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## **PROCEDURAL JUSTICE AND AUDIT-QUERY EXPERIENCES OF SMALL BUSINESSES AND TAX AGENTS**

SUE YONG\*

### **ABSTRACT**

Accounting records of many small businesses are kept predominantly for the use of their lenders and for the tax authorities. Tax authorities use audits to monitor compliance by taxpayers. This paper aims to discuss the tax audit-query experiences of 36 small business owners in Auckland, New Zealand, from 2006 to 2010 and to assess how these impact on their tax perceptions by using a procedural justice framework. As part of the triangulation process, the accounts of the small business owners were verified by 15 business experts and eight tax agents. Policy makers should pay attention to the tax perceptions of small businesses as these affect voluntary compliance. Tax authorities should adopt fair procedures when interacting with small business owners to encourage cooperation. Cooperation from this taxpayer group could help to reduce its currently high non-compliance statistics relative to the wage and salary earners group.

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## I INTRODUCTION

Micro and small businesses have fewer external reporting requirements compared to those of larger businesses. In New Zealand, the *Financial Reporting Act 1993* and the *Financial Reporting Amendment Act 2006* require reporting entities such as issuers, overseas companies, companies with subsidiaries, and 'large' businesses to file and register their audited financial statements with the Companies Office.<sup>1</sup> 'Large' businesses are those which satisfy two of these criteria: they have total assets greater than NZD10 million; they have turnover of more than NZD20 million; and they have more than 50 full time employees.

Similarly, in Australia, the *Corporations Act 2001* requires disclosing entities, such as listed companies, registered managed investment schemes, unlisted public companies and large proprietary companies to lodge half yearly and annual audited statements with the Australian Securities and Investments Commission (ASIC).<sup>2</sup> 'Large' proprietary companies are those which satisfy two of these three criteria: they have gross operating revenue of AUD10 million or more; they have gross assets of AUD5 million or more; and they have 50 or more employees (full time or part time is not specified).

In the European Union, small businesses are defined as those entities with turnover of less than €10 million (equivalent to NZD15.8 million or AUD12.5 million), and which have up to 100 employees.<sup>3</sup> However in Australia and New Zealand, small businesses are those entities with less than 20 employees.<sup>4</sup> As most small businesses do not fall within the reporting/disclosing entity or 'large' company reporting requirements, formal reporting of their business transactions is undertaken largely to satisfy tax obligations<sup>5</sup> and/or to prove their creditworthiness.<sup>6</sup> Since small businesses are not required to submit audited financial statements to government agencies, audits, where applicable, are mostly performed by tax authorities such as the New Zealand Inland Revenue Department (IRD) or the Australian Taxation Office (ATO).

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<sup>1</sup> See New Zealand Companies Office, *New Zealand Companies* (2012) <<http://www.business.govt.nz/companies/learn-about/updating-company-details/financial-reporting/new-zealand-companies>>.

<sup>2</sup> See ASIC, *Corporations Act Entities with Financial Reporting Obligations* (2008) <[http://www.asic.gov.au/asic/pdf/lib.nsf/add907be1c708f42ca256aca0007f465/145b2d613d3163f1ca2574430000d28b/\\$FILE/Corporations Act entities with financial reporting obligations 1.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/add907be1c708f42ca256aca0007f465/145b2d613d3163f1ca2574430000d28b/$FILE/Corporations%20Act%20entities%20with%20financial%20reporting%20obligations%201.pdf)>.

<sup>3</sup> European Commission Enterprise and Industry, *Small and medium-sized enterprises (SMEs): What is an SME?* (2012) <[http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm)>.

<sup>4</sup> Australian Bureau of Statistics, *Australian Small Business Operators — Findings from the 2005 and 2006 Characteristics of Small Business Surveys, 2005–06* (2005) <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/8127.0>>; Ministry of Economic Development, *SMEs in New Zealand: Structure and Dynamics 2009* (2009).

<sup>5</sup> See suggestions for record keeping for small businesses in New Zealand Companies Office, above n 1.

<sup>6</sup> Richard McMahon and Leslie Davies, 'Financial Reporting and Analysis Practices in Small Enterprises: The Association with Growth Rate and Financial Performance' (1994) 32(1) *Journal of Small Business Management* 9.

Audits have historically been used by tax authorities as deterrents for tax cheating,<sup>7</sup> based on the economic self interest approach,<sup>8</sup> whereby individuals are assumed to be utility maximisers.<sup>9</sup> Taxpayers are assumed to cheat on taxes when they assess there are low risks of being caught relative to the benefits of cheating.<sup>10</sup> Some authors suggest that deterrence-based strategies can sometimes be counterproductive,<sup>11</sup> and can produce 'likelihood of non-compliance'.<sup>12</sup>

As an alternative to the deterrence-based strategy, this paper uses the procedural justice framework as a theoretical lens to explain how small business taxpayers might behave, based on the processes tax administrators undertake in managing them.<sup>13</sup> The rationale for using the procedural justice framework is because literature has shown that decisions and processes used by authorities on its citizens affect their behaviour.<sup>14</sup>

This paper explicitly considers two issues. First, it explores how small business taxpayers are relationally treated during audits and queries by tax officers in New Zealand. Second, it discusses the perceptions of small business owners towards the tax authority in New Zealand. This question is of interest because research into compliance has shown that sanctions that are perceived to be unfair or unreasonable can often lead to active resistance towards the tax authority.<sup>15</sup>

As audit-query experiences are particular to each taxpayer, the qualitative-interpretive methodology, with the use of semi-structured face-to-face interviews, was considered the best approach to gather this type of information.<sup>16</sup> Qualitative research relies on

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<sup>7</sup> Jeffrey Dubin and Louis Wilde, 'An Empirical Analysis of Federal Income Tax Auditing and Compliance' [1988] (March) *National Tax Journal* 61; Joel Slemrod, Marsha Blumenthal and Charles Christian, 'Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota' (2001) 79(3) *Journal of Public Economics* 455; Brian Erard, 'The Influence of Tax Audits on Reporting Behaviour' in Joel Slemrod (ed), *Why People Pay Taxes: Tax Compliance and Enforcement* (University of Michigan, 1992) 95.

<sup>8</sup> Michael Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' [1972] (November) *Journal of Public Economics* 323.

<sup>9</sup> Andrew Cuccia, 'The Economics of Tax Compliance: What Do We Know and Where Do We Go?' (1994) 13 *Journal of Accounting Literature* 81.

<sup>10</sup> Allingham and Sandmo, above n 8.

<sup>11</sup> Marsha Blumenthal, Charles Christian and Joel Slemrod, 'Do Normative Appeals Affect Tax Compliance? Evidence from a Controlled Experiment in Minnesota' (2001) 54 *National Tax Journal* 125; Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University, 1992).

<sup>12</sup> Kristina Murphy, 'Regulating More Effectively: The Relationship Between Procedural Justice, Legitimacy and Tax Non-Compliance' (2005) 32(4) *Journal of Law and Society* 562, 565.

<sup>13</sup> Kristina Murphy, 'Procedural Fairness and Tax Compliance' (2003) 38(3) *Australian Journal of Social Issues* 379; Michael Blissenden, 'Procedural Fairness and Non-Assessing Decisions of the Federal Commissioner of Taxation' (2002) 5(3) *Journal of Australian Taxation* 466.

<sup>14</sup> Jason Sunshine and Tom Tyler, 'The Role of Procedural Justice and Legitimacy in Shaping Public Support for Policing' (2003) 37(3) *Law and Society Review* 513; Tom Tyler, *Why People Obey the Law* (Princeton University, 2006); Blissenden, above n 13.

<sup>15</sup> Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University, 1992); Murphy, 'Regulating More Effectively' above n 12.

<sup>16</sup> For more information on the qualitative research methodology see John Cullis and Alan Lewis, 'Why People Pay Taxes: From a Conventional Economic Model to a Model of Social Convention' (1997) 18 *Journal of Economic Psychology* 305; Norman Denzin and Yvonna Lincoln, 'Introduction: The Discipline and Practice of Qualitative Research' in Norman Denzin and Yvonna Lincoln (eds), *The Sage Handbook of*

*Footnote continues over page*

triangulation to achieve research rigour and credibility,<sup>17</sup> and therefore the accounts of the business taxpayers are corroborated by inclusion of other sources, namely tax practitioners and business experts. These two groups were chosen because they interact with small business taxpayers on a commercial and personal basis.

The structure of this paper is as follows. Part II discusses the rationale for researching small businesses. Part III examines the literature pertaining to tax compliance of small businesses and the theoretical framework. Part IV discusses the research methodology. Part V sets out the findings and analysis. Part VI concludes the paper with suggestions for future research.

## II RATIONALE FOR SMALL BUSINESSES RESEARCH

Tax revenues are collected by governments to fulfil three main kinds of objective: fiscal, economic, and social.<sup>18</sup> The approaches adopted by tax authorities to regulate and collect taxes from small businesses are important in influencing tax perceptions<sup>19</sup> as small businesses contribute significantly to the economy in terms of valued added outputs and employment.<sup>20</sup> Furthermore, small businesses are important tax collectors on behalf of governments in terms of consumption, employment, and income taxes.<sup>21</sup> They have custody over these taxes for a time period and are required to account for and surrender them to the tax authorities on due dates.<sup>22</sup> Due to their tax collection efforts,<sup>23</sup> small business taxpayers have more interactions with tax authorities than wage and salary earners do.<sup>24</sup> They have comparatively greater sanctions from tax authorities<sup>25</sup> because of their relatively low tax compliance statistics.<sup>26</sup> Some participate in the cash economy<sup>27</sup>

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*Qualitative Research* (Sage, 3<sup>rd</sup> ed, 2005) 1; David Silverman and Amir Marvasti, *Doing Qualitative Research: A Comprehensive Guide* (Sage, 2008).

<sup>17</sup>Joseph Maxwell, 'Understanding and Validity in Qualitative Research' in Michael Huberman and Matthew Miles (eds), *Qualitative Researcher's Companion: Classic and Contemporary Reading*, (Sage, 2002) 37; Jill McKinnon, 'Reliability and Validity in Field Research: Some Strategies and Tactics' (1988) 1(1) *Accounting, Auditing and Accountability Journal* 34.

<sup>18</sup> Clinton Alley et al, *New Zealand Taxation* (Thomson/Brokers, 1<sup>st</sup> ed, 2004); Francis Chittenden, Saleema Kauser and Panikkos Poutziouris, 'Tax Regulation and Small Business in the USA, UK, Australia and New Zealand' (2003) 21(1) *International Small Business Journal* 93.

<sup>19</sup> Kristina Murphy, 'An Examination of Taxpayers' Attitudes Towards the Australian Tax System: Findings from a Survey of Tax Scheme' (2003) 18(2) *Australian Tax Forum* 209.

<sup>20</sup> Ministry of Economic Development, above n 4; OECD, *SME Statistics: Towards a More Systematic Statistical Measurement of SME Behaviour* (2004).

<sup>21</sup> David Joulfaian, 'Bribes and Business Tax Evasion' (2009) 6(2) *The European Journal of Comparative Economics* 227; David Joulfaian and Mark Rider, 'Differential Taxation and Tax Evasion by Small Business' (1998) 51(4) *National Tax Journal* 675.

<sup>22</sup> Chris Evans, Shirley Carlon and Darren Massey, 'Record Keeping Practices and Tax Compliance of SMEs' (2005) 3(2) *eJournal of Tax Research* 288.

<sup>23</sup> Carol Adams and Paul Webley, 'Small Business Owner's Attitudes on VAT compliance in the UK' (2001) 22(2) *Journal of Economic Psychology* 195.

<sup>24</sup> Eric Kirchler, *The Economic Psychology of Tax Behaviour* (Cambridge, 2007).

<sup>25</sup> Eliza Ahmed and Valerie Braithwaite, 'Understanding Small Business Taxpayers: Issues of Deterrence, Tax Morale, Fairness and Work Practice' (2005) 23(5) *International Small Business Journal* 539.

<sup>26</sup> Paul Caragata, *The Economic and Compliance Consequences of Taxation: A Report on the Health of the Tax System in New Zealand* (1998); Ahmed and Braithwaite, above n 25; Ian Wallschutzky, 'Possible Causes of Tax Evasion' (1984) 5(4) *Journal of Economic Psychology* 371.



with 'unregistered income with no third party reporting'.<sup>28</sup> They are therefore considered the 'hard to tax group from the informal sector'.<sup>29</sup> Given that, tax authorities can benefit from knowledge of how small businesses comply with tax requirements in order to strategise regulatory and monitoring measures to effectively manage small businesses.

### III LITERATURE REVIEW AND THEORETICAL FRAMEWORK

#### *A Tax Compliance of Small Businesses*

Research has confirmed several tax compliance factors. These are: economic self interest;<sup>30</sup> social and psychological factors,<sup>31</sup> and tax morale, which refers to complying out of obligation as citizens of a country.<sup>32</sup> As mixed results were obtained from investigation of the above factors, several authors have suggested that tax compliance is multi-faceted and is dependent on a combination of factors.<sup>33</sup> Given this, considerations such as procedural justice (the way in which taxpayers are treated by the tax authority) may help explain why there might be lower tax compliance statistics for small businesses relative to other taxpayer groups such as the wage and salary earners.<sup>34</sup>

Burton observes that Australian small businesses had been 'sorely dealt with at the hands of oppressive government regulation'<sup>35</sup> and politicians and bureaucrats are finding ways to compensate small businesses for this injustice. Between 2005 to 2011, 10 of the total 72 publications in the Journal of the Australasian Tax Teachers Association (JATTA) were focussed on small businesses. This testifies to the increasing interest and importance of this taxpayer group to academics and practitioners. Some of these papers argued that small businesses did not get a fair deal from the tax system due

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<sup>27</sup> Julie Ashby and Paul Webley, 'But Everyone Else is Doing It: A Closer Look at the Occupational Taxpaying Culture of One Business Sector' (2008) 18 *Journal of Community & Applied Social Psychology* 194; Susan Morse, Stewart Karlinsky and Joseph Bankman, 'Cash Businesses and Tax Evasion' (2009) 20(1) *Stanford Law and Policy Review* 37.

<sup>28</sup> Klarita Gerxhani and Arthur Schram, 'Tax Evasion and Income Source: A Comparative Experimental Study' (2006) 27 *Journal of Economic Psychology* 402, 403.

<sup>29</sup> Robert McGee, Simon Ho and Annie Li, 'A Comparative Study on Perceived Ethics of Tax Evasion: Hong Kong vs the United States' (2008) 77 *Journal of Business Ethics* 147, 147.

<sup>30</sup> For more information on the economic self interest theory see Allingham and Sandmo, above n 8; James Alm and Michael McKee, 'Extending the Lessons of Laboratory Experiments on Tax Compliance to Managerial and Decision Economics' (1998) 19 *Journal of Managerial and Decision Economics* 259.

<sup>31</sup> Cullis and Lewis, above n 16; James Alm, Isabel Sanchez and Ana De Juan, 'Economic and Noneconomic Factors in Tax Compliance' (1995) 48 *KYKLOS* 3.

<sup>32</sup> Bruno Frey and Benno Torgler, 'Tax Morale and Conditional Cooperation' (2007) 35 *Journal of Comparative Economics* 136; Benno Torgler, 'Tax Morale and Direct Democracy' (2005) 21 *European Journal of Political Economy* 525.

<sup>33</sup> James Andreoni, Brian Erard, and Jonathan Feinstein, 'Tax Compliance' (1998) XXXVI *Journal of Economic Literature* 818; Cullis and Lewis, above n 36.

<sup>34</sup> Ahmed and Braithwaite, above n 25; Peter Noble, 'Qualitative Research Results: The New Zealand Cash Economy – A Study of Tax Evasion Amongst Small and Medium Businesses' (Paper presented at the CTSI 1st International Conference, Canberra, 4 December 2000).

<sup>35</sup> Mark Burton, 'Small Business Tax Advantages — Towards Holism with a Suggested Definition, Typology and Critical Review' (2006) 2(2) *Journal of the Australasian Tax Teachers Association* 78, 105.



to high start up costs<sup>36</sup> with regressive tax compliance costs,<sup>37</sup> despite various government initiatives to simplify tax requirements<sup>38</sup> and to compensate them for these injustices.<sup>39</sup> Freeman, however, cautions of the difficulty in implementing tax policies for small businesses, due to the differences from other taxpayer groups in terms of cash job opportunities and few or no withholding taxes paid.<sup>40</sup>

Discussions on small business tend to gravitate towards identifying them as a distinct taxpayer group that ought to be nurtured by tax regulators and policy makers. If that is the case, then the way in which this taxpayer group is being treated procedurally may play an important role in determining their tax compliance level and their perceptions of the tax authority and tax system. This paper aims to explore the impact of procedural justice in audits undertaken by the IRD on small business taxpayers in Auckland, New Zealand between 2006 and 2010.

### ***B Procedural Justice Framework***

Research has shown that perceptions of procedural justice affect people's attitudes and behaviours.<sup>41</sup> Individuals who feel an authority has treated them with dignity, respect, and fairness are more likely to make positive evaluations about that authority and will be more likely to comply with that authority's rules and regulations.<sup>42</sup> Procedural justice is concerned with the 'perceived fairness of the procedures involved in decision making and the perceived treatment one receives from a decision maker.'<sup>43</sup> Specifically, procedural justice is associated with the neutrality of procedure, the trustworthiness of the authority, and with the authority's representatives being polite and respectful towards individuals when interacting with them.<sup>44</sup> Tax procedures that are neutral and are consistently applied to all will favourably impact on the taxpayers' perceptions of fairness.<sup>45</sup>

Relational models of procedural justice postulate that people's motivation for compliance extends beyond their concern for favourable outcomes, but recognise the

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<sup>36</sup> Nthathi Rametse and Jeff Pope, 'Business Start-Up Compliance Costs: Policy Perspectives' (2005) 1(3) *Journal of the Australasian Tax Teachers Association* 84.

<sup>37</sup> Paul Lignier, 'The Costs and Benefits of Complying with the Tax System and their Impact on the Financial Management of the Small Firm' (2006) 2(1) *Journal of the Australasian Tax Teachers Association* 121.

<sup>38</sup> Michael Dirkis and Brett Bondfield, 'Much Ado about Nothing: Ralph's Consideration of Small Business' (2005) 1(2) *Journal of the Australasian Tax Teachers Association* 110.

<sup>39</sup> Burton, above n 35.

<sup>40</sup> Judith Freeman, 'Why Taxing the Micro-Business is Not Simple — A Cautionary Tale from the "Old World"' (2006) 2(1) *Journal of the Australasian Tax Teachers Association* 58.

<sup>41</sup> Murphy, 'Regulating More Effectively', above n 12; Sunshine and Tyler, above n 14.

<sup>42</sup> Tom Tyler, 'Why People Obey the Law' above n 14; Tom Tyler and Yuen Huo, *Trust in the Law: Encouraging Public Cooperation with the Police and Courts* (Russell Sage Foundation, 2002).

<sup>43</sup> Kristina Murphy, 'Procedural Justice and Affect Intensity: Understanding Reactions to Regulatory Authorities' (2009) 22 *Social Justice Research* 1, 2.

<sup>44</sup> Tom Tyler and Edgar Lind, 'A Relational Model of Authority in Groups' in M Zanna (ed), *Advances in Experimental Social Psychology*, (Academic Press, 1992) 115.

<sup>45</sup> Kristina Murphy, Tom Tyler and Amy Curtis, 'Nurturing Regulatory Compliance: Is Procedural Justice Effective When People Question the Legitimacy of the Law' (2009) 3 *Regulation & Governance* 1.

'importance of interpersonal treatment in determining whether people will obey the law.'<sup>46</sup> According to Tyler and Lind, people will judge procedures as fair when authorities communicate feelings of self-worth with fair and neutral procedures and are respectful of citizen's rights.<sup>47</sup> It is argued that people who feel treated fairly by the authorities will regard the authority's status as legitimate and therefore will be 'more likely to follow and accept their decision regardless of the favourability of the decision outcome.'<sup>48</sup>

Studies of procedural justice indicate that people typically consider two aspects of how decisions are being made: the processes of decision making and the manner in which they have been treated while decisions are being made. The process of decision making includes whether people are given an opportunity to present their views, whether procedures are neutral, transparent, and fact-based, and whether rules and policies are consistently applied across people and over time.<sup>49</sup> The manner in which people have been treated includes whether the processes are dignified, and whether the authorities are honest, polite, and respectful of the people's rights.<sup>50</sup> In all, research has shown that if people believe that an authority has tried to be fair with them, that they have been treated with respect, and that they have been dealt with in an impartial way, then these factors enhance feelings of fairness.<sup>51</sup>

Given the above, the way in which taxpayers are treated by the tax authority is important in influencing the fairness perception.<sup>52</sup> Wenzel found Australian taxpayers to be more compliant when they feel that the ATO has treated them in a fair and respectful manner.<sup>53</sup> He also found that trust in the ATO increased when tax officers treated taxpayers as equals, in a respectful and responsible way.<sup>54</sup> In another study, Wenzel also found that taxpayers reacted more positively to letters from the ATO when they showed respect to the taxpayers, compared to letters that were disrespectful, harsh, and overly authoritarian.<sup>55</sup> Similarly, Australian tax scheme investors were found to be more compliant when tax authorities treated them in a fair and unbiased manner.<sup>56</sup> In New

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<sup>46</sup> Tom Tyler, 'The Psychology of Procedural Justice: A Test of the Group-Value Model' (1989) 57 *Journal of Personality and Social Psychology* 830, 830.

<sup>47</sup> Tyler and Lind, above n 44.

<sup>48</sup> Michael Wenzel, 'A Letter from the Tax Office: Compliance Effects of Informational and Interpersonal Justice' (2006) 19(3) *Social Justice Research* 345, 346.

<sup>49</sup> Tom Tyler, John Dienes and Terry Thomas, 'The Ethical Commitment to Compliance: Building Value-Based Cultures' (2008) 50(2) *California Management Review* 33.

<sup>50</sup> Ibid.

<sup>51</sup> Tyler, 'Why People Obey the Law', above n 14; Murphy, 'An Examination of Taxpayers' Attitudes Towards the Australian Tax System', above n 19.

<sup>52</sup> Murphy, 'Procedural Fairness and Tax Compliance', above n 13; Tom Tyler, 'Trust and Democratic Governance' in Valerie Braithwaite and Margaret Levi (eds), *Trust and Governance* (Russell Sage Foundation, 1998) vol 1, 269.

<sup>53</sup> Michael Wenzel, 'The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers' Identity' (2002) 87 *Journal of Applied Psychology* 629.

<sup>54</sup> Michael Wenzel, 'Tax Compliance and the Psychology of Justice: Mapping the Field' in Valerie Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate, 2003) 41.

<sup>55</sup> Wenzel, 'A Letter from the Tax Office', above n 48.

<sup>56</sup> Murphy, 'An Examination of Taxpayers' Attitudes Towards the Australian Tax System', above n 19.

Zealand, perceptions of unfair treatment from the tax authorities were found to adversely affect taxpayers' compliance levels.<sup>57</sup>

#### IV RESEARCH METHODOLOGY AND PARTICIPANTS' PROFILE

Due to the individual nature of the participants' relational experiences with the tax authority, qualitative research with the use of semi structured face-to-face interviews was considered the best approach to collect the data.<sup>58</sup> The interviews took place between 2006 and 2010 and they were tape recorded with the consent of the participants. The prime reason for in-depth interviews is to understand the substance of the participant's experiences, as described from their perspective but interpreted by the researcher.<sup>59</sup> Moreover, the participant's perception of the tax authority is partly dependent on their relational experiences with the tax authority, and is best captured by interviews. Research has shown that qualitative studies can contribute to social theories by detailing the context, the social processes and the explanation for individual behaviours and beliefs.<sup>60</sup> The strength of qualitative research is two fold. First, it has the ability to explore social issues in depth and from the perspectives of actual participants.<sup>61</sup> Second, the concepts, meanings and explanations are developed inductively from the data.<sup>62</sup>

##### *A Participants' Profile and the Sampling process*

A total of 36 small business taxpayers who participated in the interview were selected based on purposeful-theoretical and snowballing sampling processes.<sup>63</sup> These selection methods are commonly found in qualitative research, as the aim is to gain an in-depth understanding of a phenomenon.<sup>64</sup> The sampled business taxpayers had been 'purposefully selected'<sup>65</sup> because of their personal encounters with the tax authority and to illuminate their relational experiences with representatives from the tax authority. Participants were 'information rich'<sup>66</sup> as they provide in-depth accounts of diverse

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<sup>57</sup> Lin Mei Tan, 'Taxpayers' Perceptions of Fairness of the Tax System: A Preliminary Study' (1998) 4(2) *New Zealand Journal of Taxation Law and Policy* 59.

<sup>58</sup> Tim Rapley, 'Interviews' in Clive Seale et al, (eds), *Qualitative Research Practice* (Sage, 2007); Irving Seidman, *Interviewing as Qualitative Research* (Teachers College Press, 1991); Carol Warren and Tracy Karner, *Discovering Qualitative Methods: Field Research, Interviews and Analysis* (Roxbury Publishing, 2005).

<sup>59</sup> Victor Minichiello, Rosalie Aroni and Terrence Hays, *In Depth Interviewing* (Pearson Education, 3<sup>rd</sup> ed, 2008) 11; Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters, 2010) 154.

<sup>60</sup> Sotirio Sarantakos, *Social Research* (Palgrave Macmillan, 3<sup>rd</sup> ed, 2005).

<sup>61</sup> Norman Denzin and Yvonna Lincoln. 'Introduction: Entering the Field of Qualitative Research' in Norman Denzin and Yvonna Lincoln (eds), *Handbook of Qualitative Research* (Sage Publications, 1994) 1, 12.

<sup>62</sup> McKerchar, above n 59.

<sup>63</sup> Pranee Liamputtong, *Qualitative Research Methods* (Oxford University Press, 3<sup>rd</sup> ed, 2009).

<sup>64</sup> W. Lawrence Neuman, *Social Research Methods: Qualitative and Quantitative Approaches* (Pearson Education, 7<sup>th</sup> ed, 2011).

<sup>65</sup> Michael Patton, *Qualitative Research & Evaluation Methods* (Sage Publications, 3<sup>rd</sup> ed, 2002) 242.

<sup>66</sup> Ibid 230.

experiences with the tax authority with regard to collecting and accounting for the various taxes in New Zealand.

### 1 *Purposeful-Theoretical Sampling*

Theoretical sampling is not representative sampling, of which a particular sample is drawn from a population to which one can generalise to the population.<sup>67</sup> Instead, theoretical sampling intends to provide contrasting settings through which theoretical comparisons can be made.<sup>68</sup> In this study, the contrasting settings are based on ethnic, industry, and age of business differences.

As business taxpayers' interactions with the tax authority are personalised encounters, these interactions are therefore useful for theoretical or analytical generalisations.<sup>69</sup> Theoretical generalisations make theory-related concepts and propositions,<sup>70</sup> which can be applied beyond the sample studied.<sup>71</sup> This is because conclusions are drawn from constructs developed from the participants studied, which are then transferable to other cases that face similar contexts.<sup>72</sup> The degree to which the findings from a study support existing theories can be assessed by 'comparing how well different cases *fit* within an established theory and how far it is able to explain behaviour in individual cases.'<sup>73</sup> This is unlike empirical generalisations, which are commonly found in quantitative studies (which uses representative sampling) to make statistical inferences about the population.<sup>74</sup>

### 2 *Snowballing Sampling*

From the initial sample of taxpayers interviewed, further participants were sought using the snowballing sampling process. The initial participants were asked to recommend other people who met the research criteria and were willing to participate in the research.<sup>75</sup> This process is continued with the new participants until saturation;<sup>76</sup> that is, until no more substantial information can be acquired through additional participants. Saturation took place when 32 business taxpayers were interviewed. However, to confirm that there were no new findings, a further four participants were interviewed, making a total of 36 taxpayer participants.

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<sup>67</sup> Ian Dey, 'Grounded Theory' in Clive Seale et al, (eds), *Qualitative Research Practice* (Sage Publications, Concise Paperback ed, 2008) 80, 90.

<sup>68</sup> Ibid.

<sup>69</sup> Sarantakos, above n 60.

<sup>70</sup> Ibid 98.

<sup>71</sup> Jane Lewis & Jane Ritchie, 'Generalising from Qualitative Research', in Jane Ritchie and Jane Lewis (eds), *Qualitative Research Practice: A Guide for Social Science Students and Researchers* (Sage, 2003) 263, 264.

<sup>72</sup> Sarantakos, above n 60.

<sup>73</sup> Lewis and Ritchie, above n 71, 267.

<sup>74</sup> Clive Seale, *The Quality of Qualitative Research* (Oxford, 1999); Sarantakos above n 60, 98.

<sup>75</sup> McKerchar, above n 59, 150.

<sup>76</sup> Sarantakos, above n 60, 165.

### 3 Profiles of Participants

All 36 business taxpayers were drawn from the Auckland region,<sup>77</sup> and the industries they operated in were representative of 14 of the total 19 sectors listed on the Australian and New Zealand Standard Industrial Classification (ANZSIC).<sup>78</sup> The industrial sectors of these small businesses cover 74 per cent of the industry groups listed on the ANZSIC. In addition to convenience sampling, Auckland has been chosen as it has the highest number of small businesses in New Zealand,<sup>79</sup> and it is the most ethnically diverse region in the country.<sup>80</sup>

There was equal representation from the four largest ethnic groups in New Zealand, namely: European, Asian, Maori, and Pacific Peoples, which reflects the country's population structure. Eighty eight per cent were micro businesses (with up to five employees), with the remainder small businesses. Forty four per cent of those interviewed were males, 47 per cent were female, and nine per cent were husband and wife teams. Thirty one per cent of the businesses were five years old and under, 36 per cent were between six and 10 years old, 28 per cent were more than 10 years old, and five per cent did not disclose the age of their business.

Questions asked of the business taxpayers concerned their demographic profile, their perceptions of tax compliance, and their relational experiences with the IRD. These questions can be found in Appendix 1.

### 4 Triangulation

In order to achieve a higher degree of validity, credibility, and research utility, the triangulation process<sup>81</sup> has been adopted for this study. Triangulation involves the use of different methods or sources to 'check the integrity of, or extend, inferences drawn from the data.'<sup>82</sup> In this study, sample triangulation<sup>83</sup> was used. This involves choosing

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<sup>77</sup> Auckland is the largest city in New Zealand, with the highest concentration of the four largest ethnic groups namely: European, Asian, Maori, and Pacific Peoples. For more information see Ministry of Economic Development, above n 4.

<sup>78</sup> There are 19 industrial sectors classified by the 2006 ANZSIC namely: agriculture, forestry and fishing; mining; manufacturing; electricity, gas, water and waste services; construction, wholesale trade; retail trade; accommodation and food services; transport, postal and warehousing; information media and telecommunications; financial and insurance services; rental, hiring and real estate services; professional, scientific and technical services; administrative and support services; public administration and safety; education and training; health care and social assistance; arts and recreation services; and other services: see Ministry of Economic Development, above n 4, 19.

<sup>79</sup> Ministry of Economic Development, above n 4, 21.

<sup>80</sup> Statistics New Zealand, *2006 census data — QuickStats-about-culture-and-identity-tables.xls* (2006) <<http://www.stats.govt.nz.ezproxy.aut.ac.nz/Census/2006CensusHomePage/QuickStats/quickstats-about-culture-and-identity-tables>>.

<sup>81</sup> Sarantakos, above n 60, 146.

<sup>82</sup> Jane Ritchie, 'The Application of Qualitative Methods to Social Research' in Jane Ritchie & Jane Lewis (eds), *Qualitative Research and Practice* (Sage Publications, 2003) 24, 43.

<sup>83</sup> Sarantakos, above n 60, 98.

participants from a variety of backgrounds and from different sources to ensure accuracy and credibility of findings.<sup>84</sup>

As taxpayers' perceptions of the tax authority may be influenced by the treatment they experienced from the tax authority, this study sought the views of eight tax agents and 15 business experts as sources of information to verify the taxpayers' accounts. The eight tax agents consisted of equal representation of males and females, and half were sole practitioners, with the other half from small and medium sized accounting firms. Questions asked of the tax agents referred to their demographic details, their interactions with small businesses and with the IRD, as well as their perceptions of tax compliance for small businesses. These questions can be found in Appendix 2.

The 15 business experts who corroborated the accounts of the taxpayers in this study were business mentors/coaches, regulators, policy makers, and advisors to small business owners. They were representatives from the IRD, Chamber of Commerce, Ministry for Maori Development, Pacific Business Trust, Small Business Advisory Group, Maori Womens Development Incorporated, New Zealand Government (a Minister of Parliament), New Zealand Trade and Enterprise, and Business New Zealand. Business experts were included in this sample as they interact with small business owners by providing financial, business, and tax advice. Questions asked of the business experts included identification of their role and involvement with small businesses, their perceptions of tax compliance for small businesses, and how small businesses manage their compliance requirements. These questions can be found in Appendix 3.

## **V FINDINGS AND ANALYSIS**

This section incorporates both the findings and analysis by using the procedural justice framework. This section is divided into several parts. First, it examines the participants' relational experiences with the IRD. These experiences are subdivided into positive and negative experiences. Further indications of negative experiences leading to taxpayers' perceptions towards the tax authority are also discussed. Finally, the adverse consequences of the tax authorities' lack of procedural justice are discussed.

### ***A Participants' Relational Experiences with the IRD***

The sample selected for this study experienced a mixture of positive and negative relational treatment from the IRD. An example of positive treatment was helpful and sympathetic IRD staff, whereas negative treatment included inefficiency, inflexibility, intimidation, insensitivity, inconsistency, and incompetency of IRD representatives. These are discussed at depth in the ensuing subsections.

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<sup>84</sup> Patton, above n 65, 93.



### 1 *Positive Experiences with the IRD*

Only three of the 36 small business (SB) taxpayers experienced positive treatment from the IRD. These taxpayers found IRD staff to be helpful and sympathetic and they experienced better than expected treatment than their peers:

I had a woman from the IRD who helped me through things and to see that there was a solution to my tax debt. I had to work really hard to get out of that situation. The IRD is not as bad as what my peers told me. (SB22 — Maori female.)

The IRD queried us on how we calculate our GST. We got stung with a bill because we under-calculate our GST simply because we did not have our system in place ... We find with the IRD if we disclose everything they are good to us ... They made all our penalties nil and they accepted all our terms of how we were going to pay the debt off. (SB29 — Pacific male.)

To a certain extent I do find the IRD to be helpful at times. I still have to ask them to speak plainly as possible so that I can grasp what they are talking about or to talk slower. (SB21 — Pacific female.)

Two tax agents (TA) also found IRD staff to be professional in their conduct, and their audit encounters were similar to those described in the following quote:

I handle the audits for my clients and the audit experience was better than I thought. What the IRD is after is to find some answers to their query ... It wasn't a harrowing experience and the IRD was quite nice and were very professional about it. (TA5 — sole practitioner.)

However the above positive experiences were relatively few compared to negative treatment most taxpayers had encountered.

### 2 *Negative Experiences with the IRD*

Common complaints from taxpayers and tax agents regarding the tax authority relate to unhelpful and judgemental IRD staff. In general, the business taxpayers in this study felt detached from the tax system because the IRD did not understand their needs. Often, tax jargon and intimidating tactics used by IRD staff discouraged business taxpayers from contacting the IRD directly. Instead, the majority relied on their accountants or peers as sources of tax information.<sup>85</sup> The specific negative treatment received from the IRD is discussed in the ensuing subsections.

### 3 *Inefficient, Impersonal, Inflexible and Inconsistent IRD staff*

Small business taxpayers felt that IRD staff met their expectations of government bureaucratic departments in that they were inefficient, impersonal, intimidating, inflexible, and inconsistent. Most business taxpayers felt that IRD staff viewed them as

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<sup>85</sup> This is consistent with the findings that government agencies, including the IRD, are least preferred and least used compared to accountants, bankers, and peers in Lewis Kate et al, *Family, Friends and Government Agencies: A Report on SMEs and the Support Infrastructure* (New Zealand Centre for SME Research, 2005) 1.



citizens with obligations to pay their taxes, and therefore they were not treated politely, consistently, fairly, nor in a respectful manner. For some, the audit processes were made difficult by inflexible IRD staff, which is similar to the experiences reported by small businesses in the United Kingdom:<sup>86</sup>

The IRD officer that dealt with us had no sense of humour or any personality at all. He was a bit inflexible as he wanted to check for every single invoice even though the invoice was stated in the supplier's monthly statement. (SB15 — European husband and wife team.)

My family was audited. It was an ugly experience for them. They had to pay some penalty and that wasn't a nice experience. It was a tense experience in the farm because they (IRD) were right and everyone else was wrong. (SB2 — European female.)

I find the IRD is acting like a police rather than a collection agency. She behaved more like a judge. (SB1 — Asian female.)

Occasionally I will ring the IRD but this is about ten years ago. I would now speak to our accountant as I have been 'burnt' by the IRD ages ago because they gave us the wrong information. The IRD does not care whether you have got misinformation or not and you are responsible for the tax returns filed. (SB9 — European female.)

The above taxpayers' experiences showed that the IRD had not adopted procedural justice in their conduct. Inefficient, inconsistent and incompetent IRD administrators were noted by business experts (BE) and tax agents as contributing factors for the negative tax perceptions by the small business community:

The small businesses view of the IRD is not very good. They want little to no contact at all with the IRD if they can help it. This is because to get to the right person in the IRD if you have a query is really difficult. You can be asking the same question and two different IRD representatives can sometimes give you two different answers. (TA1 — sole practitioner.)

Most small businesses find it confusing when they ask one IRD officer and they give them an answer and then when they ask another officer, they are given a completely different answer. (BE7 — advisor to the government)

The lack of fair procedures experienced by small businesses has caused an overall negative perception of the IRD in New Zealand:

I know from my discussion with small businesses that they tend to talk negatively about the IRD. (BE5 — Maori business mentor.)

They have always considered the IRD to be the bad boys, the bogeyman you know — truly. (BE10 — Pacific business mentor.)

#### 4 *Judgemental IRD Staff*

Experiencing judgemental IRD staff was one of the common experiences for taxpayers and tax agents in this study. This form of biased treatment reinforces the perceptions of

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<sup>86</sup> Adam and Webley, above n 23.

small businesses that the IRD has unfair practices. Due to fear of dealing with the IRD, many taxpayers delegated their tax audits-queries to their tax agents, resulting in higher compliance costs. In some instances, tax agents also found vindictive IRD staff who were determined to find faults with their clients:

The auditors came expecting to find something. But we know what we were doing and they were happy with our records and asked us to keep the records for seven years! (SB14 — Asian male.)

I invested in a mining company and the company has been audited every month because they have GST refunds every month. It is all legitimate because it has something to do with mining. The company knew that it was going to happen and the accountant has all the checks and balances and is ready for them every month. (SB5 — European male.)

It varies, they can be incredibly good auditors and also some malicious, vindictive auditors who are on a mission and we have laid complaints. There is no doubt that there are some very good audit staff and they go in with the perception that errors found are genuinely made by the clients but yet there are some who have the perception that the errors made by the clients are deliberate. (TA8 — partner of a medium sized CA firm.)

The above accounts showed that some taxpayers were being pre-judged by IRD staff even before the audit-query process. This is procedurally unfair as taxpayers had to undertake extensive measures to prove their innocence. The lack of neutral and fair treatment received by the small business owners from the IRD had led to some tax resistance:

During the audit, we had to pay the accountant to deal with the IRD. If we have the audit, you can be nervous and there is certain anxiety that can make your presentation to the IRD incorrectly. (SB12 — European male.)

I would not like the IRD to come and visit me and I want the tax man to stay away. (SB5 — European male.)

## 5 *Unsympathetic and Insensitive IRD staff*

Small business taxpayers had also encountered unsympathetic IRD staff who were not sensitive to their needs. These IRD representatives were quick to penalise small businesses and were unwilling to give concessions regardless of their circumstances:

My husband has been queried before by the IRD for not filing a tax return before we left for Canada. He had a head injury and was returning to work for a couple of hours and did not keep an invoice book. The IRD would not give us a diversion and assessed us on a large sum of money which took us 7 months to pay. They were not at all sympathetic and they interrogated us. They do not need to be so heavy handed. (SB4 — Maori female.)

As a consequence of the IRD's heavy handed tactics, it created a culture of fear amongst small business towards the IRD:

Fear of the IRD, they can be more user-friendly or more encouraging. (SB34 — Pacific male.)

Fear the IRD. Don't get on the bad books with the IRD as the IRD is unforgiving and nasty. I think the main thing is not to get on the wrong side with the IRD as the penalties will come on you quite heavy when you are filing late. They are quite ruthlessly and there is no grace period. Just dealing with them is quite difficult. They are not helpful and that you are dealing with the bureaucracy. (SB 25 — Maori male.)

Part of this fear may be attributable to power imbalance in the taxpayer-IRD relationship and possibly poor knowledge of taxpayers' rights and obligations. These factors could be verified with further research. However, in this study, fear towards the IRD resulted in 30 of the 36 small business owners saying they would not consult the IRD even if they had a tax query. This is disappointing given that significant resources had been expended to generate a more 'customer-focussed' service to taxpayers since the emergence of the Taxpayer Charter 2001.<sup>87</sup> These findings show the absence of procedural justice to be one of the primary reasons for the poor working relationship between small businesses and the IRD.

## 6 *Untrained and Unqualified IRD staff*

Small business taxpayers and their tax agents had encountered unqualified IRD staff, thereby increasing their audit costs. Incompetent IRD auditors were a consequence of poor induction and training by the IRD, which confirmed findings from the New Zealand Auditor-General regarding the poor induction practices of IRD for tax auditors:<sup>88</sup>

My feeling is that the IRD officers are not highly trained. (TA4 — sole practitioner.)

Many of the auditors are not very qualified. (SB3 — Asian female.)

I had to go through the 7 year audit with this tax guy who was a farmer and he was very rigorous and they (2 of them) spent 1 week with us. After 1 week and another month of deliberation, they then narrow down to one area which was the transfer pricing — a new area at that time. (TA2 — sole practitioner.)

To address the issue of incompetent IRD staff, the tax agents in this study queried interpretation of statutes by the IRD representatives, and were proven correct:

I have sometimes challenged their interpretation of the statutes and they have gone away and come back to agree with our interpretation. You do not expect them to know everything. (TA8 — partner of a medium sized CA firm.)

We had a Fringe Benefit Tax (FBT) audit and I had to tell the IRD auditors about some of the Goods and Services Tax (GST) treatment and ask them to check it out. They thought that I was wrong. (TA1 — sole practitioner.)

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<sup>87</sup> For more information on the importance of the Taxpayer Charter, refer to Sue Yong and Alvin Cheng, 'The IRD Taxpayer Charter and the Small Business Community' (2011) 17(3) *New Zealand Journal of Taxation Law and Policy* 1.

<sup>88</sup> Controller and Auditor-General, *Inland Revenue Department: Performance of Taxpayer Audit — Report of the Controller and Auditor-General* (2003) 1.

The result of untrained and unqualified IRD staff had led to anxiety and tax compliance costs for small businesses, as their accountants had to prove their innocence. This is procedurally unfair, which perpetuates small businesses' negative perceptions towards the IRD and their unwillingness to interact with them:

No, I don't think the small businesses have a good view about the IRD. I think there is a bit of feeling that once they are in the spotlight or on the IRD records, they feel that they have the burden as far as the IRD is concerned. I think they don't feel comfortable dealing with the IRD and they hire the accountants as the buffer when dealing with the IRD. (TA3 — sole practitioner.)

## 7 *Ineffective Audits*

In addition to having untrained and unqualified IRD staff, two tax agents had found the audit processes to be ineffective in detecting errors made by business taxpayers. IRD auditors were fixated with only one aspect of the audit and ignored the other interrelated aspects, hence overlooking other tax errors. These findings are consistent with what was found by the New Zealand Auditor-General regarding some poor audit practices of the IRD:<sup>89</sup>

It amazed me how few the audits were and the audits were always random. They come to do small audits and they come and check the car expenses and they appeared to be relatively new employees of the IRD. The other major weakness of the IRD audit is that they never look at the whole picture of the GST, FBT, and Income Tax. If there is a problem there, then there is a flow on effect from there. (TA4 — sole practitioner.)

From the above accounts, the tax agents suggest that more effective audits require a holistic approach to minimise any flow-on effects. By doing this, they may prevent future problems from recurring, as well as conducting effective tax audits. Ineffective audits are procedurally unfair to small businesses, as they could be costly to them in the long run when potentially interrelated accounting errors re-emerge in the future. The overall audit-query experiences faced by taxpayers and tax agents in this study are best summarised and depicted in Diagram 1 in Appendix 4.

## **B Summary of Findings**

In summary, small business taxpayers in this study had relatively more negative than positive relational experiences with the IRD. A majority of the business taxpayers in this study had not received fair, respectful, and neutral treatment from the IRD, which led to higher tax compliance costs and unfavourable tax perceptions. The unfavourable perceptions of the IRD have encouraged some small businesses to participate in the cash economy:<sup>90</sup>

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<sup>89</sup> Ibid; Yong and Cheng, above n 87.

<sup>90</sup> Noble, above n 34; Cash Economy Task Force, *The Cash Economy Under the New Tax System: Report to the Commissioner of Taxation*. (Commonwealth of Australia, 2003); Morse, Karlinsky and Bankman, above n 27.

People would be more encouraged if they are given incentives to want to do work for the IRD. The IRD is like a big brother who is bullying, bullying all the time and you don't want to do anything nice for him but you want to take as much from him as you can when they are not looking sort of thing. Because they are horrible and you try to take and steal their lunch or whatever and that is the scenario and that is the picture and that is how I feel. (SB 34 — Pacific male.)

Because the IRD is quite strict with the recording and small businesses have to make sacrifices in some ways. So in order to compensate them for the sacrifices, cash jobs would help. (SB11 — Asian female.)

The lack of fair, consistent, and neutral processes and decisions applied to small businesses by the IRD has caused small business taxpayers to avoid direct contact with the IRD. There are three main reasons for this. First, the IRD, being in authority, projects itself to be always correct. Second, the IRD has been shown to wield its powers on small businesses to comply at all cost. Third, the IRD gives little to no consideration to the circumstances faced by small businesses. Consequently, small business taxpayers preferred tax assistance from their accountants and peers:

Not many people will be comfortable to deal with the IRD. This is because if you ask anything else, you will probably be lumped with more tax especially if you say the wrong things. There is always the perception that the IRD is always right and I know none of my friends would be comfortable to ring up the IRD. The perception of the IRD is that they are like a blood hound, more like a policeman. They always seem to find that it is never enough. (SB3 — Asian female.)

The government and the IRD is putting a lot more onus back on the small business taxpayers ... and if they do not do them properly, they will be fined by the IRD. (BE15 — European business advisor.)

Given the above, it is important for tax authorities to adopt procedural fairness when dealing with small businesses. Unfair and inconsistent procedures used by tax authorities had resulted in tax resistance by small businesses. Continued resistance from small business taxpayers would be detrimental to the integrity of any tax system as tax burdens would fall more heavily on other taxpayers.

The findings from this study contribute to the knowledge that there is a need for tax authorities to adopt procedural justice principles towards small businesses. Fair, honest, consistent, and neutral procedures should be considered by tax authorities when managing small business taxpayers. In addition, the rights of taxpayers should be respected in order to encourage voluntary compliance and favourable perceptions of tax authorities. These measures may result in greater cooperation from small businesses and can potentially assist in combating the cash economy, which is rife amongst small businesses.<sup>91</sup>

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<sup>91</sup> Cash Economy Task Force, above n 90; Morse, Karlinsky and Bankman, above n 27.

## VI CONCLUSIONS AND SUGGESTIONS FOR FUTURE RESEARCH

The accounts given by the participants in this study attest to the relational experiences they had with the IRD. The findings from this study contribute additional knowledge to the tax literature. In this case, the author found that small business taxpayers' perceptions of tax authorities are influenced by their relational experiences with the tax authority and the processes undertaken by the tax authority when making decisions about them during audits. Furthermore, disrespectful, intimidating, and judgemental representatives of the tax authority created a culture of fear and resistance from small businesses which led to increased compliance costs and participation in the cash economy.

In order to encourage voluntary compliance amongst small businesses, tax authorities need to adopt fair procedures to create environments conducive to small businesses *wanting to comply* rather than *having to comply*. Regulating small businesses using procedural justice principles involves tax officers being more customer-focussed towards taxpayers by being unbiased, supportive, and respectful. The purpose of the audit-query by the IRD should be to prioritise education of taxpayers so that they will keep proper records and declare correct taxable incomes. Audits can be used as a powerful relationship-building tool with taxpayers, as well as functioning as a deterrent for tax cheating. It is necessary and critical for tax authorities to consider procedural justice principles when managing taxpayers, as these benefit the IRD in terms of lower monitoring costs and lower tax compliance costs for the taxpayers.

Despite the small sample size,<sup>92</sup> which is common for qualitative interview based research on small businesses,<sup>93</sup> the richness and depth of the data obtained has provided multiple views of taxpayers' perceptions towards the tax authority. Patton argues that a qualitative study sample 'only seems small' in comparison with the sample size needed for representativeness when the purpose is generalising from a sample to the population of which it is a part.<sup>94</sup> Consequently, qualitative inquiry samples are often mistakenly judged on 'logic and purpose of probability samples instead of being judged according to the purpose and rationale of the study.'<sup>95</sup> In this study, 'the validity, meaningfulness, and insights generated from qualitative inquiry have more to do with the information richness of the cases selected than with sample size.'<sup>96</sup>

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<sup>92</sup> Patton, above n 65, 244.

<sup>93</sup> For example, 30 small business taxpayers were interviewed in Margaret McKerchar, Helen Hodgson and Michael Walpole, 'Understanding Australian Small Businesses and the Drivers of Compliance Costs: A Grounded Theory Approach' (2009) 24(1) *Australian Tax Forum* 39. Another 12 small businesses participated in the interview based research section of an Australian study undertaken by Philip Lignier, 'The Managerial Benefits of Tax Compliance: Perception by Small Business Taxpayers' (2009) 7(2) *eJournal of Tax Research* 106.

<sup>94</sup> Patton, above n 65, 244.

<sup>95</sup> Ibid 245.

<sup>96</sup> Ibid.

All research, including this study, is not without limitations. As this study relied on the theoretical and snowballing sampling processes, saturation<sup>97</sup> was reached at 36 specific taxpayers-participants, which in this case were drawn from Auckland, New Zealand. The limitations of these sampling processes include selecting participants who, in the opinion of the researcher, are relevant to the study<sup>98</sup> and are purposefully selected to illuminate the phenomenon under study.<sup>99</sup> These limitations have been minimised by data triangulation as mentioned in Part IV.A.4 of this paper.

Further research from other regions and countries with similar self assessment tax regimes, such as Australia, United Kingdom, United States, Canada, and Western Europe could replicate this study to confirm or refute the existing findings regarding the impact of procedural justice on tax perceptions. The research could also be extended using the survey method to determine whether the existing proposition holds for other taxpayers.

More research on small businesses is needed in order for tax regulators, academics, policy makers, and the business community to understand how small businesses comply with tax regulations. All need to be informed of the types of regulatory strategies suitable for small businesses and such strategies should be customised to enhance the voluntary compliance necessary for the effectiveness of any tax system.

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<sup>97</sup> Denzin and Lincoln, 'Introduction: Entering the Field of Qualitative Research', above n 61; Patton, above n 65; Neuman, above n 64.

<sup>98</sup> Sarantakos, above n 60, 164;

<sup>99</sup> Patton, above n 65, 243.



## **APPENDICES**

### **Appendix 1: Selected interview questions for small business taxpayers relevant for this study**

- (a) What kind of business are you in and how long have you been in the business?
- (b) Tell me what is like to be a small business operator in New Zealand?
- (c) When the phrase 'tax compliance' is mentioned, what kind of image(s) or word(s) come to mind?
- (d) Have you or your peers experience any tax audit or query from the IRD? Can you please tell me what was it like with that query/audit?
- (e) If you are unsure about any tax issue, to whom do you speak? Why?
- (f) Can you please tell me something about your view of the IRD to assist you with tax compliance?

### **Appendix 2: Selected interview questions for tax practitioners relevant for this study**

- (a) How long have you been in the accounting business and what types of services do you offer?
- (b) Tell me some of the reasons why small businesses come to you.
- (c) What do you think 'tax compliance' entails for the SME operators?
- (d) From your experience, is there any tax compliance issue(s) that is/are distinct to small business taxpayers?
- (e) Do you handle any IRD audit inquiries relating to your clients and why? Tell me your experience with the IRD audit.

### **Appendix 3: Selected interview questions for business experts relevant for this study**

- (a) Can you please tell me your role and your involvement with small businesses in New Zealand?
- (b) From your involvement with small businesses, what do you think is the general perception of small businesses towards tax compliance?
- (c) Why do small businesses perceive it as such?
- (d) How do small businesses manage their tax compliance process?
- (e) Can you please tell me your observation of small businesses and how they address these issues:
  - (i) Managing competing demands on their business resources
  - (ii) Interacting and their perceptions of the IRD

#### Appendix 4: Summary of taxpayers' experiences with the IRD

##### Diagram: Audit-Query Experiences of Small Business Taxpayers in Auckland

