



## Ethics and taxation: A cross-national comparison of UK and Turkish firms

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### ABSTRACT

This paper investigates responses to tax related ethical issues facing firms, an area where there has been little prior research. As perceptions may be determined by response to different legal systems and regulations, we examine responses to a series of ethical questions posed to two groups of tax practitioners, one group employed in UK firms and another group employed in Turkish firms. This facilitates both an examination of responses from within each country and a cross-national comparison of ethics and taxation. Although there is a similarity of perception of the importance of a number of taxation related ethical issues between UK practitioners and Turkish practitioners, there are also several statistically significant differences between the two groups. The paper makes a significant contribution to the literature through obtaining and analysing data from tax professionals in the UK and Turkey to provide a cross-national study of corporate tax practice and ethics. The paper is novel in that no prior studies have reported cross-national studies that have examined tax issues related to firms.

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## 1. Introduction

Ethical issues related to corporate tax decisions have been under-researched in the business and management literature. This is surprising because ethical dilemmas involving tax issues in particular were identified some time ago by members of the American Institute of Certified Public Accountants as presenting the most difficult problem for them (Finn, Chonko, & Hunt, 1988, pp. 607–609). More recently there have been high profile scandals, such as the KPMG tax shelter fraud case (Herman, 2004; Johnston, 2004; Scannell, 2005), which have highlighted problems caused by differences in ethical judgements among corporate decision makers. Nevertheless, studies which examine systematically tax decision making processes are rare (see Glaister & Frecknall-Hughes, 2008), and, to the best of our knowledge, there are no prior studies which examine such issues from a cross-national perspective. The purpose of this paper is to make a contribution by examining tax-related ethical issues facing firms in two different national contexts. The study examines responses to a series of ethical tax related questions posed to a sample of UK and Turkish corporate respondents. These two countries were chosen as they provide good examples of legal and commercial frameworks and institutions that are at different stages of development, with the UK being a mature market economy and Turkey being an emerging one. In addition, the systems of each country are

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well known to the authors. The study serves to facilitate an examination of responses from within each country, but, more importantly, it allows a cross-national comparison of ethics and taxation, and makes a significant contribution in the provision of cross-country information on company tax matters.

Processes and procedures to determine a company's tax liabilities are imposed by law. Where taxpayers (corporate or otherwise) wish to pay less than a government requires, a conflict arises, long recognised, between the right of citizens to own property (including goods and money) which militates against the right of government to allow that right of ownership and/or to take away that property in the form of taxation (Locke, 1690). This conflict manifests itself as tax evasion, which is illegal, or tax avoidance, which is legal. Although tax avoidance is legal, it is often regarded as unethical, for example, by the UK Revenue authorities, and is something of which firms (especially multinational enterprises (MNEs)) are often accused (Christensen & Kapoor, 2004; Christensen & Murphy, 2004; Freedman, 2004; Mitchell & Sikka, 2005; Mitchell, Sikka, Christensen, Morris, & Filling, 2002; Reed, 2007). Given that tax evasion is illegal, this paper focuses on the area of tax avoidance, where there is no legal certainty to determine where the line is drawn between what is or is not acceptable.

Considering corporate taxes, a particular issue that has attracted significant criticism is that of 'unacceptable tax avoidance' (Wyman, 1997, p. 3). This is a term that tax authorities apply to the use of specially developed schemes, often aggressive in nature, which either stretch the word of the law beyond its intention or manipulate events/facts so that the law applies (in a way not intended) to artificially created truths, events or circumstances. The suggestion implicit in the use of the word 'unacceptable' compounds the idea that such tax avoidance activity is unethical (see Freedman, 2004) as it reduces the overall tax revenue for governments and thus the funds available for spending for societal purposes. Although tax avoidance remains a legal activity, because of the link with unacceptable behaviour it has become tainted by association, which is arguably deliberate on the part of tax authorities.

The situation is made more complex in that views have often differed as to what constitutes tax avoidance, and such views may change over time. The meaning of 'unacceptable avoidance' remains a hotly debated topic. One view is that any decision "comes down to a matter of personal judgment. One man's idea of acceptable tax planning is undoubtedly another man's idea of criminally subversive activity" (Gillett, 1999, p. 1). Others think that there is no problem here at all and that "tax avoidance is a conceptual anomaly that exists in the mind of those whose sense of morality is violated by certain effective tax practices", occurring "where legislative intention and policy miscarried and failed to anticipate and reach the transaction under consideration" (Orow, 2004, p. 415).

For any study examining the behaviour of firms in relation to taxation, it is therefore essential to establish how important obeying the law is, and whether it is acceptable to challenge the law by use of avoidance schemes which tax authorities might deem inappropriate, and also whether, as a corollary, firms will be concerned about the impact of their taxation activities on their reputation.

The rest of the paper is set out as follows. Section 2 reviews literature relating to differences between Turkey and the UK in respect of issues relevant to tax. The section then considers ethics and tax issues affecting firms, in order to provide background to the study and to help generate the study's basic research questions. Research methods are in Section 3. Section 4 provides findings and discussion. The conclusion is in Section 5.

## 2. Review of the literature

### 2.1. Turkey and the UK – issues relevant to tax

Developments regarding taxation in emerging countries are often unclear because the relevant academic literature is relatively scarce. This applies to the emerging economy of Turkey, which may be contrasted to the UK, a mature market economy that possesses one of the most voluminous and sophisticated tax codes in the world. Typically, emerging economies have less well defined tax laws (Demir, 2005), and this appears to be the situation in Turkey. Although Turkey has many of the same underlying concepts of tax as the UK (for example, a system of direct taxation of income, corporate profits and capital gains, as well as indirect taxation), there is much less depth, sophistication and complexity in terms of law. Also, Turkish law has a reputation for loopholes (World Bank, 2008), which can be exploited.<sup>4</sup> Where law is so characterised, it is often easier to find ways of 'getting round' it, which are less likely to be challenged by government authorities, and Turkey is known for the use of avoidance mechanisms. Mengüç (1998) and Ekin and Tezölmez (1999), both cited by Hisrich, Bucar, and Oztark (2003, p. 8), comment on a range of ethical problems being reported in Turkey, including "bribery, tax evasion, insider dealing and deceptive practices", which is supported by the findings of Rawwas, Swaidan, and Oyman (2005). In contrast, however, McGee and Tyler (2006) suggest that there is generally an aversion to tax evasion in Turkey.

Business structures in Turkey also tend to be different from those of the UK, dominated by concentrated national family-based ownership, not globally operating firms or MNEs (Ararat & Ugur, 2003, pp. 59, 62). Even listed companies in Turkey are often characterised by having a holding company controlled by a family. Turkey is also very different from the UK in terms of its religious and administrative heritage and historical development (Glaister, Dincer, Tatoglu, & Demirbag, 2009). We posit that key issues regarding different perceptions of taxation related ethical issues between the UK and Turkey will be

<sup>4</sup> There is no scope in this paper for a detailed overview of the Turkish and UK tax systems, especially given the voluminous nature of UK tax statutes, which run to many thousands of pages. However, a general appreciation of the two systems can be obtained from the overview entitled 'Turkish Taxation System' provided by the Turkish Revenue authority and the IFS Publication 'A Survey of UK Tax System' by Adam and Browne (2011).

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