result from the errors and mistakes of taxpayers or tax practitioners. Nevertheless, the researchers and policymakers have paid little attention to the problem of overcompliance. It may be that taxpayers are assumed to be rational enough to deal with tax matters, and thus, discovering of underreporting should be deemed the consequence of their intentional misconduct. On the basis of rationality assumptions, any mistakes may be seen as not due to incompetence but to a lack of commitment to declare a correct tax return [13].

Tax laws are increasingly voluminous, and the law provisions are sometimes terribly complicated to be fully understood. It takes a lot of time and effort to meet the tax obligations, and even if they pay much attention enough to avoid inadvertent errors and mistakes, tax liabilities are often subject to uncertainty from varying interpretations of ambiguous tax situations. For a further understanding, the following section discusses the issues of tax law complexity and ambiguity.

### 3. Tax law complexity and ambiguity

In practice, many taxpayers are faced with the complexity of tax laws and the uncertainty of enforcement. In most developed countries, tax law is complex, and it requires a very high reading age to be correctly understood [14]. Taxation cost (taxes and compliance cost) is perceived to be much more painful loss for small business taxpayers because they lack sufficient resources to manage their business [15].

If tax laws are vague and complicated, it may be difficult to fully comply with the law even with no intention to evade. Owing to the complex nature, ordinary taxpayers cannot cope well with tax requirements. Sakurai and Braithwaite [16] showed that the most important reason that their survey respondents gave for using tax service was that the desire to avoid the risk of potential tax penalties resulting from inaccurate tax returns. The professional tax knowledge that prevents the taxpayer from unintentional overpayment as well as underpayment can be purchased from the tax practitioners. Thus, an aspect of tax practitioner compliance can be better construed in connection with professional competence that ensures correct tax reporting.

McKerchar [17] maintains that tax complexity is a double edge sword for practitioners: on one side, it induces taxpayers into the arms of practitioners facilitating the market for tax service; but sometimes, it is too much a burden even for them to juggle. Although compliance duties can be addressed more correctly by the tax practitioner, the assistance of the tax practitioner cannot eliminate the risk of inadvertent noncompliance due to the complexity inherent in the law.

Carnes and Cuccia [18] argue that complexity is a source of unintentional noncompliance, and it may represent opportunities for intentional noncompliance as well. More often, tax practitioners can only reduce the uncertainty by assessing the likelihood a tax treatment will be sustained on its merits [19]. That said, inadvertent noncompliance is in part attributable to tax law ambiguity. A tax situation is ambiguous if its proper tax treatment is not *ex-ante* deterministic. Aggressive tax treatment involves a reasonable probability that the reporting position will not be upheld in a tax audit [20]. Aggressive tax practitioners are more likely to interpret the ambiguous tax situation to the benefit of their clients.

Studies on tax practitioner behavior attempt to discover the conditions in which tax advisors would recommend more aggressive reporting position [21]. A number of studies have been conducted investigating factors that impact tax practitioners' willingness to accept aggressive reporting positions; among them are attitude toward risk [22], the threat of penalties [23], and client's risk preference [24]. In particular, Prospect theory [25] may also serve as a theoretical



basis to explain tax practitioner's behavior. According to the Prospect theory, people exhibit risk seeking tendency in a loss situation, while being risk averse in a gain situation. Newberry et al. [26] found that CAPs were more likely to sign a tax return containing a large and ambiguous deduction to retain an existing client than to gain new one.

However, tax practitioner studies tend to avoid compliance or noncompliance, directly focusing instead on aggressiveness [27]. Phillips and Sansing [28] underline that conservative and aggressive are *ex-ante* labels that characterize a reporting position when the law is ambiguous. They go on emphasizing that taxpayer compliance is an *ex-post* and hypothetical concept, because in the real world, many of the reporting positions will not be evaluated by tax inspectors. Put differently, contrary to taxpayers' common beliefs, in many cases, tax compliance is not deterministic in spite of tax practitioners being involved, but it is stochastic depending on the enforcement activities of the tax administration.

#### 4. The work of tax practitioners

There are a variety of motives in hiring tax practitioners. As it is, the role of tax practitioners in tax compliance process can be best understood considering the multifaceted aspects of tax service. Frecknall-Hughes and Moizer [29] argue that the work of tax practitioners in its broadest way can be divided into two kinds: tax compliance and tax planning/avoidance advice; the formal relates to resolve uncertainty in which tax position can be correctly settled, and the latter is associated with ambiguous tax situations in which legitimate tax position is not deterministic. Stephenson [30] discovered four separate constructs underlying the demands for tax practice: legal compliance, time savings, money savings, and protection from the tax authority.

Many taxpayers tend to claim accuracy as their main objective in tax preparation [31]. In that case, the quality of tax service is to ensure the tax returns do not contain inadvertent errors or omissions. It is somewhat evident that taxpayers hire tax practitioners to save time and effort required to achieve compliance. They will delegate tax return preparation to the practitioner, if the opportunity cost of self-reporting exceeds the service fee. Tax practitioners are also expected by their clients to reduce the chances of audit and penalty, thereby lowering monetary and psychic costs associated with audits that would otherwise have occurred [32]. Tax practitioners may provide professional assurance of compliance by verifying and assessing acceptable tax positions in the SAS [33].

Every tax legislation, however, contains "gray" areas that produce ambiguous tax situations. Tax practitioners cannot get rid of entire uncertainty, but they can only gauge the likelihood the position not being upheld by the tax court. The tax position is subject to some uncertainty and hence may step into a process of negotiation with the tax authorities [29]. Indeed, Frecknall-Hughes and Kirchler [34] came up with negotiation theory as a conceptual framework for understanding the nature of tax practice. They argue that the tax advisor/preparer and the tax inspector (who are the employee of revenue authority) are negotiators who act respectively on behalf of a client and the tax authority. While laypersons may see the task of

trials and tax audits as revealing the truth about the matter, many practitioners approach their job as being able to negotiate the best settlement for their clients [35].

Some tax practitioners promote unacceptable tax minimization arrangements, assisting their clients in devising strategies to exploit legal ambiguities [36]. They are inclined to view testing the outer limits of the tax law as a natural and acceptable feature [37]. In recent decades, their role has become more complicated and sophisticated with the special tax knowledge required to facilitate tax avoidance [38]. For example, Sikka and Hampton [39] criticize that accountancy firms have sold tax avoidance schemes to corporations and wealthy individuals, which they refer to as tax solutions or tax strategies.

Nevertheless, it is important to distinguish legally permissible tax planning from potentially unacceptable tax scheme. Adapting motivational postures theory [40], Kang [41] coined two terms indicating differentiated features of tax avoidance: deferential avoidance and defiant avoidance, while deferential avoiders stand firm within the boundaries of the law, defiant avoiders try to push the boundaries of the law's intent by self-serving in terms of law interpretation.

The role of tax practitioners has been viewed as representative of both taxpayers and the government [42]. One might argue that they have to act as advocates for their clients and to serve as intermediaries in the tax system. Tax practitioners should be concerned not only with their client's interest but also with general publics in conducting their practices. Indeed, OECD [43] published a report highlighting the importance of trilateral relationships among tax authorities, taxpayers, and tax intermediaries in promoting taxpayer compliance. In a nutshell, tax practitioners have a legitimate and efficient function as intermediaries or "knowledge brokers" between taxpayers and revenue authorities [44]. They can provide a useful line of communication between tax inspectors and taxpayers. Furthermore, tax professionals can provide a check-and-balance function that prevents tax authorities' possible extortion or tax inspectors' harassment on the part of taxpayers, thereby safeguarding the equity of a tax system [7].

There are a variety of expectations for tax practitioner work, and sometimes an "expectation gap" arises from the misperception of each other's expectation. Expectations gap refers to the difference between client expectations and the professional's perceptions of those expectations and vice versa [20]. Christensen [45] argues that tax preparers' perceptions of what clients expect from tax service differ significantly from clients' expectations. Tax preparers may rationalize it is their clients who demand aggressive tax reporting. Schisler [24] maintains that many taxpayers insist on aggressive tax advice. In contrast, according to Tan [46], taxpayers favor conservative tax advice if the taxpayers' main objective is filing an accurate tax return. This issue is worthwhile to be explored in more depth in the following section.

## **5. Interactions of the taxpayer and the tax practitioner**

Research on the interaction between taxpayers and tax practitioners exists much less than is required, providing the immense amount of time and money spent on tax compliance [20]. Kaplan et al. [5] emphasize the role of tax practitioners in tax compliance by demonstrating

that if a tax practitioner provides aggressive tax advice, the taxpayer is likely to take the aggressive tax position that might not be upheld in a tax audit. On the contrary, Hite and McGill [47] argue that taxpayers tended to disagree with aggressive advice and to agree instead with conservative advice. Or, there is also evidence that conservative taxpayers defer to the opinion of aggressive tax practitioners [48]. Not surprisingly, there are taxpayers who will still accept whatever types of advice their practitioners recommend.

For the tax practitioner, clients' risk preferences could influence the willingness of practitioners to recommend aggressive positions [49]. Cloyd [50], Cuccia et al. [51], and Schisler [24] indicate tax practitioners' tendency to recommend more aggressive positions when taxpayers are more aggressive (risk seeking). Notably, Duncan et al. [52] found the opposite evidence showing the more risk-averse the taxpayer, the more aggressive the tax practitioner, and the more aggressive the taxpayer, the more conservative tax position recommended by the practitioner. Furthermore, Bobek et al. [53] examined how the role of client advocacy influenced tax professionals' decision processes and outcomes and provided empirical results revealing that client characteristics influence tax professionals' advocacy attitudes. These findings suggest that taxpayers and tax practitioners' decisions are interdependent, and studies on their interaction dynamics could be a promising approach to find new insights into tax compliance.

Wurth and Braithwaite [54] underline that practitioners are responsive to influences from many sources—clients, tax authorities, professional associations, governments, international bodies, and the organizations and cultures. For example, Doyle et al. [55] investigated the moral reasoning of tax practitioners in social contexts and in tax contexts, and they found tax practitioners' significantly lower level moral reasoning than nonpractitioners in tax contexts. The study implies that client advocacy may deter tax practitioners' moral reasoning. Reckers et al. [23] pointed out that less important taxpayers are more likely to receive more conservative advice from the tax practitioners. On the contrary, Bandy et al. [56] asserted that economic importance of the taxpayer had little effect on tax practitioners' willingness to be aggressive in terms of providing advice or signing aggressive tax return. Spilker et al. [57] provide evidence that tax practitioners interpret ambiguity in the tax law differently in planning than in compliance stage because they are more vulnerable to problematic tax advice that might result in litigations and reputational loss.

In connection with taxpayer compliance, Practitioner-Client role model developed by Tan [58] recognizes two parties' expectations, and behavioral dynamics can emphasize that how taxpayers and tax practitioners interact with each others are likely to affect each other's tax decisions. Similarly, The Wheel of Social Alignments put forth by Braithwaite and Wenzel [59] synthesizes the drivers of tax compliance regarding tax practitioners as alternative authorities to tax officials.

Some taxpayers exhibit their preference of conservative advice over aggressive one. However, Sakurai and Braithwaite [60] show that some taxpayers prefer "no risk no fuss" type. As with their diverse motivational postures [40], it is natural of taxpayers to exhibit diversity in their preference over tax advice as well as tax position. It is therefore in communicating with their clients, tax practitioners should educate, persuade, and encourage taxpayers to acknowledge the responsibility for their decisions in order to reduce expectation gap [61]. In many cases, ineffective communication is attributable to the failure to achieve compliance procedures



accompanied by unintended consequences. The absence of clear communication and the failure to make reasonable enquiries when information or documentation provided by a client appears to be inaccurate or incomplete [62] tend to engender the disappointment in their tax service experienced.

Tax practitioner self-seeking behavior together with compliance cost can afford unique opportunities to explore taxpayer decision. Tax law complexity increases the cost of compliance, and compliance costs are widely regarded as high. For the part of taxpayers, it may seem unfair to hire a tax professional in order to understand the laws. Taxpayers may expect their compliance cost to be offset by the tax service. If they deem the service fee as a mere expense accompanied by no additional benefit, they will be likely to be more aggressive in order to restore equitable condition. For instance, Jackson et al. [63] well demonstrated how taxpayers and tax practitioners decisions are interrelated. Drawing on mental accounting theory, they postulate mental aggregation of preparation cost with taxes, and tax professionals may place their clients in positive prepayment positions. The concept of mental accounting derived from research on prospect theory describes the set of cognitive operations used by individuals to organize, evaluate, and keep track of financial activities [64]. Then, they provide evidence that tax return preparation fees are larger for taxpayers who receive tax refunds than for taxpayers who owe additional taxes. It is argued that compliance costs paid to the tax preparer and the expected tax refund occur in the same mental account. Thus, taxpayers who have a favorable mental representation of tax return preparation fees may be willing to pay for higher costs incurred by tax practitioners.

## 6. Conclusion

In this chapter, I attempt to distinguish tax practitioner compliance from taxpayer compliance for a better understanding of tax compliance process. And I maintain that tax practitioner behavior can be assessed in the light of tax compliance, bringing about new perspective on tax compliance literature. As the extent and nature of tax practice are highly relevant to tax compliance, it is worthwhile to investigate the meaning of tax compliance in relation to tax practitioner compliance behavior.

As in taxpayer compliance, tax practitioner compliance can be either inadvertent or intentional. Tax practitioner noncompliance results the lack of professional competence and objectivity. Nevertheless, it is somehow inevitable for them to make mistakes due in part to the inherent uncertainty and ambiguity of the tax legislation. In order for them to ensure compliance, the tax practitioners continue to develop their professional skills; they must stay knowledgeable about current tax issues that have impact, positively or negatively, on their clients. Furthermore, the tax practitioner should be responsive to the environment in terms of both what clients want as well as what tax laws allow. However, their ethical judgment based on professional proficiency should not be affected by client pressure.

In return for their prestige, professions have certain obligations to their clients, colleagues, and the society [65]. For the meaning of tax compliance must include both compliance with the

letter of the law and a respectful attitude toward the spirit of the law and fiscal policy [66], tax practitioner compliance may as well be construed in their decisions as well as underlying attitudes toward clients, colleagues, and the tax system. As a service provider, the tax practitioner must strive to reduce inconsistencies between expectations and experiences. As a member of the professions, the tax practitioner refrains from abusive tax schemes that can stimulate institutional corruptions. As a professional, the tax practitioner should safeguard the integrity of the tax system. In short, the tax practitioners should be carefully place themselves between tax authority and their clients as watch dogs to maintain the integrity of the tax system.

Tax practitioners' noncompliance, in its extreme, occurs when they ignore clients' legitimate right to reduce tax dues, but in its other extreme, tax practitioner noncompliance ensues from their acceptance or collusion of tax evasion. It is therefore necessary for tax authorities to acknowledge that tax practitioners play a role of effective interventions to improve taxpayer compliance. Above all, the practitioners are the ones to prevent taxpayers from taking overly aggressive or/and illegal tax positions. Furthermore, business taxpayers and their tax practitioners can be highly interdependent for tax practitioners can become business confidants [67].

There are many areas of research that have been understudied. Among them lies the conflict of interest between taxpayers and tax practitioner. Although the tax practitioner is hired by the taxpayer, they may act in accordance to their own interest rather than to the benefit of clients. This type of problem mostly arises from the information asymmetry between the taxpayer and the tax practitioner. Some practitioners may take advantage of private information to their own merit. The conflict of interest between taxpayers and tax practitioners that is worthwhile to be explored to establish a complete body of tax compliance literature.

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