The Cultural Grounding of Tax Issues: Insights from Tax Audits

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Income tax laws are the primary motivation for many to learn and use the basics of accounting. Three stages of preparing tax returns—collecting records, organizing the information into tax and accounting categories, and abstracting the information on tax returns—successively draw individuals further into the culture of accounting. The issues raised during tax audits provide a window into the problems taxpayers have understanding and following accounting concepts and procedures. An analysis of the stages of return preparation provides insights into how issues are handled during audits and how the accounting skills of taxpayers may affect their outcomes. Data from a sample of state audits generally confirm the hypotheses and illustrate the grounding of taxpaying in accounting. Tax laws may draw individuals into this culture, but the information taxpayers collect and process to meet the needs of the government often, after the fact, has utility for the taxpayers themselves.

Most modern polities have broadly based income tax systems for individuals and businesses. The laws governing these income tax systems pose legal obligations on almost all working or income-producing adults and even many children. Unlike many of the laws affecting the behavior of individuals in democratic societies, income tax laws are prescriptive rather than proscrip-

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tive, placing often burdensome information collecting and reporting obligations on individuals. While the reporting obligations are typically only annual rites for most individuals, collecting and retaining the information needed for preparing the reports is an ongoing obligation. As a consequence, income tax laws must be incorporated into the everyday lives of most individuals (Kidder & McEwen 1989).

Many of the concepts and procedures that must be used to meet tax reporting obligations, however, are divorced from the rest of the daily interactions and cognitive perspectives of most individuals. They are instead derived from the arcane culture of rational financial accounting and analysis (Carruthers & Espeland 1991).[1] The government, in the dominant position, has been able to shift its information collection, storage, and interpretation requirements onto the subordinate taxpayers. Taxpayers, in other words, are required to be information buffers who abstract information into the form that is usable by the tax agency (Heimer 1985). As information buffers for others, taxpayers must collect information and use cultural categories that they often do not feel are required for their own purposes. Income tax laws thus force most individuals to become more immersed in the cognitive perspective of financial accounting than they otherwise would be.[2]

By the culture of rational financial accounting, I am referring to the *unified body of knowledge, practices, norms, and cognitive perspectives* that are most fully embodied today in the accounting profession. Scholars such as Weber, Schumpeter, and Sombart (for cites and summaries, see Carruthers & Espeland 1991) have argued that the economic rationality fostered by this culture was crucial for the development of capitalism. Today elements of this cultural perspective permeate the financial reporting and planning activities of governments, nonprofit organizations, and corporations. Indeed, it is almost impossible to discuss these activities without using concepts whose meanings are grounded in accounting. The concepts, norms, and perspectives of the culture, however, are not a natural and routine part of the everyday activities of most individuals and small businesses. Specialized training and practice are required to understand and use the concepts and procedures correctly. Internalizing the perspective

[1] There is a considerable debate among experts in tax policy about the distinctions between tax accounting methods and the generally accepted accounting procedures (see, e.g., McMahon 1994; Raby 1994). For the purposes of the analysis here, however, these distinctions are at the margin. Both methods require an understanding of the principles, categories, and procedures of the culture of accounting. Indeed, to even understand the debate requires more knowledge of accounting than the vast majority of affected taxpayers possess.

[2] Individuals can delegate, at a cost, some aspects of their reporting obligations to professionals trained in the culture; however, many crucial aspects of the obligations must be met by the taxpayers themselves. As I develop later, this fact has implications for how issues are handled in tax audits.

of an accountant, in other words, is in many respects a socialization process.

To use a physical metaphor, at the core of the culture are the esoteric manipulations and interpretations of abstracted and summarized information using relatively "pure" accounting concepts and procedures, the activities prototypically done by professional accountants. At the periphery are the collecting, categorizing, and checking procedures that bring information into the accounting sphere, work prototypically done by bookkeepers. (For further discussion of the core and periphery of professions and their cultures, see Abbott 1981.)

Many regulatory regimes are also grounded in other specialized cultures. Health regulations are based on principles from biology, medicine, and epidemiology; building codes presuppose an understanding of the concepts and terms used in architecture and the building trades; environmental laws are grounded in biology, biochemistry, meteorology, and various areas of engineering; and so forth. In most regulatory areas, however, those who are regulated have by and large been socialized into the relevant cultures as part of their occupational or professional training, and the socialization tends to be taken for granted in studies of regulatory enforcement. Indeed, the issue often is whether the lawmakers and regulators are as well versed in the culture as are the regulated. In contrast, many taxpayers do not have the understanding of rational financial accounting principles needed to meet their tax obligations. Analyzing the accounting difficulties faced by taxpayers, thus, helps illuminate the more general cultural grounding of tax and regulatory laws.

In this article, I first analyze the stages of preparing a tax return and explore the socialization required for taxpaying and the problems it poses. This analysis takes us from the periphery toward the core of the accounting culture. I then turn to income tax audits as an arena in which taxpayers' problems with accounting are likely to become visible. I use information about the issues and disputes that arise during income tax audits, as seen from the point of view of the auditors, in two ways. First, the nature of the issues raised during audits provides a window into the types of problems taxpayers have following some of the norms and principles drawn from the culture of accounting. Second, turning the lens around, an analysis of the accounting demands placed on taxpayers gives a new perspective on how disputes between taxpayers and auditors are handled and resolved during audits. In the third section I analyze some quantitative data about audit issues drawn from a larger study of state income tax audits,[3]

[3] The larger study of state individual income tax audits focused on the expectations and orientations that taxpayers and auditors bring to audits, the negotiating and interpersonal aspects of the audit process, and the taxpayers' reactions to and evaluations of the experience. In this study we conducted open-ended interviews with auditors and their

again looking through the audit window both ways. After looking at the relative frequency of the different types of problems, I statistically test some of my hypotheses about how socialization into accounting affects the handling of issues.

Moving Deeper into the Culture

In a paper on the complexity and uncertainty of identifying and measuring noncompliance, Smith (1988) argued that there are two distinguishable aspects of compliance with tax laws: informational compliance and taxpaying compliance. There must be an adequate level of compliance with the requirements for collecting and maintaining information before one can classify and manipulate the information and apply the laws to determine and pay the correct amount of tax.

The same sequence from the collecting of information to the classification and interpretation of it is captured in the sequential three sets of books that have been described in accounting texts since the 15th century. For information on the history of accounting and its cultural ramifications, I am relying on the research and analysis by Carruthers and Espeland (1991). Information about transactions is first entered in full detail in the waste-book, then posted in summary form in the journal and checked, and then finally interpreted and summarized formally in accounting terms in the ledger. Each step involves abstraction and further immersion in the culture of rational accounting. For most taxpayers, the shoebox of receipts, checkbooks, bank and credit card statements, loan papers, insurance reports, etc., are the analog of the waste-book. Periodically (for many only at tax preparation time) individuals collate and summarize the information on work sheets, adding machine tapes, and spreadsheets—the journal step of tax reporting. Finally, the information is interpreted, manipulated, and formally summarized on tax forms: the information in the shoebox has been pulled further into the culture of accounting and tax law and presented in a form that is useful and meaningful for its primary audience, the tax agency.[4]

managers and pre- and post-audit interviews with taxpayers. The auditors also completed a questionnaire about each audit they completed during the study period (the source of the quantitative data here). Finally, William Kenny of Portland State University and I read and coded information from the auditors' logs and working papers for 431 audits. The qualitative analysis and examples here are drawn in large part from these interviews and working papers. I have at times changed irrelevant descriptive details to protect confidentiality.

[4] The examples I use in the following sections are illustrative and in many cases selected because of their relevance for my later discussion of issues that arise in audits. Tax professionals and many taxpayers with relatively complex financial arrangements could cite many additional examples. My focus is on how taxpayers learn about and cope with the tax laws. Consequently, I am mainly citing IRS publications and instructions—

Collecting and Maintaining Records and Documentation

Keeping records of income, expenses, and activities is not something that most businesses and individuals do easily and routinely. Many individuals would have difficulty accounting with any degree of accuracy how they spent their money during the past month, much less over the past year or more. However, the tax laws of the United States require even low-income individuals and households to keep detailed records if they are to take full advantage of the tax benefits to which they are entitled. For example, to meet the support test for claiming someone as a dependent, taxpayers in complex household or family situations need to keep track of how much was spent overall for the dependent's housing, food, clothing, medical, and other expenses and how much they personally spent. Likewise, to support the head of household filing status, taxpayers need to "track the total cost of maintaining the home, including costs for rent or mortgage, utilities, property taxes, insurance, repairs, and food. Then, they must determine what portion of this total they paid" (GAO 1993a:2). An analysis by the U.S. General Accounting Office (GAO) of the reasons for erroneous claims of dependents indicates the burdensome and difficulty of the recordkeeping task: From detailed Internal Revenues Service (IRS) audit data, the GAO estimates that 43% of those whose claims of dependents could be denied in an audit would have inadequate documentation to support their often legitimate claims (GAO 1993a).

Individuals who itemize their deductions need to have similar types of records in order to calculate their deductions, and homeowners are at an advantage if they maintain records of any expenses that improve their property, at least until they sell the property or, in the case of primary residences, until they sell the last of an unbroken chain of residences. Investments pose another difficulty of recordkeeping: Tax calculations that may lie many years in the future are going to be dependent upon information about when securities were purchased, the number of units, and the price per unit, along with any related expenses. Taxpayers who take business deductions need to keep even more detailed records of the expenses they incur. In many cases the calculations they will make for tax purposes require information not only about what the payments were for but also about how the items or services were used in their work.[5]

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the sources used by most taxpayers and many tax preparers—rather than the supporting code sections and regulations.

[5] For instance, the uniform capitalization rules for section 263A of the Internal Revenue Code require the separation of costs broadly related to inventory. For transportation costs, the new rules require identifying between which points the transportation of goods occurred because some costs of shipping goods should be capitalized (another accounting term, as discussed below), while others can be deducted as an expense in the year in which the costs occurred (Minasian, Herndon, & Tovig 1994).

Households also receive checks, cash, and—increasingly—direct deposits from a large number of sources apart from employers. The information needed for tax purposes requires a more detailed record of the amounts and sources than householders would typically keep for the own purposes. Income from employment has to be separated from dividends, interest, gifts, insurance claims, sales of securities or property, loans, payments on loans to others, and so forth. Taxpayers who own or operate businesses must do even more detailed recordkeeping to track their income, particularly if much of the income is in the form of cash that is later deposited in the bank.

The information needs of tax administration extends in many cases to documentation about activities, in addition to documentation about expenses and income. Those with large medical expenses involving many trips to doctors and medical facilities should keep track of the number and length of the trips so that they can deduct them as medical expenses. People who travel for business need to maintain even more detailed records because of the classifications they need to use in organizing expenses for tax purposes.[6] Those who are involved in several business activities or are self-employed on a part-time basis may also need to keep track of how many hours they spend on various activities.[7]

To some extent, third-party recordkeeping, most notably by banks, credit-card companies, pension and annuity administrators, and investment firms, has assumed some of the burden of collecting and maintaining information for individual taxpayers. However, the taxpayers still have to keep information on the details of transactions. A credit-card charge from a hardware or discount store could be for several different items purchased for different purposes; an ATM cash withdrawal on a bank statement may help balance the checkbook, but it gives no information about how the taxpayer used the cash.

In sum, the annual rite of filing income tax returns forces many individuals and businesses to think and act more like bookkeepers than they ever would otherwise. Even though the recordkeeping may be part of sound business or household financial practice, the primary motivation for many is "for tax purposes." In interviews, accountants and bookkeepers report that cajoling their clients to keep decent records is one of their most frustrating tasks and that they often use tax requirements as one of their

[6] Taxpayers who deduct automobile expenses, for example, need to keep track of the separate trips they make in a day. Travel from home or a union hall to the first job of the day and travel from the last job to home are personal commuting expenses, while travel between jobs is a business expense.

[7] The amount of time devoted to an activity is one of the factors considered in deciding whether the activity is a business or hobby. It is also critical in determining if a taxpayer "materially participated" in a business or if it was a passive activity (IRS 1993b:C2).

few effective sticks. For individuals employed by others, the time and effort expended on the record collecting and maintenance primarily detracts from leisure time. The self-employed generally feel that the time and effort would be better spent on productive, income-producing business activities.

Organizing the Information into Categories

The kind of information taxpayers need to collect and maintain is largely determined by the categories that must be used in organizing the information for preparing tax returns, the taxpaying parallel of summarizing the information from the wastebook in the journal. Understanding and using the required categories takes one further into the culture of accounting. Almost any page of even the IRS instructions for Form 1040 or the tax guides published by outside organizations use terms and categories from the world of accounting. Some instructions assume knowledge of accounting categories that are far from the everyday discourse of most adults. For instance, the IRS instructions on calculating increases to the basis of property begin with the sentence, "Increase the basis of any property by all items properly added to a capital account" (IRS 1993a:5).

Some distinctions required for tax forms, such as "exemptions," are specific to tax law rather than accounting; however, my larger point is that the very process of dividing income, expenses, and activities into categories that correspond to lines in a tax form or columns in a ledger book involves the cultural mindset found in accounting but not in many other aspects of life. Most individuals live their lives doing and buying what they need or want; most business people left to their own preferences do the activities and purchase the items that they believe will contribute to their financial or occupational success. Most would not on their own accord devote time to organizing information about these activities into discrete categories. For the sole proprietor of a business, separating personal and business expenses and income is of little consequence. However, income tax laws in effect make the government an investor in the business for whom the distinctions do matter, and the government has the legal power to transfer the burdens of its information needs onto the taxpayer.

Moreover, many of the distinctions required of self-employed individuals and others with moderately complex financial arrangements are not clear-cut ones that can be easily and unambiguously made even by accountants and tax experts. Indeed, some of the thorniest issues in preparing tax returns concern the appropriateness of the categories for a particular taxpayer. Was the person the taxpayer hired in her business an employee or an independent contractor? Is this activity a business engaged in for profit, or is it a hobby (Khorsandi 1993)? Does the work this person does in the home meet the criteria for an office in the home (Hulsey 1993; IRS 1994; but see also *Walker v. Commissioner* 1993; *Burleson v. Commissioner* 1994)? Was this a bona fide loan, were there serious attempts to collect, and did it become clearly uncollectible in the year in which it was claimed as a bad debt loss? Which clothing and equipment can be business deductions? Was that trip for business or pleasure? Were these interest charges business and investment related? Did this college course meet the requirements for a business expense? Was the payment from the former spouse alimony, part of the divorce settlement, or child support? The 1986 Tax Reform Act added to the list of difficult categories the fact-driven distinction between active and passive participation in an enterprise or line of business.

These are all examples of classification decisions that involve the totality of the "facts and circumstances" of a situation weighed against several criteria. As Marvin Chirelstein, author of a leading law text on federal income tax, has noted:

> Maybe the element that requires simplification, but at the same time is somewhat out of reach of simplification, is the rather pedestrian problem of distinguishing between personal and business deductions—a problem that afflicts ordinary taxpayers in sizable numbers. Home office expense would be a typical case, I guess, and a lot of travel and education expense and the like, where the borderline between business and personal is hard to determine. (Hanna & Olchyk 1994:14)

Making these "rather pedestrian" classifications controlled by facts and circumstances criteria requires selecting and weighing a range of information in the way an accountant or tax expert would. The classifying thus involves not only understanding and using the categories of accounting; it also requires at least a rudimentary grasp of the decisionmaking processes of accounting. Many taxpayers turn to tax professionals or published tax guides for answers to such these questions, but they still need to have sufficient understanding of the terms and criteria so that they can ask the right questions or provide the relevant facts to their advisers.

Often decisions about the relevance of categories lead to a quantitative decision about the proportional allocation of expenses and some types of income between categories. Proportional allocations are often employed, for instance, for offices in the home or the business and personal use of vehicles. In accounting and tax practice, there are generally accepted methods for calculating these proportions. The methods are not necessarily the ones many taxpayers would intuitively select, and issues about allocations in many instances are raised in audits because the taxpayers lacked adequate knowledge of the culture.

After the relevance of the categories has been decided and, in some cases, the proportions calculated, there is still the time-consuming and tedious task of allocating items and adding and cross-checking figures. As one of the auditors in our study sometimes tells taxpayers, "I know you must have gotten these figures somewhere. Why don't you go through your books and records again so that you can show me how you calculated them?"

Abstracting and Summarizing the Information on the Tax Form

The final step into the culture of accounting that tax laws require is abstracting and structuring the categorized information as numbers in the appropriate boxes and lines on the tax forms and schedules. For many the difficulties at this step are primarily clerical and arithmetic rather than accounting: completing tax forms is among the most demanding reading and computational tasks many individuals do. The difficulties of reading and following detailed and complex instructions and performing arithmetic computations are not limited to those with larger incomes or more complex financial affairs. The instructions and worksheets for partially taxable pensions and annuities and for the earned income credit, for instance, are long, detailed, and quite complex.[8]

Transforming information into the form needed on tax returns, however, also introduces many taxpayers to additional subtleties of accounting principles. The sums for the various categories of income and expenses for a given year often cannot simply be transferred to the tax form. They first must be manipulated and further abstracted. Three examples are particularly relevant for my later discussion of audits: basis, capitalization and depreciation, and accrual accounting.[9]

[8] The errors are also not insignificant. The IRS has computer programs for checking clerical and arithmetic errors on the filed returns and forms. The errors the programs find are naturally in both directions in terms of the amount of tax owed, but the net result of the errors is an understatement of tax obligations. For tax year 1987, the IRS estimates that the net understatement on individual returns was $1.05 billion (IRS 1988: Table I-1). This figure does not reflect the probably larger number of computational errors made on worksheets that are not filed with the returns—the math and clerical errors discovered by auditors that I discuss later.

[9] "Basis" in its simple form is the total, net amount of money a party has invested in an asset (property, business, stock, etc.) at a particular time. "Capitalization" and "depreciation" refer to the accounting treatment of "capital" items whose economic value extends beyond the year of purchase but also decreases over time. The total cost of such an item is not charged as an expense in the year of purchase; rather, a portion of the cost is taken as an expense each year during the expected economic life of the item, following one of several possible depreciation schedules: The item is "capitalized" and then "depreciated." "Accrual" accounting is an accounting method in which income is reported when it is earned and expenses are deducted (or capitalized) when they are incurred, regardless of when actual payments are received or made. The simpler and more common method of accounting for individuals and small businesses is the "cash" method in which income and expenses are both recorded when the actual payments are received or made.

The notion of the basis of an asset is an accounting abstraction from discrete economic events. Basis for many types of assets can be increased or decreased by a variety of transactions spread out over many years: It is not a fixed amount for which one has a single receipt or canceled check. This relatively arcane concept, though, is involved in several common tax calculations. Everyone who sells securities; sells or repossesses property; claims a theft, casualty, or bad debt loss; or has a debt completely or partially forgiven must understand the notion of basis and try to calculate her basis at the time of the sale, loss, or repossession.[10]

Depreciation and the related concept of capitalization became a concern in accounting with the development of railroads and other industries with large investments in machinery and other durable goods whose productive value gradually deteriorated. Income tax laws today, however, introduce the concepts to a wide range of individuals, including almost everyone who owns a business. Taxpayers who have rental property, whose businesses involve real property, inventories, or the use of trucks or other vehicles, power equipment, computers, books, and professional journals, and so forth need to deal with capitalization and depreciation issues. Also, all taxpayers who "produced real or tangible personal property or acquired property for resale" must include some expenses in inventory or capitalize them (IRS 1993b:C-2). Those for whom capitalization is relevant must decide what items and related expenses should be capitalized rather than "expensed," the number of years over which the items should be depreciated, and the depreciation method. The selection of depreciation method further takes one into the accounting world of straight-line, declining balance, MACRS, ACRS, and other depreciation schedules. Those who purchase ongoing businesses also have to deal with distinguishing and valuing intangibles such as goodwill.

Current U.S. tax law requires all businesses involving inventories to use the accrual method of accounting for sales and purchases rather than the cash method. With the approval of the IRS, others can elect to use it if they kept account books and if it clearly reflects their income. In most cases, accrual accounting probably does present a more accurate picture of income and assets, but it does so with the cost of additional complexity and abstraction. The timing of income and expenses is not captured simply by the transfer of money as in the cash method. Rather, it is determined by more abstract and arbitrary criteria focusing on when income is earned and expenses are incurred. Another issue that involves similar argumentation is the allocation of interest payment among personal expenses and various categories of

[10] The IRS publication explaining basis of assets (IRS 1993a) cross-references 17 other publications.

business activities, a problem also complicated by the 1986 Tax Reform Act. These criteria become routine for those trained and experienced in accounting. They are much more difficult to grasp and use consistently by those outside the culture.

Before we turn to audits, there is one other relevant observation about taxpayers' entering the culture of accounting. The further into the culture the tasks are, the more taxpayers can delegate them to others. Taxpayers can hire accountants or tax preparers to make decisions about capitalization and accounting methods, to track the depreciation schedules, and to calculate basis. Bookkeepers or accountants can categorize and summarize all the separate income and expense items. They can also help taxpayers set up systems for recording income and expenditures in sufficient detail. However, only the taxpayers, the other members of their families or households, and their employees can record the items and collect and maintain the necessary documentation. Also, only the taxpayers know all the details of their transactions and activities that will be needed in making facts and circumstances classifications or calculating basis.

Audits as a Window on the Problems of Crossing the Cultural Boundary

Auditing is one of the procedures through which tax agencies check on the adequacy and accuracy of the information collected and maintained by taxpayers and whether they and their agents have categorized, interpreted, and abstracted it correctly. For my purposes here, we can use audits as a window on how well taxpayers understand and employ the norms and principles of the rational financial accounting, on what problems they have, and on what potential errors they make. Just as in other types of regulation, some potential errors seen by auditors may not be raised as issues: the possible tax consequences (in either direction) may be de minimis; the perceived errors are countervailing so that the net tax change is likely to be small; the tax treatment is probably wrong, but the legal issues are sufficiently ambiguous that a convincing case probably could not be sustained; or there are extenuating circumstances and questions of equity and fairness that argue against pursuing the issue. In most cases, however, the auditor will raise potentially material issues with the taxpayer. Consequently, the issues auditors raise during audits and the disputes between auditors and taxpayers provide information on the problems of crossing the cultural boundary, whether or not the official determination at the end of the process is that the taxpayer has made an error or committed intentional or unintentional noncompliance.

The generally accepted procedures of rational bookkeeping and financial accounting have evolved in part with the objective of providing the kinds of paper trails and cross-checks that make intentional cheating more detectable. Thus, the issues raised in audits reflect possible failures to adhere to the norms of the culture, leaving open how many of those possible failures are because of inadequate socialization. As several researchers have noted, determining motive is far more difficult than determining if there is tax compliance (see, e.g., ABA Commission on Taxpayer Compliance 1988; Long & Swingen 1991; Roth, Scholz, & Witte 1989:20-23; Smith 1988; Smith & Kinsey 1987). Perhaps as a consequence, we found in our study of state income tax audits that the auditors and their managers tended to downplay questions of intent and motivation except in egregious cases.[11] There is no question that many taxpayers intentionally cheat on their returns; however, most auditors and tax practitioners we have interviewed believe that many of the problems found in tax audits are the result of incompetence in bookkeeping and accounting, honest errors, and honest differences of opinion, rather than intentional cheating, a view that is consistent with our reading of auditors' working papers and interviews with audited taxpayers.

Analytical Classification of Audit Issues

Possible problems and errors can occur at all three steps of moving from financial transactions to tax returns, and we can gain additional insight into how issues are handled and resolved during audits by asking three questions related to the cultural demands that taxpaying places on individuals. What is the focus of the issue and where is it located in the stages of collecting and abstracting information in accounting and tax terms? Who has the information that would help resolve the issue? And how much knowledge of accounting and tax principles is involved? These three questions suggest two broad categories of issues, the first focusing on the documentation and classification in the first two steps, and the second primarily concerned with the correct abstraction and manipulation of the facts in terms of accounting principles and tax law. Additional examples of the issues in these two broad categories are given in the later section on the statistical distribution of issues in a sample of income tax audits.

[11] One manager with more than 20 years of experience was taken aback when asked to estimate the proportion of audited taxpayers who intentionally cheated. He said he had never really thought about the question before. In our interviews with state and federal tax auditors, we have found that almost all are very hesitant to try to estimate the proportion of taxpayers who intentionally cheat, suggesting that it is not a category they regularly use. Dick Hessing, Henk Ellfers, and Henry Robben (personal communication) report that auditors in The Netherlands are also not used to categorizing taxpayers in terms of intent.

"Show Me" Issues about Documentation and Classification

The most concrete issues that are understandable with only minimal knowledge of rational accounting concern the adequacy and accuracy of the documents and other factual evidence for the tax positions taken on the returns. The second step of classifying and organizing the facts leads to issues about whether categories are appropriate for the circumstances of the taxpayer and whether expenses and income have been placed in the correct categories. While issues about categories may be among the most complex and ambiguous ones in tax law, they are still very much fact driven. Like issues about collecting and maintaining adequate records, they are in essence "show me" issues in which the auditors are fact finders and interpreters seeking documentation and support for the facts claimed by the taxpayers. Answering questions about details of financial transactions, especially personal ones, and the motivations behind them, and locating the relevant documentary evidence generally cannot be delegated by the taxpayer to a professional representative. The taxpayer knows or has access to this information far more than does anyone else; consequently, the taxpayer is likely to become involved in issues of fact even if she or he had hoped to delegate the entire audit to a representative. The taxpayer must take charge of tracking down the information and often ends up meeting with the auditor to resolve such factual issues or to explain the reasons and motivations behind activities.

Issues about Abstracting and Structuring the Information

Further into the culture of accounting are issues that focus more on whether the information was abstracted, structured, and manipulated in accordance with the principles of accounting and tax law than on the accuracy of the facts themselves. Examples are issues about the correct calculation of basis in property or businesses and the correct treatment of capitalization and depreciation. The resolution of these more abstract issues typically involves the presentation by one side or the other of a worksheet or narrative summarizing and abstracting a sequence of transactions in accordance with generally accepted accounting practices. Many lay taxpayers are at a loss to know how to organize an acceptable worksheet for calculating basis or depreciation or to track the relevant activities linking a loan to a particular use of the funds. This knowledge, however, is routine for most accountants and many tax preparers; and taxpayers can successfully delegate the negotiation of these issues to professional agents.

In many respects, this classification of audit issues cross-cuts the often-used dimensions of complexity and ambiguity. As Marvin Chirelstein (quoted earlier from Hanna & Olchyk 1944:14) noted, the rather pedestrian "show me" issues about facts and circumstances are among the most complex and ambiguous issues. However, commentators concerned with complexity and ambiguity in tax laws often cite examples from the more arcane areas of tax law, especially those of concern primarily to large corporations and wealthy individuals; and there is no question that these areas also involve complexity and ambiguity.

My distinction is close to the classic one between questions of fact and questions of law: Issues in both categories have fact components, but the "show me" issues generally focus more on determining the facts, while in the second set of issues there often can be disagreements about how to abstract, structure, and summarize the information even though there is agreement on the facts. It is also important to emphasize that complexity and ambiguity are not simply a consequence of how the law, including both statutes and regulations, is crafted. For instance, the ambiguity of classification issues does not reside in the facts or the laws; rather, it emanates from the juncture of fact and law, from trying to apply the law to the totality of the facts.

The concepts of complexity and ambiguity are useful for many types of analyses, and we began our exploration of tax audits with them as guides, only to discover that they did not provide an adequate framework for understanding many aspects of how issues are handled in audits. I believe an analysis of issues in terms of the stage of the tax preparation process, the parties having the relevant information, and the specialization of the required knowledge leads to a fuller understanding of the audit process and the handling of disputes than does an analysis simply in terms of complexity and ambiguity.

Some Consequences for the Handling of Tax Disputes

In this section I explore how these aspects of the socialization into accounting may affect the handling of disputes during tax audits. Later, I shall use data from our study of state audits to test empirically some hypotheses about these possible effects.

First, as I have already noted, the nature of the issue is likely to affect who is involved. The taxpayers are the ones most likely to have original documents and perhaps the only ones who can recall details of transactions that occurred two or more years before the audit. Consequently, taxpayers are likely to become involved in issues about documentation even if they initially have their accountant or preparer represent them in the audit. If they do not meet directly with the auditor, their representative is likely to become the intermediary for a number of detailed questions and answers, and there may still be a heavy burden of time for the taxpayer if the records are incomplete or disorganized. On the other end, issues involving more sophisticated aspects of accounting, such as basis and depreciation, are likely to end up involving representatives even if the taxpayers begin by representing themselves. If the stakes seem high and the taxpayers feel they are in unfamiliar cultural territory, then they are likely to seek professional help in negotiating with the auditor.[12] Because issues focusing on facts and circumstances involve both knowledge of the taxpayers' particular situations and knowledge and skill in accounting and tax law, these issues are perhaps the most likely to involve both taxpayers and representatives. Disputes between auditors and representatives about the distinction between a business and a hobby, for example, will often involve a meeting with the taxpayer before the issue is resolved.[13]

Underlying these expectations about the parties involved in various types of issues is an analysis of who has control over the relevant information, knowledge, or skills. Taxpayers are the ones with the relevant information about issues concerning documentation and facts. Because of this imbalance of information between taxpayers and auditors, taxpayers can control the outcome of a dispute if their documentation is adequate and organized and if they have sufficient understanding of the culture of accounting to present their information competently and convincingly. For issues about the correct abstraction and manipulation of the facts, there is often an imbalance of expertise in the other direction between auditors and taxpayers if the taxpayers do not delegate these issues to professional representatives. If auditors wish to avoid exercising formal decisionmaking power in what may appear to be an arbitrary manner, then they in effect must become educators and socializing agents for the taxpayers, a process we often observed in audits. In the best of circumstances, the imbalance of expertise is likely to lead to a less full exploration of the more esoteric issues simply because it is difficult for one person to identify and explore all the relevant ramifications of a complex and abstract problem.

[12] In most cases, the decision about whether to use a professional representative for the audit is decided well before the nature of the issues or the scope of the audit is determined. However, taxpayers with representatives often become more involved in particular issues than they anticipated, and taxpayers occasionally bring representatives into the audit midstream. Regardless of representation, locating and identifying records and documentation is generally the responsibility of the taxpayer. From the audit papers, we initially tried to code the possible monetary stakes of issues but had to abandon the effort because the raising and negotiation of issues does not follow a simple model of proposal and counterproposal. An auditor often raises an issue by asking for an explanation or more documentation, and considerable discussion and negotiation can occur before either side puts a dollar figure on a possible adjustment. Consequently, if the auditor decides in the end that the taxpayer's position is acceptable, the issue can be settled without any statement of the possible tax consequences. Of the 684 issues we coded from the audit files, we could determine how 357 were initially raised: The auditors raised 62% by asking for an explanation or documentation and 34% by proposing an adjustment (4% were raised by the taxpayer or representative).

[13] My impression from reading the working papers for many audits is that representatives who generally try to insulate their client from the auditor will agree to a meeting with the taxpayer on a hobby issue as the best way to establish the business motivation and orientation of their client.

Carruthers and Espeland (1991) argue convincingly that double-entry bookkeeping through the centuries has had a rhetorical, or symbolic, value for a wide range of audiences. Having well-organized and annotated records in accordance with good bookkeeping practice serves symbolically to convey more general competence in financial affairs, adequate socialization into rational accounting, and honesty in financial reporting. Good books, of course, are not an empty symbol. Others have come to rely upon their rhetorical significance because they indeed are usually a reliable indicator of more general competence and honesty. Sophisticated tax cheaters and financial swindlers often take advantage of this fact, however, and prepare well-organized, seemingly complete, but "cooked" books.

This rhetorical value of following the cultural norms can be seen in tax audits of individuals. For some types of issues, it has in fact become established in caselaw. For instance, one of the key criteria for determining if an activity is undertaken as a business or a hobby is whether the taxpayer maintains adequate business records (Khorsandi 1993). It is easier to convince an auditor (or appeals officer or court) that the records are adequately maintained if they are complete and organized in a customary way that permits "footing" and cross-checking. In other words, if an activity is to be considered a business for tax purposes, then one must run it in a businesslike manner, and one rhetorically important indicator that the activity is run like a business is that generally accepted accounting and bookkeeping procedures are employed.

Displaying competence in the more esoteric aspects of financial accounting also has rhetorical effects on how issues are handled in audits. Even when the more abstract aspects of accounting or law are at the heart of the issue, there can still be secondary questions about the accuracy of the facts underlying the accounting manipulations and interpretations. However, being able to communicate competently with the auditor about the formal principles of accounting seems to shift the focus away from the questions about the raw documentary evidence. If there is a symbolic indication of adequate socialization, then the analytical reasoning expressed in accounting working papers is more likely to be the subject of investigation than are the facts behind the abstracted and summarized figures. While I cannot test the proposition quantitatively with the data I have, my sense from reading audit files is that questions of supporting documentation are more likely to be raised about relatively straightforward business or personal expense lines on a return than they are about more abstract accounting issues. The process of reducing facts and figures into a formal account using the accepted principles of rational accounting absorbs a great deal of empirical uncertainty (March & Simon 1958). It is as though auditors are reassured about the facts by knowing that the facts have properly gone through the process of classification and manipulation to end in a formal account, and they focus their inquiry instead on the consistency and reasonableness of the inferences made within the conceptual world of financial accounting.

How deeply into the culture an issue lies may also influence the affective tone of a dispute and the willingness of the parties to approach it with reason and dispassion. Issues concerning legal and accounting abstractions and manipulations that only have meaning within the cultural framework of accounting are by that token also more divorced from the everyday life of taxpayers than are issues of fact. If the processing of the information is not delegated, then taxpayers typically undertake them as tasks separated from their everyday life and the running of their businesses and financial affairs. During audits, these more abstracted issues of accounting procedures and legal interpretation clearly have financial consequences for taxpayers, but they also are cognitive and intellectual problems that can be explored without bringing in other aspects of one's life. Rational arguments can be presented by both sides; and the auditors, taxpayers, and representatives take on the roles of debaters. There are often disagreements over interpretations and the correct application of accounting and legal principles, and there at times are emotional exchanges, but there usually is not frustration unless the other side is perceived to be unreasonable or incompetent.

In contrast, the "show me" issues about adequate documentation and facts and circumstances distinctions can be both frustrating and personally revealing. The taxpayers are in the position of having to prove and support what they believe to be more or less correct to the satisfaction of a resistive audience. Unlike disputes about the reasonableness of accounting manipulations and conclusions, these disputes about facts are often frustrating for both sides with tensions running high because there is no clear means of resolving them consensually if the taxpayers cannot find documentation or explanations that satisfy the auditors. These issues are also much more revealing of oneself and one's financial affairs because their resolution requires laying out everyday aspects of one's life in the cold form of receipts, bankbooks, loans, correspondence, etc. Exposing details of one's life to a stranger in an official capacity can pull up old memories and defenses and can for many taxpayers be heavily laden with negative affect. Several of the taxpayers in our study volunteered that they felt audits involved an unwarranted invasion of their privacy; some expressed a strong emotional feeling of having been violated. Issues about fact and circumstances distinctions, such as between a business and a hobby, can also bring into question the taxpayers' self-definitions of significant aspects of their lives. The defense of one's position on these issues consequently tends to take on a personal tone that may lead to a hardening of positions and an unwillingness to cooperate in seeking a satisfactory resolution.

Ironically, auditors probably have more discretion on these issues than they do for many of the issues focusing on accounting principles and legal interpretations: The procedures for handling issues toward the center of a professional culture are generally better defined than are those for "dirty" issues on the periphery (Abbott 1981). With the "show me" issues, auditors at some point must make a judgment about how far they can trust the recall, veracity, and motivations of the taxpayers, based on their interactions during the audit, their cooperativeness and attitudes toward the audit, and criteria such as the neatness and organization of their records and working papers and their sophistication in accounting.[14] Therefore, we should expect to see more willingness by auditors to compromise or even capitulate on questions about facts and circumstances distinctions and adequate documentation—the very issues on which taxpayers are likely to be the most defensive and uncompromising.

Data from Oregon Individual Income Tax Audits

Thus far I have analyzed how the problems taxpayers have with socialization into the culture of accounting, and the information and skills needed at the three stages of tax return preparation are related to the types of issues raised in audits. I have also suggested how these relationships may affect the way issues are handled and resolved during audits. In this section I turn to some quantitative data to obtain an estimate of the relative frequency of the analytic types of issues and to test hypotheses about the handling of the issues.

My primary source of quantitative data is a larger study of a sample of individual income tax audits conducted by the Oregon State Department of Revenue (DOR). Our sample of audits was drawn from four of its field offices, which cover a major metropolitan region, a smaller metropolitan area, and a rural region. The four offices performed about 70% of the audits done statewide, and sampling from them provided a good mix of taxpayers' economic and social circumstances while also minimizing travel time and expense in the data collection. The scope of the larger study is briefly described in note 3.

During the period of our study, which extended until almost all of the sampled audits had been completed, the participating auditors filled out a brief questionnaire at the end of each audit

[14] Similar findings have been found in research on enforcement in many different regulatory arenas. See, e.g., Bardach & Kagan 1982, Braithwaite 1985, Hawkins 1984, Hutter 1989, Gilboy 1991, and several of the contributions in Hawkins & Thomas 1984.

they completed.[15] These "Audit Report Forms" included information on the characteristics of the tax returns that were selected for audit, the nature and resolution of the major issues raised with the taxpayers during the audits, and descriptions and evaluations of the auditors' interactions with the taxpayers and their representatives. The completion rate, arrived at admittedly with some prodding, was 84% with a total of 466 completed Audit Report Forms.[16]

The DOR targets most of their field audits on taxpayers who are self-employed or in a partnership or S-corporation at least part time or who have significant investment income. Consequently, we are looking at the issues and problems experienced by taxpayers who are probably on average more sophisticated in financial and accounting matters than are the majority of individual taxpayers.[17] From the Audit Report Forms, the lowest adjusted gross income (AGI) on the returns initially selected for audit[18] was a loss of over $100,000; the maximum AGI was almost $1 million. Of the selected returns, 8% had negative AGIs (net losses). Of those with positive AGIs, the median was $30,297 with an interquartile range from $15,046 to $53,024. The audited taxpayers are typically in small businesses: 75% of the selected returns had Schedules C for self-employed businesses, and 21% included income or losses from either partnerships or S-corporations. Only 14% of the returns had no self-employment, partnership, or S-corporation forms. The taxpayers are also involved in investments: 38% of the returns had either Schedule D or the supplemental Form 4797 for capital gains and losses.

In the Audit Report Form, the auditor was asked to describe up to four of the potentially largest (in either direction) issues raised with the taxpayer. The directions defined quite broadly the range of issues to include:

15 To assure confidentiality, we selected for interviews only about 90% of the taxpayers whose audits began during the study period. The auditors and their managers at no point knew which taxpayers were in our sample for interviews or which ones had actually been interviewed, except in a few cases where the taxpayers volunteered the information in the course of the audit.

16 The exact completion rate is difficult to calculate because of incomplete DOR information on the cancellation of audits and the dates when the audits were completed, particularly for those audits that we did not sample for interviews with taxpayers. One auditor who conducted 17 of the audits in our sample consented to give a general interview about his audit experiences, procedures, and perspectives but declined to complete any Audit Report Forms.

17 The decisions about which returns in this pool are to be audited are usually made by the individual auditors, often on the basis of a scanning of the returns themselves. In one office the manager selected the returns and assigned them to the auditors, in part with an eye toward the professional development of the auditors. These are not random audits: Returns are selected for audit because something on them or related returns appears problematic.

18 Audits often are expanded to include additional years and other returns of the audited taxpayer.

> In selecting the four potentially largest issues, we would like you to consider all of those issues that were raised in one way or the other with the taxpayer or representative beyond a request for documents in the initial contact letter. These issues include:
> 1. Those about which you requested more documents or asked for clarification, whether or not you ever proposed a change in them.
> 2. Those which were raised with the taxpayer or representative as potential problems or errors or for which you proposed a change in meetings, phone calls, or correspondence but in which no change was made ultimately.
> 3. Those for which a change was made in your final audit report.

We focused only on those issues raised with the taxpayer or representative for two reasons. Potential issues that were not communicated to the taxpayer or representative were most likely either de minimis or readily determined to be reasonably correct from the documentation provided initially by the taxpayer and, hence, less indicative of significant compliance difficulties. Second, for the purposes of the larger study we wanted to maximize the likelihood that the issues in the Audit Report Forms would also be described by the taxpayers in their interviews.

A total of 962 issues were described in the 466 Audit Report Forms. These issues are the unit of analysis for the tables and graphs presented later. For each issue, the auditors described the nature of the issue, how it was resolved, and the forms or schedules involved. The auditors were given a set of categories for describing the issues and were also encouraged to write additional comments. We developed the categories in consultation with some DOR auditors we interviewed during the initial stages of the project. In what follows I use the information about these issues, first, to estimate the relative frequency of the types of issues I delineated earlier and, second, to explore quantitatively some of my expectations about how the type of issue affects what parties are involved and how the issues and resulting disputes are handled.

The Distribution of Issues Raised in the Audits

Table 1 summarizes six analytical categories of audit issues that encompass almost all those listed on the Audit Report Forms. Two of the categories are further broken down by the more specific issue codes the auditors used in completing the forms. Although I developed my analysis of how audit issues are related to the culture of financial accounting after we developed the Audit Report Form, the classification of issues we asked the auditors to use can generally be mapped relatively unambiguously into the analytical categories I described above.

Table 1. Auditors' Descriptions of Issues Raised during the Audits

Issues Raised with Taxpayer		% of Issues
1. Math or clerical error		8.7
2. Unreported income		21.6
3. Insufficient documentation		22.8
4. Classification and allocation issues		24.5
a. Allocation issues		
1. Personal or business	9.7	
2. In or out of state	1.7	
3. Exemptions and dependents	0.3	
b. Other expense and loss issues	12.9	
5. Abstract accounting or legal issues		20.9
a. Basis in corporation or partnership	3.0	
b. Other basis issus	7.6	
c. Capitalization and depreciation	4.6	
d. Distributions from corp. or partnership	1.8	
e. Times issues other than clerical	3.0	
f. Interest expense allocations	0.9	
6. Other		1.5
a. Taxable vs untaxable income	1.2	
b. Other miscellaneous	0.2	
		100.0%
		(962)

The first category, possible math or clerical errors, cuts across the steps of abstracting information for tax returns. Most of them, however, occur during the first two steps of collecting and maintaining the records and organizing the information into categories. They range from isolated errors—such as an addition error, copying sums incorrectly, entering an item twice, or putting it in the wrong category—to more systemic ones such as a preparer's computer program misallocating one category of expenses. Sometimes an apparent error proves to be actually correct, or errors cancel out so that there is no change in the return. Auditors generally find this type of problem when they are first organizing the supporting documents and comparing them against worksheets and the return. As shown in Table 1, 9% of the issues raised by auditors during our sample of audits were of this type.

Most issues about possibly unreported income were related to incomplete or poorly annotated records. Sometimes the incompleteness was quite likely intentional: There were a few instances in which some income was completely "off the books," such as tip income for a service worker; and there were some cases in which the taxpayers' personal and business expenses seemed to be larger than their income allowed and the possibility of underreported receipts was high because of the nature of the business and the bookkeeping procedures. But auditors primarily raised these issues when they found unexplained deposits in their analyses of the taxpayers' bank statements. The income was in the books but not carried through to the return, either because it was nontaxable (gifts, loans, transfers between accounts, etc.) or because it was incorrectly omitted taxable income. When confronted with a list of unexplained deposits, the taxpayers must search their memories and records to try to identify and document where they came from. Typically, taxpayers can whittle away at the list so that the final adjustment, if any, is less than the initially unexplained total.

The third type of issue in Table 1, insufficient documentation, is the parallel on the expenditure side of possibly unreported income. Either the records and receipts add up to less than the claimed amount spent or the nature of an expenditure is insufficiently documented. Together these two types of issues, focusing primarily on problems in the first step of collecting and maintaining records and documents, account for 44% of all the issues raised by the auditors. Thus, fulfilling the burdensome and distracting obligation to record and tabulate one's activities like an accountant appears to be just as problematic as the more abstract obligation to interpret and apply the law and accounting principles.[19] As I noted earlier, recording and tabulating one's activities is also an obligation that generally cannot be delegated to a CPA or tax preparer, and most taxpayers can afford to delegate it only partially to a bookkeeper. No wonder many taxpayers come away from audits vowing to keep more complete and clearly annotated records.

Almost one-fourth of the issues were described by the auditors as classification and allocation ones, the types of issues focusing on the second analytical step of deciding what categories are appropriate and allocating the recorded income and expense items among them. Distinguishing between personal and business items often involved the percentage allocation of home and automobile expenses, although this category in Table 1 also includes issues about the appropriateness of categories, such as whether the taxpayer met the criteria for an office in the home and whether an activity was a business or a hobby. Questions about casualty losses, bad debts, charitable contributions, medical expenses, and so forth are among the other expense and loss issues. Many of the auditors probably also included questions about inventory here, although they often involve decisions about the capitalization of expenses under the uniform capitalization rules (IRS 1993a; Minasian, Herndon, & Tovig 1994). While the auditors reported that the issues in these categories were primarily about classification and allocation, the handling of many of them also involved the taxpayers providing support-

[19] Issues about the adequacy of documentation and substantiation for claims appear to be a sizable proportion of the issues carried into the appeals process, both in Oregon and at the federal level and for both individual and corporate returns. For some figures on the distribution of issues handled by the IRS's Office of Appeals, see GAO (1993b).

ing documentation for the positions they took. Furthermore, the auditors would not have raised many of these issues if the initial documentation had been more complete and better organized in proper accounting form. In other words, the distinction between issues focusing on collecting and maintaining records and issues about organizing and summarizing the information in appropriate categories is, in practice, often shadowy and somewhat arbitrary. However, they both are "show me" issues that are more likely to be raised and debated if the taxpayer has not followed the canons of bookkeeping and accounting.

The more abstract and esoteric accounting and legal issues such as basis, capitalization and depreciation, interest baskets, and so forth may predominate in the work and professional writings of tax lawyers and accountants; however, they were the focus of only 21% of the issues raised in our sample of individual and small business audits. Just over half of them concerned the correct calculation of basis. These issues are quintessential accounting ones that must be stated and resolved within the framework of the accounting culture. In our reading of audit files, we were struck by the fact that issues about basis were typically resolved neither by additional primary-source documentation nor by reference to tax law; rather, they were resolved when both sides could agree on a worksheet that laid out a sequence of transactions in the accepted accounting form for calculating basis. There might have been some follow-up checking of supporting documents, but the primary focus was on the worksheet whose meaning and significance was embedded in accounting.[20]

Most of the audits in our sample involved a range of issues. Using the six broad categories of issues in Table 1, we found that over half of audits in which the auditors reported raising at least one issue ($N = 451$) involved two or more categories of issues. As shown in Table 2, 11% of these audits involved only abstract accounting or legal issues, while 25% involved both this type of issue and one or more of the less abstract issues (math or clerical error through classification and allocation); 16% involved both a classification and allocation issue and one or more issues about math or clerical errors, unreported income, or documentation.

Despite this admixture of issues within a single audit, there are some clear and interpretable relationships between the type of issue and some of the auditors' evaluations of the audit as a whole. On the Audit Report Form, the auditors rated the adequacy and complexity of the taxpayer's records and the uncertainty of the tax issues on a scale from 1 for "not at all" to 5 for

20 I have classified the taxable versus nontaxable income issues in the catch-all other category in Table 1 because there was not enough information to determine how much legal interpretation was involved in handling them.

Table 2. Distribution of Issues in Audits with One or More Issues ($N = 451$)

General Type of Issue	Only Type	Cumulative Combinations[a]
1. Math or clerical error	3.3%	—
2. Unreported income	6.0	1.8%
3. Adequacy of documentation	7.1	12.4
4. Classification and allocation	13.5	16.4
5. Abstract accounting or legal	10.6	25.5
6. Other miscellaneous	0.7	2.4
Totals	41.2%	58.5%

[a] Percentage of audits involving this type of issue in combination with one or more higher in the table.

"very."[21] Figure 1 plots the means of these three ratings for the five analytical types of issues, using the individual issue as the unit of analysis. The one-way ANOVAs for all three scales are statistically significant beyond the .01 level, and the linear trends from left to right for the uncertainty of the issues and the complexity of the records are also significant at the .001 and .05 levels, respectively (weighted statistics). Both the uncertainty of the issues and the complexity of the records are highest when an abstract accounting or legal issue is raised in the audit, and auditors are most likely to raise issues about documentation when the ade-

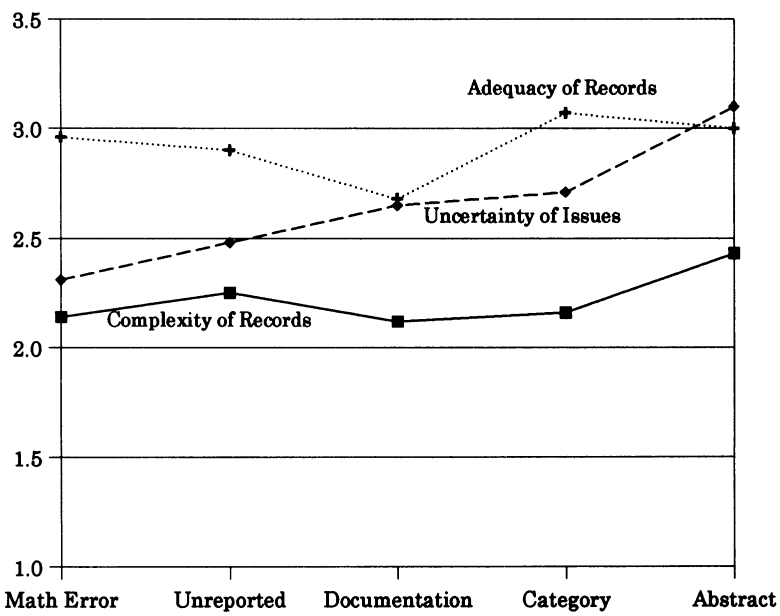

Figure 1. Mean complexity, uncertainty, and adequacy for each type of error

[21] Adequacy of records as reported here is the mean of the auditors' ratings of the completeness and organization of the records (Cronbach's $\alpha = .91$); uncertainty of the legal issues is the mean of their ratings of the complexity, unusualness, and grayness of the tax issues (Cronbach's $\alpha = .80$).

quacy of the taxpayer's records is relatively low. The relationship between issues about unreported income and the complexity of records may be because these issues are most likely to arise for taxpayers with several sources of income, which in turn add to the complexity of their records.

The Effects of the Type of Issue

My analysis of the information and knowledge needed to handle the various types of issues suggested that different parties were likely to be involved. For the "show me" issues dependent upon information most readily accessible to the taxpayers, I argued that taxpayers are likely to be involved even if there is a representative. On the other hand, taxpayers are likely to enlist the assistance of tax professionals for the more abstract issues requiring an understanding of the accounting culture.

At the beginning of the audit process, many taxpayers elect to handle the audit on their own, while others elect to delegate the audit to a professional representative. Consequently, the analysis of the relationship between the parties involved and the issues raised must be conditional: Given that the auditor had contact with a representative, the auditor was more likely to also have contact with the taxpayer for the "show me" issues (62%) than for the abstract accounting and legal issues (46%) ($\tau_b = .14$, $p < .001$). The other expected conditional relationship is weaker: Given that there was contact with the taxpayer, the auditor was somewhat more likely to have contact also with a representative for the abstract issues, but the relationship is significant at only the .10 level. There are several reasons why this relationship may be weaker. Many taxpayers are sufficiently socialized into the accounting culture that they have an adequate understanding of the accounting issues involved in their returns. If they are not, then they may still accede to the expertise of the auditor rather than pay for a representative, or the auditor may explain the accounting issues to the taxpayer.[22] Indirect support for the relationship comes from the fact that the conditional likelihood that a representative was involved along with the taxpayer increases as the uncertainty of the tax issues increases.[23]

[22] For example, in many cases the auditors gave unrepresented taxpayers explanations of how to calculate basis and provided depreciation schedules to use in later years.

[23] With the uncertainty scale divided into 3 categories, $\tau_b = .14$, $p < .001$. I should note that the data on the parties involved are for the audit as a whole, so the relationships reported may be weaker than they would be if we had information on who was involved in the handling of the specific issues. These relationships are probably not affected by the likely size of the tax consequences because the relatively simple issues of inadequate documentation are just as likely to result in sizable tax increases as are the more uncertain issues and those involving abstract accounting operations. See also the discussion in note 12.

The five general types of issues also tend to have different outcomes, as shown in Figure 2.[24] For each issue the auditors described on the Audit Report Form, they indicated the outcome at the end of the audit using an analytical set of categories. Overall, the auditors accepted that taxpayer's original position on 35% of the issues and made no change; they ended up making a change for 52% of the issues; and 12% of the issues were unresolved at the end of the audit.[25] Unresolved issues are those on which the taxpayer and auditor have not been able to agree, either by one party accepting the position of the other or by negotiating to reach a new solution that is acceptable to both (Smith & Stalans 1994). In the DOR, auditors are encouraged to reach amicable agreements with taxpayers, so there often is considerable discussion and negotiation before the parties declare an impasse. When the parties fail to agree on an issue, the auditor includes his or her position in the final report and makes the corresponding adjustments. The taxpayer then must decide whether to "lump it" and pay the additional tax, interest, and occasionally a penalty, or to appeal the auditor's decision through the DOR's appeals procedures.

Not surprisingly, most of the questions about possible math or clerical errors resulted in a change by the auditor that was accepted by the taxpayer, although 20% of these issues ended with no change. There usually are not many grounds for debate about these questions, and only 3% were unresolved. Issues about unreported income were the most likely to result in no change (46%), and almost all these issues were resolved at the end of the audit (7% remained unresolved). In my earlier analysis of how issues were typically handled, I argued that the "show me" issues, particularly those about the applicability of categories were often contentious and difficult to resolve, both because of the imbalance of information and because these issues often exposed sensitive aspects of the taxpayers lives. In Figure 2, the distribution of outcomes for documentation and category issues are similar to those for the more abstract accounting and legal issues, with virtually the same proportion of category and abstract issues going unresolved (17% and 15%, respectively). Contentions about the interpretations of facts are often just as difficult to re-

[24] Cramer's *V* for the two-way association in Fig. 2 is .15 ($p < .001$). Because of the significant association between the type of issue and the parties involved and the three scales shown in Fig. 1, I also did a multinomial logistic regression of outcome on all five types of issues, the parties involved in the audit, and the two scales from Fig. 1 that have significant effects on outcomes, uncertainty of the issues, and adequacy of the records. All the main effects in the model are statistically significant at the .001 level, and there are no significant interactions. The results of the multinomial logistic regression are given in Table A1 in the appendix.

[25] For the analyses here I have eliminated 7% of the issues for which the auditors reported that they made no changes because the difference was not material or that the issue had an idiosyncratic outcome that did not fit the analytical categories.

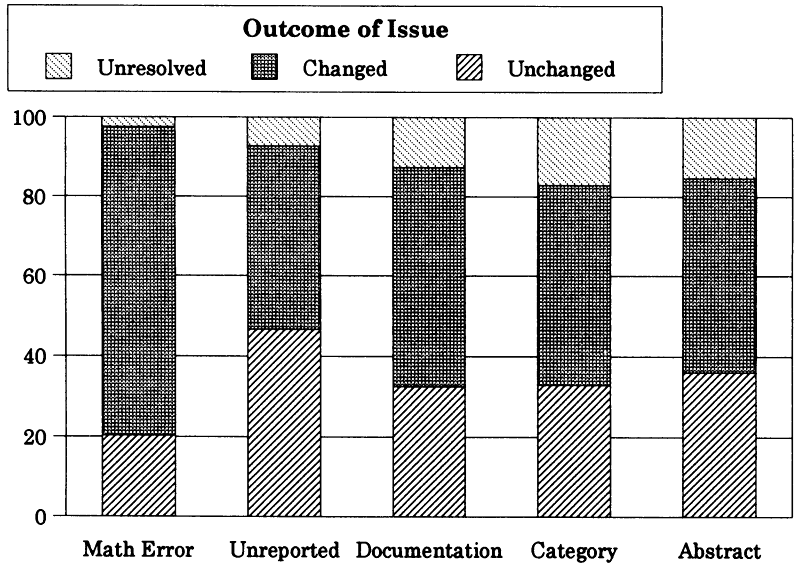

Figure 2. Outcomes by types of issues (in percentages)

solve as are contentions about more abstract interpretations of the law and accounting principles.

I also noted that auditors probably have more discretion on the "show me" issues than on the abstract accounting issues. With less than perfect documentation and information, auditors often have to make judgments about how much they should rely upon the taxpayers' assertions, judgments based in part on their interactions with the taxpayers and the taxpayers' cooperativeness and attitudes toward the audit. My analysis thus predicts that the auditor's perception of the competence and cooperativeness of the taxpayer has more effect on the outcomes of the "show me" issues about facts and circumstances distinctions and adequate documentation than on the outcomes of the more abstract accounting issues.

At the end of the Audit Report Form, we asked the auditors to evaluate the taxpayers and their representatives on a series of adjectives, using a scale from 1 for "not at all" to 5 for "very." The mean evaluations of cooperative, informed, and efficient form an internally reliable scale of the taxpayer's and representative's "facilitation" during the audit (Cronbach's $\alpha = .78$ for taxpayers; .83 for representatives). The three adjectives together seem to indicate both an adequate competence in accounting and a willingness to use that competence to expedite the audit. To test the predicted interactive effect of facilitation and the type of issue, I used the auditor's evaluation of the taxpayer if the taxpayer had had contact with the auditor and of the representative if the auditor had not had interactions with the taxpayer. I then condensed this combined scale into three ordinal categories.[26] Because math and clerical errors do not fit clearly into the analytical stages of preparing a tax return and because they have a distinct distribution of outcomes, I am limiting my analysis to the other four types of issues. Also, the effect on outcome of the categorized scale of facilitation for unreported income issues was not statistically distinguishable from its effect for documentation issues, so I have combined these two analytically similar issues to clarify the interpretation and increase statistical power. With this condensing of categories, the interaction between facilitation and type of issue has a significant effect on outcome in a multinomial logistic regression including facilitation and type of issue as the main effects ($p < .001$). (See Table A2 in the appendix.) The interaction between issues and only the top two categories of facilitation is also statistically significant ($p < .01$).

The interaction is shown graphically in Figure 3. For all three categories of issues, the taxpayers or representatives with low facilitation were the most likely to have the issue unresolved at the end of the audit, particularly for the first two types of issues. This consistent pattern may very well be because the auditor's evaluation of low facilitation reflects in part the fact that one or more issues could not resolved; in other words, the effect may be from how the issues were unresolved to low facilitation rather than the other way around. As one moves from the less abstract issues on the left of Figure 3 to the more abstract on the right, there is also an increasing likelihood that those with low facilitation will have their returns changed by the auditor: The percentage unchanged decreases and the percentage changed increases.

The patterns for medium and high facilitation more clearly address the hypothesis and provide some qualified support for it. Compared with moderate facilitation, high facilitation decreases the already low proportion of unresolved issues about documentation and unreported income, but it does not have this effect for the more emotionally charged issues about categories and classification. For both the unreported income and documentation issues and the categories issues, however, the main difference between medium and high facilitation is that there is a shift from changed to unchanged outcomes: For these issues, increased facilitation above some threshold on the part of the taxpayer or representative does not primarily affect the likelihood that the parties will agree on a resolution; rather, it decreases the likelihood that the auditor will in the end propose a change. On the other hand, the primary difference between medium and high

[26] The low category includes values that are 1 and 2.5 (18%); the middle category includes values between 2.5 and 3.5 (38%); and the high category includes values 3.5 (44%). For 39 issues (4%), the auditors gave an evaluation of neither the taxpayer nor the representative.

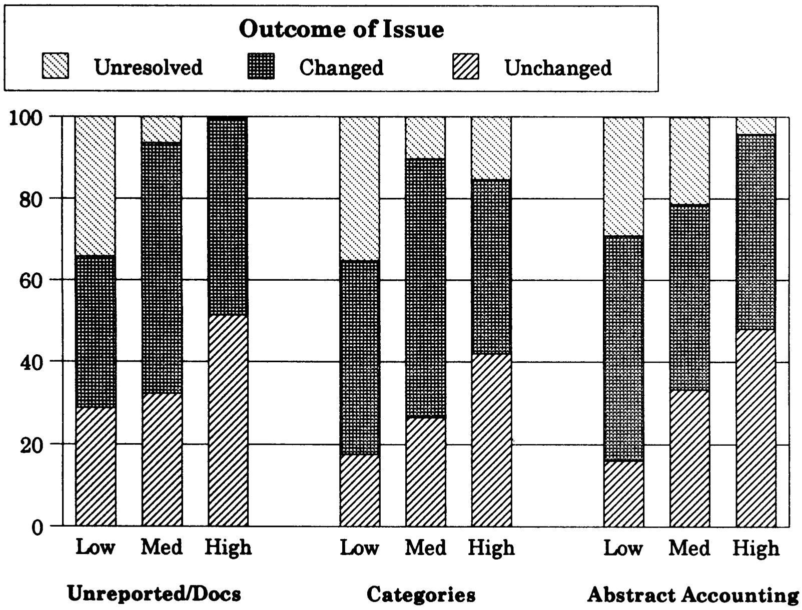

Figure 3. Outcomes by facilitation of taxpayer or representatives for 3 types of issues (in percentages)

facilitation for abstract accounting issues is a shift from unresolved to unchanged; the proportion of these issues on which the auditor made a change accepted by the taxpayer is essentially the same for both levels of facilitation. Thus, for abstract accounting issues, facilitation seems to be as much related to the willingness of the parties to negotiate and modify their positions as to the auditor's decision to propose a change.

We can also view Figure 3 from the perspective of how different types of issues may be developed and negotiated. Consistent with my analysis that the issues focus on different stages of the tax reporting process, the shift from changed to unchanged for the medium and high facilitation categories in the first two types of issues suggests that the emphasis in these "show me" issues tends to be on information gathering and discussion before the auditor decides whether to formally propose a change, with less debate about the decision once it is made. In contrast, the shift from unresolved to unchanged for the abstract accounting issues suggests these issues tend more to involve negotiation and debate after the auditor has proposed a change.

Finally, as information buffers for tax administrators, taxpayers can more effectively present their positions on issues during audits if they have collected and organized the information in the way that is most relevant for the work of the auditors. Also, I have suggested that following the canons of accounting has a rhetorical benefit for taxpayers as a symbolic indicator of more general business and tax reporting ability and forthrightness.

Across all types of issues, the adequacy of the taxpayers' records is one indicator that they understand and follow the basic methods and norms of the accounting culture. This reasoning suggests that the likelihood that issues are resolved in the taxpayers' favor increases with the adequacy of the taxpayers' records. To explore this hypothesis, I condensed the scale for the adequacy of records (see note 21) into three ordinal categories and examined the distribution of outcomes within each of them. Figure 4 shows that there is indeed a significant positive relationship between adequacy of records and the type of outcome (see Table A3 for the related multinomial logistic results).[27] As the adequacy of records increases, the proportion of issues that ended with no change increases, and the proportion with a change decreases. Also, the proportion of unresolved issues decreases somewhat. Thus, the adequacy of the underlying information both increases the likelihood that the auditor will not make a change and, if a dispute does arise, facilitates reaching a resolution that is acceptable to both parties.

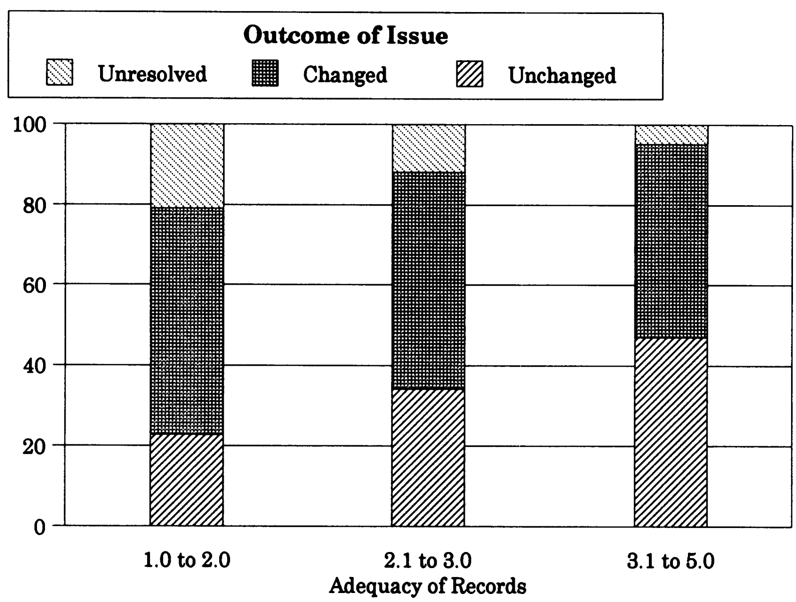

Figure 4. Outcomes by adequacy of records (in percentages)

[27] Cramer's V for the relationship in Fig. 4 is .18 ($p < .001$); Somers' $d = .21$ ($p < .001$). Although the relationship in Fig. 4 is zero-order, it is consistent across issues. In a multinomial logistic analysis with type of issue included, there was no significant interaction between adequacy of records and the five types of issues or between adequacy of records and the three categories of issues used in Fig. 3.

Summary of Quantitative Findings

This section of quantitative analysis has been quite detailed and dense. To highlight the main themes, here is a brief summary of the primary findings on the nature of audit issues and their relationships with socialization into accounting.

- The less esoteric problems that arise during the first two stages of the tax filing process make up the bulk of the issues in audits: 44% were issues about unreported income and insufficient documentation; 24%, classification and allocation issues; and 21%, basis, capitalization, and other abstract accounting and legal issues.
- Both the uncertainty of the tax issues and the complexity of the records are highest when an abstract accounting or a legal issue is raised.
- Even if representatives are involved in the audit as a whole, taxpayers are likely to become involved with the "show me" issues. To a lesser extent, representatives tend to become involved with abstract issues even if the taxpayers were involved in other aspects of the audits.
- Contentions about the interpretations of facts, especially for classification issues, are just as difficult to resolve as are contentions about more abstract interpretations of the law and accounting principles.
- Demonstrating both the ability and willingness to cooperate in expediting the audit affects how issues are resolved: For all types of issues, facilitation by taxpayers or representatives increases the likelihood that the auditors will accept their positions.
- For the "show me" issues, the focus tends to be on information gathering, and facilitation decreases the likelihood that the auditors will propose a change. For abstract issues, the focus is on alternative conclusions based on different manipulations, and facilitation primarily decreases the likelihood that the issues will go unresolved.
- Collecting and maintaining adequate records is another indicator of the taxpayers' socialization into accounting, and it also significantly affects the handling of issues. Having adequate records increases the likelihood both that auditors will not make changes and, if disputes do arise, that the parties will agree on a resolution.

Concluding Observations

Throughout this article I have been arguing that the prescriptive obligations of income tax laws drag many taxpayers reluctantly into the culture of rational financial accounting. They are drawn into it because they are required to be information buffers to meet the resource needs of the government and to provide the information needed by tax officials for the effective administration and enforcement of the tax laws. In the abstract, individuals may know that acting more like accountants would be "good" for them, but it is very often tax obligations that force them to learn some of the concepts and procedures and to discipline themselves to use them. I have also presented some evidence indicating that adequate socialization into the culture of accounting increases a taxpayer's chances of prevailing on issues raised during audits. To conclude I want to stand back to take a broader perspective and suggest that the socialization also has long-term benefits for at least some taxpayers, particularly those who own or participate in small businesses. Good accounting procedures may be dull and burdensome, but the checks and summaries provided by adequate journals and ledgers provide information that may often meet unanticipated needs of the taxpayers themselves.[28]

Socialization into accounting procedures can provide information that can help households track their income and expenses and make more informed and rational decisions about the use and allocation of their resources. The information required by tax laws and administration also meets the internal needs of businesses. As businesses grow and involve employees or more than one owner, the owners become more removed from some of the transactions and they find themselves in the position of principals who need more information to check on the actions of their agents. One of the most poignant cases we encountered illustrates the point. A couple owned a small retail business that was being run for them by some close relatives. These relatives also handled most of the finances, and the couple was concerned that the business was doing very poorly, so poorly in fact that it was selected for audit by the DOR. The audit revealed that the relatives were making large personal draws to cover their own rent, insurance, and other living expenses. Too late, the audit focused the taxpayers' attention on the need for better internal controls and accounting procedures so that, as the auditor noted in his working papers, "they don't get stuck paying all the taxes and their relatives get all the draw."

Similarly, good accounting procedures can help preserve good relationships among partners and co-owners, or at least provide a means by which they can check on the good faith of one another. Good books and an accurate accounting of basis and assets throughout the life of a business is even more critical

[28] Kagan (1989) discusses some of these same points from the perspective of systemic pressures outside the tax system that make the income flows of taxpayers more visible. Here I am considering how meeting the obligations of the tax system can help taxpayers develop the expertise and information they may want to use later to address other needs and pressures.

during the often nasty dissolution of partnerships and corporations.

The procedures and information developed for tax purposes may also help businesses meet their own resource needs. A good set of books that summarize and present the financial history of a business is often critical when seeking loans or additional capital from banks or investors, or when businesses merge or are bought. For the external audiences involved in these transactions, the interpretation of a financial summary structured within the framework of rational accounting may be largely rhetorical, but that fact does not detract from its utility for the owners of the business.

What all these examples have in common is that the need for a good accounting system often is recognized only after the fact, when it is too late for the need to provide an incentive to collect, structure, and check the financial information. For many individuals and businesses, the tax laws provide one of the few prior and continuing incentives to do so. Because of the pervasive nature of broadly based income taxes, the tax system, consequently, has become one of the primary motivations for individuals to be socialized into the culture of rational financial accounting.

Information from audits and other tax enforcement activities indicates that many taxpayers are still not socialized enough to be able to file accurate tax returns, and a common theme in our interviews with accountants and tax preparers is that they cannot convince many of their clients to follow even simple bookkeeping procedures. However, this evidence of incomplete socialization does not gainsay that individuals and businesses in the aggregate would do much less bookkeeping and accounting if they did not have income tax obligations. The financial information initially produced for income tax purposes, thus, probably improves the rational decisionmaking of individuals and businesses and, at least in principle, also increases the efficiency of the economy as a whole.

Finally, my analysis of the cultural grounding of taxpaying can be extended in two directions. First, as I noted at the outset, most bodies of regulatory law are also grounded in the specialized knowledge, procedures, and norms of other scientific, engineering, or professional fields. Analyzing compliance problems in other regulatory arenas in terms of these cultural groundings and the related socialization requirements may lead to new insights and avenues of investigation. Likewise, how does this perspective contribute to our understanding of the dynamics of enforcement in various regulatory areas?

Second, recognizing the grounding of taxpaying and tax law in the culture of accounting has implications for the transfer of portions of legal systems into other societies, one of the current themes in research on globalization. If meeting tax obligations is the initial motivating force for many to learn the fundamentals of bookkeeping and accounting, then who is to do the training and socializing? Clearly, tax administrators are, and should be, important socializers, through both their assistance and enforcement activities. In modern capitalist countries, however, they do not have to assume primary responsibility for bringing taxpayers into the culture of financial accounting. There is also an "infrastructure" of accountants, tax preparers, and tax and financial advisers who are already well versed in rational financial accounting and who are willing and able to inform and train others, personally and through publications and the media. Most accountants, in fact, probably spend a good deal of their time educating their clients and trying to cajole them into routinely using good bookkeeping and accounting practices.

Other countries today are often being encouraged to model their tax systems on those of the leading capitalist countries. Therefore, it is important to note that an infrastructure of accounting professionals does not exist in many developing countries or in the formerly communist Eastern bloc, where concepts such as profit, basis, capitalization, and depreciation have not long been part of the standard business lexicon. In many of these countries, tax administrators with historically low legitimation may have to take a leading role in socializing the large mass of individuals and business who are not under the tutelage of Western advisers. My analysis of the cultural grounding of the income tax system, thus, has discouraging policy implications for how readily and efficiently these societies can implement an income tax for individuals and small businesses.

Appendix
Results of Multinomial Logistic Regressions

The results presented in Figures 2–4 were supported by multinomial logistic regressions with outcome (unchanged, changed, unresolved) as the dependent variable. As mentioned in note 22, the first analysis included the five general types of issues shown in Figure 2, the parties involved in the audit, and the scales for the uncertainty of the issues and the adequacy of the records. The coefficients in the model are for the log odds of changed versus unchanged and unresolved versus unchanged. Four variables were used to represent the five types of issues, with the last type—abstract accounting and legal issues—as the omitted category. The variables were coded 1 for the corresponding issue, 0 for the other three represented issues, and −1 for the omitted fifth issue. The coefficients, consequently, represent deviations from the average of all five issues. Parties were represented by two dummy-coded variables, one for taxpayer only and one for both taxpayer and representative, with representative only as the omitted reference group. The effects of all of the main terms were significant beyond the .001

level. None of the two-way interactions were significant at the .15 level, and I have left them out of the final model. The estimates for the model are in Table A1.

Table A1. Multinomial Logistic Regression of Outcome on 5 Issues and Other Selected Variables (Main Effects Only) *T*-Test Probabilities (2-tailed) in Parentheses

	Log Odds				Test for Variable		
Independent Variables	Changed/ Unchanged		Unresolved/ Unchanged		χ^2	df	p
Issues[a]					40.09	8	<.001
Math or clerical error	.801	(.001)	−.639	(.308)			
Unreported income	−.553	(.001)	−.648	(.033)			
Classification	−.082	(.591)	.072	(.793)			
Parties involved[b]					26.17	4	<.001
Taxpayer only	.545	(.005)	−.144	(.667)			
Both taxpayer & rep	.916	(<.001)	.937	(.004)			
Uncertainty of issues	.072	(.424)	.662	(<.001)	22.02	2	<.001
Adequacy of records	−.359	(<.001)	−1.045	(<.001)	72.83	2	<.001
Constant	>.917	(.021)	−.560	(.379)			
	Max. likelihood χ^2 for model = 172.86; df = 16; $p < .001$						

[a] Contrast coded so that effects are deviations from the average of all categories. Effects for omitted abstract issue are −.175 (.282) and .364 (.179).

[b] Dummy coded so effects are compared with the effect of the omitted category, representative only.

The multinomial logistic regression corresponding to Figure 3 included three categories of issues (unreported income and documentation issues combined, classification issues, and abstract issues), three levels of facilitation (low, medium, and high) as described in note 24, and the two-way interaction between issue and facilitation. To simplify the interpretation of the interaction effects, the three issues were represented by dummy variables for the combined unreported income and documentation issues and for classification issues, with abstracted issues as the omitted reference group. There were also two dummy variables representing facilitation, one for low and one for high, with medium facilitation as the reference group. The estimates for the model are in Table A2.

In the analysis shown in Table A1, there was no significant interaction effect between issues and the scale for the adequacy of the records. For Figure 4, this lack of an interaction was confirmed for the trichotomized adequacy of records with the three categories of issues in Table A2, with unreported income and documentation as separate issues (math and clerical errors were omitted in both cases as described in the text), and with all five issues. The main effect estimates for the model with adequacy of records (the medium category is the omitted reference category) and the three categories of issues as in Table A2 are in Table A3.

Table A2. Multinomial Logistic Regression of Outcome on 3 Levels of Facilitation and 3 Issues with Interaction
T-Test Probabilities (2-tailed) in Parentheses

Independent Variables	Log Odds: Changed/Unchanged		Log Odds: Unresolved/Unchanged		Test for Variable: χ^2	df	p
Facilitation[b]					77.83	4	<.001
Low vs. medium	.916	(.110)	1.034	(.108)			
High vs. medium	−.307	(.391)	−1.982	(.004)			
Issues[b]					14.88	4	.005
Documentation & unreported income	.334	(.290)	−1.163	(.014)			
Classification	.563	(.143)	−.498	(.364)			
Interaction					28.64	8	<.001
Low facilitation:							
By documentation	−1.307	(.050)	.750	(.342)			
By classification	−.807	(.312)	.604	(.516)			
High facilitation:							
By documentation	−.399	(.353)	−.791	(.531)			
By classification	−.543	(.275)	1.924	(.025)			

Max. likelihood χ^2 for model = 114.51; df = 16; $p < .001$

[a] Main effects tested with only the other main effect in the model.
[b] Dummy coded so effects are compared with the effect of the omitted category.

Table A3. Multinomial Logistic Regression of Outcome on 3 Levels of Adequacy of Records and 3 Issues
T-Test Probabilities (2-tailed) in Parentheses

Independent Variables	Log Odds: Changed/Unchanged		Log Odds: Unresolved/Unchanged		Test for Variable: χ^2	df	p
Adequacy of records[a]					65.94	4	<.001
Low vs. medium	.410	(.050)	1.073	(<.001)			
High vs. medium	−.545	(.003)	−1.314	(<.001)			
Issues[a]					15.72	4	.003
Documentation & unreported income	−.096	(.629)	−.760	(.012)			
Classification	>.248	(.279)	.359	(.261)			

Max. likelihood χ^2 for model = 73.98; df = 8; $p < .001$

[a] Dummy coded so effects are compared with the effect of the omitted category.

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