

CENTRE FOR TAX SYSTEM INTEGRITY



Procedural justice and
tax compliance

Kristina Murphy



WORKING PAPER 56 • FEBRUARY 2004

PROCEDURAL JUSTICE AND TAX COMPLIANCE

Kristina Murphy

Centre for Tax System Integrity
Research School of Social Sciences
Australian National University
Canberra, ACT, 0200

ISBN 0 642 76846 3
ISSN 1444-8211

WORKING PAPER No 56

February 2004

© *Centre for Tax System Integrity, Research School of Social Sciences,
Australian National University 2004*

© *Commonwealth of Australia 2004*

National Library of Australia
Cataloguing-in-Publication data:

Murphy, Kristina, 1973-
Procedural justice and tax compliance.

Bibliography.
ISBN 0 642 76846 3.

1. Investments - Taxation - Law and legislation - Australia.
2. Tax evasion - Australia. 3. Taxation - Law and
legislation - Australia. 4. Tax planning - Australia.
5. Taxpayer compliance - Australia. I. Centre for Tax
System Integrity. II. Title. (Series: Working paper
(Centre for Tax System Integrity); no. 56).

343.9405246

*If you would like to make any comments on this working paper please contact the author
directly within 90 days of publication.*

Disclaimer

This article has been written as part of a series of publications issued from the Centre for Tax System Integrity. The views contained in this article are representative of the author only. The publishing of this article does not constitute an endorsement of or any other expression of opinion by the Australian National University or the Commissioner of Taxation of the author's opinion. The Australian National University and the Commissioner of Taxation do not accept any loss, damage or injury howsoever arising that may result from this article. This article does not constitute a public or private ruling within the meaning of the *Taxation Administration Act 1953*, nor is it an advance opinion of the Commissioner of Taxation.

THE CENTRE FOR TAX SYSTEM INTEGRITY WORKING PAPERS

The Centre for Tax System Integrity (CTSI) is a specialised research unit set up as a partnership between the Australian National University (ANU) and the Australian Taxation Office (Tax Office) to extend our understanding of how and why cooperation and contestation occur within the tax system.

This series of working papers is designed to bring the research of the Centre for Tax System Integrity to as wide an audience as possible and to promote discussion among researchers, academics and practitioners both nationally and internationally on taxation compliance.

The working papers are selected with three criteria in mind: (1) to share knowledge, experience and preliminary findings from research projects; (2) to provide an outlet for policy focused research and discussion papers; and (3) to give ready access to previews of papers destined for publication in academic journals, edited collections, or research monographs.

Abstract

Throughout the 1990s, tens of thousands of Australian taxpayers invested in mass-marketed tax effective schemes. They enjoyed generous tax breaks until the Australian Taxation Office (Tax Office) told them in 1998 that they abused the system. This study examines the circumstances surrounding taxpayers' decision to invest in scheme arrangements. It also explores investors' perceptions of the way the Tax Office handled the schemes issue and, perhaps more importantly, why such a large number of investors defied the Tax Office's demands that they pay back taxes. Data were taken from in-depth interviews conducted with 29 scheme investors. Consistent with the procedural justice literature, the findings revealed that many of the scheme investors interviewed defied the Tax Office's demands because the procedures the Tax Office used to handle the situation were perceived to be unfair. Given these findings, it will be argued that to effectively shape desired behaviour, regulators will need to move beyond enforcement strategies linked purely to deterrence. A strategy that aims to emphasise the procedural justice aspects of a regulatory encounter will be discussed.

Procedural justice and tax compliance

Kristina Murphy

Introduction

Why people choose to obey or disobey decisions made by institutions has been the topic of much psychological research since the late 1950s (for example, Easton, 1958; French & Raven, 1959; Tyler, 1990; 1997; Tyler & Lind, 1992). Two quite different theories that attempt to explain non-compliant behaviour have come out of that work; they are the rational choice model and the attitudinal model. The rational choice model, on the one hand, has tended to dominate the formulation of public policy in areas as diverse as criminal justice, welfare policy, and taxation. The model argues that people are motivated entirely by profit seeking. They assess opportunities and risks and disobey the law when the anticipated fine and probability of being caught are small in relation to the profits to be made through non-compliance (for a discussion see Kagan & Scholz, 1984). Advocates of the rational choice model therefore believe that individuals or firms will only comply with an authority's rules and decisions when confronted with harsh sanctions and penalties.

While some research supports the view that deterrence measures can affect compliance behaviour (for example, Allingham & Sandmo, 1972; Williams, 2001; Witte & Woodbury, 1985), other more recent research suggests that the effects of threat and legal coercion can sometimes be counterproductive (for example, Ayres & Braithwaite, 1992; Blumenthal, Christian & Slemrod, 1998; Braithwaite & Braithwaite, 2001; Murphy, 2002a). In fact, research into reactance has shown that the use of threat and coercion, particularly when perceived as illegitimate, can produce the opposite behaviour from that sought. In other words, these actions are more likely to result in non-compliance or overt opposition (Brehm & Brehm, 1981). In response to findings such as these, a number of researchers have instead suggested that attitudes and moral obligations, in addition to purely economic calculations or fear of punishment, are important in explaining compliance behaviour and therefore need to be considered when managing non-compliance (for example, Braithwaite, 2002; Kagan & Scholz, 1984). This is the basis for the attitudinal model of compliance.

According to Tyler and Smith (1998), people's behaviour is strongly linked to views about justice and injustice. Procedural justice in particular concerns the perceived fairness of the procedures involved in decision-making and the perceived treatment one receives from the decision maker. The procedural justice literature demonstrates that people's reactions to their personal experiences with authorities are rooted in their evaluations of the fairness of procedures those agencies use to exercise their authority (Lind & Tyler, 1988; Tyler, 2000; 2001; Tyler & Blader, 2000).

In fact, there is evidence to show that people who feel they have been treated fairly by an organisation will be more likely to trust that organisation and be inclined to accept its decisions and follow its directions (Lind & Tyler, 1988; Murphy, 2002a; Tyler & Degoe, 1996). It has also been found that people are most likely to challenge a situation collectively when they believe that the procedures are unfair. For example, in a study of work tasks, student participants complained more to a third-party authority figure when they were treated unfairly and received an unfavourable outcome (Greenberg, 1987). The same study also showed that students were most likely to take collective action when the procedural injustice they experienced reflected institutional policy than when it reflected the actions of a single person. Research has consistently shown that individuals seek justice in a number of ways when they feel that the groups to which they belong have been treated unfairly (for an in-depth discussion of this topic see Tyler & Smith, 1998). These ways can include pursuing collective change in ways that are socially acceptable (for example, political lobbying), or turning to third parties to intervene on their behalf (for example, taking a class action, referring the decisions to the courts).

The procedural justice literature specifically highlights the importance of an authority's trustworthiness, interpersonal respect, and neutrality in its dealings with others (Tyler, 1989; 1994; 1997; Tyler & Smith, 1998). One's judgment about whether or not an authority is motivated to treat them in a fair way, to be concerned about their needs, and to consider their arguments (that is, their trustworthiness) has been shown to be the primary factor that people consider when evaluating authorities (Tyler & Degoe, 1996; Tyler & Lind, 1992). If people believe that an authority is 'trying' to be fair and to deal fairly with

them, they trust the motives of that authority and develop a long-term commitment to accepting its decisions.

Research has also shown that being treated politely, with dignity and respect, and having genuine respect shown for one's rights and social status, all enhance feelings of fairness. Tyler (1997) has specifically shown that people value respectful treatment by authorities and view those authorities that treat them with respect as more entitled to be obeyed. People are also influenced by judgments of the neutrality of decision-making procedures. Neutrality includes assessments of honesty, impartiality, and the use of fact, not personal opinions, in decision-making. People basically seek a level playing field in which no one is unfairly advantaged. As people are seldom in the position to know the correct outcome until it is actually made, they focus on the evidence that the procedures are even-handed.

Within political psychology, procedural justice is widely hypothesised to be an antecedent of legitimacy. Researchers (for example, Magner, Sobery & Welker, 1998; Tyler, 1997; Tyler & Lind, 1992) have shown that people who feel they have been fairly treated by an authority regard their authority status as more legitimate; and this is regardless of the decision outcome. Tyler (1997) goes on to argue that if an organisation is perceived to be legitimate then people are generally more likely to follow and accept their decisions.

Critics of the procedural justice view have suggested that people would care more about the favourability of their outcomes (for example, how much money they stand to lose) and less about fairness when the stakes are high. Research has not supported that argument, however. Instead, it has been shown that concerns about fairness remain high even when outcomes are important (Casper, Tyler & Fisher, 1988; Lind, Kulik, Ambrose & de Vera Park, 1993). For example, in a study of authorities in political, legal, managerial, educational, and family settings, Tyler (1997) found that authorities draw an important part of their legitimacy from their social relationship with group members. Specifically, Tyler showed that poor treatment by authorities affected views about their overall legitimacy, not judgments about gain or loss.

Justice in the taxation context

While the literature indicates that government regulators can benefit by employing fair procedures, little empirical research has been conducted on the effects of procedural justice on tax compliance. Of the research that has been conducted, it has been shown that taxpayers are generally more compliant when they think they have been treated fairly and respectfully by a tax authority. For example, Alm, Jackson and McKee (1993) investigated whether procedural aspects of a decision about how tax revenue should be spent affected tax compliance. As predicted, it was found that student taxpayers, who were tested in an experimental setting, were more likely to respond positively—and so to increase their tax compliance—when faced with a tax expenditure program that they selected themselves. When the decision was imposed upon them, compliance suffered. In a Swiss study, Feld and Frey (2002) presented empirical evidence to suggest that actual tax compliance increased when taxpayers were treated as trustworthy in the first instance by tax authorities. In a study of Australian taxpayers, Wenzel (2002) also studied the impact of justice perceptions, but this time on self-reported tax compliance. Using a survey methodology, Wenzel found that taxpayers were more compliant when they thought that they had been treated fairly and respectfully by the Tax Office. Worsham (1996), however, failed to find an increase in tax non-compliance when taxpayers experienced procedural injustice. Using an experimental manipulation, Worsham (1996) found that procedural injustice experienced personally, either by being subject to inconsistency in enforcement or to enforcement attempts brought about by inaccurate information, did not increase the level of tax non-compliance. He did, however, find that procedural injustice experienced indirectly through becoming aware of another's unfair treatment did increase self-reported tax non-compliance.

Although not directly testing the effects of procedural justice on tax compliance, Stalans and Lind (1997) compared how taxpayers and their tax preparers judged the procedural fairness of tax audits and the Internal Revenue Service (IRS). Seventy taxpayers participated in interviews after the completion of their tax audits and were asked to describe their impressions of the audit and the auditor, and to rate how satisfied they were with the auditors' treatment and fairness. Both taxpayers and representatives who viewed

audits as a procedure that should indicate the truth about the accuracy of their return, were less satisfied with how the auditor treated them. In addition, they were less likely to think that the auditor tried to be fair when compared to representatives who viewed the audit process as a way of achieving the best outcome for their clients. After completion of the audit, taxpayers were also asked about their views toward the IRS. In general, it was found that taxpayers thought the IRS treated honest taxpayers like they had done something wrong.

Coupled with the other studies in the procedural justice literature, these tax studies in general suggest that individuals do not react to authorities primarily or exclusively in terms of what they do or do not receive from those authorities. Instead, they react to how they are treated. If individuals trust the motives of authorities, feel that they behave neutrally, and feel treated with respect and dignity, it appears that they will be more willing to defer to authorities and obey their decisions (see Tyler, 1990).

The present study

The aim of the present study is to explore whether possible feelings of procedural injustice may have led a group of approximately 42 000 Australian taxpayers to actively resist the Tax Office's demands that they pay back a tax debt. In brief, throughout the 1990s tens of thousands of Australian taxpayers 'invested' in mass-marketed tax effective schemes (for an example of the schemes referred to in this paper see Appendix). Their investments provided them with combined tax deductions exceeding four billion Australian dollars. The Tax Office maintained that investments in these arrangements were largely funded through tax deductions and claimed that little private capital was at risk. The Tax Office therefore came to the conclusion in 1998 that taxpayers who invested in these schemes did so for the 'dominant purpose' of obtaining a tax benefit and, as a result, the anti-avoidance provisions of Part IVA of the Australian Income Tax Assessment Act 1936 applied. The Tax Office moved to disallow scheme related tax deductions claimed up to six years earlier, and issued amended assessments to all taxpayers involved in schemes. Scheme investors were told that they had to immediately pay back taxes with interest and appropriate penalties or they would run the risk of facing the full extent of the law.

Investor reaction toward the Tax Office's decision to disallow previous years' scheme-related tax deductions came as somewhat of a surprise to the Tax Office. The majority of investors claimed that the schemes they invested in had been sold to them, in many cases by their accountants, as a way of legally minimising tax. Many investors therefore believed that they had done nothing wrong by investing in these schemes and actively resisted the Tax Office's demands that they pay back tax. At the time of starting fieldwork for this study in October 2001 — three and a half years after amended assessments had been issued — more than 50 percent of scheme investors had still refused to enter into settlement arrangements with the Tax Office to pay back their tax debts. The possible reasons behind this subsequent non-compliance are therefore of interest to the present study.

It should be noted at this point, however, that it is not the aim of the present study to discuss the legal issues surrounding the mass-marketed schemes issue. Instead, using in-depth qualitative interviews conducted with scheme investors, the present study only attempts to provide a possible explanation to why the majority of scheme investors reacted in such a negative way toward the Tax Office's handling of the issue.

Method

Participants

In-depth interviews were conducted with 29 scheme investors from and around the goldfields town of Kalgoorlie, Western Australia. Interviews were conducted in the Kalgoorlie area because of the large number of residents known to be involved in tax effective schemes. Figures obtained from the Tax Office indicate that approximately 600 taxpayers from Kalgoorlie and its immediate surroundings invested in tax schemes. The investors interviewed were considered to be typical investors from the goldfields region, in that they came from middle-class working families¹.

¹ The goldfields region of Western Australia is recognised for its prominence in the mining industry, with approximately 22 percent of the total workforce employed in this industry (Department of Local Government and Regional Development, 2001). Given that incomes earned by most miners place them into the highest possible tax bracket, the region provided a lucrative pool for promoters who marketed tax avoidance schemes.

Procedure

Interviews were conducted over a two-week period in October 2001. The semi-structured interviews averaged approximately one hour and explored the circumstances that led participants to invest in scheme arrangements, respondents' experiences with the Tax Office, and their beliefs about the Tax Office and its procedures.

In order to find an adequate number of scheme investors to interview, a 'snowball' technique was used. Initially, community groups in the mining town of Kalgoorlie were contacted and briefed about the aim of the project. The names of investors who were particularly vocal in the community were then provided. These investors then suggested the names of additional investors who they thought might be interested in participating in the study. Approximately 90 percent of those contacted by telephone agreed to participate and several additional investors also volunteered to participate in the study during the course of the two-week period. All interviews were tape-recorded for subsequent transcription and analysis, but at the request of one investor, his interview was not tape-recorded.

Results and discussion

While it is acknowledged that only 29 investors living in the goldfields region were interviewed, the situation surrounding their outstanding debt was quite varied. Two investors had already fully paid back their outstanding tax debt, two investors had or were attempting to enter into payment settlements with the Tax Office, five had either filed for bankruptcy or were seriously considering the option, eleven had joined fighting funds in an attempt to absolve them of any debt, six were waiting to see the outcome of various court cases before deciding what to do², two stated that they refused to pay the bill, and there was one who simply chose to ignore the situation.

² Several court cases relating to various tax effective schemes have been conducted over the past few years. Three have so far confirmed the Tax Office's interpretation of tax law that scheme related tax deductions were not allowable under Part IVA of the *Income Tax Assessment Act 1936* (see Howland-Rose & Ors vs. Federal Commissioner of Taxation (2002) FCA 246, (2002) 49 ATR 206, 2002 ATC 4200; Puzey vs. Federal Commissioner of Taxation (2002) FCA 1171, 50 ATR 595; Vincent vs. Federal Commissioner of Taxation (2002) FCA 656, 50 ATR 20) and one has confirmed the investors' interpretation of tax law that they are allowable (see Sleight vs. Federal Commissioner of Taxation (2003) FCA 896).

How did investors first hear about the schemes?

Participants were asked to explain how they first came to hear about the schemes they invested in. One investor explained how they had seen a pamphlet in their letterbox. To hear more about the investment, they then contacted the ‘financial adviser’ whose name was printed on the pamphlet. Eleven other investors initially got the idea from a friend or family member, eight from their accountant or financial advisor, and nine from a door-to-door salesman promoting the product (in some cases this salesman was a financial planner).

Of particular interest was the finding that 25 of the 29 investors interviewed said they sought additional independent advice from a third party as to the legitimacy of the scheme arrangements they were about to invest in. For example, 25 investors said they sought advice from their accountants or solicitors. Some of these investors said they also sought additional advice from the Australian Securities and Investment Commission and the Tax Office³. One investor made the following point about the advice he received from his accountant:

When you’ve got a CPA who knows the tax law saying, ‘This is a sound investment, there’s no problem with it’, then why wouldn’t you do it?

In fact, one investor explained the reason why he had used a tax agent:

I thought that if an accountant did your tax you were less likely to be audited because the tax accountant themselves went through a reasonable amount of due process to make sure it was all ridgy didge and above board.

Similar comments were provided by most of the other investors interviewed. Many investors therefore thought they took the correct steps to check the legitimacy of the schemes in which they invested. Most believed that they had done all that was possible and

³ From the interviews, however, it is not clear what advice they were given from the Tax Office, as the Tax Office does not give financial advice over the telephone.

expected of them under Australia's self-assessment system⁴. They were therefore surprised when the Tax Office later disallowed their deductions and penalised them for 'avoiding' their taxes.

Reason for investing

The draw card of many investments is that they proffer the opportunity to legally minimise tax. In a study of Australian taxpayers, Braithwaite, Reinhart, Mearns & Graham (2001) found that approximately 22 percent of taxpayers look at several different ways of minimising their tax each year. While many of the scheme investors interviewed acknowledged that they entered into scheme arrangements because the touted tax breaks were attractive, they were adamant that they did not enter the schemes for the dominant purpose of avoiding tax. Investors asserted that the schemes they had invested in had been sold to them, sometimes by their accountants, as a way that they could legally minimise the tax they were required to pay while still being involved in a viable long-term investment⁵. One investor mentioned the conversation he had with his accountant before investing in tax schemes:

I suppose I had been going to my tax agent, and I've been concerned that I've been paying that much tax. I don't mind paying tax, you know, but I've been concerned that I've been probably paying more than I should have so I've been asking him questions about it and he said there's a couple of investments you can go and invest in. And he put a couple forward to me and I said, 'I'm not interested in those'. I specifically said, 'I don't want to go into anything that's illegal. It's got to be ridgy-didge'.

⁴ In 1986, the Tax Office introduced a self-assessment system to taxation. Under this system all taxpayers lodge a tax return containing detailed information and calculations of their taxable income. Returns are not subjected to technical scrutiny, but are accepted at face value. All onus of responsibility is therefore placed on the taxpayer to prepare an accurate return. Audit activity is then primarily used post assessment to check the accuracy of some returns (D'Ascenzo & Poulakis, 2002).

⁵ Some people still question investors' underlying motivations, however, based on the argument that the investments they entered into seemed 'too good to be true'. In retrospect, this might be the case. But as can be seen in this study, the majority of investors interviewed sought advice from their accountants as to the legitimacy of the investments. They were therefore led to believe that the investments were legitimate and above board.

When asked about whether he had questioned his accountant about the tax benefits offered by the schemes he got involved in, the same interviewee later said:

I asked about the tax on it and I said ‘What’s the deal with the tax here? Is that still legitimate?’ And I was told yes. So I just took that attitude and okay, it’s no big deal. My tax accountant thinks it’s okay, why wouldn’t I?

This comment highlights the trust taxpayers place in their tax agents. It also emphasises the importance that tax agents play in taxpayer compliance, and in this case, non-compliance. In a survey study of Australian taxpayers, Sakurai and Braithwaite (2001) discussed how taxpayers open to low-risk tax minimisation strategies often find themselves with tax agents who serve taxpayers open to high-risk minimisation strategies (see also Murphy & Byng, 2002). Tax agents are usually expected to correctly interpret the level of risk their clients are willing to take and are also expected to judge what is acceptable minimisation behaviour. As can be seen from the comments made by the investor above, often this does not occur. Tax agents tend to be more adventurous than their clients in thinking a particular minimisation strategy will be upheld by a subsequent legal challenge (Hansen, Crosser & Laufer, 1992). Thus, what is high risk for a taxpayer may be considered low risk for a tax agent⁶.

Whilst aware of the taxation benefits arising from the initial investment, many investors reported that they believed these benefits were acceptable to the Tax Office because they were more than outweighed by the potential tax on future returns. As one investor said about his investment, ‘We were making money on it and we’re paying the tax on it’.

Some investors said that they saw investing in their schemes as a way to support Australian business. As can be seen from the following quote, one investor actually said that investing in a forestry scheme was a good way to redirect her taxes into rural areas:

⁶ In a survey of the general population, Braithwaite, Reinhart, Mearns & Graham (2001) found that approximately five percent of taxpayers reported that their tax agents had recommended complicated tax schemes to them that would enable them to avoid tax. It therefore appears from this figure that approximately five percent of tax agents are aggressive in nature.

We were also told that our tax money was getting channelled into the country areas; it was a way of directing our tax into the country areas where people would be employed. And coming from a country area, I thought that was right-on. For me it was doing something with our taxes other than paying people who don't want to work.

In addition, many investors commented on how they were trying to set themselves up for retirement. As one investor noted:

I figured there will be no such thing as a pension by the time I retire. So, I mean, how do you live? You've got to have something.

With the pension slowly being phased out in Australia, and the government encouraging Australians to 'look after themselves' in retirement, one could argue that there is little wonder why so many people were being lured by investments which required no initial cash outlay.

So while it is acknowledged that some scheme participants may have invested in schemes to avoid tax, it should be noted that all of the investors interviewed in the present study said they were led to invest based on trust in the proposals marketed to them. In some cases, the proposals were marketed by respected accountants and financial advisers. Thus, it is proposed that the subsequent reaction by such a large number of investors to defy the Tax Office's demands that they pay back taxes may have been due to the way the Tax Office initially handled the schemes issue. This idea is explored in more detail in the following section.

Procedural justice and the Tax Office

Government agencies such as the Tax Office often find themselves attempting to elicit certain behaviours (for example, pay your fair share of tax) in order to obtain what they see as a solution to a given social problem (for example, funding services). These attempts to elicit or change a particular behaviour sometimes involve persuasion and sometimes involve more or less coercive tactics. As discussed in detail in the Introduction to this paper, if people believe that an authority is trying to be fair and to deal fairly with them,

they will trust the motives of that authority and be more inclined to follow its directions and decisions.

Tax Office communication

As discussed by Wenzel (2001), letters are probably the most frequently and broadly applied measure that the Tax Office uses to communicate and gain compliance from non-compliant taxpayers. These letters, however, have often been regarded as too technical. For example, in a performance audit of the Tax Office, the Australian Auditor-General found that Tax Office letters to taxpayers were 25 percent more difficult to read than what was recommended (Australian National Audit Office, 2001). The Auditor-General therefore suggested that the Tax Office work to improve its communication with taxpayers by improving the reading ease of letters and documents sent to clients.

The letters that the Tax Office sent to scheme investors were also regarded by those interviewed to be too technical. The following comment, provided by one investor, supports this claim:

And the letters you get from the ATO. You know, like, as I said, an average educated person won't be able to construe the terms they're using there. I mean, they're just over my head ... They just baffle you.

Tax Office letters sent to scheme investors were also seen to be unsympathetic and threatening. As can be seen from the following quote, the Tax Office's procedure of sending a large number of amended tax assessments several days before Christmas was seen to be particularly callous and unsympathetic:

MALE: When I got the first letter from the ATO.

FEMALE: Christmas 2000, wasn't it?

MALE: It would be something like that, wouldn't it? I said, 'Oh, this is a fantastic Christmas present', you know? Really livened my Christmas up for me.

On talking about the timing of the letters, the following investor said:

The timing of the letter wasn't anything but the fact of the way it was written, 'Righto, you've got 14 days to pay ... or this will take place. We'll start recovery action'. And you go, 'Hang on, what's all this mean'.

The technical language and demands used in the letters therefore left investors feeling overwhelmed, confused and angry. Many investors also expressed anger at the lack of consultation and warning they personally received before being issued with letters telling them that their deductions had been disallowed. The Tax Office's initial failure to advise investors of the settlement provisions, debt recovery policies and hardship relief measures offered by the Tax Office was also met with disappointment. As one investor commented:

I'm really disappointed with them ... they don't offer to help, maybe if they'd offered a payment plan or something to ease the burden of this big bill you know like and not put all this - keep putting this interest on, it's just ridiculous. I mean that would have been heaps easier than you're a tax cheat, you've got to pay \$40 000 now or we're going to put all this interest on it, you'd just never get it paid.

This investor therefore felt that the Tax Office had not been helpful in looking for a cooperative and fair solution. Even when investors actively sought help by calling the Tax Office contact number given in their letters, they said it was not forthcoming. As one investor said:

You can ring the ATO five times in a week and ask the same question and get five different answers.

To make matters worse, many scheme investors felt that the Tax Office letters sent to them implied that they were 'tax cheats' by stating that their dominant purpose for entering into a scheme arrangement was to avoid tax. So although the Tax Office did not actually use the words 'tax cheat', many investors believed that it was implied. As can be seen from the comments provided by three investors below, this perception was met with intense anger and dissatisfaction with the Tax Office:

As far as I am concerned, I've been really really badly treated by the ATO. They've just seen me as a tax evader. No worrying about my circumstances or my reasons for going into it or anything. They've just nailed me.

It's pretty damn rude to give me a tax return and then say, 'Bad luck, by the way you're doing something illegal. Actually you're a tax cheat.'

It [the letter] had all these things about schemes and you're fraudulent and whatever, and I just saw red.

Why investors reacted so strongly to the 'apparent' accusations in the letters might relate to their perceptions of justice. Perceptions of justice have been found to be strongly related to feelings of self-worth and self-concept (for example, Tyler & Smith, 1998). Tyler and Smith (1998, p. 596) noted that individuals use the justice of their social experiences to define and evaluate the status of their group and within that group their social standing, their self-worth and their self-concept. Research conducted in Australia has shown that most Australian taxpayers express pride in being a member of the group called 'honest taxpayers' (Braithwaite et al., 2001). Most investors also considered themselves to be honest taxpayers (see also Murphy & Byng, 2002). As one investor said:

I've been in the mining game for probably nearly nine or ten years now, so in that period of time I've paid a lot of tax and never, ever have I ever had an audit done on me, never had any queries, no dramas at all, just the average, law abiding person that pays their tax.

In the case of scheme investors, the label 'tax cheat' appears to have threatened their inclusion in the 'honest taxpayer' group. Thus, the reaction of so many investors to defy the Tax Office's request that they pay back taxes appears, in part, to be one of protest at being branded a tax cheat. The following quote from an investor who had initially tried to pay off their debt seems to sum up the attitude and mindset held by so many scheme investors:

In hindsight, I'm glad he [the bank manager] didn't [give me a loan] because at the end of the day I'd much sooner fight, because I still don't think that I did anything wrong.

Timeliness

One of the major criticisms of the Tax Office's handling of the mass marketed schemes issue has been their delay in making the decision to crackdown on tax avoidance schemes. Investigations into tax minimisation schemes started as early as 1987, yet it was not until 1998 that the Tax Office actively sought to recover lost revenue from investors involved in mass-marketed tax schemes (see Murphy, 2002b; Senate Economics References Committee, 2001). This time delay had two important consequences. First, for many investors, the tax refunds they received for their initial deductions encouraged them to invest in subsequent schemes, thus serving to increase their overall tax debt. As one investor said:

That's just so unfair, they were just negligent, just slack. I mean, there's obviously a better word, but yes, not warning people, because people once they're told they're okay and they've got their deductions. But obviously now they're telling us that we can go back, but the average person doesn't realise.

Many investors had also sat by for many years watching friends and relatives invest in schemes. As one investor said, her sister had been involved in schemes since 1995:

They had been doing it for years, so we thought, by now if it was bad, the government would have stopped it.

In 1998 she and her husband invested in a tax scheme that promoted skin care products, and as a result subsequently owed the Tax Office thousands of dollars.

The second consequence of the Tax Office's time delay was that it had the effect of magnifying the interest charge levied on participants' tax debts. This is because the Tax Office applied interest from the date the scheme related deduction was initially claimed by the taxpayer. This was seen by investors to be particularly unfair, especially by those who had invested many years before Tax Office recovery action had started. One investor expressed confusion towards the amount she owed the Tax Office:

We were expecting something like \$10 000 because I mean really that was all the extra sort of cash that did come out of our tax return and when you open this bill for

\$40 000 I nearly fainted, yeah. I mean how come we had to pay all of a sudden \$40 000 from \$10 000? That part I couldn't understand.

It became apparent that a large proportion of the \$40 000 debt had come from penalties and the accrual of interest from the time the deduction had first been claimed. Many investors were similarly confused about how the Tax Office had calculated their tax debts. In particular, investors were confused and angry about having to pay such large amounts of interest because of the Tax Office's perceived lack of timeliness to identify the problem in the first place.⁷ The majority of investors interviewed therefore indicated that the abolition of culpability penalties and interest, as recommended in a Senate report on the matter, would be a significant step towards bringing the matter to a close (Senate Economics References Committee, 2001). As one investor said:

I would like to see them squash the interest rates, and squash the penalties because we didn't do anything wrong. We bought into something that we thought was going to be a good thing, not for the sole purpose of evading tax or cheating the ATO or whatever they want to put it these days.

In fact, in February 2002 — four years after action was first taken against scheme investors — the Tax Office put forward a final settlement offer in which culpability penalties and interest on scheme related tax debts would be abolished for those investors who had been the victims of aggressive marketing and bad advice. As part of the deal, investors were given a two year interest free period in which to repay their debts. As part of this final settlement offer, the Tax Office also thoroughly explained to investors how they could take up the offer, what the settlement option meant for them, and respectfully indicated what would happen if they did not accept the offer given the outcome of one of the court cases⁸. This offer proved to be highly successful for the Tax Office, with 87 percent of investors agreeing to take up the offer.

⁷ It should be noted that the anti-avoidance provisions of the *Tax Act* do allow the Tax Office up to six years to disallow a claim. The Tax Office therefore argues that action was taken within the time frame provided by the law.

⁸ All of these procedures would be considered to be procedurally fair.

So why is it that the Tax Office's most recent strategy worked? Research indicates that people are concerned about being well regarded by others. For example, as discussed earlier most Australian taxpayers express pride in being a member of the group called 'honest taxpayers'. Being accused of purposeful tax avoidance implies dishonesty and untrustworthiness, which in turn can be perceived as a threat to one's reputation. By being responsive to scheme investors, and finally giving them some benefit of the doubt (that is, that they were victims and not tax cheats), the Tax Office's gesture acted to bring the majority of investors back into the system voluntarily.

Legitimacy

Also of interest to the present study was how negative experiences with authorities can shape peoples' views about the legitimacy of an organisation. As noted in the Introduction to this article, if an organisation is perceived to be legitimate then individuals are generally more likely to follow and accept their decisions. This has been found to be regardless of the decision outcome (see Magner et al., 1998)⁹. Part of forming an opinion of an authority's legitimacy therefore involves the way individuals feel treated by that authority.

Upon interviewing scheme investors it became apparent that they perceived the Tax Office's initial handling of the schemes issue to be procedurally unfair. This was the case even for investors who had already paid any outstanding debts or who had already entered into settlement arrangements with the Tax Office. When questioned about how he now viewed the Tax Office, one investor said:

Well, I don't trust them any more. I always thought, you know, if you filled the form out properly and you did the right things and went through your normal accountant, registered accountant, or whatever, they would just get on with the business. But what it has actually alluded to me is that they're not very well organised; they are running a reactionary-mode tax department.

⁹ Magner et al., (1998) examined the effects of the personal favourability of the outcome of a municipal property tax decision, and the fairness of the procedures by which the tax outcome was established, on citizens' reactions toward the municipality and its legislators. It was found that perceptions of procedural justice, not outcome favourability, had an effect on citizens' sense of affiliation with the municipality. It was

With many scheme investors questioning the legitimacy of the Tax Office (also see Senate Economics References Committee, 2001), the potential for further uncooperative behaviour is a real possibility in the future. As discussed in the Introduction to this paper, it has been shown that people often seek justice in a number of ways when they feel that the group to which they belong has been unfairly treated. As discussed, these ways can include political lobbying or turning to third parties to intervene on their behalf. In the case of the scheme situation, a number of fighting funds and lobbying groups were set up to represent scheme investors' interests. These fighting funds offered 'resistant' investors the chance to have their say and the opportunity to fight the Tax Office's view of the law in court. In fact, the fighting funds made the public more aware of their rights, that they were able to express their rights and that they could defend them when necessary. In other words, they made the public aware that they can challenge the authority of the Tax Office.

A major problem, however, comes from taxpayers who continue to question the legitimacy of the Tax Office in years to come and who subsequently choose to disengage from the tax system as a result¹⁰. Several tax scheme investors interviewed, for example, showed signs of more extreme defiance towards the tax system by expressing views that paying tax should now be avoided as much as possible. As one investor said:

Every carpenter or plumber or electrician or any of those that I use now, I always say to them, 'How much for cash'. Because I thought, well, stuff it. I'm going to stop the Tax Department from getting as much as they can. So I'll just pay all the tradesmen cash. They love it. Beautiful. They don't have to declare it. And that mindset will grow. You know, it's just my little way of thinking, I'm having a win. No worries. I'll just make you [the ATO] lose a little bit more.

The real threat to the integrity of the tax system comes when disengaged taxpayers such as these seek out alternative ways in which they can further exploit the tax system. Such ways may include seeking out others who can help them to achieve their purpose. For example, the self-assessment system of taxation has given rise to a professional culture that prides

also found that citizens had particularly low levels of resentment towards legislators when the tax outcome was favourable and the tax decision-making procedures were perceived to be fair.

¹⁰ This extreme reaction to perceived unjust treatment has been found to occur in a small number of people (Taylor & Moghaddam, 1994).

itself on knowing tax law, how to take advantage of it, and most importantly, on meeting customer demand (Braithwaite, 2003; Erard, 1993; Klepper & Nagin, 1989; Klepper, Mazur & Nagin, 1991; Murphy, in press; Murphy & Sakurai, 2001; Sakurai & Braithwaite, 2001). With disgruntled taxpayers questioning the legitimacy of the tax system, the opportunity arises for these professionals to position themselves as an alternative authority to the Tax Office; an alternative authority that fosters non-compliance (see Braithwaite, 2003; Murphy, in press; Murphy & Sakurai, 2001).

Research conducted at the Centre for Tax System Integrity at the Australian National University has in fact shown that these professional groups have captured the psyche of many disgruntled taxpayers. In a study of Australian taxpayers, Sakurai and Braithwaite (2001) showed that a small number of taxpayers actively seek out aggressive tax agents (that is, those that explore the loopholes in the tax law). In a follow up study, Murphy (in press) attempted to explain what led taxpayers to seek such advice. It was shown that those taxpayers who sought out aggressive tax agents placed less value on the tax system and the Tax Office. Compared to taxpayers in general, they were less likely to view the Tax Office as a legitimate institution and were more likely to disagree with Tax Office decisions. Thus, their tendency to engage in aggressive tax planning was seen to be a reaction towards an organisation that they perceived to be illegitimate. Given the degree of anger held by so many scheme investors (see Senate Economics References Committee, 2001), a major concern to the future integrity of the Australian tax system is whether a large portion of these scheme investors will engage in this sort of purposeful tax avoidance in the future. This, however, still remains to be seen.

Summary of findings

From the findings presented in this paper, it can be seen that scheme investors were concerned about a number of issues in relation to the Tax Office's handling of the schemes issue. These included being concerned about the Tax Office's failure to identify earlier the compliance risks posed by schemes, their initial aggressive use of threat and legal coercion, their failure to consider individual investors' motivations for entering into scheme arrangements, their general lack of helpfulness, and their lack of empathy for the

financial hardship faced by many investors. Investors were also concerned about being thought of as ‘tax cheats’. Finally, it was revealed that the legitimacy of the Tax Office’s authority status was also negatively affected because of the way they had treated scheme investors.

General discussion

Knowing what motivates people to obey and defer to decisions and rules is very important for regulatory authorities. As discussed in the Introduction to this article, the ‘rational choice’ model of the individual has previously dominated the formulation of public policy in many areas. This view suggests that people are motivated to maximise their personal gains and minimise their personal losses. Those advocating such a view therefore believe that non-compliance can only be dealt with by handing out harsh sanctions and penalties.

The situation surrounding the mass-marketed tax scheme issue, however, demonstrates that the use of threat and legal coercion as a regulatory enforcement tool — in addition to being more expensive to implement — can actually be counter-productive (see also Ayres & Braithwaite, 1992; Bardach & Kagan, 1982; Hawkins, 1990; Murphy, 2002a). The Tax Office’s initial use of threat and legal coercion with 42 000 tax scheme investors in fact appeared to produce the opposite behaviour from that sought. Instead of complying, the majority of tax scheme investors actively resisted the Tax Office’s repeated attempts to recover tax owing on their scheme related tax debts.

When attempting to explain why investors did not comply with the Tax Office’s directives to pay back tax, the present study showed that perceptions of unfair treatment played a very important role in explaining their behaviour. This finding is interesting because it indicates that investors were not purely driven by self-interest variables as one might have expected, but that they were also strongly concerned about issues of fair treatment and respect in forming their opinions about the Tax Office and how they should subsequently respond.

Implications for regulatory enforcement

So what can regulatory enforcement agencies do in the future to prevent widespread resistance towards their decisions and what can they do to ensure that citizens voluntarily comply with their obligations? The results of the present study suggest that to effectively shape desired behaviour, regulators will need to move beyond enforcement strategies linked purely to deterrence. Regulators will instead need to acknowledge the importance of procedural justice in their dealings with non-compliant citizens.

Doubts about the effectiveness of a deterrence-based model of enforcement are not new. In fact, for the past decade, many contemporary regulatory theorists have been arguing that the most effective way in which to achieve genuine acceptance of regulations is not by an exclusive reliance upon threat and legal coercion but rather through the use of strategies that attempt to bring the best out of those being regulated (for example, Ayres & Braithwaite, 1992; Braithwaite, 1993; Murphy, 2002a; Sparrow, 2000). These theorists argue that regulatory agencies risk discouraging civic virtue if they engage in aggressive prosecution for relatively minor offences, because those being regulated are likely to feel that their past good faith efforts at compliance have not been acknowledged.

Given that people appear to be strongly concerned about issues of fair treatment, neutrality, and respect in forming their opinions about the way a regulator handles their situation, a strategy that therefore takes into account the problems, motivations, and conditions behind non-compliance might prove to be particularly effective in gaining voluntary compliance (for a discussion see Ayres & Braithwaite, 1992; Braithwaite & Braithwaite, 2001). According to Ayres and Braithwaite (1992), giving people the opportunity to first cooperate voluntarily before escalating to more interventionist forms of regulation is more likely to bring a person's law abiding self to the forefront. As the findings of the present study demonstrate, if sanctions or punishments are used as a strategy of first choice and are subsequently perceived to be procedurally unjust, regulators run the risk of undermining their own legitimacy.

This is not to say that sanctions and penalties should not be used at all when dealing with non-compliant individuals. There are some people who would take advantage of a regulatory strategy based purely on cooperation. Ensuring that there is still the threat of punishment in the background for those who resist initial appeals for cooperation will reinforce to individuals that a regulator's attempts at cooperation should be listened to (see Ayres & Braithwaite, 1992)¹¹. If such a responsive strategy works, both sides avoid expensive enforcement and litigation procedures and more resources will be left to expand regulatory coverage. In such a situation, society will gain the benefits of greater compliance at a lower cost to the economy.

Conclusion

While this has not been the first study to show that the use of threat and legal coercion can produce the opposite behaviour from that sought, it has been one of the first studies to highlight the importance of procedural justice when dealing with non-compliant individuals in the taxation context. In particular, the findings from the present study have shown that if taxpayers feel poorly treated by a tax authority as a result of their infractions, this can lead to them questioning the legitimacy of the tax authority. This can then go on to affect their willingness to comply, and can in fact lead to active resistance¹². It has been proposed here that by using a regulatory strategy based on mutual respect and cooperation in the first instance, regulators will be more likely to prevent widespread resistance towards their decisions, while at the same time nurturing the good will of those with a commitment to compliance.

¹¹ The threat of punishment in the background should not just be an idle threat that never eventuates, but should be one that the regulator follows through with if compliance is not forthcoming. Regulators do not want to get the reputation of being toothless tigers.

¹² In making these conclusions it is acknowledged that the present study certainly has its limitations, mainly due to the small sample size. Any causal relationships made in the paper should therefore be taken with caution. It should be noted, however, that findings obtained from a survey of 2292 scheme investors yielded similar findings (see Murphy, 2003; Murphy, 2002a; Murphy & Byng, 2002).

REFERENCES

- Allingham, M., & Sandmo, A. (1972). Income tax evasion: A theoretical analysis. *Journal of Public Economics*, 1, 323-338.
- Alm, J., Jackson, B. R., & McKee, M. (1993). Fiscal exchange, collective decision institutions, and tax compliance. *Journal of Economic Behaviour and Organization*, 22, 285-303.
- Australian National Audit Office. (2001). The use of audit in compliance management of individual taxpayers: Australian Taxation Office. *Australian National Audit Office Audit Report No. 37*. Commonwealth of Australia.
- Australian Taxation Office. (2000). *Australian Taxation Office Annual Report 1999-2000*. Canberra: Commonwealth of Australia.
- Ayres, I., & Braithwaite, J. (1992). *Responsive Regulation: Transcending the Deregulation Debate*. New York: Oxford University Press.
- Bardach, E. & Kagan, R. (1982). *Going by the Book: The Problem of Regulatory Unreasonableness*. Philadelphia: Temple University Press.
- Blumenthal, M., Christian, C., & Slemrod, J. (1998). The determinants of income tax compliance: Evidence from a controlled experiment in Minnesota. *National Bureau of Economic Research Working Paper No. 6575*. Massachusetts, USA.
- Braithwaite, J. (1993). Responsive business regulatory institutions. In C. J. Coady & C. J. Sampson (Eds.), *Business Ethics and the Law*, Sydney: Federation Press.
- Braithwaite, J. (2002). *Restorative Justice and Responsive Regulation*. Oxford: Oxford University Press.

Braithwaite, V. (Ed.). (2003). *Taxing Democracy: Understanding Tax Avoidance and Evasion*. Aldershot: Ashgate.

Braithwaite, V., & Braithwaite, J. (2001). An evolving compliance model for tax enforcement. In N. Shover, & J. P. Wright (Eds.), *Crimes of Privilege*. New York: Oxford University Press.

Braithwaite, V., Reinhart, M., Mearns, M., & Graham, R. (2001). *Preliminary findings from the Community Hopes, Fears and Actions Survey*. Centre for Tax System Integrity Working Paper No. 3. Canberra: Australian National University.

Brehm, S. S., & Brehm, J. W. (1981). *Psychological Reactance: A Theory of Freedom and Control*. New York: Academic Press.

Casper, J. D., Tyler, T. R., & Fisher, B. (1988). Procedural justice in felony cases. *Law and Society Review*, 22, 483-507.

D'Ascenzo, M. & Poulakis, T. (2002). Self assessment: Quo vadis? *Taxation in Australia*. 36(8), 412-416.

Department of Local Government and Regional Development (2001). *Goldfields-Esperence Economic Perspective: An update on the economy of Western Australia's Goldfields-Esperence Region*. The Government of Western Australia.

Easton, D. (1958). The perception of authority and political change. In C. J. Friedrich (Ed.), *Authority*. Cambridge, MA: Harvard University Press.

Erard, B. (1993). Taxation with representation: An analysis of the role of tax practitioners in tax compliance. *Journal of Public Economics*, 52(2), 163-197.

Feld, L. & Frey, B. (2002). *Trust breeds trust: How taxpayers are treated*. Centre for Tax System Integrity Working Paper No. 32. Canberra: Australian National University.

French, J. R. Jr., & Raven, B. (1959). The bases of social power. In D. Cartwright (Ed.), *Studies in Social Power*. Ann Arbor: University of Michigan Press.

Greenberg, J. (1987). Reactions to procedural injustice in payment distributions: Do the ends justify the means? *Journal of Applied Psychology*, 72, 55-61.

Hansen, D. R., Crosser, R. L., & Laufer, D. (1992). Moral ethics versus tax ethics: The case of transfer pricing among multinational corporations. *Journal of Business Ethics*, 11, 679-686.

Hawkins, K. (1990). Compliance strategy, prosecution policy and Aunt Sally: A comment on Pearce and Tombs *British Journal of Criminology*, 30(4), 444-466.

Kagan, R. A. & Scholz, J. T. (1984). The criminology of the corporation and regulatory enforcement strategies. In K. Hawkins & J. M. Thomas (Eds.), *Enforcing Regulation*. Boston: Kluwer-Nijhoff Publishing.

Klepper, S., & Nagin, D. S. (1989). The role of tax practitioners in tax compliance. *Policy Sciences*, 22, 167-192.

Klepper, S., Mazur, M., & Nagin, D. S. (1991). Expert intermediaries and legal compliance: The case of tax preparers. *Journal of Law and Economics*, 34, 205-229.

Lind, E. A., Kulik, C. A., Ambrose, M., & de Vera Park, M. V. (1993). Individual and corporate dispute resolution: Using procedural fairness as a decision heuristic. *Administrative Science Quarterly*, 38, 224-251.

Lind, E. A., & Tyler, T. R. (1988). *The Social Psychology of Procedural Justice*. New York: Plenum Press.

Magner, N., Sobery, J. S., & Welker, R. B. (1998). Tax decision making in municipal governments: Citizens' reactions to outcomes and procedures. *Journal of Public Budgeting, Accounting and Financial Management*, 9(4), 552-570.

Murphy, K. (2002a). *'Trust me, I'm the taxman': The role of trust in nurturing compliance*. Centre for Tax System Integrity Working Paper No 43. Canberra: Australian National University.

Murphy, K. (2002b). *Procedural justice and the Australian Taxation Office: A study of tax scheme investors*. Centre for Tax System Integrity Working Paper No. 35. Canberra: Australian National University.

Murphy, K. (2003). An examination of taxpayers' attitudes towards the Australian tax system: Findings from a survey of tax scheme investors. *Australian Tax Forum*, 18, 209-241.

Murphy, K. (in press). Aggressive tax planning: Differentiating those playing the game from those who don't. *Journal of Economic Psychology*.

Murphy, K. & Byng, K. (2002). *Preliminary findings from 'The Australian Tax System Survey of Tax Scheme Investors'*. Centre for Tax System Integrity Working Paper No. 40. Canberra: Australian National University.

Murphy, K., & Sakurai, Y. (2001). *Aggressive Tax Planning: Differentiating those playing the game from those who don't*. Centre for Tax System Integrity Working Paper No. 25. Canberra: Australian National University.

Sakurai, Y., & Braithwaite, V. (2001). *Taxpayers' perceptions of the ideal tax adviser: Playing safe or saving dollars?* Centre for Tax System Integrity Working Paper No. 5. Canberra: Australian National University.

Senate Economics Reference Committee (2001). *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection: Interim Report*. Parliament of the Commonwealth of Australia.

Sparrow, M. K. (2000). *The Regulatory Craft: Controlling Risks, Solving Problems and Managing Compliance*. Washington DC: Brookings Institution Press.

Stalans, L., & Lind, E. A. (1997). The meaning of procedural fairness: A comparison of taxpayers' and representatives' views of their tax audits. *Social Justice Research, 10*, 311-331.

Taylor, D. M. & Moghaddam, F. M. (1994). *Theories of Inter-Group Relations*. New York: Praeger.

Tyler, T. R. (1989). The psychology of procedural justice: A test of the group value model. *Journal of Personality and Social Psychology, 57*, 830-838.

Tyler, T. R. (1990). *Why People Obey the Law*. New Haven, CT: Yale University Press.

Tyler, T. R. (1994). Governing amid diversity: Can fair decision making procedures bridge competing public interests and values? *Law and Society Review, 28*, 701-722.

Tyler, T. R. (1997). The psychology of legitimacy: A relational perspective on voluntary deference to authorities. *Personality and Social Psychology Review, 1*(4), 323-345.

Tyler, T. R. (2000). Social justice: Outcome and procedure. *International Journal of Psychology, 35*(2), 117-125.

Tyler, T. R. (2001). Trust and law-abidingness: A proactive model of social regulation. *Boston University Law Review, 81*(2), 361-406.

Tyler, T. R., & Blader, S. (2000). *Cooperation in groups*. Philadelphia: Psychology Press.

Tyler, T. R., & Degoey, P. (1996). Trust in organizational authorities: The influence of motive attributions on willingness to accept decisions. In R. Kramer, & T. R. Tyler (Eds.), *Trust in organizational authorities*. Beverly Hills: Sage.

Tyler, T. R., & Lind, E. A. (1992). A relational model of authority in groups. In M. Zanna (Ed.), *Advances in experimental social psychology, Vol 25*. New York: Academic Press.

Tyler, T. R., & Smith, H. J. (1998). Social justice and social movements. In D. G. Gilbert, S. T. Fiske, & G. Lindzey (Eds.), *The Handbook of Social Psychology (4th ed.) Vol II*. New York: Oxford University Press.

Wenzel, M. (2001). *Principles of procedural fairness in reminder letters and awareness of entitlements: A pre-study*. Centre for Tax System Integrity Working Paper No. 10. Canberra: The Australian National University.

Wenzel, M. (2002). The impact of outcome orientation and justice concerns on tax compliance: The role of taxpayers' identity. *Journal of Applied Psychology*, 87, 629-645.

Williams, R. (2001). *Prosecuting non-lodgers: To persuade or punish?* Centre for Tax System Integrity Working Paper No. 12. Canberra: Australian National University.

Witte, A. D. & Woodbury, D. F. (1985). The effect of tax laws and tax administration on tax compliance: The case of the US individual income tax. *National Tax Journal*, 38, 1-15.

Worsham, R. G. (1996). The effect of tax authority behavior on tax compliance: A procedural justice approach. *The Journal of the American Taxation Association*, 18(2), 19-39.

Appendix

To date, three categories of mass marketed schemes operating in the Australian market have been identified by the Tax Office (Australian Taxation Office, 2000). These include: (1) round-robin schemes, including non-recourse financing, often in agriculture, afforestation and franchises; (2) certain film schemes, with guaranteed returns that are, in effect, a return of part of the invested funds; and (3) employee benefit arrangements that have tax benefits as their main purpose. It is only the first two types of scheme that are of relevance to the present study.

An example of a franchise scheme is 'Oracle'. Oracle offered investors the opportunity to invest in a business that promoted and presented personal development and educational workshops. By making an initial cash outlay of \$10 000 and borrowing \$30 000 from Oracle's financing company, investors could claim an immediate tax deduction of \$40 000. This would therefore lead to some investors, depending on their original income level, receiving a tax refund from the Tax Office of up to \$19 400 (Source: Oracle International Pty Ltd Prospectus, p. 3). From here, \$10 000 of the \$19 400 went into paying the initial \$10 000 set up fee. In some cases, investors were therefore able to pocket the remaining \$9400.

Several aspects of the investment were of concern to the Tax Office. One major concern was that the loan of \$30 000 was repayable only from the proceeds of the business. If the business made no profit investors would not be required to repay the loan. Therefore, unlike many other investments (for example, negative gearing of property), there was no risk to the investor. In addition, some scheme investors made a profit from their tax return (in some cases the profit was as high as \$9400). Another concern for the Tax Office related to the nature of the deduction made. Specifically, only a fraction of the \$40 000 claimed as a tax deduction went into the underlying activity. For many scheme arrangements, the majority of the money raised went into financing the management fees.

**THE CENTRE FOR TAX SYSTEM INTEGRITY
WORKING PAPERS**

- No. 1. Braithwaite, V., & Reinhart, M. *The Taxpayers' Charter: Does the Australian Taxation Office comply and who benefits?* December 2000.
- No. 2. Braithwaite, V. *The Community Hopes, Fears and Actions Survey: Goals and Measures.* March 2001.
- No. 3. Braithwaite, V., Reinhart, M., Mearns, M., & Graham, R. *Preliminary findings from the Community Hopes, Fears and Actions Survey.* April 2001.
- No. 4. Mearns, M., & Braithwaite, V. *The Community Hopes, Fears and Actions Survey: Survey method, sample representativeness and data quality.* April 2001.
- No. 5. Sakurai, Y., & Braithwaite, V. *Taxpayers' perceptions of the ideal tax adviser: Playing safe or saving dollars?* May 2001.
- No. 6. Wenzel, M. *The impact of outcome orientation and justice concerns on tax compliance: The role of taxpayers' identity.* June 2001.
- No. 7. Wenzel, M. *Misperceptions of social norms about tax compliance (1): A prestudy.* June 2001.
- No. 8. Wenzel, M. *Misperceptions of social norms about tax compliance (2): A field-experiment.* June 2001.
- No. 9. Taylor, N. *Taxpayers who complain about paying tax: What differentiates those who complain from those who don't?* June 2001.
- No. 10. Wenzel, M. *Principles of procedural fairness in reminder letters and awareness of entitlements: A prestudy.* June 2001.
- No. 11. Taylor, N., & Wenzel, M. *The effects of different letter styles on reported rental income and rental deductions: An experimental approach.* July 2001.
- No. 12. Williams, R. *Prosecuting non-lodgers: To persuade or punish?* July 2001.
- No. 13. Braithwaite, V. *Tensions between the citizen taxpaying role and compliance practices.* July 2001.
- No. 14. Taylor, N. *Understanding taxpayer attitudes through understanding taxpayer identities.* July 2001.
- No. 15. Shover, N., Job, J., & Carroll, A. *Organisational capacity for responsive regulation.* August 2001.

- No. 16. Tyler, T. R. *Trust and law-abidingness: A proactive model of social regulation*. August 2001.
- No. 17. Genser, B. *Corporate income taxation in the European Union: Current state and perspectives*. August 2001.
- No. 18. McBarnet, D. *When compliance is not the solution but the problem: From changes in law to changes in attitude*. August 2001.
- No. 19. Schneider, F., Braithwaite, V., & Reinhart, M. *Individual behaviour in Australia's shadow economy: Facts, empirical findings and some mysteries*. September 2001.
- No. 20. Taylor, N., & Wenzel, M. *Assessing the effects of rental property schedules: A comparison between self-prepared tax returns lodged via paper and e-tax*. March 2004. (A version of this paper appears as 'Comparing rental income and rental deductions for electronic versus paper lodgers: A follow-up investigation'. Working Paper No. 20, 2001).
- No. 21. Braithwaite, J. *Through the eyes of the advisers: A fresh look at tax compliance of high wealth individuals*. September 2001.
- No. 22. Braithwaite, J., Pittelkow, Y., & Williams, R. *Tax compliance by the very wealthy: Red flags of risk*. September 2001.
- No. 23. Braithwaite, J., & Williams, R. *Meta risk management and tax system integrity*. October 2001.
- No. 24. Braithwaite, J., & Wirth, A. *Towards a framework for large business tax compliance*. November 2001.
- No. 25. Murphy, K., & Sakurai, Y. *Aggressive Tax Planning: Differentiating those playing the game from those who don't?* October 2001.
- No. 26. Morgan, S., & Murphy, K. *The 'Other Nation': Understanding rural taxpayers' attitudes toward the Australian tax system*. December 2001.
- No. 27. Ahmed, E., & Sakurai, Y. *Small business individuals: What do we know and what do we need to know?* December 2001.
- No. 28. Hobson, K. *Championing the compliance model: From common sense to common action*. December 2001.
- No. 29. Savage, M. *Small Business rural taxpayers and their agents: Has tax reform affected their relationship?* November 2004.

- No. 30. Job, J., & Honaker, D. *Short-term experience with responsive regulation in the Australian Taxation Office*. May 2002.
- No. 31. Frey, B. *A constitution for knaves crowds out civic virtues*. June 2002.
- No. 32. Feld, L., & Frey, B. *Trust breeds trust: How taxpayers are treated*. June 2002.
- No. 33. Wenzel, M. *An analysis of norm processes in tax compliance*. July 2002.
- No. 34. Wenzel, M. *The social side of sanctions: Personal and social norms as moderators of deterrence*. October 2002.
- No. 35. Murphy, K. *Procedural justice and the Australian Taxation Office: A study of tax scheme investors*. October 2002.
- No. 36. Hobson, K. *Financing Australia: A 'post-modern' approach to tax compliance and tax research*. August 2002.
- No. 37. Hobson, K. *'Say no to the ATO': The cultural politics of protest against the Australian Tax Office*. December 2002.
- No. 38. Wenzel, M. *Altering norm perceptions to increase tax compliance*. December 2002.
- No. 39. Murphy, K., & Byng, K. *A User's Guide to 'The Australian Tax System Survey of Tax Scheme Investors'*. December 2002.
- No. 40. Murphy, K., & Byng, K. *Preliminary findings from 'The Australian Tax System Survey of Tax Scheme Investors'*. December 2002.
- No. 41. Webley, P., Adams, C., & Elffers, H. *VAT compliance in the United Kingdom*. December 2002.
- No. 42. Wenzel, M. *Principles of procedural fairness in reminder letters: An experimental study*. December 2002.
- No. 43. Murphy, K. *'Trust me, I'm the taxman': The role of trust in nurturing compliance*. December 2002.
- No. 44. Braithwaite, J. *Making tax law more certain: A theory*. December 2002.
- No. 45. Murphy, K. *Moving towards a more effective model of regulatory enforcement in the Australian Taxation Office*. November 2004.

- No. 46. Murphy, K. *An examination of taxpayers' attitudes towards the Australian tax system: Findings from a survey of tax scheme investors*. November 2004.
- No. 47. Cooper, G., & Wenzel, M. *Does the Tax Value Method increase 'certainty' in dealing with tax? An experimental approach*. November 2004.
- No. 48. Geis, G. *Chop-chop: The illegal cigarette market in Australia*. January 2005.
- No. 49. Murphy, K. *The role of trust in nurturing compliance: A study of accused tax avoiders*. November 2004.
- No. 50. Murphy, K. *Procedural justice, shame and tax compliance*. November 2004.
- No. 51. Sakurai, Y. *Comparing cross-cultural regulatory styles and processes in dealing with transfer pricing*. November 2004.
- No. 52. Rawlings, G. *Cultural narratives of taxation and citizenship: Fairness, groups and globalisation*. February 2004.
- No. 53. Job, J., & Reinhart, M. *Trusting the Tax Office: Does Putnam's thesis relate to tax?* February 2004.
- No. 54. Braithwaite, V. *Perceptions of who's not paying their fair share*. February 2004.
- No. 55. Geis, G., Cartwright, S., & Houston, J. *Public wealth, public health, and private stealth: Australia's black market in cigarettes*. February 2004.
- No. 56. Murphy, K. *Procedural justice and tax compliance*. February 2004.