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Working hard for the money : tax noncompliance in the small building and construction industry

Anne Austin Carroll
University of Tennessee

To the Graduate Council:

I am submitting herewith a thesis written by Anne Austin Carroll entitled "Working hard for the money : tax noncompliance in the small building and construction industry." I have examined the final electronic copy of this thesis for form and content and recommend that it be accepted in partial fulfillment of the requirements for the degree of Master of Arts, with a major in Sociology.

Neal Shover, Major Professor

We have read this thesis and recommend its acceptance:

James Black, Hoan Bui

Accepted for the Council:
Carolyn R. Hodges

Vice Provost and Dean of the Graduate School

(Original signatures are on file with official student records.)

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Neal Shover

Neal Shover, Ph.D.

We have read this thesis
and recommend its acceptance:

James W. Black

James Black, Ph.D.

Hoan Bui

Hoan Bui, Ph.D.

Accepted for the Council:

Vice Provost and Dean of Graduate Studies

WORKING HARD FOR THE MONEY: TAX COMPLIANCE IN THE SMALL BUILDING AND CONSTRUCTION INDUSTRY

A Thesis
Presented for the
Masters of Arts Degree
The University of Tennessee

Anne Austin Carroll
December 2002

DEDICATION

This thesis is dedicated to the memory of my aunt

Jacqueline C. Austin

without her undying inspiration and support,
my return to school would not have been possible.

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In my life outside the department (what is left of it), I am grateful to all of my friends and family for standing by me in my decision to return to school. I particularly thank my parents, Bill and Martha Austin, for their enduring love and support for all that I have done in my life. I also thank my "other family," Tommy, Jennifer, Caine, Ashley, Abby and, most especially, Harman Austin, for their continuing understanding and

friendship through this process. And, finally, I cannot express in words the gratitude I feel for the unconditional love and support I have always received from my daughter, Kristen Anne Loden.

ABSTRACT

The closing decades of the 20th century saw significant policy developments in the movement to improve business compliance with regulatory and tax requirements. Previously, controversy about whether a more or less interventionalist approach was needed dominated discussions of and proposals to enhance regulation. At the core of the debate were the theoretical assumptions about the motivations driving compliance. Advocates of the more interventional approach referred to as command-and-control regulation assume self-interest motivates compliance and a fear of sanctions deters noncompliance. Those arguing for a less interventional approach known as cooperative regulation assume civic duty, moral beliefs, fairness and legitimacy of government determine compliance. More recently, regulatory and tax agencies have adopted a convergence of the two approaches known as "responsive regulation." Responsive regulation suggests a wide range of motivations from inadvertent error to self-interest influence compliance and, thus, require a broad scope of interventions beginning with dialogue aimed at securing and maintaining engagement in the regulatory process and ending with a willingness to resort to sanctions when other efforts fail. Investigation into motivations that influence compliance, especially in the tax arena, have been limited because of the recency of developments. The available research, however, tends to support the basic assumptions of responsive regulation. Drawing from interviews with 25 owners of small building and construction firms, the current study provides an increased understanding of compliance in an industry well recognized for noncompliant taxpayers. Specifically, it explores participants' taxpaying behaviors and the motivations driving their taxpaying and then compares their taxpaying compliance with compliance in other regulatory areas. Results suggest that taxpaying among the participants is a complex and dynamic process which will probably not be accounted for by one theoretical model, that the tenets of responsive regulation may be the more efficacious intervention and that the tradition of criminological research may serve well to inform future regulatory and tax compliance research.

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CHAPTER 1
BACKGROUND

Drawing from economic and classical theories of crime, rational choice theory assumes that participation in illegitimate activity is a function of cost and benefit analysis by rational actors (Becker, 1968; Cornish and Clarke, 1986). Specifically, individuals pursue goals reflecting their self-interest and consciously choose to commit a criminal act if the expected benefits of illegitimate activity exceed the benefits from engaging in legitimate activity. Conversely, the decision to forgo criminal behavior may be based on the individual's perception that the benefits are no longer there or that risk of detection and subsequent cost of engaging in illegitimate activity is too great. In other words, individuals explore their options and choose the alternative with the highest expected gain. Contemporary rational choice theorists acknowledge the calculus of criminal behavior may on occasion be rudimentary and misinformed but contend that at least some consideration and rationality direct choices to participate in crime. This decision making process occurs through two fundamental processes (Cornish and Clark, 1986).

First, individuals are heavily influenced by a number of personal factors and learning experiences in choosing their behavior. Personal factors may include psychological make-up, social and demographic characteristics and background characteristics; learning experiences may include direct and vicarious experiences with criminal activities, contact with enforcement agencies and development of conscience, moral attitudes and self-perception. While other theorists take account of these factors as predisposing certain individuals toward a penchant for criminality, rational choice theorists reinterpret these factors as influencing the calculus to commit a criminal act. To wit, individuals who conform in many aspects of their lives may commit a criminal act and the reverse may also be true.

Second, individuals are influenced by situational and contextual factors. Some individuals are more likely than others to confront situations where the benefits of illegitimate activity outweigh the costs. Opportunity, risk of detection, potential consequences and necessary skills and information vary particularly for different criminal acts. From the rational choice perspective, decision making models should be "crime-specific"(Cornish and Clarke, 1986).

Rational choice theory assigns the state a strong regulatory role in preventing crime by making it "rational" for individuals to behave so as to reduce negative consequences. Since businesses by nature operate instrumentally and are typically risk-aversive, threats weighted against potential gains appear particularly ideal for dealing effectively with their noncompliance (Paternoster and Simpson, 1996). Noncompliance by businesses is seen as willful action by "amoral calculators" who respond to illicit opportunity by calculating costs and risks (Kagan and Scholz, 1984). The principles of rational choice theory, therefore, have served as a base for command-and-control strategies to secure business compliance with regulatory rules. Command-and-control enforcement incorporates inspections, legal threats and the mechanical imposition of penalties for noncompliance. Limits are clearly defined in advance and officials readily increase the pressure to comply including the initiation of legal action when limits are tested.

While command-and-control regulation traditionally dominated discussions of and proposals to enhance regulation, a variety of evidence suggested that its adversarial nature fosters resentment, mistrust and resistance, at least in some industries and industry sections. Persistent doubts about its benefits and effectiveness eventually led to calls for programs of cooperative regulation and enforced self-regulation. Such programs are distinguished by shared state-corporate responsibility for enforcement and by a wider range of official options for responding to noncompliance.

Advocates of cooperative regulation contend that individuals tend to obey laws made and implemented by authorities that are perceived to be legitimate (Tyler, 1990; Tyler, 1998). They argue that compliance with regulations is influenced by the extent to which individuals accord legitimacy to enforcement agencies. Legitimacy is a normative assessment by individuals of the appropriateness or right of enforcement agencies to restrict their behavior. Therefore, compliance is higher when individuals accord a high level of legitimacy to enforcement agencies. Achieving compliance is not seen as an immediate objective but a long-term aim. Preferred methods of enforcement include persuasion, negotiation and education. However, proposals for and programs of cooperative regulation also came under fire by critics who questioned whether they can deliver fairer and more effective outcomes (Snider, 1990; Pearce and Tombs, 1990; Pearce and Tombs, 1991).

The punishment-versus-persuasion controversy led Ayres and Braithwaite (1992) to propose a convergence of the two approaches known as "responsive regulation." Responsive regulation research suggests failure to comply with regulations may result from willfulness but many times it does not. Responsive regulation is grounded in hierarchical development and application of enforcement strategies that take into account the circumstances and capabilities of differing business entities. Advocates of responsive regulation emphasize educating, assisting, and persuading businesses to comply. If they fail to comply despite appeals and cooperative actions, officials can escalate their responses and sanctions in proportionate fashion. In other words, as the seriousness of infractions and the willfulness they represent increase, so do the severity of sanctions. As Braithwaite (2002: 30) explains, "It is an attempt to solve the puzzle of when to punish and when to persuade."

Conceptually, Ayres and Braithwaite (1992) present their notion of responsive regulation in the form of a "regulatory pyramid" which is depicted in Figure 1.

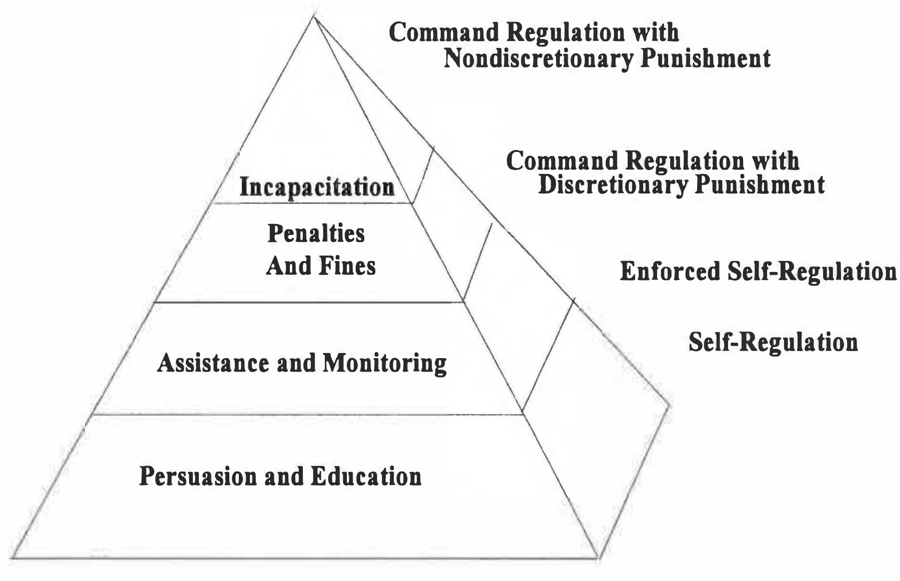

Figure 1. Regulatory Pyramid

The base of the pyramid is made up of broad cooperative strategies of self-regulation that emphasize education about rules and provide assistance with complying. The top of the sanctions pyramid is represented by a "benign big gun." Ordinarily kept in the background, it represents the most severe sanctions in the arsenal of regulatory officials. The availability of the benign big gun, coupled with officials' clear willingness to employ it, serve to push enforcement down toward the base for those who fail to respond to assistance or to punish those who commit an offense beyond deterrence or refuse to cooperate. This approach to regulation nurtures voluntary compliance while displaying a willingness to employ escalating sanctions should the need arise.

Ayres and Braithwaite (1992: 4) suggest officials "be responsive to industry structure in that different structures will be conducive to different degrees and forms of regulation." More specifically, effective responsive regulation requires that officials understand and take account of the diverse motivational postures taken by those being regulated. V. Braithwaite (1995) identifies four common motivational postures: capture (acceptance and identity with the regulatory system), managerial accommodation (incorporation of the firm's own strategies to achieve compliance), resistance (confrontation and challenge of regulations), and disengagement (withdrawal from the regulatory process).

Echoing reports of investigators, advocates for responsive regulation contend that motivations toward noncompliance are not fixed and immutable but qualities that are subject to shift within the dynamics of the regulatory process. Movement in the direction of compliance may be accomplished by engaging the owners/managers of business firms in a common regulatory culture with strong social bonds and shared sense of mission. This assumes that failure to comply may result not only from willfulness but also from ignorance of what is required, from inadvertent errors, or from changes in circumstances. In such cases, most are neither resistant to nor disengaged from the system. Understanding both diverse motivational sources of noncompliance and the need for mutual respect and trust in contacts with business firms is central to improving compliance. Thus, business firms who are inclined to comply with the law may be strengthened in this posture by officials who treat them as trustworthy if confused or misguided citizens while those of a more resistant bent may be nudged toward compliance through judicious use of educative efforts laced with a dose of threat. The more recalcitrant are another matter for they may need to be reminded of or even experience first hand criminal prosecution or loss of their license to do business.

Investigators have made progress exploring empirically the diverse motivations for compliance by businesses across a broad spectrum of regulatory programs. Ashford et al. (1985) found that consistency of enforcement and regulation structure most influential in motivating businesses to establish and engage in innovative practices to ensure regulatory compliance. Genn (1993) interviewed management personnel in a wide cross section of firms in England and Wales to learn about their motivations for compliance with occupational safety and health requirements. Her study showed that some firms, particularly the largest ones, are proactive in their approach while others are more reactive. Firms in the former category approach expressed support for and took actions to be knowledgeable about and to comply with regulations. Managers of reactive firms by contrast tended to be less informed about regulations and more ad hoc in their compliance strategies. Typically, their approach to compliance is confined to implementing improvements demanded by inspectors during visits.

Braithwaite and Makkai (1991) asked a sample of 410 Australian nursing homes executives to estimate the chances that discovery and sanctions would occur under a condition of continued violation of six standards and regulations and to gauge the costs to their organization of several sanction types in the event that they were caught and penalized. Using qualitative methods to assess cross-sectional self-report and official measures of compliance, they found a formal deterrence model to be a "stark failure" (Braithwaite and Makkai, 1991: 29).

Paternoster and Simpson (1996) investigated intentions to commit four types of corporate crime by MBA students. They found that where participants held personal moral codes, these were more important than rational calculations of sanction threats in predicting compliance. While sanction threats were found to be somewhat important, they concluded that appeals to business ethics were more effective.

Bansal and Roth (2000) collected interview data on compliance motivations in tape recorded interviews with 88 managers in 53 theoretically sampled firms in the United Kingdom and Japan. The investigators were interested not only in motivations for compliance but also contextual factors that apparently lead to corporate ecological responsiveness. Using standard qualitative research techniques of analytic induction, they identified three common motivations for compliance with environmental protection regulations: competitiveness, legitimation and ecological responsibility. Competitiveness is belief that compliance may hold potential for improving long-term profitability, for example, by improved energy and waste management. Legitimation refers to the desire of a firm to improve the appropriateness of its actions within an established set of regulations. Ecological responsibility refers to the concern that a firm has for its social obligations and values.

May (2002) used a mail survey of 260 residential home builders in western Washington to examine attitudes toward compliance with building codes. His data led him to distinguish between affirmative and negative motivations. The former are grounded in a concern for one's general reputation, demands for homes without defects, confidence in building codes and a sense of duty to comply. The latter are grounded in fear and potential sanctions associated with noncompliance. Affirmative motivations were found to be more effective than negative motivations in producing compliance.

Research into motivations for regulatory compliance tend to confirm the basic assumptions of responsive regulation: "[Improved compliance] will not be accomplished by considering [firms] one at a time as value-maximizing unitary actors. . . The drivers of compliance are plural. By seeing and managing compliance appeals in pyramid fashion so that reward and trust are favored strategies at the base and tough enforcement at the peak, we can move responsively to improve compliance by mobilizing appropriate drivers at propitious moments" (Braithwaite and Braithwaite, 2001: 417-18).

While research into the motivations of regulatory compliance has been of interest to social scientists for some time, the same has not been true of investigation into the motivations for tax compliance. Because tax authorities have historically relied so heavily on command-and-control strategies of enforcement, research has been dominated by economic theorists (Roth, Scholz, and Witte, 1989). Economic theorists concentrate on estimating the amounts of revenue lost to untaxed economic activity, gathering sociodemographic characteristics of noncompliant taxpayers and building enforcement models derived from economic theories. Social science research into tax compliance has been limited in volume and empirical knowledge has been "best regarded as pioneering rather than definitive" (Roth, Scholz, and Witte, 1989: viii).

In the past decade, however, social science research into motivations for tax compliance has become increasingly necessary due to a shift in tax enforcement strategies. In the United States, the president signed into law the Internal Revenue Service Reform and Restructuring Act of 1998. This act came into law after the adversarial nature of tactics used by the Internal Revenue Service (IRS) met with complaints and criticisms from citizens, the press and, in time, legislators. It establishes a board that includes private citizens to oversee administration of the IRS, shifts the burden of proof in civil cases from the taxpayer to the IRS and deemphasizes enforcement actions while increasing taxpayer education initiatives (Lee and Lipman, 1999; Pace, 2001).

The challenge for social science research is to identify motivations driving taxpayer compliance and translate findings into practical policy recommendations. Currently, researchers are limited in their understanding of the motivations driving compliance with tax requirements (Roth, Scholz, and Witte, 1989; Cash Economy Task Force, 1998; Schneider, Braithwaite, and Reinhart, 2001). As a high ranking IRS official notes, “we need to know where groups of taxpayers are having difficulty in complying with tax law. That would allow us to more effectively deploy resources to help them understand” (Pace, 2001). The next section addresses what has been learned about compliance with tax requirements.

CHAPTER 2
TAX COMPLIANCE

While most citizens consider payment of taxes necessary for a sustainable society, this does not necessarily reflect positive regard for tax law compliance. Tax law is often considered complex, time-consuming and unfair leading to justifications for widespread noncompliance by certain segments of the population. The largest of these segments includes participants in alternative economies recognized by countries worldwide and characterized by unreported income (AICPA, 1983; Portes, Castellas, and Benton, 1989; Schneider, Braithwaite, and Reinhart, 2001). In Sweden, this phenomenon is referred to as the "secret economy," in Britain as "fiddling," in Russia as the "second economy" and in Australia as the "cash economy" (AICPA, 1983; Cash Economy Task Force, 1998). In the United States, the IRS has subdivided the alternative economy into the "illegal economy" and the "informal economy" (AICPA, 1983). The former includes provisions of good and services that are illicit such as prostitution, gambling, extortion and drug dealings. Being illegal, monetary transactions for services are not reported for tax purposes. The latter comprises income derived from legal employment and business transactions that are not declared for tax purposes. Typically, income is in the form of cash that is not recorded in the books from which the tax return is prepared. Guttman (1977) and Fiege (1978) estimate the informal economy makes up two-thirds of all unreported income in the United States, and they predict its growth at rates exceeding the conventional economy. In 1970, the informal economy in the United States was estimated to comprise between 3.6 and 4.6 percent of the total economy (Schneider, 2000). By 1998, this estimate had grown to 8.9 percent of the total economy, an increase of 168 percent (Schneider, 2000).

Evidence suggests that a substantial portion of the informal economy is made up of "informal suppliers" (Kagan, 1989; Cash Economy Task Force, 1998; Bajada, 1999). Informal suppliers are small businesses whose income tends to be received in small amounts from customers who generally do not keep records of expenditures (Kagan, 1989: 88). They conceal their income by using cash transactions with customers and suppliers, keeping unsystematic records, selling surplus materials and failing to maintain a licensed or fixed place of business with visible assets (Kagan, 1989; Bajada, 1999). Business transactions from informal suppliers are difficult to detect because the "paper trail" is nonexistent and there is usually no third party reporting. The U.S. General Accounting Office (GAO) approximates that self-employed workers report 36 percent of their income and informal suppliers working on a cash basis report 11 percent (Hite, 1997).

In the closing decades of the 20th century, revenue losses from the informal economy gained the attention of tax enforcement officials and social scientists (Roth, Scholz, and Witte, 1989). The former are interested in reversing the trend while the latter are interested in the theoretical bases for doing so. The two are united in the quest for answers to the question of what motivates some people toward compliance with tax law and others toward noncompliance. As noted previously, since command-and-control tactics dictated enforcement by tax authorities until recently, much of what is known about motivations for tax compliance stems from economic and rational choice theories.

Based on this model, taxpayers are deterred from noncompliance and prompted toward compliance when they fear detection from audits and criminal investigations and punishment through prescribed financial penalties, liens, seizure of assets and federal prosecution.

The deterrence principles of rational choice theory found support among early investigations into tax compliance (Allingham and Sandmo, 1972; Grasmick and Scott, 1982; Beck and Jung, 1989). However, more recent research has made clear that techniques to improve tax compliance based solely on surveillance and sanctions can be inadequate or counterproductive and do not explain voluntary compliance in the absence of surveillance (Alm, 1991; Blumetal, Christian, and Slemrod, 1998; James and Nobes, 2000; Taylor, 2001). Much of this research has relied on investigative tools such as surveys of behavior, attitudes and intentions, analytical models, data from tax agencies and experimental studies (Taylor, 2001). Variables suggested to influence tax compliance include civic and moral duty, trust in government, perception of tax fairness and tax identity (Tyler, 1990; McGraw and Scholz, 1991; Mason and Mason, 1992; Roberts and Hite, 1994; Taylor, 2001).

Klepper and Nagin (1989) completed an extensive review of the survey research conducted on the determinants of tax compliance. They report the following factors to be significant: 1) perceptions of the probability of detection of noncompliance; 2) severity of informal sanctions when individuals expected public revelation of detected noncompliance; 3) moral beliefs about violating tax laws; 4) experience with other noncompliers and past experience IRS enforcement (greater experience with both is associated with greater noncompliance); and 5) demographics with older individuals engaging in less noncompliance.

Drawing from the research literature and from theoretical work, Kidder and McEwen (1989) suggest a typology of tax compliance and noncompliance and a range of influencing factors. These include self-interest, habit, laziness, loyalty, social pressures, procedural complexity and tax advisor influence. While not empirically derived, their typology is helpful as a "heuristic device [that calls] attention to the rich complexity of taxpaying behavior and the need for an ambitious research agenda" (Kidder and McEwen, 1989: 48).

Brooks and Doob (1990) sent surveys to 900 randomly selected persons in Canada and received a response rate of 33 per cent. Using their survey results, they examined the major premises underlying deterrence theory. They found that perception of likelihood of apprehension for various forms of tax evasion is not related to whether or not a person evades tax requirements and that tax evasion does not appear related to safe opportunity to evade. By comparing the responses of evaders and compliers, they concluded that deterrence is not a major explanation for tax compliance. They suggested that tax decisions may not be made with the sort of careful thought and planning that had been originally thought.

Carroll (1992) collected information from 100 U.S. taxpayers who kept daily diaries of tax-related thoughts and behaviors and talked through their major tax preparation work in the presence of a research assistant. He found that 60% of all tax-related statements centered around obtaining a refund and that different factors were significantly related to noncompliance by those participants misrepresenting income and by those misrepresenting deductions. The former were related to lower income levels, more opportunity for noncompliance, reliance on a tax professional, and fear of detection. The latter were related to post season tax knowledge, reliance on a friend or relative as a source of information in the prior year, receiving a better-than-expected refund and unfairness of tax procedures.

Noble (2000) utilized interviews with owners and employees of small to medium businesses in New Zealand to describe attitudes, perceptions, motivations and behaviors linked to tax compliance and evasion. He identified two primary groups of tax evaders: those who do pay tax and operate within the tax system and those who do not pay any tax and operate outside the tax system. Within the former group, he identified five types of taxpayers: non-evaders, opportunists, rebalancers, victims and calculating sharps. Non-evaders comply with tax law due to their long or short term goals of either making a success of the business or enjoying the lifestyle of the business. Opportunists undertake undeclared cash jobs for business needs such as those who see undeclared cash jobs as a small perk or need undeclared cash income to make enough to survive. Rebalancers over-claim expenses due to perceptions of being over taxed or to offset under-claiming in other areas. Victims have been unable to pay tax owed because of external circumstances such as bad debtors or their businesses no longer trading. Calculating sharps are extreme evaders strongly focused on their financial success through evading their tax obligations. For the group operating outside the tax system, he identified two types: those who actively opt out of the tax system and those who passively opt out of the tax system.

Business owners who actively opt out of the tax system may include calculating sharps who have been caught or victims who are unable to settle with tax authorities or go out of business. Those who passively opt out of the system are typically business owners who lack knowledge of their tax obligations. Furthermore, he found that as the amount of tax evasion by firms increases, negative perceptions of tax authorities increases as well.

The Australian Tax Office identified a constellation of factors, known as BISEPS, that presumably shape firms' capacity and inclination to comply with taxation requirements (Cash Economy Task Force, 1998). This host of business, industry, sociological, economic and psychological factors condition the ways typical firms perceive and interact with tax and regulatory agencies and personnel. The use of BISEPS enables the ATO to tap into industry specific information and target strategies to enhance compliance.

Drawing from the ATO research, Shover, Job, and Carroll (2001: 7-8) describe what has been learned about the Australian small building and construction industry:

> Life in the small building and construction industry in Australia is filled with uncertainties. The participants are a fairly casual lot who are prepared to take risks but are also content to remain small businesses. This an industry dominated by males with low literacy levels and variable skill levels, many of whom come from non-English speaking backgrounds. Distrust of government and fear of the ATO are common. Generally it is considered okay to not pay tax, and peer pressure contributes to many taking the risk of cheating. These are independent people who like to manage their own show. Nearly half of these business owners are sole traders, and nearly a third are in partnerships, commonly with their wife. The overwhelming majority of them use the services of tax agents, but few maintain on-going relationships throughout the year. The business records are maintained by the wives. This industry is often faced with economic uncertainty and pressures from competition, inflation, and interest rates, and the weather. Business relationships are characterized by informality;

> written contracts are eschewed and a great deal of advertising is by word of mouth. Trade regulation is minimal and licensing requirements vary. Barter is common, as is the use of cash. The industry norm is that weekend work is paid for in cash that is not declared as income. The industry ethic is very much one of looking after each other, and the high level of union membership illustrates this. There is a strong belief in the "level playing field," meaning that everyone in the industry should have an equal chance to make a living.

This research illustrates the existence of many possible motivations and justifications underlying the nature of tax compliance and noncompliance. For some, the tax system may be considered too complex and time consuming. Taxpayers are not secure in their knowledge of the tax system or in the accuracy of their records and returns (Cash Economy Task Force, 1998). On the basis of interviews with small building and construction business owners in Australia, Shover, Job, and Carroll (2001) found that a substantial proportion of respondents believe that little good and potentially a great deal of trouble and lost production time can come from contacts with the ATO. A particularly colorful representation was given by a plumber and his business partner:

> I mean it's all too hard: that something that should be so simple is made so hard. On top of going to work and making a living, we're expected to work all our tax out and everything else out, and it's that bloody complicated. Chartered accountants can't work it out who trained to do that. And yet they want us to do it. I mean, like, how many of those guys can come and put up gutters and dig trenches and lay plumbing? Fucking none of them! But they expect us to be able to do--to keep our books in--absolute perfect order (Shover, Job, and Carroll, 2001: 23).

There is further perception that tax enforcement is applied unfairly; insufficient attention is paid to larger corporations while small businesses are harassed over small sums (AICPA, 1983; Cash Economy Task Force, 1998). Survey data from Yankelovich, Skelly, and White (1984) show that a substantial majority of U.S. taxpayers believe, "the present tax system benefits the rich and is unfair to the ordinary working man or woman." An Australian small building and construction firm owner expressed an opinion of unfairness about the taxation system:

> [T]he thing that you'll find in the building industry is that they are particularly hostile to the Taxation Department because they sit there and they watch multinational companies paying no bloody tax at all [whilst] they are being screwed into the ground. That's where the hostility comes from. That's where a lot of cash economy comes from, because there . . . is resentment . . . The rates are too high, [and] multinationalists will not pay their taxes. And not only multinationals, there are others too. But generally the wealthy don't pay their bloody taxes, and that's where the resentment comes from (Shover, Job, and Carroll, 2001: 22).

This sentiment can be a strong incentive for small businesses to create their own tax savings and ignore tax laws (AICPA, 1983).

Research also suggests the general public is extremely tolerant of cash transactions by small business owners. Justifications include "everyone does it at some time" and " it does not hurt anyone" (Bardach, 1989; Mason and Mason, 1992; Cash Economy Task Force, 1998). Surveys conducted in Australia by the Cash Economy Task Force (1998) reveal taxpayers are more tolerant of small businesses in the cash economy cheating on their taxes than larger and more established businesses in the conventional economy. Noble (2000) reports that the general public in New Zealand does not view cash jobs as contributing to tax evasion; evasion was seen only as a problem in cases of corporate avoidance or benefit fraud. Additionally, he noted that the public did not see an advantage in curtailing the cash economy. Often times, consumers believe that they can obtain lower prices through the cash economy and that the community as a whole would not benefit from the extra taxes collected from cash businesses. Similarly, many perceive of tax "cheating" as a victimless crime (Bardach, 1989; Mason and Mason, 1992). The Cash Economy Task Force (1998) notes, "Most people who make donations to charities feel positive about it. However, it appears that very few taxpayers send a cheque to the ATO with same positive feeling."

Although the social science research into tax compliance tends to be in an early stage of development, it suggests motivations in addition to self-interest and fear of sanctions may be of considerable significance. Some of these motivations include civic duty, moral beliefs, perceptions of tax fairness, tax complexity and time constraints. In-depth research is necessary to gain the insights that have been achieved in other areas of compliance and that are necessary to inform policy makers.

CHAPTER 3
RESEARCH QUESTIONS AND RESEARCH METHODS

The corpus of research into tax and regulatory compliance has neither a long history nor the strong base of generally accepted factual knowledge to match what is known about individuals and their noncompliance. The bulk of social science and criminological research into compliance has focused on individuals and their behaviors. The legacy of past research provides a substantially improved ability to explain, predict, and control noncompliance by individuals and has influenced crime control strategies in the criminal justice system. There is reason to believe that tax and regulatory noncompliance may parallel its individual forms. Research into the criminal calculus offers strong arguments for motivations other than utilitarian motivations (Cromwell, 2003). Similarly, research into the motivations for tax compliance suggests the notion of individuals as "amoral calculators" may not be completely accurate. Currently, however, we do not know for sure; the research is too limited to make the strong arguments allowed in traditional criminological literature. As Wickerson (1995: 15) notes, "compliance data needs to be supported by more qualitative data which can indicate the general nature and causes of noncompliance. Tax administrators need such qualitative data in order to determine how to best respond to noncompliance within particular populations."

The current study uses qualitative interviews to explore the taxpaying behavior of small business owners in a particular population, specifically the building and construction industry. In this method of research, interviews are less structured than survey interviews; researchers ask open-ended questions and elicit specific responses but participants are allowed and prompted to explain and clarify their responses (Babbie, 1998; Cromwell, 2003). It is a method that allows access to participants' knowledge, experiences and opinions in their own words (Reinharz, 1992; Rubin and Rubin, 1995; Johnson, 2002; Warren, 2002). The results of qualitative interviews offer "deep" or "thick" descriptive information and understanding of the activity being studied (Johnson, 2002).

Understanding the meanings of participants' taxpaying actions are central to this study because it allows the researcher to go beyond commonsense explanations (Babbie, 1998; Johnson, 2002; Cromwell, 2003). For instance, qualitative research into the calculus of robbers and burglars, typically considered driven primarily by instrumental motivations, reveals expressive motivations may be as much or a more salient explanation (Flemming, 2003; Cromwell, 2003). Additionally, qualitative investigation into gang violence, typically thought to be related to turf and conflict, reveals money and drug dealing may be the more important driving factors (Padilla, 2003). Cromwell (2003: xi) summarizes the significance of such findings: "Thus, effective crime control strategies must take into account the factors that drive crime. Field research that allows offenders to 'speak for themselves' is ideally suited to these studies."

Research Questions

Three primary research questions guide the current research. First, what are the different types of taxpaying behaviors for the business owners participating in the study? More specifically, do they file annual tax statements, claim all income, keep records accurately and state deductions truthfully? Second, what factors shape, influence and condition their taxpaying behavior? That is, what drives some owners of small building and construction firms to comply with tax requirements while others do not? What motivates these business owners to comply with some tax requirements but not other requirements? Third, the study investigates the degree to which tax compliance parallels compliance with other regulatory requirements? In other words, is compliance with tax requirements an unitary or diverse phenomenon?

Sample

The small building and construction industry was selected as the focus of the study for several reasons. First, smaller businesses have lower tax compliance rates than larger, corporate businesses. The IRS-estimated voluntary compliance rate for small businesses is approximately 79% as compared with 90% for corporations with assets of $1 million or more (Internal Revenue Service, 1983). Second, the building and construction industry is well recognized as a principal contributor to the informal economy (Kagan, 1989; Sassen-Koob, 1989; Cash Economy Task Force, 1998; Schneider, Braithwaite, and Reinhar, 2001). The IRS-estimated voluntary compliance rate for builders is ranked among the lowest of classification codes, approximating that less than 60 percent of income is reported (IRS, 1983). Finally, owners of small building and construction firms are subject to numerous opportunities for cash income that may not be reported to tax officials (Kagan, 1989). Based on surveys of consumers and their expenditure patterns, the IRS (1983) found home repair and additions ranked among the highest of household purchases from informal vendors by types of goods and service in

1981.

The sample for the study consists of 25 owners of small building and construction firms operating businesses in Knox County, Tennessee and contiguous counties. For purposes of this study, small building and construction firms are those that employee or subcontract no more than five persons at a time. The building and construction industry comprises different occupational sectors such as carpentry, flooring, landscaping, excavation, remodeling and general contracting.

The sample was obtained through snowball sampling. Initially, participants were known personally and agreed to participate in the research project. They provided referrals and contacts with other owners of small building and construction firms. Upon completion of interviews, participants were asked to provide referrals and contacts with other owners of small building and construction firms. Most participants were reluctant to do such without first contacting potential referrals themselves. Upon gaining permission from potential referrals, participants then gave the researcher a name and phone number to contact. Several participants declined requests to furnish referrals or contacts. Typically, they explained that they did not feel comfortable asking someone else to participate in research related to taxation. A few participants who agreed to provide referrals did not call back within a reasonable period of time. On these occasions, they were contacted and asked about the progress of securing referrals. In each of these cases, participants informed the researcher that the potential referrals had declined to be contacted. Many times the owners of small building and construction firms do not answer their calls but use an answering machine and messages were left for referrals. Some referrals never returned messages even after several attempts to reach them. It was assumed they did not wish to participate in the study. Difficulties in eliciting participants limited the sample size.

Several reasons for the problems experienced in obtaining participants were noted. One reason is the personal and sensitive nature of taxpaying. Most persons approached about participating in or providing referrals for the study expressed apprehension about discussing taxation and personal finances. For instance, when asked if they talked about taxpaying with other owners of small building and construction businesses, most participants responded that they did not. One floorer stated, "you don't 'cause that's pretty much your own business. This stuff is really personal." A little later in the same interview the participant was asked if he ever discussed taxpaying with other people in general. The participant replied, "[I] did not really ever talk to them about it. Like I said it's personal." Another participant who admitted never filing a tax return reported conversations about taxpaying were usually limited to talk about filing deadlines. This participant revealed: "They say, 'You got your taxes in?' I say, 'Oh yeah.' I don't even hesitate because I don't want anybody to know [that I don't file taxes]."

A second reason is that noncompliant persons do not want to risk being identified by authorities (Brook and Doob, 1990; Schneider, Braithwaite, and Reinhart, 2001). Shover, Job, and Carroll (2001) found that a substantial majority of small building and construction firms identified through ATO files declined requests to be interviewed in their study. The researchers were seeking to interview firms/owners who had varying degrees of contact with the ATO in the preceding two years. The researchers estimated that not more than 5% of all firms contacted agreed to and completed an interview. Most of these owners were tilted toward compliance with tax laws and had no particular reason to be wary of sharing their experiences and opinions about the tax office. In the current study, many participants were willing to participate only on the condition of confidentiality and several wanted reassurance the study was not connected with the IRS. Two participants allowed notes to be taken during the interview but refused to be tape recorded conveying they did not want to risk being identified at some point. Both of these participants admitted noncompliance with tax laws.

A third difficulty in soliciting participants for the study included the time constraints owners of small building and construction firms experience. Most of the participants do not have offices they work from and a majority of time is spent manually working on job sites. Forty hour work weeks are considered light. Time after work is usually devoted to paperwork, returning calls and completing responsibilities at home. Interviews with participants and their spouses illustrate the problem:

> PI: How many hours do you put in a week?
> Subject (landscaper): About 40 hours during weekdays and then Saturdays. It's physically draining.
> PI: Does that count paperwork?
> Spouse (who works with subject): No, that's just the physical work. Paperwork is another monster in itself.
> Subject: Yeah, I have already just put in about 3 hours today on it and will probably work some more after this.
>
> PI: Do the hours get to you?
> Subject (general contract): It used to not. It does now.
> Spouse (keeps books and works a fulltime job): You didn't have any kids then.
> Subject: You can say I have a mess out there right now and normally I wouldn't keep it like that. Tools, trailers, materials, whatever else, from

> one end of the property to the other.
> PI: What happens?
> Subject:: Well, you got kids, I mean you can only pay daycare for so long and realistically I could work seven days a week, twenty-four hours a day. . .
> Spouse: You make sacrifices . . . if you're working all the time something else is going to suffer and that's either your work or your family. It's the things. The lawn doesn't get mowed. It's those simple things . . .Then you have to put in that I work over 40 hours a week and you got two kids and when you come home the last thing you want to sit down and talk about is work. That is such a big effort nowadays especially when it's I mean the business consumes so much of our time . . .

The sample size is smaller than was initially hoped due to these reasons as well as time constraints to complete the study. Because the sample is small, nonrandom and limited to a specific geographic region, the results of the study cannot be generalized to the building and construction industry as a whole. Limitations are discussed further in the conclusion of the study.

Demographic Characteristics

Participants ranged in age from their late twenties to their mid-fifties and the average age was 36 years old. The sample included twenty-one males and four females and all were white. Fourteen participants were married, two were divorced and nine were single. Four spouses who assist in business responsibilities participated in interviews. Fifteen were homeowners and the remaining ten rented their residences. Twenty-two of the participants had a high school education and four had attended college. Several participants had training through an apprenticeship or vocational program. Two participants had college degrees.

The overwhelming majority of participants were raised in working class families and a few were from middle class backgrounds. Most of the participants' parents worked blue collar type jobs while very few worked as professionals. More times than not, both parents worked outside the home. None of the participants reported both parents being unemployed.

Business Characteristics

As noted earlier, the small building and construction industry includes different trades. Many participants contended that they were a "jack of all trades" but when asked about a specialty most committed to one particular occupation in the building and construction industry. Specialty areas included excavation, flooring/carpeting, landscaping, painting, carpentry and glass and door. Several considered themselves general contractors. Table 1 summarizes the types of businesses for participants in the study.

An overwhelming majority of participants, specifically twenty-three, operated their businesses from home and assumed bookkeeping responsibilities; for the married participants, spouses were likely to take on bookkeeping tasks. Two participants ran their business out of an office. Of the two, one kept his own records and the other used his mother in the position of company bookkeeper. Few of the business owners in the study employed regular, full time employees. The two participants working out of an office and four participants working out of their home employed regular employees. The other twenty-one participants typically used irregular and/or part time workers. Table 2 summarizes the number of employees/subcontractors by the businesses represented in the sample.

Table 1: Summary of Types of Businesses in Study

Business Types	n
Flooring and Carpeting	9
General Contractor	5
Landscaping	3
Carpentry	2
Excavation	2
Door and Glass Installation	1
Heavy Machine Operator	1
Vinyl Siding Installation	1
Architecture	1

Table 2: Summary of Number of Employees for Businesses in Study

Number of Employees	n
5 or less employees	3
4 or less employees	5
3 or less employees	6
2 or less employees	11

Data Collection

Twenty-two interviews were conducted face-to-face and three by telephone. Interviews were conducted at a time and place convenient for the participant. Seventeen interviews took place in participants' homes and during evening hours. Three interviews were held at job sites while participants were working and two were conducted at local restaurants. While interviews varied in length, none lasted more than two hours. Most averaged forty-five minutes.

An interview guide was used to ensure uniform coverage of topics. Interviews opened with questions about family background, marital history, education and training, and work history. Participants were then asked questions about their business history such as what type of business they operated, how they learned aspects of their business, the length of time they had been in business, the types of customers they serviced, the types of payments they received and the number and types of persons they employed. The core of the interviews focused on specific bookkeeping and taxpaying behaviors and the motivations driving such behaviors. Interviews concluded with inquiry into regulatory compliance. The interview questions were refined as necessary throughout the research process. For example, initial inquiries into regulatory compliance centered entirely around compliance with Occupational and Safety and Health Administration (OSHA) requirements. Many participants were unfamiliar with the guidelines or stated that their work did not fall under OSHA requirements. Other regulatory requirements such as fire codes, workman's compensation, licensing and permits were, however, often discussed during interviews. Subsequently, other regulatory requirements were added during questioning. A copy of the final interview guide is provided in Appendix A.

Data Analysis

Twenty-three of the interviews were tape-recorded. Two participants requested that their interviews not be tape-recorded but they gave permission for the researcher to take notes during the interviews. Audio-taping was preferred to ensure a precise record of questions and responses. Participants who agreed to audio-taping of their interviews did so on the premise that anonymity and confidentiality be maintained. They were assured that this would be the case and all participants who were interviewed face-to-face signed an Informal Consent form to participate in the study. Those who were interviewed by phone were read the Informed Consent form and agreed verbally with its provisions. The Informed Consent Form is included in Appendix B.

Interviews were transcribed by the researcher. Keeping with the terms of anonymity and confidentiality, all names of the participants and any names said during the interview were omitted. Interviews were then analyzed using NUD*IST (Nonnumerical Unstructured Data by Indexing, Searching and Theorizing) Vivo (Nvivo), a computer program for analyzing text-based data (Richards, 1999). Nvivo allows the researcher to code, recode and store ideas, concepts, categories and themes relevant to the qualitative data being analyzed. Databases are created and can systematically be retrieved and managed. Additionally, Nvivo offers the ability to maintain information about cases by storing attributes. Information can be exported to create spreadsheets and databases. This was especially useful for tracking demographic, business and compliance characteristics and creating databases.

During data analysis, a systematic coding strategy developed. First, the study examined two areas of government regulation for small building and construction firms: taxation and regulatory rules. Categories specific to each were created. For taxation, categories included filing a tax return, reporting income, reporting employee income and claiming deductions. Categories for regulatory rules consisted of OSHA requirements, building and fire codes, workman's compensation, licensing and permits. Under each of these categories, subcategories were created as necessary. For instance, under filing a tax return, a subcategory included whether a tax statement was estimated quarterly or annually or if a return was filed every year. Next, compliance levels were constructed and subcategories were coded as appropriate. While there was considerable variation in taxpaying behaviors and levels of compliance, at a broad level it was possible to distinguish different types of behaviors and compliance levels. Last, statements pertaining to behaviors and compliance were noted, highlighted and coded as necessary. The next three sections describes the findings of analysis. The final section concludes with a discussion of the limitations and theoretical and policy implications of the study.

CHAPTER 4
TAXPAYING BEHAVIORS

Statistics from the IRS show that taxpayers who are subject to withholding report and pay in a timely manner 97% of the taxes due on their income (Internal Revenue Service, 1994). This is in contrast to a voluntary compliance rate of 78% for individuals who are not subject to withholding (Internal Revenue Service, 1994). Noble (2000) suggests this variance in compliance rates may be explained by the different roles adopted by these two groups of taxpayers. Noble (2000) distinguishes these roles as "passive" and "active" respectively.

Regular wage earners or passive taxpayers typically give little thought to taxpaying throughout the year. Taxes are considered inevitable; appropriate taxes are withheld from each paycheck and submitted to tax authorities by the employer. Regular wage earners do not have access to earnings withheld for taxes and base their personal budgets on net income. When the time comes to file an annual tax statement, employers provide a W-2 form summarizing total pay and the amount of taxes withheld for the year. Wage earners file statements after the end of the year based on information from the W-2 form and on standard allowable deductions such as the number of dependents. Unless wage earners itemize deductions beyond those allowed by the government, minimal records are required. Often times, wage earners anticipate a refund and look forward to filing their tax statement.

By contrast, small business owners are active taxpayers. They are charged with collecting and paying taxes as they earn income and reporting monies paid to employees and/or subcontractors. In order to comply with tax requirements, they must at a bare minimum have a system in place to record business income, expenses and payments to others. From these records, they are responsible for estimating and paying taxes for income on a quarterly basis. At the end of the year, they file a tax statement calculating the actual amount of tax owed for the year based on reported income and allowable itemized deductions. If taxes have been overestimated and paid quarterly, the owner is entitled to a refund. If taxes have been underestimated, the balance must be paid by the taxpaying deadline. Additionally, penalties are incurred if the owner fails to file and pay an estimate of taxes on quarterly earnings when the taxes owed exceed $1000 for the year. Penalties and interest are assessed for any taxes not paid by the annual filing deadline. Owners are also required to withhold and submit payroll taxes for employees and to report monies exceeding $600 that are paid to others performing services for the business. The W-2 form is provided to employees and the 1099 form is provided to subcontractors at the end of the year. The 1099 summarizes payments to each independent contractor or subcontractor.

The relevance of the differing roles in taxpaying between regular wage earners and owners of small businesses is found in the distribution of opportunities for tax noncompliance. Shover and Wright (2001: 96) define opportunities as "arrangements or situations that offer attractive potential for criminal reward, largely because they are accompanied by little apparent risk of detection or penalty." For wage earners, the reporting of income and withholding of taxes by employers decreases their opportunities for noncompliance. That is, the risk of detection becomes more likely because noncompliance is more "visible" to authorities by virtue of the documents and information submitted by employers (Kagan, 1989). By contrast, for small business owners, a considerable amount of income may be "invisible" to authorities because of the lack of documents and information from third parties (Kagan, 1989). In other words, detection by authorities comes only with a greater amount of effort and resources that are typically not available.

This chapter identifies five primary behaviors that the owners of small building and construction firms in this study use in response to the increased opportunities for noncompliance with taxpaying requirements: failing to file an annual tax statement; failing to report all business income; maximizing deductions; falsifying business records; and overpaying taxes. The specific behaviors are detailed separately along with the frequency of each behavior and the profiles of the businesses and owners employing each behavior. It is should be noted that the taxpaying behaviors are not fixed or mutually exclusive and participants may fall into more than one category.

Failing to File an Annual Tax Statement

Failing to file an annual tax statement was the second most common taxpaying behavior identified among the owners of small building and construction firms in the study. Five of the participants admitted never filing taxes and one ceased filing for the past two years. Three other participants reported previous periods of failing to file a tax statement. Characteristic of owners in the study not filing annual tax returns was their lack of personal responsibilities and commitments. None were married, had children, owned a home, or maintained a line of credit while not filing a tax return. Most described a lifestyle considered less than conventional by society's standards with a penchant toward "partying" and little concern for or obligation to anyone including tax authorities.

> Back in the early days when I was making good money and spending good money, you know on drugs and partying, I just didn't pay my taxes. I was just having a good time.

Along with a lack of personal responsibilities, many spoke of enjoying freedom from authority and a structured work situation.

> I couldn't work for no one else. After awhile, I got so used to it, everything I wanted to do [I did] the way I wanted.
>
> I'll tell you what. One time, actually I went to work for [company name] and I worked there for about two weeks on the second shift and I went in one night and that's when Tennessee and Vanderbilt were the two best basketball teams in the country and they were playing on TV that night and I wanted to watch that game. And the more I thought about it, the more I wanted to watch it. So I just went over there and clocked out and the foreman told me, "What's the matter?" And I told him, "I am going home to watch that ballgame." He said, "Well, you can't do that. You do something like that and I'll have to fire you." I said, "No you don't. I quit." I went to the bar and watched the ballgame.

Typically, the dislike for structure transferred into their business style. Participants failing to file tax statements kept poorly organized business records, if any at all. For instance, during one interview on a job site, a participant wanted to show me the invoice book used to keep records and had difficulty locating its whereabouts. Upon finally locating the book, the participant found in it a previously misplaced $300 check and stated, "I guess not many people lose checks like this."

Additionally, these participants were unable and not interested in expanding their business. Usually they were restricted to accepting residential jobs that paid cash or personal checks and work contracts in semi-rural to rural areas where work tends to be less formal. As one participant who had formerly not filed a tax statement conveyed:

> You know there is a downside though. I mean you can only go so far if you're going to have a reputation other than you do good work. But if you're working strictly cash these days, a lot of people aren't going to work you because they want to claim what they're having done.

While a substantial proportion of participants that had not filed annual tax statements spoke of working mainly for cash income, they also, at times, accepted checks from companies for contract and subcontract jobs and received 1099 forms from the companies. All denied detection by tax authorities even though the pay was documented and reported to the government. Several participants discussed that they had at some point a fear of authorities catching up with them but resolving their trepidation as time went on without consequence.

> PI: When you talk about the fear of consequence, is it something that hangs over you?
> SUBJECT: It did the first three years that I got clean [from drug addiction].
> PI: How have you gone about resolving that fear?
> SUBJECT: Well, it just didn't bother me that much. You know one time I moved to Georgia for about three months and worked and got a little 1099 from somebody for about six grand and they [tax authorities] came knocking on [former employer's] door looking for me in Georgia. But not here. All these years. And I was gone and he told them I had moved to Montana. They've never bothered me.
> PI: But other contractors send in 1099's too?
> SUBJECT: Yeah, they sent one for about $25,000 on me one year. Never heard a word from them [IRS]. They don't do a very good job.

Several alluded that the "trick" was to remain anonymous with authorities by not filing an annual tax return. One participant reported being told the same by an IRS worker.

> I had one cool IRS worker who told me the same thing they did

> [describing others who remained anonymous with tax authorities]. If you just ignore them and you don't file anymore and you lose touch with them then they just lose track of you. It seems the ones who do file and try to work it out are the ones who have constant problems with them [the IRS].

Participants who became compliant after a period of noncompliance found this last statement to be true.

> I had gotten down about twenty-five thousand dollars [in back taxes]. When I finally got straightened back up and started doing the right thing, living better, I just went in and set up payments with them and I paid payments on it for three or four years . . . They did put some liens on things. Two years ago, I went and borrowed twenty thousand dollars and just paid it off . . . It was the liens and it was hard just trying to buy even menial things. I mean it is on your record. You can't have anything. I tell you gotta have credit and good credit to live alright . . . I mean they were adding interest and penalties. They didn't care. It took me two or three years to get straightened out but I paid my bills.

> They write you a letter telling you they are going to start looking into your assets. I mean, "We are going to start checking into your assets, boy!" Basically, that's what it says . . . It's like I had an $8000 note from '93 and it's got off after about six years. It was about $12,000. That's a pretty good lick.

Ironically, though, while the owners who had never filed a tax statement were not receiving official sanctions, their personal and business lifestyles were not without consequence. They had little to show in the way of fruits of their labor as the years progressed. As the oldest noncompliant participant reflected:

> I worked all these years and never saved a penny but I had a good time spending it. I had such a good time, that's why I'm now waiting on a liver transplant.

<u>**Failing to Report All Business Income**</u>

Failing to report business income on the tax statement was the most common taxpaying behavior among owners of small building and construction firms in the study.

Fourteen of the nineteen owners who filed tax returns admitted that they had to some degree not reported income to tax authorities. The income varied in the types and amounts that went unreported and was concealed through side jobs, side businesses and cash payments.

Side Jobs

Side jobs refer to the work that owners take on outside their typical business schedule. Three of the owners admitted taking side jobs for extra money. They considered money earned from side jobs apart from regular business income.

> Subject: When I do a little side job then people just usually give me money.
> PI: You said, "A side job." What do you consider a side job?
> Subject: Well, it's when I don't do it for a company but for an individual who calls me and wants me to do something. If it's somebody you know. I mean if they write me a personal check and don't ask for no social security number then it's cash on the side.

For one owner, side jobs were used to barter for services from other businesses for personal use. "Most of the time it is for trades and stuff. Like, I will trade with a guy for some insulation work or things like that."

Typically, income from side jobs was viewed as spending money to be used for enjoyment and recreation.

> If you have cash in your pocket then you are going to spend it not necessarily for equipment or maintenance or work costs . . . it's just for extracurricular activities. You might want to go buy something you don't normally have the money for, you know.

Side jobs were infrequent for most of the owners in the study because many worked extended hours including nights and weekends just to maintain their businesses.

Side Businesses

Side businesses differ from side jobs. The owners working side jobs did so as an extension of their business. The owners of side businesses operated their businesses in addition to being employed in the conventional economy. They reported high compliance when paying tax on income from their conventional jobs but admitted not reporting the income earned from their side businesses.

Three participants in the study operated side businesses. They shared several characteristics. They were not married, did not have children, and did not own their home. It should be noted, however, that while they were single without families, they alluded to many others operating side businesses who were married with families. One owner worked at a professional job and conducted his side business at night and on weekends. Two of the owners worked as union laborers and operated their businesses primarily when laid off and collecting unemployment benefits.

For the owner who worked a full time professional job, the side business was considered an entrepreneurial effort to be rewarded and capitalized upon.

> Employment's different than doing some work. If I was in this full time, I would have to think about that [paying taxes] . . . doing the side work I never see myself as part of the whole system . . . with the side stuff, I say that money is mine.

For the other two owners, the side businesses were viewed as a lucrative continuation of their union job.

> [The company] puts the guys on unemployment for the wintertime. They lay them off. We're a union company. So, I don't know if you've heard this before, but once you get so many hours in for the year with the union then your benefits are paid for the year. So if you work a thousand hours

> then your personal benefits are paid for one year. So if you only work six months, you're still covered for the whole year. So around December or January, they lay everyone off and if you have a side business then you can get cash while you collect unemployment. And that's all cash money and that's the same money you make normally before the taxes come out. So you gotta love that.

The owners that operated side businesses appeared the most calculating of all participants interviewed. They described well thought out schemes to avoid detection and to ensure earnings were not taxed. For example:

> Most [jobs] are at the lower end, like residential. The commercial is the one you have concern with. I talk to the big jobs or the commercial like, "How is that going to look on your books." I make sure to ask about that. I say, "How do you guys put that on your books." I usually know the person so I ask them to put it under [name] Enterprises in their book and then make the check out to me personally. That way if they [tax authorities] look at the books, I am nowhere to be found. It is just another business gone. Now if they looked at the checks then that's another thing. But they usually look at the books and that's not going to be of concern. If it came down to it and they pulled checks, then something might happen . . . I hold onto the paperwork for a couple of years in case it ever came back up. And I overcharged the materials and kept the receipts but I returned a lot of the stuff and I had paid cash to the workers I had so I could also claim more on it. They couldn't track that way how much I really paid out. If it came down to it, I could show them that I really didn't really make that much off of it.

While owners of side businesses constituted a small proportion of the sample, participants suggested many construction workers operate these types of businesses. As one of these participants stated, "It's like a little network out there."

Cash Payments

Eleven owners in the study admitted that they had not stated cash payments from regular business transactions on their income tax returns. Personal characteristics varied among the eleven owners; they did not have specific attributes in common. For instance, they were married and divorced, homeowners and renters, and some had children. Business characteristics also differed such as by trade and the number of employees.

While all admitted they had not reported cash payments on their tax statement, the significant majority denied doing so regularly or for large amounts of income. The largest amounts of cash not reported annually were estimated at 20% and 40% of total earnings respectively by two owners. Other owners stated that the amounts they failed to claim was a much smaller percentage of their earnings. Several respondents reported limiting the amount of cash that they did not report.

> I tried to keep as proper as can be on [cash jobs] most of the time. I mean I turn in usually anything over $100. If it was under that or tips, I usually don't keep up with it. You know the piddly things.

Many stated that cash jobs often were not available for the level of business they were interested in conducting.

> PI: Let me ask you, how do people usually pay you, checks or cash?
> Subject: It's with checks. The ones you are going to make any money on nine times out of ten . . . are going to pay you checks.

> We are getting more jobs where people are paying us in checks. Like for the past nine years, our jobs were usually with people that had money and would just pay in cash. Now we are getting some advertising rather than just word of mouth referrals and those kind of folks have more of a tendency to want to pay with a check so they can claim it back. You know I've always found it unusual that people would pay us in cash and not have any records of us being on the job.

> Normally so I do take some cash jobs but I rarely claim them 'cause I don't take that many. They're not traceable. It's usually the little jobs like a $200 or $300 cash job. Anything above that is usually in check anyway.

Many admitted that cash transactions were attractive due to invisibility to tax authorities. One owner summarized the point well:

> They can't prove nothing. I don't have no record of it. The people that give it to me have no record of it. They got to prove that I done [the job] and had [the cash] and spent it. It's hard to explain without paper to back it up.

Despite the lucrativeness of cash payments, it appeared more important for these owners to report the significant majority of their income for credit purposes and to avoid detection.

> Subject: It catches up with you in the future especially if you decide, "Well, I think I will get married and have some kids."
> Spouse: Especially when you want to get a mortgage. If you don't claim your income, it kind of catches up with you. You have to show your tax returns to get anything.

> I figure the government can only come after me on what they can prove. That would be the only way is by what I show through the bank and the bills I spend like, you know, car payment, house payment, things like that. That's real obvious as to how much money I made.

Maximizing Deductions

Maximizing deductions was another common taxpaying behavior found among participants in the study. The behavior of maximizing deductions refers to claiming as many business and personal expenses as possible in order to minimize the tax burden. By maximizing deductions, business owners often push the limits of legitimacy. As one participant stated, "I mean if I could get away with deducting the dog I would."

Eight of the participants in the study described maximizing deductions as a taxpaying behavior. While participants who do not file a tax statement were characterized by a lack of responsibility in their lifestyle and business style, the opposite was found for participants maximizing deductions. Six were married and two had been married and all owned their own home. Six of the eight had dependent children. As a group in comparison with other participants in the study, they tended to work more regular hours, to accept more jobs for formal customers and businesses, maintain organized business records, and use accountants to file their tax statements.

Although similar in many characteristics, I identified two distinct groups of owners that maximize deductions: professional and non-professional. Professional owners of small building and construction firms had a place of business separate from their home, a bookkeeper or elaborate bookkeeping system, and stable, full-time employees. Additionally, they had their businesses set up as a corporations and more aggressively sought tax relief through deductions. Non-professional owners operated their business from their home, kept their own books or kept them with the assistance of a spouse when married, did not typically keep regular/full-time employees, and filed their business taxes as a sole proprietorship or as self-employed.

Professional Owners: Maximizing Deductions

Two participants were identified as professional business owners maximizing deductions. Both of these participants operated their businesses from an office with fulltime/regular employees who carried out the majority of labor tasks. The professional owners typically worked 40 hour work weeks and focused on running the business. Both reported investing the time and energy to become knowledgeable in ways to ensure business and financial success.

> . . . learning how to do it the first go around, I made terrible mistakes. I mean it was trial and error. I mean in school, they never taught us anything about business. There were no business courses. I learned more in high school general business than anything in college. I mean the first go around, I was about twenty-five years old and really had no idea. [That]

> first year when I took everything in for the tax return and they said you made this much money and you have to send this much money to the IRS, I couldn't believe it. I didn't know anything. I mean money for taxes, money for social security. I mean finding out things along that line. This go around here, I shopped. I have a program that takes care of everything all of the time. . . It used to be trial and error and now I know what I was going into and prepared for it. So I stay up with everything everyday. . . I have done quite a bit of research, done a number of things. I think a lot of people get scared of learning to do new things or don't know how to begin. I am always looking into different ways to do things, to make my business operate better.

> I was an idiot in the beginning being a sole proprietorship and not a corporation and the way I paid taxes at first. I mean I paid like $22,000 a year in taxes and it was unbelievable . . . I did that for five or six years. . . Then I met a guy [accountant] at a concert . . . and he said, "You are a fucking fool. You got to get incorporated. You are paying a fortune." And I had been paying all that in taxes and let him do my taxes the next year and I got $5000 back. I said, ". . . this the greatest thing I have ever seen . . ." He carried me as an employee and he filed my taxes separate from the corporation . . . I probably have saved hundreds of thousands for myself in having the business as a corporation. Like five or six years of self-employment taxes at twenty to thirty-eight thousand a year. We are talking major that I have saved. . . It takes $100 to become a corporation. I thought it was this long drawn out $5000 attorney deal. . . I really felt like it was a big drawn out deal and so hard to do like it was going to be expensive and so hard to do and all this worries about it. I didn't know anything about it.

Both of these owners had incorporated their business. By incorporating their businesses, they shielded themselves from personal liabilities for the businesses' losses and risks and capitalized on tax advantages. Corporations are taxed as an entity separate from the individuals comprising them. The income of the business owner was paid by the corporation and subject only to personal income tax.

> I don't have to pay taxes for the business because I pay myself as an employee and then just get a W-2 and file regularly . . . We have [business income] where all of it accumulates and then at the end of the year we, the holders, have a total sum that we can take or roll over to the next year.

> [The accountant] started carrying me as an employee and he filed my taxes separate from the corporation . . . and the corporation was always broke at tax time. I took corporate funds at the end and it was perfectly legal and paid payroll taxes to myself on it you know and then I'd let the company pay that . . I let the company pay my personal taxes too. I just have them write another check and take it off for payroll the next year.

Both business owners reported comprehensive bookkeeping methods for tax purposes; they recorded all business income, estimated and paid taxes in a timely manner, reported all employee income and paid payroll taxes. Both used the services of an accountant to advise them and prepare tax statements.

> I have someone to do that for me. We take everything to her and she takes care of filing everything. She seems to be able to show us the best way to file things. Everything is legitimate but she just knows how to do it the best for us. I mean there are things like even what type of car you should drive to get the best break. We do everything by the books though.

This owner expressed resolution and confidence in the interview that he and the accountant maximized deductions aggressively but did so legitimately. The other owner was also forthcoming in reporting the importance of having an accountant that would aggressively minimize tax costs. However, this owner was more tentative in contending all behaviors were above board even though he claimed high tax compliance. Excerpts from the interview describing experiences with accountants illustrate the point.

> My dumb ass paid $18,000 last year from [accountant's name] because the crazy woman put down everything I gave her. Whatever I gave her is what she put down on paper and I wanted to make sure my mom [who is the bookkeeper for the business] felt comfortable with the person we go to and she never felt comfortable with [the former accountant]. She agrees he was a good thing but she never liked his tactics . . . And so I got away from him and went to [above-mentioned accountant] and she did the same thing to us for a couple of years and I said I have got to change this. There is no reason in the world why we should be paying taxes. Sure enough I went to a new accountant and I told him I do not want to pay any taxes. I

said I don't want to get any back, I just don't want to pay anything. And he said, "We'll see what we can do. . ." She wasn't utilizing the whole tax system. . . She wasn't counseling us and coming in and saying you can do this different and you've done too much in this area. Like, "Why don't you take a bonus for the next couple of months and let this balance out." She didn't watch my books, she just added it up. Good accounting is crucial. It makes so much of a difference.

I have cheated a lot when I was with [first accountant]. Well, not really cheating but his theory was take it and if there is any argument we can fight it. So anything we were able to take even that would remotely relate to us we would take it. He was smart enough even though a little unconventional at times but superintelligent and he always had a plan and took notes on everything we did so we could remember what was going on . . . He goes to a lot of tax and IRS seminars. He is up that way and he goes to DC and the IRS teaches everybody how to win everytime and he is always there. He knows the IRS inside and out and he makes it his duty to learn . . . He is just really into beating the IRS. Well, not really beating them but just playing their game the way they tell him to play. We keep it totally legal and keep explanations of why we did the way we do. I mean it's the way they say it can be done and we do it.

Non-Professional Business Owners: Maximizing Deductions

Six participants were identified as non-professional owners maximizing deductions. Their taxpaying behaviors differed in several ways from professional owners maximizing deductions. Non-professional owners filed their tax statements as sole proprietors or as self-employed. As sole proprietors, all income from their businesses were filed on their personal tax statements in the year the income was earned and was subject to both income and self-employment taxes. According to the participants, their taxes constituted 25%-30% of their income. While all admitted not reporting some income, they claimed that they reported the majority of the earnings and used deductions to reduce their tax burden. As one owner summarized, "It just makes more business sense to deposit [income] in the bank and pay your bills and take your deductions."

Also unlike their professional counterparts, the non-professional owners were limited in the time they could devote to developing business management and taxpaying skills. They spent most of their time laboring on jobsites; business tasks often took a backseat to the jobs at hand. Time constraints played a significant role in the way the non-professional business owners went about utilizing the tax system to their benefit. For instance, only one of the six participants completed payroll tasks and issued W-2 forms. The other participants paid employees as independent subcontractors and submitted 1099 forms and they employed workers irregularly. These behaviors allowed the owners to minimize paperwork but deduct worker's earnings. One owner and spouse described how they go about this behavior.

> Husband: I start them [employees] out at 6 [dollars] an hour and then if they stay around I'd push them up to about 9 [dollars an hour] eventually and then they were responsible for claiming it because it helps me out . . . [to spouse] What is that she [accountant] calls it when you pay so many people up to so much money and we don't have to send nothing on them?
> Wife: Contract labor.
> PI: How much can you claim on them?
> Wife: You can go up to $900 per person for six people . . . We can claim them without having to do the paperwork on them. That helps a lot.

Another example of owners taking time constraints into account included the decision to pay penalties rather than estimate taxes quarterly. Four of the six owners failed to estimate their taxes quarterly. They reasoned that the penalty was minimal in comparison with the time saved or that the penalty was offset by deductions.

> Yeah, I just file at the end of the year and there is a penalty involved but it is not that big of deal.

> We should do it quarterly but we do it once a year. It just is easier to do it once a year.

PI: Do you pay quarterly or do you pay the penalty for once a year?
Spouse: Honestly, we've never really had to pay the penalty. Because the child care thing . . . Because we file jointly on our taxes, what I pay in covers a portion of his taxes. With all the deductions, you know once you claim all the deductions.

The last quote represents a common impression by most of these participants. That is, if they do not have to send money at the end of the year regardless of what has already been paid in taxes or penalties, such as in the case of taxes being withheld from the spouse's payroll, then they are not paying taxes. Thus, reducing the bottom line on their tax statements through deductions became an overreaching goal.

I keep every receipt and try to get every deduction I can . . . I go to dinner and talk about business and keep the receipt. Every chance, I try to write off.

You would be surprised. We keep every receipt you can imagine.. . . even my cable because I got to watch the weather for my business [landscaping].

In finding ways to maximize deductions, the services of a tax accountant or preparer recurred as a primary theme. Although the non-professional owners only visited the "tax person" on a yearly basis, securing a "good accountant" was no less important than for the professional owner.

Subject: A good accountant makes a big difference.
PI: So a good accountant makes a difference you think?
Subject: Well, it does . . . I mean he helps me take care of everything legal and like that but also to take what [deductions] I can.

Spouse: The accountant knows how to do it all.
Subject: She is creative.
Spouse: It is her specialty and she knows the ins and outs.

> Well we changed [accountants] . . . [previous accountant] was getting old and not keeping up and [new accountant] seems to be up with things. I mean the tax laws are always changing. [New accountant] seems to be more thorough and asks more questions and seems to look for what we could take and stuff. [New accountant] looks for the deductions. You gotta have someone who hunts for things.

Searching for deductions was one of the most common characteristics owners were looking for in a qualified accountant. Another characteristic was alerting owners to "flags."

> [Accountant] knows what we need to watch for. If she sees we have been doing something, she tells us we need to stop doing that . . . Well, like she tells us, "better not put that down because the IRS sees flags when things change."

> [Accountant] tells me when something red flags and I have to watch out because [accountant] knows I'm not perfect and not always totally accurate . . . So we just estimate and make it work out close to the last year.

It is interesting to note that while this last statement points to impropriety, the owner considered himself to be a rather compliant taxpayer as did most of the owners maximizing deductions. For the owners in the study, maximizing deductions was perceived a good business behavior regardless of pushing the limits.

> I mean the system will work for you. You buy equipment, you buy a truck, your socks. You get to deduct everything from the socks down on your feet. I do anyway. I mean it works for you if you work it.

Falsifying Business Records

Falsifying business records was a lesser common taxpaying behavior among owners in the study. Falsifying records was typically used to compensate for disorganization in bookkeeping or to minimize owed taxes. Five participants in the study described falsifying business records as a primary behavior when preparing their tax statement.

In examining characteristics of these owners, most appeared to be attempting to make ends meet in their business and personal lives. Four of the participants were married and one was divorced. Four had children under the age of ten years and one had no children. Three owned modest homes while the other two rented their places of residence. Three spouses held part-time jobs and one also attended college part-time. The spouses of the married owners assisted in the business to varying degrees and managed business tasks. The business was often a source of stress in family life.

> I mean the business consumes so much of our time . . . you know it's like your marriage almost revolves around the business and you just cannot do that when you're raising kids. And it's not good for us.
>
> My computer's bogged down because I can hardly use it now. It's so overloaded right now. And that desk, there's not enough room for the business and for our family and everything else. It's that growing thing. It's getting so hard because [the kids], when he finally comes home, they want his attention. We're sitting here trying to go over what bills have been paid, what he's written checks for today to pay out for materials, and it's like, "What's that again," because everyone's talking and everyone's tired. I mean it's like the other night and we were working at midnight on a big bill that we had to send to a guy that morning."
>
> Spouse: We've been able to squeak by. When it gets bad, I call my parents.
> Owner: I mean this not a lifestyle for everybody. This is a very up and down type of thing. I mean we are able to get ourselves through. I mean when one of us is having a tough time then the other has to pick up the slack and vice versa.
> Spouse: I am considering going back to work because of the cash flow problems. Just for the security. And so we can get health insurance which we don't have. To me I find it very stressful.

References to financial difficulties were typical in interviews with participants who were falsifying records.

Spouse: We were going to file bankruptcy in December. We had gone to Consumer Credit Counseling . . . and we just couldn't do it so we looked at it and we looked and what it entailed and he [subject] said n.
Subject: You know I just said no because I wasn't going to do it to my wife and kids . . . being by myself, I could get out of it and say the hell with it and start back over tomorrow. . . but it could destroy a marriage and everything. It could destroy her.

We're making it stretch right now. You can get in trouble easy. Once you start to get behind in your bills. Like we can easily pay $250 per month in late fees alone if it's a bad month . . . If I can stay on top, I pay a little extra on things but then when I have a bad time then it doesn't help to keep ahead and you slide right back where you were.

Yeah, it takes a lot of fenagalling when you have projects. Got a lot of income for materials and labor and they're late with partial or full payment [for the job] then it makes it very tough to keep up. You have to make up for the slack.

Additionally, the business was the primary source of income for the households and many times separating money for the household and money for the business was difficult.

Subject: If I went and did a job and a guy writes me a check for $2000, well, I'm going to go down to the bank and cash that $2000 check and I'm going to put it wherever. Well, I need $500 to pay this insurance. Well, it don't need to be like that. And what she's been saying is it don't need to be like that. I don't like it. If I need money, if I need $100 to get fuel, I just get $100 instead of taking money out for fuel. Like taking money for us.
Spouse: He don't take a payday. We work off what we're making. Everything goes in the pile. Whatever. We take everything out of the pile, the bills, the groceries.

Descriptions of their taxpaying behaviors often paralleled their descriptions of their financial problems and record keeping. Terminology such as "fenagling," "knocking out the bottom line" and "thinking creatively" were recurrent as participants discussed dealing with tax records and finances. Following are some examples of the behaviors that these owners and their spouses used to make ends meet in their taxpaying.

> Spouse: So when it comes to filing our taxes I try everything I can to knock out our bottom line--to not have to pay them so much at the end of the year.
> PI: So how do you knock it out?
> Spouse: Well, I mean, a lot of it is legitimate. Where we pay and I shouldn't do this but . . . where he has paid people who help him on jobs or you know when he split the money with another contractor, I don't ever put that in as independent contractors or subcontractors. I run it under materials. It doesn't mess the other person up and it saves me having to work having to file all these 1099's. I don't have time to do it. So you try to think creatively. Say we go buy tires. You know we are going to try to make sure that's on something we are using for work.
>
> Lots of times I try to get the customers to write multiple checks [to the owner and employees]. . . most of our clients know we are trying to get the best for them and not cheat them then they work with us. Like if they don't mind then we try to get them to write checks out to all of us that way.
>
> Spouse: [Relative] is our accountant and I just print out everything under the sun and let him have it. He knows how to operate without throwing up the red flags. He tells me where I can put things that will fly and I just defer things to wherever he thinks is best.
> PI: I heard someone else call it "creative paperwork." Have ya'll heard that term?
> Subject: We made it up.
> Spouse: No. We do that but I have not heard it called that.
>
> Subject: We will dump a lot of cash and expenses into inventory, maintenance.
> Spouse: Like [accountant] will play with the numbers . . . I don't feel good about not being honest but it's just unfortunately part of it. I just don't know otherwise how we can do it.
>
> PI: What do you do when [accountant] says there are red flags?
> Subject: We just change it. We shift it around and just change it, you know.

Throughout the interviews with owners and spouses who were falsifying records, many were cognizant that their behaviors were illegitimate and most discussed having plans to change their situation.

> Subject: We're on the verge of setting up an office. We're in the process. I've got a trailer and I'm fixing to build a garage for my equipment. I'm going to put it [the office] right beside the shop and she's going to go daily at least a couple of hours of the morning or the night or whatever . . . The business is picking up. I mean if it's going to be run right.
> Spouse: It's time. It's no longer a hobby. It's become a job. And that's how you have to start out.
>
> So we need to shoot for incorporating . . . because if we go down it's not just the business going down which is really what is happening it would be everything. And that's not a lot of fun to think about.
>
> I am trying to change jobs. I want completely out of the building business. Pretty much I want to get a regular job. You know, working steady forty to sixty hours a week . . . it's not nearly as much independence if I do that though . . . but then I won't have to worry about getting the calls and paying the bills.

Overpaying Taxes

Overpaying was the least common taxpaying behavior found among participants in the study. Overpaying resulted from paying more tax than owed by reporting all income and underclaiming deductions. Three participants in the study described overpaying as their primary taxpaying behavior.

In common, the three owners who overpaid taxes were married and had dependent children in the home. Two of them owned their home and one rented. Spouses of all three worked in the conventional economy; they were employed full time and received regular paychecks and benefits from their employers. These owners espoused traditional lifestyles for the most part by participating in school and recreational activities with their children and for two attending church weekly. One owner discussed recovering from alcoholism and being actively involved in a twelve step program. All three owners reported a strong work ethic and satisfaction in their work.

Two of the participants had been employed by large companies prior to entering business for themselves. They described their business successfully developing from a side business while laid off from previous employment.

> When I got laid off the last time at [company], just gosh, probably word of mouth got around church and then I ran an add in the paper, stuff like that and it happened. Up until a year or so ago, I never turned a job down. Just whatever somebody wanted done, if I couldn't do it, I'd find a way to get it done.

> I was laid off for about six months from [company]. I just couldn't sit around so I started doing jobs for people and word got around . . . I began making decent money . . . I liked being able to get a job done right . . . When they called me back to work, we sat down and decided I could make a go of this and I have.

The other participant learned the trade by working for another small business owner and, upon discovering the profits that could be earned, branched out independently.

> Well, I tell you, when I worked with [name], [they] showed me one time how much [they] were making and I was working for them at seven dollars an hour. Well, I tell you what, I just really started paying attention and I thought, "You know, I could do this on my own." It was true too. I mean I have done real good for us doing this.

While all three owners spoke with pride about the financial rewards of their work, it was just that--the rewards of their work. That is, none of the three owners displayed an interest in gaining financial success through means other than their labor. Business tasks were kept to a minimum. For example, all three described simply keeping records through their checkbook. One owner described the bookkeeping process.

PI: How do you keep your books?

> Subject: Just do what has to be done. Whatever. You mean bookkeeping as in?
> PI: Like people pay you and then you have to record it and keep up with it and your expenses and all that.
> Subject: I just go through my checking account. Whatever people pay me goes in my checking account and whatever I pay out comes out of my checking account.
> PI: Do you keep a separate checking account or do you use your personal checking account?
> Subject: Keep it in the same one. I used to have two checking accounts back when I was with [company]. [Wife] had one and I had one. It just gets to be a hassle to keep up with tow and I would have a separate one for business but one is always lost. So you need to write a check and, hey, you got two checkbooks and one's lost and you just use the one you found. So it's just easier to have one . . .
> PI: How do you keep up with employee records? How do you pay people that work for you?
> Subject: Out of my personal checking account. I just write them a check. I just try to keep everything as simple as I can because it can get too complicated. In my checking account, I can just go down through there and you know exactly what you made and got.

All three owners maintained that they deposited all income including cash in their checking accounts and reported it on their tax statement. The same was not always true for reporting deductions. They typically described keeping poor records of deductions and estimating deductions usually to the benefit of the government.

> I just estimate the best I can. I mean I probably cheat myself more than I cheat them. I mean there are a lot of deductions I know I'm not giving myself that I'm probably eligible for. Like a business portion of my home. You know I have a room upstairs with a computer in it for the business. I just get way behind . . . When you come in at night, you have the choice to do your bookwork or do work around the house or spend time with the family. You put the bookwork off . . . I mean it works okay.

None of the three owners were currently using an accountant to prepare their tax statement. They had some previous experience in using an accountant but were not interested in advice on minimizing their tax burden or in paying someone to simply fill out the forms.

> I went to a tax lady once that someone told me about. I had everything listed from the checkbook. She just wanted to complicate it and me to do a bunch of stuff I wasn't wanting to keep up with. I just wanted the papers filled out and I can do that myself for nothing.
>
> Sometimes I took it to an accountant. Mostly, I took it to one and they charged me. She said, "Oh, it makes it so easy when you have everything listed here in order on a sheet of paper." All she had to do was transpose off my sheet onto hers. It took her about fifteen minutes. She said, "It just makes it so easy with everything listed here. And that will be $280 for fifteen minutes." I thought, "Well, wait just a minute. Something is wrong with this scenario." So the next year, I just got my form out and I transferred it to over where she had them.

Like the owners who believed they were not paying taxes if they deducted enough expenses and did not have to write a check at the end of the year, owners overpaying taxes reported "not having to pay that much at the end of the year because their spouses paid in." When questioned about the illusion presented, the owners expressed content with their tax burden regardless of paying more tax than owed. A statement by one of the participants summed up the general attitude of the three: "I don't really mind. If nobody paid taxes, where would we be."

CHAPTER 5
MOTIVATIONAL DRIVERS

One of the most obvious conclusions drawn from the review of the tax compliance literature is that we know little about the motivations driving taxpaying behaviors. As noted previously, tax compliance research has centered almost exclusively around economic benefit and potential loss through punishment as the primary motivation for noncompliance. While social scientists have more recently begun to explore other variables, an understanding of motivations other than self-interest remains limited. What is clear, however, is that one motivation does not stand alone among the others and that the motivations underlying taxpaying are complex and dynamic dimensions of human behavior.

The second objective of this study was to explore the motivations driving the taxpaying behaviors of the participating owners of small building and construction firms. In order to achieve the objective, participants were asked specifically about their motivations for compliant and noncompliant behaviors. Many times, motivations became apparent through discussions of taxpaying behaviors. Five primary motivational drivers were identified in the study: fearing legal consequences; developing/maintaining social capital; obtaining business and taxpaying skills; perceiving the tax system as fair or unfair; and compensating for long hours and a lack of benefits.

Fearing Legal Consequences

The fear of legal consequences operated in several ways to effect compliance and noncompliance among owners of small building and construction firms in the study. It was reported by all participants engaged in the tax system as a primary motivation for filing an annual tax statement and for reporting the majority of income on the tax statement.

> PI: What motivates you to pay taxes?
> Subject: Afraid not to.
> PI: What makes you afraid?
> Subject: I don't know. I just do it. I mean, what difference does it make whether you agree with it or you don't agree with it. You gotta do it whether you want to or not.

PI: What is the main motivation or thing that motivates you to claim money for taxes?

> Subject: The fear of getting in trouble. The fines. Having to pay them unexpected fees and fines. Them going back and coming with money you might owe them.

While none of the participants referred to the possibility of prosecution or imprisonment as a potential consequence they feared, many talked about their fears of tax authorities assessing penalties, liens and seizure of assets if noncompliance was detected.

> The government can come in and take what they want and they pretty much audit you and I don't want to be stuck with a bill that's you know like them saying, "You cheated us for fifty thousand dollars and we want it now." I don't like to owe nobody nothing.

> They can threaten to garnish your money or seize your property. I mean I have heard of people they have that shit happen to them . . . I mean they'll take your house and stuff and garnish your money and hit your bank accounts . . . They get you in and they're the government and you can't do anything about it. I mean you don't have any recourse with them.

> The government can come in and take what they want and they pretty much audit you and I don't want to be stuck with a bill that's, you know, like them saying, "You cheated us for fifty thousand dollars and we want it now." I don't like owing nobody nothing.

While the threat of formal consequences steered these participants toward compliance with filing a tax statement and claiming income, this fear also motivated many, especially those who had experienced sanctions, to seek out ways to minimize their tax burden. Nine owners had at some time experienced sanctions from tax authorities in the forms of penalties, interest and liens. Many of these owners considered themselves fundamentally compliant and believed they were penalized for what they considered errors and/or minor improprieties. The imposition of sanctions often served to embitter them toward seeking personal remedy by maximizing deductions.

> I'm not real crazy about Uncle Sam. I mean he can kiss my ass. But because of the amount of money we have had to pay, we had to borrow fifty thousand dollars because we got so behind on our taxes so I'm not real crazy about the whole tax thing. So every chance I can I try to get a write-off. I thinks it's so bad . . . all those penalties and interest and we had to pay a lot of money.

One participant disengaged from the tax system altogether due to mounting penalties and interest after years of trying to comply.

> The penalty . . . and the interest is figured in automatically and the interest keeps building. The way they have it set up you just get in deep 'til you can't get out . . .They set you up on this payment schedule and you can pay it just like you do your other bills but then it just gets bigger and bigger with the interest and you never can get caught up. They just let you get screwed and they don't give a shit . . . I just gave up on them [stopped filing a tax statement]. I don't have anything for them to take really right now . . . but I think they have lost track right now.

Similarly, for participants who failed to file an annual tax statement, a fear of consequences often kept them disengaged from the tax system.

> PI: What is the main reason you never paid [taxes]?
> Subject: Well, you know, after I got out of the service in '68, I pretty well spent several years where all I did was party. And then you know and I kinda slowed down a little bit and thought, "Well, I better file and pay these taxes but then no if I do that then they'll catch me for these past

years." So I just never did.

> PI: Have you given any thought to eventually beginning to pay your taxes?
> Subject: Yeah, sometimes I have but every time I think about it I think about how I'm going to explain all this time that I've not paid anything and what they'll do. So I just keep rolling along the way it is.

Others who had not filed a tax statement reported that they did not have a fear of consequences.

> I really don't worry about it. I mean I don't think . . . Hell, they won't put you in jail. They'll set up payments for you if you volunteer to pay. You'll just be. It's just not that scary or hard. My dad's been through it. They put him up for fifteen thousand dollars and he set up payments and sent them a couple of thousand here and there. You know set up payments. I mean they want their money. They don't want to spend money to have lawyers and go to court.

Developing/Maintaining Social and Business Capital

In the past decade, one of the most important contributions to criminological theory and research has been the introduction of Sampson and Laub's (1993) age-graded theory of crime desistance. Their research suggests that building "social capital" reduces the likelihood of continued deviance by individuals. The term social capital was introduced by Coleman (1988) and refers to the development of positive relationships with individuals and institutions that are life-enhancing such as marriage and stable employment. According to Sampson and Laub (1993), building social capital supports conventional behavior in the same way that building financial capital improves the chance for personal success.

Developing and maintaining social capital has not been examined as a factor in tax compliance research. Demographic characteristics and interviews from the current study, however, suggest that developing and maintaining social capital played an important role in driving tax compliance among the majority of the participants. Demographic characteristics varied between the most and least compliant participants in the study. Participants indicating higher levels of compliance with taxpaying tended to lead traditional lifestyles and operate more established and organized businesses. They were typically married or had been married, had children and owned their home. Their businesses allowed them a satisfaction that they were not willing to risk with tax troubles.

> We usually really make about $50,000 a year. I mean that is not too bad. We have a good home and do okay. I mean, we have things we never would have dreamed of having when we were younger.
>
> I want to make money to put my daughter through a private school and give her the best. That is my main concern. I just want a decent life. I am not greedy. If I can be fed, take care of my daughter, have good friends and be happy then I am a blessed man.

Alternatively, owners who failed to file a tax statement tended to be single without children, lacked home ownership and a line of credit and led less than conventional lifestyles. Additionally, their businesses appeared unorganized and poorly structured. The three participants who began filing tax statements and became increasingly tax compliant after years of complete tax noncompliance described developing a more conventional lifestyle as significant in their transition. For one owner, getting married and establishing a home and family motivated compliance.

> Subject: When I met my wife, I wasn't doing, let me take that back, I really didn't have to do it [filing a tax statement]. I was single. I didn't make an effort to do it, you know. I think that happens to a lot of single people . . .The first year, I had a problem with it [coming into compliance].
> Spouse: Yeah, you showed you earned sixteen hundred dollars. I said, "Like excuse me. I don't think so. I know you earned more money than

that."
Subject: Responsibility makes it. Growing up and responsibility. Put it that way.
Spouse: Deciding what's important, what you want.
PI: Do you have to comply with things to get to that point?
Spouse: I'm sure there are people out there that say no but I wasn't raised that way. I think there are probably people who think you can have things in life and not have to comply but I think those things catch up with you. I don't want to take that risk.
Subject: Yeah, they will catch up with you. I was like that until I met [spouse]. I mean really I still feel that way but you know I have to do what she says. If I could get my way, I would.
(Later in the interview.)
PI: So [subject], what motivates you to pay taxes?
Subject: My wife.
Spouse: He likes to be able to take a loan and buy a piece of equipment and he likes to have a truck. You have to be able to borrow money and you can't borrow money if you don't have anything to show for it, for what you've earned.

For the other two participants who had changed the trajectory of their taxpaying history, the decision to desist in a "partying" lifestyle led to their decision to become tax compliant.

> I filed one year and then I didn't file nothing until '91. So that was from '79 until '91. Nothing. And then when I got clean, (describing the ninth step process of Narcotics Anonymous) I wrote the IRS a letter and said, "Look, I'm a drug addict and if I owe you any money, I want to know. You know, I want to get straight with you." I didn't go into large detail.

> When I finally got straightened back up [from cocaine] and started doing the right thing, living better, I just went in and set up a payment with them and I paid a lot for three or four years.

Owners in the study who were currently not filing tax statements also talked about the effects of their lifestyle on their lack of compliance. Apparent was the lack of accountability to others.

> The only person I ever have to answer to is the customer and I do good

> work for a good price. I set my own hours in getting a job done and even then I can make changes if I want . . . I can go out and party and have a good time when I want . . . I stay my own person.

For the most noncompliant owners, life changes may at some time sway their taxpaying behavior toward a more compliant bend. One of the most noncompliant owners in the study is planning to marry soon and discussed thoughts along this line.

> Subject: I think I am going to file this year?
> PI: What has made you thin you are going to this year?
> Subject: I'm getting married and we're buying stuff and even if we weren't buying stuff, [fiance] just you know inspired me. . . Until I got engaged, I just never really had to worry about it. It has been kind of hard too. [Fiance] shows about $55,000 a year and I show nothing. I am more of a liability.

<u>Obtaining Business and Taxpyaing Skills</u>

As described earlier, by becoming a business owner participants assumed additional tax and business responsibilities that were not present when they were employed by others. All of the participants described being unprepared to assume the organizational, business management and tax responsibilities required of a business owner. As one participant aptly noted, "I drive nails. I don't do books." Most owners in the study described learning the necessary business skills through trial and error.

> Trial and error are a big part of it and a lot of errors are made. You just get back up and try again. You learn from it.

> You know I was young into it. I didn't know. You know, I guess if I got audited now, I'll just say [that] I thought I was doing the right thing. And that's the truth. And if I learn otherwise then I'll correct it and use it so I don't have to go through it again and hopefully the penalty will not be bad.

> PI: [Spouse], you do most of the books. How did you learn to do it?
> Subject: That first year, she didn't know what she was doing. She was trying to screw me over.

> Spouse: I did not. The first year we did it, I remember I had a room. We filed an extension and it was the day we were suppose to go see our tax person. I still had a room full of receipts I was looking through. When I say a room, I mean it was my upstairs vacated bedroom that was supposed to be my office but really looked like my junk pit. And it was strewn with receipts. Going through all of them and just trying to organize it to the extent of here's what we spent on materials, here is oh yeah, we can use this. Here is a gas receipt. You know the first year was a live and let learn kind of thing.

The learning process appeared to be the same for owners of the smallest businesses and the owners of the larger incorporated businesses participating in the study. The primary difference between the professional owners and the nonprofessional owners in the study seemed to center around the resources, time and energy, and capacity to develop the necessary business skills. Several nonprofessional owners related that they were unable to handle business growth due to these deficits.

> We have had a lot of people working here and a lot of huge jobs constantly but it was unmanageable. It's hard to keep quality of work up. To be compliant, you have to be bigger and settle for less quality . . . I was just trying to maintain things . . . We finally fired everyone and just did it ourselves for a little while.

> Basically what I did was, see I took a couple of losses last year. I had too many jobs going on at one time. Took a couple of losses. [I] ad a couple of customers that bitched, whined and griped, wasn't going to pay. So I went back to "it's a dog eat world out there" . . . It's a learning process.

> Well, actually the first couple of years I made a lot of money but then I started assuming debt after a couple of years and then this year I'm finally getting myself straight. Realistically, the best way to do is, you know, [is] to stay small or get big and don't get in between. And I'm in between . . . If you're real small like I said, you can make a real good living at it . . . You can live like pretty much like everyone else. But this fourth year, I'm beaten down to death.

As mentioned earlier, nine owners had experienced past IRS sanctions and many of these owners attributed their noncompliance to errors made because of disorganization, uneducated bookkeeping methods and a lack of knowledge. Two owners who never filed a tax statement attributed a part of their noncompliance to a lack of the skills necessary to operate a business.

> This will be the first year that I'm trying to do the books, keeping all my receipts and about once every month or so I dig them out of this console thing [in the work van]. It's really horrible. I dig them out and put them in this folder all crumpled up with cappuccino stains . . . the ADD (Attention Deficit Disorder) just wouldn't allow me to it or organize enough . . . Just poor organization.

> Well, that [bookkeeping] is just something I never learned. I don't do none of that kind of stuff . . . I just work for a living.

Perceiving the Tax System as Fair or Unfair

The perception of fairness, or more accurately the unfairness, of the tax system was an issue in the majority of the interviews with participants who filed annual tax statements. Most complained that the percentage of taxes owed as self-employed/sole proprietors was inflated. The owners claimed consistently that taxes "took" a minimum of 25% and a maximum of 35% of their business income. For many of the owners who failed to report cash income, maximized deductions and falsified records, perceiving the tax system as unfair served as a justification for their noncompliance.

> I mean it's hard to justify at the end of the month or the end of three months. This what we made so now let's take 25-30% and send it to the IRS?

> PI: When you get cash, do you claim it on your taxes?
> Spouse: Not hardly. It's unbelievable what you have to take out of it if you do.
> PI: Unbelievable? How much is it?
> Subject: It's 33% or 34%. . . It's crazy. I mean we have to pay 30% plus

on what we make plus social security plus medicare. I mean they hit you for it. We used to get four or five thousand dollars back when he worked a regular job.

PI: What about when you get a cash job and you don't claim it, what motivates you not to claim the money?
Subject: Probably because having to pay so much taxes is the main reason. It would be having to pay so much in taxes. I mean we are paying so much already that I mean the money is probably going to go to them anyway so why give them more.

The last quote demonstrates a related justification given by several of these participants: the income tax system is not the only tax that is unfair but the tax system in general is unfair. For instance, one owner explained, "Like I pay taxes for public school even though my daughter goes to a private school. You know I don't think that's right. It (not claiming all income and maximizing deductions) all just works out." Several participants talked at length about their thoughts about taxes in general in order to justify their noncompliance. The thoughts of one business owner particularly represents the typical argument.

> See you're talking about taxes. You bought your car new. You paid taxes on that car. When you sell that car why should that person, for instance, you sell your car tomorrow to [spouse]. Why should she have to turn around and pay tax on that car again. You see. That's one example. Just like my trucks for example. How many times I buy used stuff. How many times are you going to have to pay taxes? Everytime you sell it. But why? That's what I don't understand. If I have a truck out here and I'm the fifth owner of that truck. Well, I paid tax. I've got a truck right now I have to go down there and register. I'm going to have to pay tax on that and ain't no telling how many people has done that. I don't understand why you have to do that. Vehicles is one of the most things being taxed. You should pay taxes the one time you buy it and that should be it in my opinion. But that's not how it works.

While many of the owners spent some portion of the interviews discussing the unfairness of the tax system, the owners who were overpaying their taxes believed the tax system was fair. Their perceptions of tax fairness served to justify their compliance.

> They [other owners] don't appreciate what we have as much as some do. People that pay all of their taxes appreciate the way we live in this country more than those that hide money from taxes. You know not being bossed around by Taliban, stuff like that. You know I appreciate that.

<u>Compensating for Long Hours and a Lack of Benefits</u>

Similar to participants' dissatisfaction with the tax system was their discontent with the long hours and the lack of benefits associated with being small business owners. Many of the owners were frustrated by the long hours they worked without vacations and by the high costs of personal and family medical insurance, liability insurance and workman's compensation.

> Not many people do that [keep money back for owed taxes] because of cash flow problems. You have that money and you need to pay bills or something comes up or you need something for the job and you have to use the money. By the time everything comes out, you don't make that much anyway. Like on about $50,000 after a contractor take their 18% and then the 12% for workman's comp and then more for liability and then if I keep taxes out, I end up with about $18,000. And I don't have any benefits.
>
> People say, "Boy, you made that much money today." They don't know what comes out that today. What I pay in taxes, what I pay in insurance. Don't get me wrong, I mean as long as I can work and [spouse] can stay home raising these kids, that's what I agreed to do when we got married. But it's hard, you know what I'm saying. When you have to take your health insurance. Everything I make, everything comes out of it.
>
> Like for instance, health care. You get like us. We don't have healthcare. And I tried to get the kids on Tenn Care like twice even temporarily. As someone who pays taxes and spends a lot of damn money in a year's time, it kinda pisses me off. I see people bailing out. Like my family members, crack addicts that get several thousand dollars a month and the government and every damn thing else and it makes me mad.

The unrest of these owners led them to compensate for their perceived losses by underclaiming income and maximizing deductions.

CHAPTER 6
TAX COMPLIANCE:
UNITARY OR DIVERSE PHENOMENON

The bulk of the paper, thus far, has centered around compliance with tax requirements. The last research objective introduces compliance with other regulatory requirements into the study. Specifically, the study examined the degree to which tax compliance paralleled regulatory compliance for the owners of small building and construction firms participating in the study. Research has shown that there appears to be very little offense specialization for the vast majority of street offenders (Petersila, et. al., 1978; Peterson and Baker, 1980; Chaiken and Chaiken, 1982). Whether noncompliance is confined to one of area of regulation or shows a pattern of dispersal across multiple areas and regulatory programs is an unexplored area of research into tax and regulatory compliance.

In order to explore whether tax compliance was a unitary or diverse phenomenon among the participants, I inquired into their compliance with regulatory requirements at the close of interviews. As discussed earlier, it was initially planned to examine their compliance exclusively with OSHA standards. Early into the study, though, it was learned that not all of the participants fell under OSHA requirements but that all participants were required to abide by some type of regulatory requirement. The type of standards participants were required to follow often depended on the type and size of jobs. To compensate for the differences in regulatory standards among participants, compliance with regulatory requirements was generally examined. In other words, rather than looking for compliance levels with a specific requirement, determining participants' overall compliance level with regulatory requirements became the objective. Comparisons of tax compliance and regulatory compliance were made by grouping participants by the taxpaying behavior they most often practiced. The results are presented in this manner.

Failing to File an Annual Tax Statement

Six participants admitted that they did not file an annual tax statement; they were completely noncompliant with tax requirements. All of these participants also admitted that they did not follow any regulatory requirements. Additionally, they did not carry liability insurance or workman's compensation insurance unless forced by a contractor as a condition of a particular job. In these cases, the contractor carried the insurance and subtracted the cost from the payment for the job. One of the owners confided that they did not usually even carry auto insurance on their work vehicles. One participant described a government job that the owner and crew walked off because of regulatory requirements.

> We walked off a job one time. Like it was a government apartment building that the government financed. They had, we had, we done half of them and all of a sudden they came in and "you have to wear steel-toed shoes and hard hats." I mean that's just not something you could do easily. Like with steel-toed boots, your feet didn't bend and you're wearing a hard hat and the thing would fly off against the wall or something . . . we just went and told them we weren't doing that and we left.

This description was not typical among these noncompliant owners. Usually they worked residential jobs and avoided work that would put them in contact with authorities. As one owner stated, "I don't take the big jobs that make you do all that stuff. . . I don't need no one telling how I need to do things."

Failing to Report Income–Side Businesses

Three owners operated side businesses and failed to report any income from their businesses. These three owners also reported that they typically did not follow any regulatory guidelines. This group of owners described scheming to avoid detection by regulatory authorities just as they had described efforts to avoid paying taxes on income earned from their businesses. While they were adamant in contending that they followed "common sense" safety standards, they made no effort to hide that their primary motive was to turn in low bids and make a profit.

> Most of the homeowners feel it is their home and no one's business what they are doing to their home. They don't want to hassle with all that stuff. You know also they don't want to know about all of those requirements. If you tell them they are going to have to have permits and inspections and all that stuff they are going find someone else who isn't going to make them hassle with it. . . It's just common sense on what you have to do to stay safe and do it right. I mean you know what you're doing. You aren't going to do stupid things. You know what's smart to do. Okay, you do things because how it is done because of someone putting it in a book.
>
> We won't win jobs on a bid if you comply with OSHA one hundred percent. Then you won't get any jobs. . . It's just too much money and safety. . . [if you comply] they'll get the next person. . . I mean you would lose a lot of work if you gave prices according to OSHA regulations.

While profit was a primary motive, the owners of side businesses also wanted to maintain the anonymity of their businesses. As one stated, "You don't want to get tied up in the system. That's why I keep it on the side."

Maximizing Deductions–Professional

Two participants were identified as professional business owners who maximized deductions. They reported being highly compliant with tax requirements operating within the system to minimize their tax burden. They also reported high compliance with regulatory requirements.

> You know we are required by law and I have to keep up with that to maintain the business. So I mean the state required it be done by the requirements and that's what we do and people know that or in my business you don't work. I mean we are held by standards and contractors know that. You can't do business if you don't.
>
> I keep up with everything. The fire marshal is probably the biggest thing I have to keep up with. They come by every two to three months and walk around and look at the place and make recommendations or write you up and check. I keep up with it. . . Everything is by the book. It's not worth hurting people. You know it's there to protect people so we try to stay good so there is no reason to try to beat the system. . . Some people may say fuck it and not do it totally by the book but I do it all by the book.

Interestingly, though, the last quote came from the same owner who reported high tax compliance while alluding to possible improprieties in completing tax requirements. The same was found while this participant discussed compliance with regulatory requirements. The above quote followed the next quote describing noncompliance with standards.

> Everytime you work on one of those doors, you have to bring it back into your UL listed shop that has been inspected and work on it there. You can't work on it out in the field. . . That is good for us because we can charge for four hours instead of one. You know it is good for us but it is a pain in the ass sometimes. Now, sometimes we do run it around the side of the building and cut it at the truck and bring it back in and say we didn't get that much traffic.

The participant was asked about the inconsistencies in his philosophies and actions.

> PI: What about when you take a door around the side and cut it, how do

> you account for that?
> Subject: It just saves the hassle fo bringing it in. It doesn't compromise safety. We only do that on little jobs and know what the regulations are for it so it is really by the book. . . Just time-saving not safety or requirements.

While it was important to take this participant's word with a grain of the proverbial salt, he was at least consistent.

Maximizing Deductions–Non-Professional

Six non-professional business owners in the study maximized deductions as their primary taxpaying behavior. Results in comparing their levels of tax and regulatory compliance were varied. Two of these participants considered themselves as highly compliant in both tax and regulatory compliance. For the others, their tax and regulatory compliance did not parallel each other.

Falsifying Records

Falsifying records was the primary taxpaying behavior for five of the small business owners participating in the study. These owners admitted shifting expenses on their tax return to their benefit and they did not always claim cash income. They all identified themselves as moderately compliant with tax requirements. As for regulatory requirements, they claimed to be moderately compliant (N=3) or highly compliant (N=2). The participants who were moderately compliant in both arenas appeared to focus on the day to day operation of their businesses with little foresight; they were just trying to make ends meet in the present.

> I'm about 70% [compliant with regulatory requirements]. I mean I try to. I mean there are some things just like going down the road with a machine chained down. They require two chains. I don't put two chains down. . .

> unless I'm going to Knoxville. But if I'm just going down the road, I won't even chain one [piece of heavy equipment]. . . I just got an $800 fine for using another person's equipment whose wasn't up to par. I just had that feeling I'd end up getting caught. Well, I did. I didn't know not even his headlights would work on his truck.

The two owners who were moderately compliant in their tax requirements but highly compliant with regulatory standards appeared to place a premium on safety. Their commitment to safety appeared to be the catalyst driving their higher level of compliance with regulations.

> Subject: I checked into things when I first started and we are more than sufficient. This doesn't matter whether they have standards or not, it's just the way I do business. Safety is the main thing.
> Spouse: We are all over it.
> Subject: I mean we even watch each other. They [employees] remind us even if we forget to put on our glasses. We are all in this together. We live the safety things.

Overpaying

Three owners reported claiming all income and understating deductions on their annual tax statements leading them to overcomply with their tax obligations. Summarizing from earlier, they were concerned primarily with the labor tasks at hand and with keeping business matters simple. Their simplicity in taxpaying paralleled their attitude toward regulatory requirements. This same attitude, however, led to noncompliance with regulatory requirements.

> PI: Are you under any regulatory guidelines, like OSHA requirements?
> Subject: Probably but I don't know who they are.
> PI: They would be like the safety people who may come to jobs to see if you are following saftey standards. You know like requirements to wear hardhats, have first aid, use harnesses.
> Subject. No. Nobody comes out and checks on jobs. I don't need anybody to check on anything. I just do my work.

PI: What about any other types of regulatory requirements?
Subject: No.
PI: Do you carry any business insurance or workman's comp?
Subject: No.

The other two participants who overpaid their taxes responded similarly to questions regarding regulatory requirements.

CHAPTER 7
CONCLUSION

This thesis opened with a brief description of the theoretical foundations supporting regulatory approaches to enhance business compliance with regulatory and tax requirements. To summarize, a binary model of enforcement had been the center of debate for researchers and policy makers (Hutter, 1989, Braithwaite, 2002). The two approaches at issue involved command-and-control regulation grounded in principles of rational choice theory and cooperative regulation based on normative theories. The command-and-control approach assumes that individuals are driven by self-interest and that compliance decisions are made based on an evaluation of the utility of considered actions and the risk of detection and subsequent sanctions. This approach prescribes rules and responses to violations and mandates sanctions to offset perceived benefits of noncompliance. Cooperative regulation assumes individuals in the business community are respectable citizens and when treated as such they will comply with rules and regulations. Strategies to secure compliance include persuasion, negotiation and education (Tyler, 1990).

Responsive regulation moved beyond the dichotomous debate and proposed a "holistic approach toward regulation in which mixes of regulatory strategies appeal to the complexity and variety of motivations underlying compliance" (Ayres and Braithwaite, 1992; Parker, 2000: 535). Responsive regulation assumes a wide range of motivations influence business noncompliance from inadvertent error to self-interest but posits most businesses tend toward compliance with little to no state intervention. It suggests a dialogue-based approach to elicit compliance backed up by willingness to use sanctions if necessary (Braithwaite, 2002). Soliciting and maintaining engagement in the regulatory process is a fundamental aim. In the past decade, regulatory and tax enforcement agencies have begun to move toward programs of responsive regulation.

The motivations driving compliance are at the core of theoretical differences among regulatory strategies. Research into motivations for regulatory compliance have a longer history than those for tax compliance but both reach a similar conclusion: self-interest and a fear of sanctions are among many motivations that account for compliance and noncompliance. Some of the more notable additional factors suggested to determine compliance include civic duty, moral beliefs, perceived fairness and legitimacy of requirements, and law complexity. Investigations aimed at understanding compliance behavior, however, has been limited and results are not conclusive. Additionally, there have been few qualitative studies into taxpaying behavior.

The fundamental goal of the current study was to provide an increased understanding of tax noncompliance in the small building and construction industry. To this end, the study used qualitative interviews with 25 owners of small building and construction firms to learn about their taxpaying behaviors, the motivations driving their behavior and their compliance across different arenas. Five primary conclusions are suggested from the findings of this research.

First, results lend support to the fundamental tenets of responsive regulation. Most of the participants were engaged in the tax system and considered themselves moderately to highly compliant. These participants reported consistently that the threat of financial sanctions helped motivate them to comply with basic requirements. However, those who had been the recipients of sanctions developed resentments toward tax authorities. The resentments led participants to adopt noncompliant behaviors by maximizing deductions and underreporting income. One participant disengaged entirely from the tax system after difficulties meeting sanction requirements. For those participants disengaged from the tax system, the threat of legal consequences served little but to perpetuate distance from the tax system or made no difference at all.

Second, most owners in the study described being unprepared to take on the responsibilities and tax requirements of a business. Many participants recounted stories of trial and error in learning to operate their businesses and negotiate tax obligations. Often times, the lack of skills led to inadvertent errors and situations in which the owner was attempting to just make ends meet. At other times, participants turned to the assistance of an accountant or tax preparer to complete tax returns. In these cases, the overriding goal shifted from obtaining assistance to minimizing the tax burden and avoiding the scrutiny of tax authorities.

Third, results from the study provide evidence that taxpayers are more dynamic than the model "amoral calculators." Likewise, tax compliance and noncompliance are not the dichotomous dependent variables they often times appear; tax and regulatory requirements comprise many affirmative requirements and practices through the year as well as a lifetime. In accordance with contemporary rational choice theory, motivations varied among the different taxpaying requirements suggesting decision making in regard to tax compliance may be "requirement specific."

Finally, findings concerning the most noncompliant participants paralleled findings in the criminological literature of street offenders. Two particular findings especially illustrate this point. For one, results suggest developing and maintaining stakes in conformity or social capital was an important factor driving tax compliance. Alternatively, a lack of such stakes appeared related to the most noncompliant behavior of the most noncompliant participants. For another, the most tax noncompliant business owners in the study were also among the most noncompliant with regulatory requirements.

While the results of this study provide some interesting insights into taxpaying behavior, the limitations of the study must be taken into account. Because the sample is small and nonrandom and limited to a specific geographical region, the results cannot be generalized to the general population of owners of small building and construction firms. Similarly, since the study focused on one industry, results cannot be generalized to other industries. Furthermore, in using a snowball sampling technique, the selection of participants was dependent on the subjective referrals of the initially selected participants. This may have led to a sample that was "densely interconnected" (Heckerthorn, 2002). In other words, the sample may be unrepresentative even for participants in the same region and industry as in the case of this study since like social groups tend toward each other. The limitations, however, serve to highlight the need to replicate research of this type and to do such for other industries and in other regions. The volume of criminological research has increased its reliability and made significant contributions to crime control and prevention policy.

Despite its limitations, the results of the study point to several implications that may be important for informing policy and future research. First, the restructuring of tax offices to offer education and assistance may be a promising goal especially considering the lack of business and taxpaying skills displayed by participants in this study. However, trust for tax authorities will need to improve dramatically, at least among the participants in this study, before this goal may be realized. As results indicated, many participants sought the help of and paid for the services of a tax adviser or preparer and in return anticipated a reduction of their tax burden. Free assistance from IRS officials may reduce this expectation as well as the influence of private tax advisers seeking to secure and maintain a consumer base through services that minimize tax payments. An additional and possibly more effective strategy on a structural level may be to incorporate taxpaying education in the public school system.

Next, the results suggest criminological theory and research may have important implications for the study of compliance. Criminological investigations have done much to inform law enforcement, policy makers and the judiciary in dealing more effectively with individuals through the criminal justice system. Replicating these types of studies in the area of business compliance and especially noncompliance may do the same for regulatory and tax enforcement agencies.

Finally, the results theoretically support the recent policy developments toward responsive regulation to enhance regulatory and tax compliance. However, the recency of these developments have inhibited research into the actual effects of these changes. This turn in events offers many opportunities for compliance research and policy evaluation alike. While the legacy of criminological research may help inform investigation into business compliance, research into changes in regulatory and tax enforcement may serve to inform enforcement strategies in the criminal justice apparatus.

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APPENDICES

APPENDIX A

INTERVIEW GUIDE

INTERVIEW GUIDE

Demographic Information
- Age
- Race
- Gender
- Family History
    - Parent's marital history
    - Parent's occupation
    - Siblings
- Marital History
- Dependents
- Education/Vocational Training
- Employment History

Business History
- Type of business
- How learned business
- How long in business
- Employees
    - How many
    - Type–fulltime, parttime, regular, irregular
    - How paid–check, cash
    - Tax records–W-2, 1099
    - Benefits

Customers
- Contract/Subcontract
- Type–residential, commercial, government
- Payment types–check, cash, barter

Bookkeeping Practices
- Who keeps books
- How keep books–payments, employee income, expenses

Taxpaying Practices
- File–self-employed, sole proprietor, corporate
- File quarterly or annually–penalties
- Deductions
- Accountants

Regulatory Practices
- OSHA
- Licensing
- Fire Codes
- Workman's Compensation

APPENDIX B
INFORMED CONSENT FORM

**WORKING HARD FOR THE MONEY:
MOTIVATIONS FOR TAX NONCOMPLIANCE IN THE
SMALL BUILDING AND CONSTRUCTION INDUSTRY**

INFORMED CONSENT

It is my understanding that by agreeing to participate in the project, "Motivations Behind Tax Noncompliance in the Small Building and Construction Industry," my rights, welfare and privacy will be maintained in the following ways:

- I have had the details of the research project explained to me by the project director.

- I understand the procedures to be used and have been made aware of the possible risk involved.

- All responses I give to questions will be confidential and accessible only to the project director and her project advisor.

- Should the results of this project be published, I will be referred to only by a research number assigned by the project director.

- In signing the consent form, I have not waived any of my legal rights nor have I released this institution/agency from liability for negligence.

I have been informed of this information in (a) written ___ or (b) verbal ___ form. All of my questions have been answered. If further questions arise about the project, I can call the project director, Anne Carroll, at (865) 974-6021. I freely and voluntarily agree to participate in the project.

______________________________ ________________
Signature of Volunteer Date

______________________________ ________________
Signature of Witness Date

VITA

Anne Austin Carroll was born and raised in Knoxville, Tennessee. She received her Bachelor of Arts Degree in Sociology at the University of Tennessee in 1979. She worked in several capacities for the State of Tennessee Department of Juvenile Corrections for ten years. She worked the next eight years in the field of substance abuse and addiction at several facilities. She was accepted as a graduate student in the Department of Sociology at the University of Tennessee in 1999. She plans to continue the program as a doctoral student. She lives with her dog and faithful companion of nine years, a great pyrenees, Bear. She has a daughter and son-in-law, Kristen and Wes Loden, who brought into this world a son and Anne's first grandchild, Jonathan Thomas Loden, on September 30, 2002.