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# A psychological perspective on tax avoidance: Differential avoidance vs. defiant avoidance

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## ***Abstract***

Is a taxpayer's act of tax avoidance deemed compliant or non-compliant? Academic researchers, investigating tax compliance behaviour, address the term tax avoidance differently for a variety of purposes. In order to gain insight into compliance behaviour, it is important to get a clear understanding of the meaning of tax compliance. In addition, how to classify and perceive the various behavioural responses to taxation is of crucial importance not only for academic researchers and policy makers, but for ordinary taxpayers whose tax behaviour is embedded in social structure and influenced by social representations. In this paper, I discuss relevant issues regarding the conventional conceptualisations of tax avoidance, and present a distinguished concept of tax avoidance which represents two different statuses with insights from psychological approaches to tax behaviour in general and Abstract



Roth et al. (1989) claim that tax compliance is accomplished provided the taxpayer files all required tax returns at the proper time, and that the returns accurately report

it is almost always ambiguous whether the transaction is permissible or not. In many cases of tax avoidance, one cannot easily determine the legality of a tax structure. The definition of tax avoidance provided by OECD<sup>2</sup> reflects the tricky business:

[Tax] avoidance is a term that is difficult to define but which is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his liability and that although the arrangement could be strictly legal



(1978) reported that the typical taxpayer considers tax evasion only slightly more serious than stealing a bicycle.

McBarnet (2003) views game playing as a particular kind of attitude towards the law, in which one regards the law as something to be utilised to meet one's purposes rather than as something to be respected as defining the limits of acceptable activity. Similarly, Salter (2010) addresses the game playing with of society's rules which involves the use of technically legal means to subvert the intent of society'. He argues that a rule-following game (or compliance game) involves the actual exploitation of these gaming opportunities. This involves following the letter of the law but not necessarily its intent or spirit, as well as violating grey areas of the law in ways that are not easily understood or recognised as violations. In this regard, tax avoidance can be characterised as a rule-following game in tax compliance decisions. McBarnet (2003) also argues that one of the functions of creative compliance is 'fraud insurance': a tax planning device may fail in court without being branded a tax fraud. He refers to the creative compliance (tax avoidance) 'whiter than white collar crime' in that it

lawyers and accountants view testing the outer limits of the law as a natural and acceptable feature. As entrepreneurial businesses, accountancy firms have developed organisational structures and strategies to sell tax avoidance schemes to corporations and wealthy individuals, which they refer to as tax solutions or tax strategies (Sikka and Hampton, 2005). As Braithwaite (2003a) points out, the industry of tax avoidance primarily rests on the talents of financial advisors. Furthermore, the tax preparer has a direct interest in whether a position is determined *ex-post* in an IRS audit to be overly aggressive. An overly aggressive position may result in a loss of client goodwill or a preparer penalty in such a jurisdiction as the US (Kaplan et al., 1988). Brock and Russell (2015) further illustrate the role of professionals in designing, promoting and implementing abusive tax avoidance strategies as the prerogative of wealthy individuals and large corporations.

In some cases, avoidance is encouraged by legislation granting favourable tax treatment to specific activities and no additional risk exposure to be challenged as illegal. For example, investing in municipal bonds or paying into superannuation schemes to minimise tax is explicitly encouraged, whereas off-shore tax havens are explicitly discouraged and put the taxpayer in an uncertain tax position. Thus, a tax planning activity or a tax strategy as an act of tax avoidance could be anywhere along the continuum of tax compliance depending upon *ex ante* intentions as well as *ex-post* enforcement. Seldon (1979) coined the term 'avoision' to capture the problem associated with differentiating legal and illegal tax schemes. Braithwaite (2003b) argues that it is possible to divide the strategies of tax avoidance in terms of the degree to which they push the limits of legality. James and Alley (2004) argue that the meaning of compliance can be seen as a continuum of definitions: the meaning of tax compliance can be defined from narrower economic rationality to wider behavioural cooperation. Van De Braak (1983) argues that tax resistance, conceived of as an





the letter to gaming with the law, and also to cheating the government. The thesis is that avoidance in itself should not imply any negative connotation.

As noted above, some researchers have tried to differentiate two different aspects of tax avoidance such as aggressive tax planning or abusive tax planning. However, the aggressiveness and abusiveness rest primarily on subjective interpretations of attitudes towards risk and morality, respectively. Essentially, they fail to capture the different behavioural intentions of a taxpayer in terms of compliance with the provision and spirit of the law. Defiant avoidance refers to the potentially unacceptable avoidance, which has the capacity to be challenged by the tax inspector and disallowed by the tax court. On the contrary, deferential avoidance is in compliance not only with the provision of the law, but also with the spirit and purpose of the law and fiscal policy. In this respect, tax evasion can be conceptualised as illegal avoidance, whereby the term avoidance itself should be treated as being neutral. Therefore, the concept of tax non-compliance should include defiant avoidance and illegal avoidance (tax evasion), but exclude deferential avoidance.

Although traditional economic models of tax evasion tend to frame the evasion decision as rational taxpayers' gambling with tax authorities (Baldry, 1986), it seems more like a 'cheating' rather than a fair gambling. The real gambling situation is prominent in case of defiant tax avoidance because both the taxpayer and the tax authority are confronted with uncertainty about the *ex-post* legality of transaction which ultimately depends on a court decision

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