

Tax Knowledge, Tax Agents and Co-operative Compliance:

Implications for New Zealand

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Seminar Outline:

1. Context: UK, Australia, New Zealand
2. Rise of Compliance Models
3. Role of Tax Agents
4. Tax Knowledge & Planning Research
5. An Important Precursor: Knowledge Management
6. Findings from ACCA Project
7. Implications for New Zealand

1. Context

1. Debate on CSR; corporate tax burdens; tax avoidance ...
does it simply reinforce an adversarial approach ?
2. Co-operative compliance suggests importance of trust,
integrity, procedural justice ...
panacea or lip service and problematic ?
3. Role of tax agents ...
how ethical are the professionals ?
4. Levels of unrepresented taxpayers ?
over 90% UK taxes are remitted by businesses
5. How is tax knowledge managed ?
by: firms / agents / tax authorities ?
6. “No one size fits all” or is tax practice international ?

2. Rise of Compliance Models

Developed by:

ATO following work at ANU (see Braithwaite, 2003; 2005) and earlier work by John Scholz

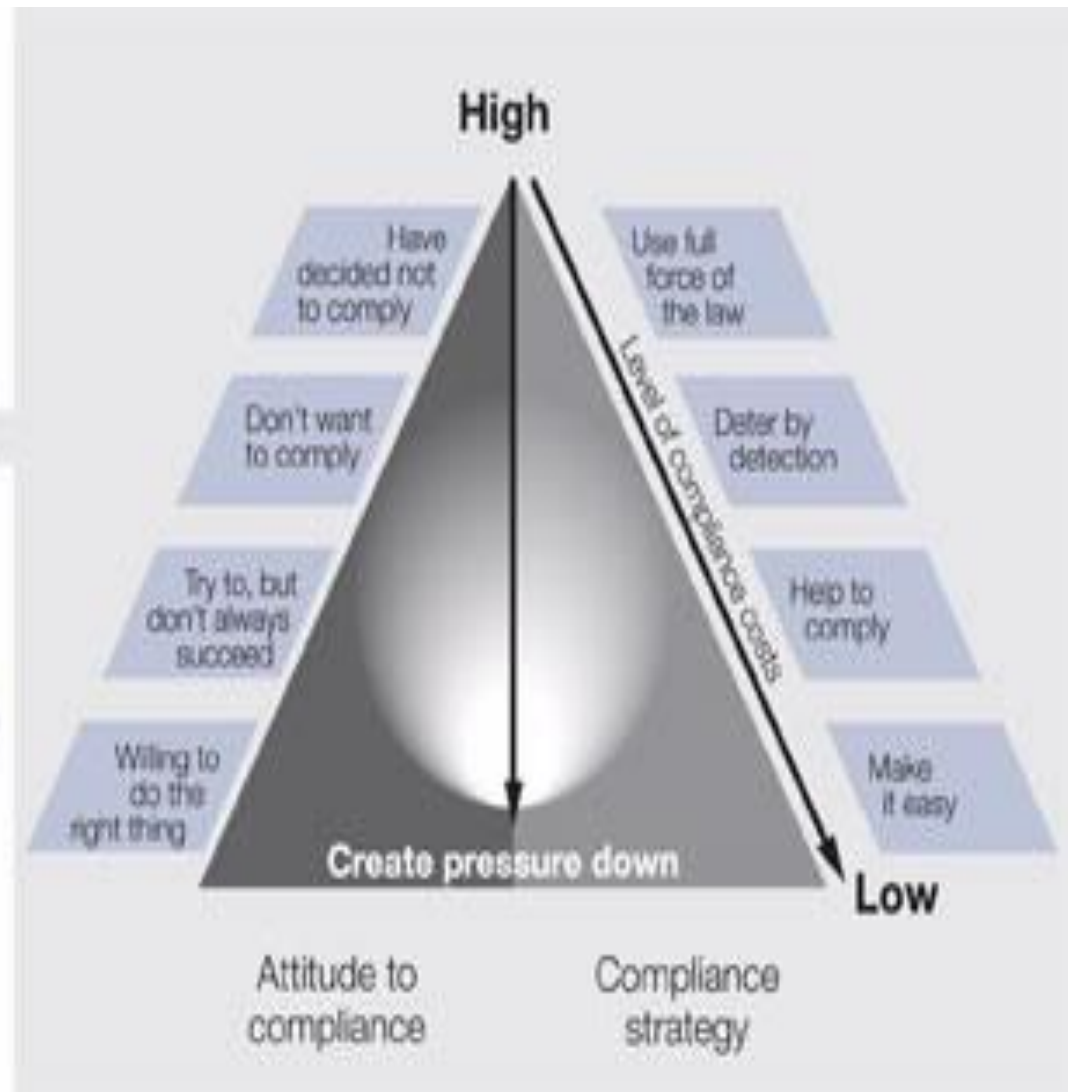
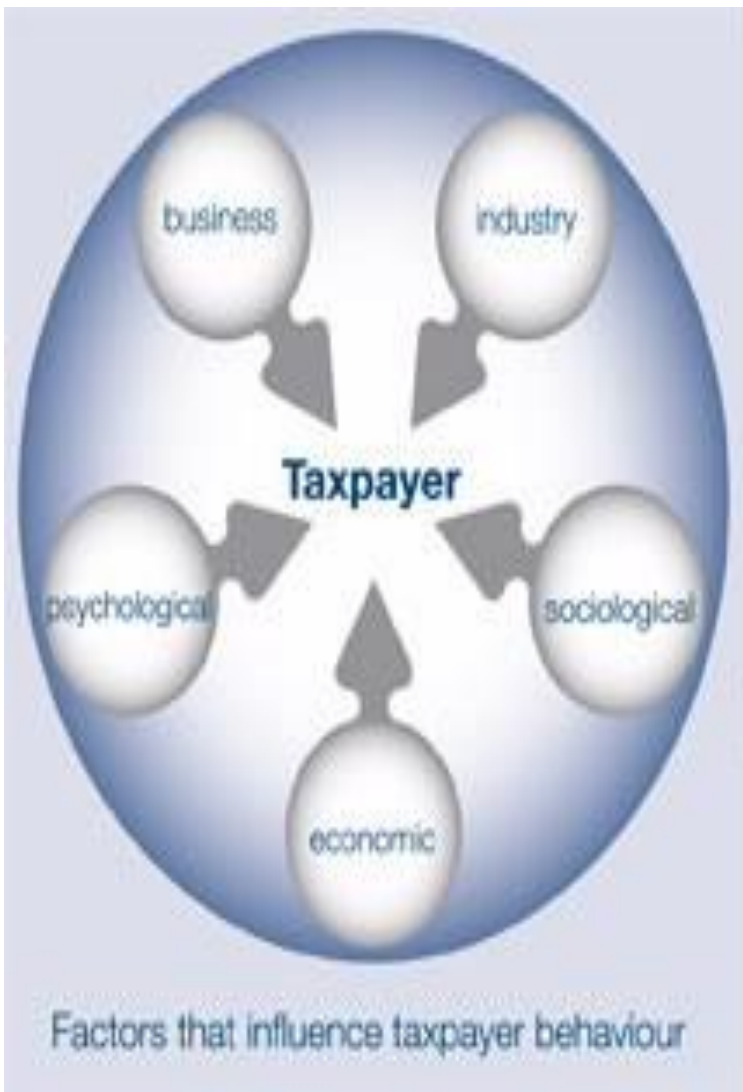
Used by: ATO and IRD

www.ato.gov.au/corporate/content.asp?doc=/content/5704.htm

www.ird.govt.nz/aboutir/reports/soi/soi-2006-2009/soi-2006-2009-part3/

Applicable to Agents?

Agents as tour guides – leading their clients to the pyramid's base ?





Factors that influence customer decisions and behaviour





IRD's general approach to improving compliance:

from Compliance Focus 2010-2011:

- Making it easy
- Helping individuals and businesses to comply
- Detecting non-compliance
- Using the full force of the law

Two critiques of Compliance Model:

Burton (2007):

- Compliance Model is a quantum shift and works with determinate tax law. Yet tax law is often indeterminate and vested interests exist.
- Are agents recommending less ‘aggressive’ stances in ambiguous areas ?
- If people disagree on what the law is, then it is difficult to agree the proper interpretation of laws and a partnership approach.
- Or, Can parties agree to disagree?

Kornhauser (2007):

- Models are vague as to exact implementation
- Tax authority must avoid being seen as too soft or too hard. Both can reduce compliance
- A flexible system (of responsive regulation) can create arbitrary decisions (inconsistent administrative response)
- Model assumes that attitudes/motivations are reflected in taxpayer behaviour
- This isn't always true. One person may comply because of sanctions and another person may comply because of social norms
- IRD action might therefore influence the two taxpayers differentially



Compliance Model extensions:

Tax morale:

Torgler (2007)

Critique: McKerchar and Pope (2010)

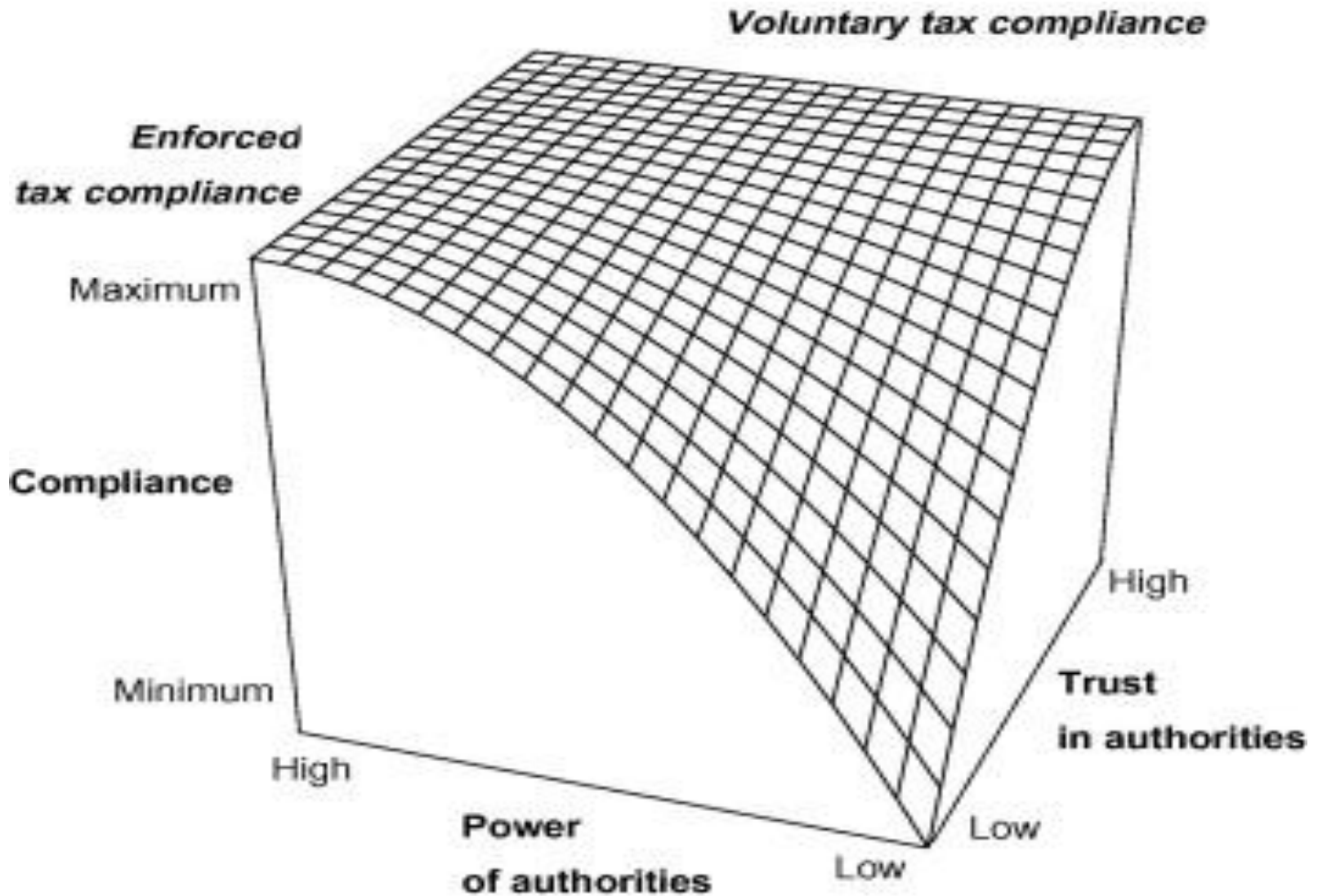
Slippery Slope Framework:

Kirchler (2007) and recent empirical tests

SSF suggests compliance is explained essentially by two variables:

Trust in Authorities and Power of Authorities

Simplistic model that doesn't reflect agents and vested interests



Kirchler, E., E. Hoelzl & I. Wahl (2008) "Enforced versus Voluntary Tax Compliance: The Slippery Slope Framework", *Journal of Economic Psychology*, Vol. 29: 210-225

3. Role of Tax Agents

- Extensive prior research where type of agents is key
- What factors influence agent behaviour (J & DM) ?
 - Socialisation of training
 - Psychological aspects
 - Culture of tax agency / client / firm
 - Reputation issues e.g. firm and individual
 - Regulation (governing agents)
 - Task factors e.g. routine compliance vs. planning
 - Ethics and risk management
- “Enforcer vs. Exploiter” (bee analogy to follow)

IRD approach to tax agents

- List of tax agents maintained by IRD (n = 5,000)
- IR Compliance Focus 2010-2011 areas:
 - Tax agents' own compliance behaviour
 - Tax agents' performance
 - Target: those promoting “inappropriate tax arrangements”
- Regulation governing agents:
 - Select countries: –
 - Australia: Tax Practitioner Registration Board
 - UK: Working with Tax Agents initiative
 - US: Oregon & California have stiffer requirements

4. Tax Knowledge / Planning Research

Experimental:

- Tax JDM: US centric e.g. Bonner et al. (1992); Cloyd (1997); Roberts (1998). Hite & McGill (1992); Tan (1999) – clients prefer conservative advice. Doyle's work on ethics.

Qualitative

- Braithwaite, J (2005)
- Freedman et al. (2009)
- Oats and Tuck (2006; 2008)
- Mulligan and Oats (2009)
- Sakurai (2002)
- Sikka (2010)
- However, most of the above focus on one player (e.g. Tax Agency; or Tax Directors) or one issue (avoidance etc)

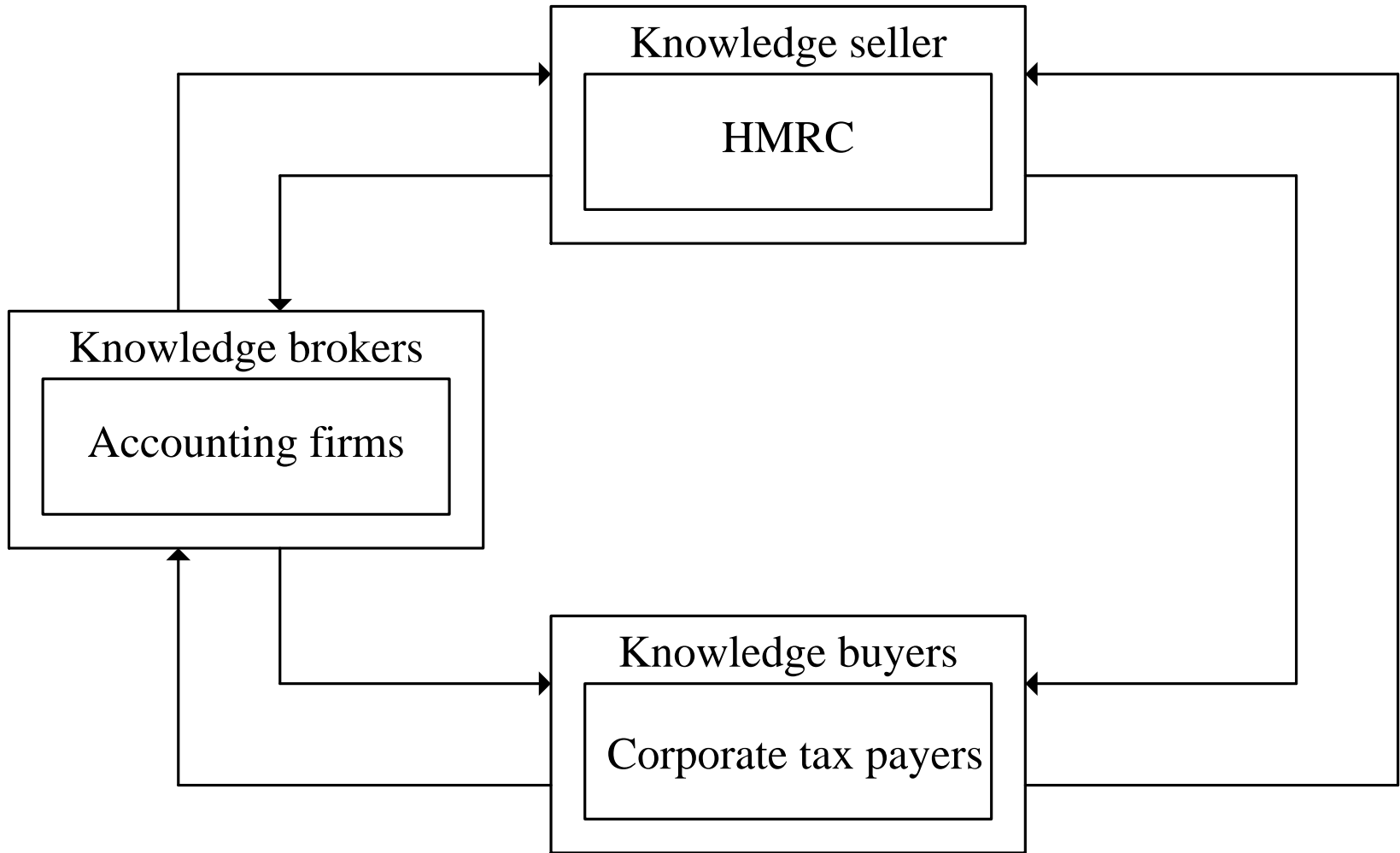
5. An Important Precursor: Knowledge Management

Literature:

1. Multi-disciplinary, but: Knowledge is an economic asset
2. Work conducted in professional service firms (Empson, 2001) and consultancies
3. Knowledge Market – i.e. Sellers, Buyers and Brokers
4. There exist inter- and intra- organizational knowledge flows
5. Also implicit / explicit knowledge and codification in practice
6. So: Accounting firms offer their clients intangible assets in the form of knowledge and skills and “need to claim superior expertise to maintain their value and competitive position” (Fincham, 2002)

6. The Management of Tax Knowledge

- ACCA Project (with K. Holland & P. Van der Rijt)
- 26 Interviews and two surveys
- www.accaglobal.com/general/activities/research/reports/enhancing_financial_literacy/rr_112
- Framework of Knowledge Market and Relationships explored
- Abridged results from interviews then follow



Results Summary: Intra-Organisational Flows


	HMRC	AF	CT
<u>Facilitators of Knowledge Sharing:</u>			
Electronic media	✓	✓	✓
External sources			✓
Internal technical manuals	✓	✓	
Internal training	✓	✓	✓
Intranet	✓	✓	✓
Precedence files and databases	✓	✓	✓
Training	✓	✓	✓
Use of Subject Experts		✓	✓
<u>Barriers to Knowledge Sharing:</u>			
Anxiety in sharing too much			✓
Confidentiality Issues		✓	✓
Information overload		✓	✓
Inadequate information technology	✓		
Insufficient incentives		✓	
Insufficient resources	✓		
Perceived lack of relevance to KS		✓	
Shortage of time		✓	✓



Inter-organisational knowledge flows appear to be crucial for the creation of intra-organisational knowledge.


“We had a case study that was drawn up jointly with the big four accountancy firms. We focused on a software case study, where the inspectors in syndicate groups worked through the case study and looked at typical questions arising about the R&D claim. And in each syndicate group there was a software specialist from one of the big four accountancy firms, who helped the inspectors to understand the issues in making a claim”.

(HMRC interviewee 1)




Intra-organisational knowledge flows - often dependent on non-tax professionals within the firm.

“Sharing with[in] the businesses is obviously one of the tricky things that I have to deal with because... I am actually reliant on accountants of the businesses who aren't actually tax people, to do a lot of the basic tax work.it is helpful if they have some tax knowledge. But on the other hand, you don't want to so overburden them with tax knowledge that either they can't cope or frankly it's something that they only do once a year and you know ... well you can't expect them to sort of give their all to it if they're not going to use it again for a year.” (CTP interviewee 2)




If alternative or competing knowledge sellers exist with differing incentives, conflicts can arise. Their avoidance requires a certain level of knowledge and has implications for the appropriate level of decision making delegation.

“... they have other sources ... a great number of them probably know quite a lot about R&D tax credits because as you can imagine, people out in the market are often trying to sell them R&D tax credit work. ... as far as they’re concerned, they’re taxpaying because they have to pay for their group relief. So they’re taxpaying, so they can see the benefit of it. But of course, on a group perspective, where the group isn’t taxpaying, it actually isn’t worth anything to us. So you have to sort of say ‘well hang on’ ... And they sort of phone me up and they say ‘I’m just about to engage this person to come and do this work for me, that’s alright, is it? And we’re going to pay them; that’s alright, isn’t it?’ (CTP interviewee 2)




Transfer of knowledge can be improved by the appropriate motivation and use of subject experts, both internally and externally. For instance, a particular seller can add credibility to a particular transfer:

“One thing we do and we’ve always been very keen to do is use visits from HMRC to come in and actually take them out to departments to make departments realise that [tax] is a real issue. And it puts the departments on edge, which probably isn’t a good thing but it makes them realise that tax is serious. ... we are quite keen to make sure that HMRC are visible on visits that we take them round”. (CTP interviewee 7)




Corporate taxpayers may take into account legal considerations that influence the form in which knowledge is retained and even influence whether it is created in the first instance.

“There’s another area of concern which is that of discoverability of documentation. Most companies have no problem at all in making factual information available to revenue authorities. I think where companies start to have a problem is on expressions of opinion, either internally or prepared by advisors. ... if we go out for advice, much of that expression of opinion is not privileged unless it’s within very confined sort of parameters involving lawyers. And therefore there’s a lot of concern about whether we either inadvertently will find ourselves in a position of having to provide expressions of opinion to revenue authorities when it’s not really appropriate”. (CTP interviewee 1)



The dynamic relationship and interdependence between inter- and intra-organisational knowledge flows can also be found in the interviews with employees of accounting firms.


“The chances are that clients have seen whatever it is we’ve seen and we need to be able to have a conversation with the clients about the implication. ... They (“our people” need to know enough to then have a sensible conversation. They might not need to know the detail or the answers, they just need to be aware of maybe some of the implications. And then within a very short space of time, we actually need to have taken it to the next stage and actually be looking at the interpretation and the full implications, what some of the solutions and answers might be to that. And it’s trying to get that different levels of knowledge out at the right time. And as a technical group, we’ve got some of the best technical brains sat within the group and we can be very, very detailed. So one of our challenges is frequently, is almost like ‘do they really need the Rolls Royce or would the pushbike do at the moment?’” (AF interviewee 1)



Within accounting firms, formal precedence systems are often used to capture and transfer knowledge. Here the accounting firm is acting in all three capacities, as (internal) knowledge buyer, seller and broker. The effectiveness of a precedence system is dependent on the volume and quality of the submissions, the generation of which can conflict with more immediate demands.

“.... people are all being measured nowadays in this environment, they’re all being measured on utilisation, charge-out rates and that kind of stuff. ... creating knowledge submissions; they can’t charge that to anything, so it really has to be done ... almost out of the goodness of their hearts.”

(AF Interviewee 2)




The interviews indicate that the intermediate role of accounting firms is acknowledged by all players on the knowledge market. HMRC interviewees seem to have a relatively positive attitude towards the mediating role of accounting firms in communicating with corporate taxpayers.

“If we’re doing an enquiry and we find the agent’s got the wrong end of the stick, if you can educate the agent and get them to do things right in the future, that has a huge effect compared with just educating one company”. (HMRC interviewee 2)

and in reverse:

“Another way we might feed things back is via the accounting firms, so they might write to us and say ‘Do you have any views that you’d like us to put in our representations?’ And we find that quite a convenient way to do things”. (CTP interviewee 3)



Corporate taxpayer interviewees mentioned benefits from having accounting firms as intermediates in knowledge flows from and to HMRC.

“HMRC tell it as it is, the accounting firms analyse it and explain the implications for you, which is quite helpful”. (CTP interviewee 3)



similarly

“I think the client is always wondering whether they’ve actually captured the knowledge, which has been so expensively purchased. ... any time we are planning a complex transaction and there’s something with which we even feel familiar, we still feel compelled to go out and take expert advice in all the specialist areas applicable to the transaction. Which may well be going over old ground and even if we think we understand the issues, we still have to do that to confirm that we’ve not forgotten anything that’s happened in the law in the meantime”.
(CTP interviewee 1)


“You want some external assurance that the decision you’ve come to is the right one. ... in the sense that you want someone else to have come to the same conclusion as you, so that you don’t get sacked for it later”.
(CTP interviewee 3)



Accounting firms seem to vigorously defend their position as intermediaries.


“HMRC are trying to be very close to the taxpayer and almost be seen as business advisors and we clearly want to stand in the middle of that. So we don’t necessarily want HMRC to be going straight to corporates because we believe our role is to facilitate that. ... we have a lot more experience actually as to how we can make that work effectively. Whereas sometimes the corporates can be quite naïve and see HMRC as their friend, where actually they’re never going to be that. And they can’t be because they’re a Governmental institution and actually they’ve got their rules to abide by”. (AF interviewee 1)

“.... it’s a kind of ... balancing act of them sharing knowledge between the clients, so obviously not giving away all of our ... trade secrets”. (AF interviewee 2)



Corporate taxpayers appear to experience doubts about the reliability of the accounting firms, especially when accounting firms shift their focus from performing as a knowledge broker to acting as a knowledge buyer:

“They come and review our files, have a chat to see what we are doing. ... often I say to myself, they probably learn more from us than we learn from them, when they come to our organisation, sit down and discuss and see what we do. And I’m sure there are things which they can then go and sell to other companies. I’m sure it happens. Many things which we agree with the local VAT office, certain VAT treatments, certain VAT recovery, certain practices, which are not within the legislation, they may be at a discretionary treatment. And yes, I think the professional folks do come in and see how we are doing things and I’m sure they take that away and see that as an opportunity to go in other firms and do a similar exercise”. (CTP interviewee 8)



Accounting firms are aware of (the view of the other players on the knowledge market on) their precarious role as knowledge broker.

“We really don’t use information from one client with another, it’s too risky. And you know, we’d need permission and on the whole, we don’t want to go to clients and ask their permission for that sort of thing, so we just don’t do it. We change teams, so that we don’t have people working on competitor claims either. So it’s not that you might have one person with that knowledge going from one claim to the next, we tend to split our teams in such a way that within a sector, we don’t have people working on direct competitor’s claims”. (AF Interviewee 3)



similarly

“There’s something about confidentiality and there are various areas of the business where there are some enormous barriers to sharing knowledge because of confidentiality. ... I’m thinking of one incident in particular I know which was a few years ago, where someone had come up with a very creative piece of planning, which was worth quite a lot to them. But actually we also operated for their main competitor and therefore it was stipulated they didn’t want any of this going onto any sort of central databases because their main competitor would see it and they no longer would be sort of stealing a march on it effectively”. (AF Interviewee 1)



Continuing

“It does make us want to have known and trusted advisors and relationship building with advisors is very important. And I think those relationships can be damaged if information is exchanged inappropriately. But I find the big four, the big law firms, extremely professional in that context”. (CTP interviewee 1)



7. Implications for New Zealand

- Tax agents are the “bee” in compliance
- Agents engage but only to a limited extent. They are “reputable but adventuresome”
- Large firms are likely more concerned with their CSR spin to the public than their tax risk management. Tax planning comes down to dollars and cents sense!
- Challenge for IRD on how to respond to this “double-edged sword”. (e.g. an “enhanced relationship”)

7. Implications for New Zealand

- The relationships between the players will affect attitudes, compliance behaviour, and ... validity of compliance models?
- Internationally there is some ‘sabre rattling’ with much focus on intermediaries and tax avoidance
- So the unavoidable tension between customer-friendly initiatives (per compliance models and the SSF) and initiatives such as disclosure regimes, increased reporting requirements seems certain to continue
- Comments on the New Zealand perspective are welcome