



# Practitioners can benefit from academic tax research

**Editor:**

Annette Nellen, Esq., CPA, CGMA

**Author:**

Janet A. Meade, CPA, CGMA, Ph.D.

**Academic journals employ vigorous review processes to ensure publication of the highest-quality articles, and the insights from those articles are worth practitioners' consideration. The findings of four recent research papers are distilled in this column.**

Academic tax research is multidisciplinary. It encompasses accounting, law, finance, economics, and psychology. It addresses issues related to tax compliance, tax policy, tax planning, tax reporting, tax incentives, and an assortment of tax behaviors. Among the many perspectives it adopts are those of the taxpayer, tax preparer, tax adviser, taxing authority, and interconnected social networks.

The leading organization of tax academics is the American Taxation Association (ATA), a section of the much larger American Accounting Association (AAA). One of the objectives of the ATA is to foster the dissemination of tax research. Toward this end, the ATA External Relations Committee selected four recent articles to showcase the breadth of research conducted by tax academics. In selecting these articles, the committee solicited nominations and then scored each nominated article for its relevance to tax practitioners.

Although each selected article appears in a different journal, all share a similar editorial and review process. Prior to submission to the journal, the authors most likely presented their research to peers at their university and perhaps at a conference to obtain feedback during the research and drafting process. This feedback helps in focusing the work, noting where more work is needed and identifying related research and theories to consider. An article submitted to an academic journal

is expected to feature important new discoveries or analysis.

The journal review process plays an important role in ensuring publication of the highest-quality work. Initially, manuscripts are submitted to a journal via an electronic submission system. After each submission is inspected for completeness, the senior editor determines the suitability of the manuscript for the selected journal and assigns it to an editor. Typically, the editor selects two reviewers with expertise in the research paradigm (e.g., experimental, archival, analytical) and topical area (e.g., tax avoidance, tax compliance, multijurisdictional taxation, tax provision, net operating losses). If the review is "blind," the reviewers are not informed of the author's identity and the authors do not know the names of the reviewers (a "double-blind" review process). Based on the reviews and the editor's own reading of the manuscript, the editor decides whether to reject, invite a revised resubmission, conditionally accept, or accept the paper. The time from first submission to final acceptance may be over a year.

The four papers selected by the committee appear in *The Journal of the American Taxation Association*, *The ATA Journal of Legal Tax Research*, *The Accounting Review*, and the *Journal of Emerging Technologies in Accounting*. The American Accounting Association publishes these four journals, together with 13 others. All these journals use a



double-blind review process. Acceptance rates for the journals over the period from 2014 to 2018 are approximately 19% for *The Journal of the American Taxation Association*, 50% for *The ATA Journal of Legal Tax Research*, 12% for *The Accounting Review*, and 70% for the *Journal of Emerging Technologies in Accounting*.

Summaries of the four articles are presented next.

### **'The Effects of Economic and Social Bonds With Clients on Tax Professionals' Recommendations'**

In this article, published in the Spring 2020 issue of *The Journal of the American Taxation Association*, authors Beth Vermeer, Brian Spilker, and Anthony Curatola examine how the economic and social relations of tax professionals and their clients affect the aggressiveness with which ambiguous issues are resolved. Prior literature presumes that a client's economic importance biases a tax professional's judgment and leads to aggressive tax recommendations for high-fee clients. Empirical studies of this effect, however, find conflicting results. Vermeer, Spilker, and Curatola posit that prior results may indicate the existence of a U-shaped inflection point where the potential costs of aggressive reporting outweigh the potential rewards. They hypothesize that tax professionals provide more aggressive recommendations for clients of moderate economic importance than for clients of either low or high economic importance.

The authors also examine whether the aggressiveness of a recommended tax position is biased by the social connection between the client and the tax professional. Social identification theory (SIT) posits that strong interpersonal relations with others lead to higher levels of social identification and that real or perceived membership in distinct groups biases an individual's attitudes and behaviors favorably toward that group. In

a tax context, SIT is relevant because tax professionals often engage directly with clients as they prepare tax returns and provide tax planning services, sometimes forming close personal ties. SIT suggests that these types of interpersonal relations may create strong client identification and lessen a tax professional's objective evaluation of tax authority. The resulting loss of objectivity may bias a tax professional's recommendations toward aggressive client-preferred tax positions.

While a considerable body of research supports the tenets of SIT, studies also point to moderating conditions, such as when a conflict exists between group demands and individual goals. In these situations, the psychological effects of group identification are dominated by individual needs. In the context of a tax engagement, the authors speculate that the increase in risk associated with clients of high economic importance may elevate tax professionals' public perspective and cause them to act in a socially responsible manner, even when doing so is contrary to client preferences. The authors expect tax professionals to provide less aggressive tax recommendations to clients of high economic importance than for those of low or moderate economic importance.

In an experiment involving 133 tax professionals recruited at a national tax conference, Vermeer, Spilker, and Curatola tested their hypotheses. The experiment asked the professionals to review relevant tax authority and determine whether the songwriting activity of a married client should be treated as a business or a hobby. Business treatment is more favorable to the client because the expenses of the activity are fully deductible and generate tax savings. Hobby treatment is unfavorable because the expenses are not deductible and provide no tax benefit. Participants were randomly assigned to conditions that manipulate client economic importance at three levels (low, moderate, and high) and client

identification at two levels (low and high). Afterwards, participants answered questions about their experience with business/hobby decisions, their familiarity with tax penalties and standards of professional care, and an adapted SIT survey measuring social identification.

Results of the experiment confirm the authors' prediction of an ordinal interaction between economic importance and client identification. Tax professionals are more inclined to recommend aggressive tax positions for clients of moderate economic importance than for clients of low or high economic importance. Further, tax professionals with high vs. low client identification provide more aggressive recommendations but only for clients of low or moderate economic importance.

### **'Congress Finally Passed Carried Interest Legislation: But Is It Enough?'**

After several failed attempts to enact legislation taxing "carried interest" income attributable to services as compensation rather than capital gain, Congress enacted Sec. 1061 as part of the law known as the Tax Cuts and Jobs Act of 2017, P.L. 115-97. Pursuant to Sec. 1061, some, but not all, carried interest income is characterized as short-term capital gain, eligible for offset against an unlimited amount of short-term capital losses and exempt from self-employment tax. In this article, published in the Spring 2019 issue of *The ATA Journal of Legal Tax Research*, authors Hughlene Burton and Noel Brock discuss the requirements of Sec. 1061 and clarify areas of confusion created by the law. They also examine the new law's policy implications.

A carried interest is a contractual right that entitles general partners of private-equity and hedge funds to share in the fund's profits. Depending on the investment, the general partners' share of the profits can include interest, dividends, royalties, and capital gains.



The general partners receive carried interests as compensation for their investment management services, often in addition to an annual fee based on fund size. Prior to 2018, income from carried interests was generally characterized as long-term capital gain eligible for taxation at preferential rates. Some elected officials, however, opposed this tax treatment, and legislation treating carried interest income as ordinary was proposed in both 2007 and 2010. Only in 2017, however, was a change in the tax treatment of carried interests enacted into law.

Beginning in 2018 and thereafter, Sec. 1061 characterizes a portion of carried interest income as short-term capital gain if the interest is held less than three years. Sec. 1061 does not apply to a capital interest in a partnership or an interest held by a corporation. Sec. 1061 does apply, however, when an interest is received in exchange for services.

Burton and Brock discuss several ambiguities of Sec. 1061. As they explain, carried interest holders may be able to opt out of Sec. 1061 treatment by distributing, rather than selling, partnership property held for more than one year but less than three years. Similarly, where a partnership sells a Sec. 1231 asset for a gain, Burton and Brock believe that Sec. 1061 applies only to the portion of the gain allocated to a profits interest partner. They also point out that where a partner receives multiple profits interests at different times, the rules of Sec. 1061 should be applied separately to each interest. As for situations where a carried interest holder has held an interest for less than three years but the partnership sells an asset it has held more than three years, Burton and Brock provide arguments for using the holding period of either the carried interest holder or the partnership and call for additional guidance to clarify the issue.

In the final section of the article, Burton and Brock address whether Sec.

1061 represents sound tax policy. They argue that the equity and efficiency concepts of tax policy call for the portion of carried interest income attributable to services to be taxed as compensation subject to self-employment tax. They also assert that Sec. 1061 fails the policy goals of simplicity and certainty because it introduces complex tracking and tracing requirements laden with ambiguities.

### **'The Effect of Voluntary Clawback Adoptions on Corporate Tax Policy'**

In 2015, the SEC proposed rules requiring all registrants to adopt an executive compensation "clawback" policy that allows for recoupment of compensation paid to executives based on misstated financial results. Although the SEC has yet to finalize these rules, many companies have voluntarily adopted clawback policies. In this article, published in the January 2020 issue of *The Accounting Review*, authors Thomas Kubick, Thomas Omer, and Zac Wiebe examine the effect of voluntary clawback adoptions on corporate tax policies that increase reported earnings.

Prior research indicates that most publicly traded companies face capital market pressures to meet earnings expectations. Studies also show that these pressures do not subside after clawback adoption and that executives subject to clawback provisions search for alternative ways to meet earnings goals. Kubick, Omer, and Wiebe propose that one alternative for achieving earnings expectations is to reduce income tax expense, either by investing in tax planning that minimizes tax liabilities and tax volatility or by manipulating income tax accruals. Because opportunistic reporting decisions using tax accruals tend to attract regulatory scrutiny and result in restatements, the authors hypothesize that companies with voluntary clawback policies are more likely to invest in tax planning than to engage in manipulative income tax accruals.

Kubick, Omer, and Wiebe test their hypothesis using a sample of 233 companies that voluntarily adopted clawback policies during the fiscal years 2005 through 2011 and a matched control sample of 169 nonadopting companies with similar characteristics. Within their sample, they first look for change in annual book effective tax rates (ETRs) between the pre- and post-clawback adoption periods. They observe a decrease in ETRs after adoption of clawback policies. They also note that the decrease persists beyond the adoption year, suggesting a longer-term effect.

The authors then address whether the observed change in ETRs relates to investments in tax planning, tax accruals, or some combination of the two. They consider three tax-planning investments that are often associated with lower ETRs: setting up subsidiaries in tax-haven countries, using auditor-provided tax services or purchasing tax services from an industry tax-expert audit firm, and expanding connections between executives and their counterparts at companies with low ETRs. They also investigate pretax discretionary accruals, tax accruals, and tax-related misstatements.

Kubick, Omer, and Wiebe find that companies adopting clawback policies are more likely to report a new subsidiary in a tax-haven country following adoption. They also observe that companies increase investments in auditor-provided tax services after adoption and that connections between clawback adopters and low-tax companies expand. Additional tests show a decrease in pretax discretionary accruals and tax accruals, as well as tax-related misstatements after clawback adoption. In supplemental analysis, the authors find that companies have more stable ETRs and higher disclosure quality after clawback adoption. They interpret their results as evidence that companies invest in more tax planning following the adoption of clawback policies and that there is an



association between that investment and more sustainable tax outcomes.

### 'Tax Preparer Certification and Organization Form Among Uncertified Preparers Influence Client Satisfaction and Experience'

In this article, published in the Fall 2018 issue of *Journal of Emerging Technologies in Accounting*, authors Candace Witherspoon and Dan Stone use linguistic analysis to examine online Yelp reviews of U.S. tax preparers to better understand the client experience. Their study is motivated by prior research showing that taxpayers evaluate tax preparers on multiple dimensions such as accuracy of prepared returns, time and tax savings, and communication skills. They also seek to address allegations regarding low levels of customer satisfaction and poor service quality among large franchise preparers.

Witherspoon and Stone divide the tax preparer market into three categories: certified preparers (e.g., CPAs, enrolled agents, and attorneys), big box franchise firms (e.g., H&R Block, Jackson Hewitt Tax Services, and Liberty Tax Service), and independent uncertified preparers. They hypothesize that tax clients' Yelp ratings of certified preparers are higher than those of other preparers, while the ratings of franchise firm preparers are lower than those of other preparers.

They also examine the comments of tax clients for evidence of relational vs. transactional interactions. Relational interactions are sustained, ongoing, and long-term relations built on trust, cohesion, shared identity, and understanding. Linguistic indicators of relational interactions are words indicating affiliation, client achievement, positive emotion, cognitive insight, third-person singular or inclusive pronouns (e.g., he, she, we), and use of the present tense. In contrast, transactional interactions tend to be one-time, self-interested transactions focused on results. Linguistic indicators

are words indicating negative emotion, first-person singular or impersonal pronouns (e.g., I, me, they), and the use of the past tense. Witherspoon and Stone hypothesize that tax clients' comments about certified preparers are more indicative of relational interactions and that the comments about franchise preparers are more consistent with transactional interactions.

To test their hypotheses, Witherspoon and Stone harvest 3,984 online Yelp reviews of tax preparers for the years 2004 through 2011. Of the reviews, 55.5% (2,211) are about certified preparers, 16.5% (658) are about franchise preparers, and 28% (1,115) are about small preparers. Like other researchers investigating online reviews, they observe more positive than negative reviews. They also note that the three big box franchise firms received the largest number of reviews (658), that the five largest certified firms in the sample received between 18 and 28 reviews per firm, and that 71% of the firms in the sample received only one online review.

Consistent with their expectations, Witherspoon and Stone find that, as a group, the ratings of certified preparers are higher than those of uncertified preparers. They also find that the ratings of franchise firm preparers are lower than those of nonfranchise firm preparers. To determine the extent to which the Yelp reviews contain targeted words in specialized linguistic categories, they employ the help of Linguistic Inquiry and Word Count LIWC2015 software. Results provide evidence that certified preparers' clients write reviews that have fewer impersonal pronouns, more first-person plural and affiliation pronouns, more third-person singular pronouns, more positive emotion, greater cognitive understanding, and more client achievement statements than clients of other firms. Comparing the comments about franchise firms to other firms, the analysis finds more first-person singular and impersonal pronouns, fewer third-person

singular pronouns, more swear and anger words, and a greater focus on the past than the present.

### Practitioner and faculty engagement around research

Students, department chairs, and faculty often invite practitioners to visit a tax, accounting, or audit class, or an accounting club meeting, to share their experiences and help students to better understand the field of accounting. These opportunities can be expanded and reversed to have faculty visit CPA firms and corporate tax departments to discuss their research and obtain feedback. Some research such as the first one discussed in this column involved the need for accounting professionals to answer surveys. Practitioner and faculty relationships where both parties share their work and expertise can help faculty members gain access to survey subjects, gain insights in the design of hypotheses for further research, and inform practitioners of findings.

It is hoped the insights into the research of tax faculty will help move the findings beyond the academic enclave and into the larger accounting and tax arena, with greater opportunities for all to share ideas and findings. ■

### Contributors

Janet A. Meade, CPA, CGMA, Ph.D., is an associate professor of accountancy and taxation in the C.T. Bauer College of Business at the University of Houston. Annette Nellen, Esq., CPA, CGMA, is a professor in the Department of Accounting and Finance at San José State University in San José, Calif., and is the immediate past chair of the AICPA Tax Executive Committee. For more information about this column, please contact [thetaxadviser@aicpa.org](mailto:thetaxadviser@aicpa.org).