

**CENTRE FOR TAX SYSTEM INTEGRITY**



Turning resistance into compliance:  
Evidence from a longitudinal study  
of tax scheme investors

Kristina Murphy



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**TURNING RESISTANCE INTO COMPLIANCE:  
EVIDENCE FROM A LONGITUDINAL STUDY  
OF TAX SCHEME INVESTORS**

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## **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**

Why do some people actively resist government authority and decisions? What situations are more likely to encourage this sort of behaviour? And how can authorities turn resistance into compliance using the limited resources they have available to them? The aim of this paper will be to try to shed some light on these questions by examining the attitudes of 659 taxpayers who have been involved in a long-standing dispute with the Australian Taxation Office (Tax Office). Using longitudinal survey data collected in 2002 and 2004, it will be shown that taxpayers who perceive enforcement action taken against them to be procedurally unjust will be more likely to be resistant towards the Tax Office. It will also be shown that actual compliance behaviour can be affected by enforcement action that is perceived to be procedurally unfair. The paper will attempt to offer some practical suggestions for how regulators such as the Tax Office might be able to better manage their regulatory enforcement strategies in the future. The discussion is intended to have direct relevance for those administrators who work with both compliant and seriously non-compliant individuals.

# **Turning resistance into compliance: Evidence from a longitudinal study of tax scheme investors**

*Kristina Murphy*

## **Introduction**

Why do some people actively resist government authority and decisions? What situations are more likely to encourage this sort of behaviour? And how can authorities turn resistance into compliance using the limited resources they have available to them? These questions have often been posed by officers working in different regulatory contexts. They are also questions of interest to academic scholars working in the field of regulation. The aim of this paper will be to try to shed some light on these questions by examining the attitudes of 659 taxpayers who have been involved in a long-standing dispute with the Australian Taxation Office (Tax Office). Using longitudinal survey data collected in both 2002 and 2004, the paper will attempt to offer some practical suggestions for how regulators such as the Tax Office might be able to better manage their regulatory enforcement strategies in the future. The paper is intended to have direct relevance for those administrators who work with both compliant and seriously non-compliant individuals. While the ideas and suggestions will be based on findings collected in the context of taxation, it should be noted that they will also be of relevance to other regulatory contexts.

Before examining some of the key findings, Section A of the paper will first attempt to give the reader an insight into the taxation dispute used to illustrate the ideas in this paper. This will be followed in Section B by a review of earlier research conducted in this area and the literature that helped to inform this research. Section C will discuss the motivation for conducting the present study, Section D will discuss the methodology used, Section E will discuss the findings, and Section F will discuss the implications that the findings have for regulatory enforcement agencies responsible for ensuring compliance with laws and regulations.

## Section A: The taxation dispute

In June 1998, Australia's Commissioner of Taxation announced that the Tax Office would be implementing a series of initiatives aimed at combating aggressive tax planning. Part of their crackdown on aggressive tax planning involved issuing amended assessments to tens of thousands of taxpayers involved in mass marketed tax avoidance schemes<sup>1</sup>. The Tax Office maintained that taxpayers who became involved 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.<sup>2</sup>

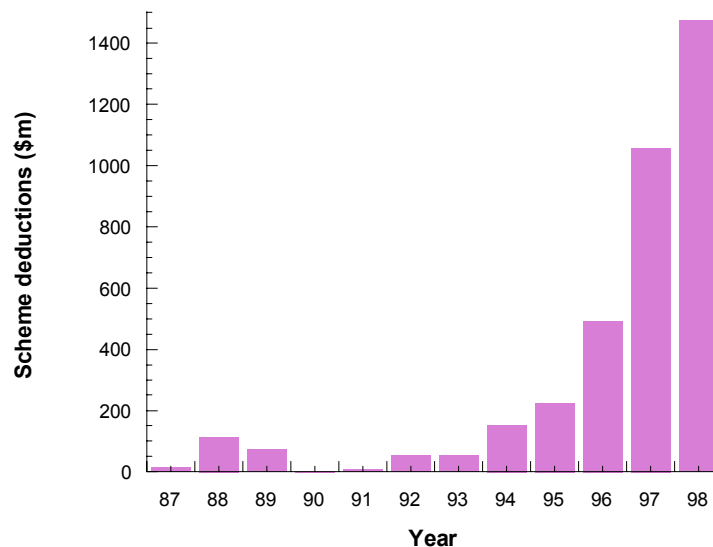
The Tax Office's concerns over aggressive tax planning first arose in 1996 out of its analysis of internal and external information that showed a dramatic increase in the number of taxpayers becoming involved in scheme arrangements. This coincided with an increase in the amounts being claimed as tax deductions. As can be seen in Figure 1, scheme related tax deductions were found to increase from AUD\$54 million in the 1993-94 income year to over AUD\$1 billion in the 1997-98 income year.

The Tax Office's concern over mass marketed schemes was further heightened when they analysed some of the scheme arrangements and gained a better understanding of the way they were structured. In the Tax Office's view, the fundamental compliance problem or 'tax mischief' common to these schemes related to the way they were financed, and not necessarily to their commercial nature or business activity. According to the Tax Office, many participants' investments were largely or almost wholly funded through tax deductions, with relatively little private capital being at risk.

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<sup>1</sup> In the event that the incorrect amount of tax has been paid by a taxpayer, the Tax Office can issue an amended assessment to ensure that the correct amount of tax is paid. This usually involves the automatic application of penalties and interest on the tax shortfall.

<sup>2</sup> The anti-avoidance provisions give the Tax Office the power to recover a taxpayers' tax shortfall with interest and penalties for a period of up to six years after the initial tax deduction was first claimed.



**Figure 1: Growth in claimed scheme-related deductions from 1987 to 1998** (*Source: personal correspondence with the Tax Office*).

In order to address the increasing compliance problem posed by schemes the Tax Office therefore decided to take enforcement action against the 42 000 participants thought to already be involved in such schemes. By taking enforcement action against the investors, the Tax Office saw it as a way of discouraging future marketing and investment in such arrangements.

Investor response towards the Tax Office's initial enforcement approach came as somewhat of a surprise to the Tax Office. The taxpayers involved argued that the schemes were sold to them by accountants and financial planners as a way of legitimately minimising tax while still enabling them to make a long-term investment. They resented the Tax Office's implication they were 'tax cheats', and were disappointed that they had not been consulted over the matter (Murphy, 2002a). During much of 1998 and 1999, therefore, thousands of investors made complaints to the Commonwealth Ombudsman about the Tax Office's handling of their case, various legal fighting funds were set up to represent investors' interests, and the majority of taxpayers involved simply refused to pay back their scheme related tax debts. In fact, four years after the Tax Office asked taxpayers to pay back their taxes with interest and penalties, more than 50% of taxpayers had still



refused to pay back their debts. This was despite the fact that their debts were increasing exponentially because of the interest being charged. The dispute between the taxpayers and the Tax Office culminated to the point where the matter was referred to a Parliamentary Senate Committee for review in June 2000.

The Tax Office was extremely interested in finding out why there was such widespread taxpayer resistance towards their decisions, and as a result approached the Centre for Tax System Integrity to undertake some research into this area.

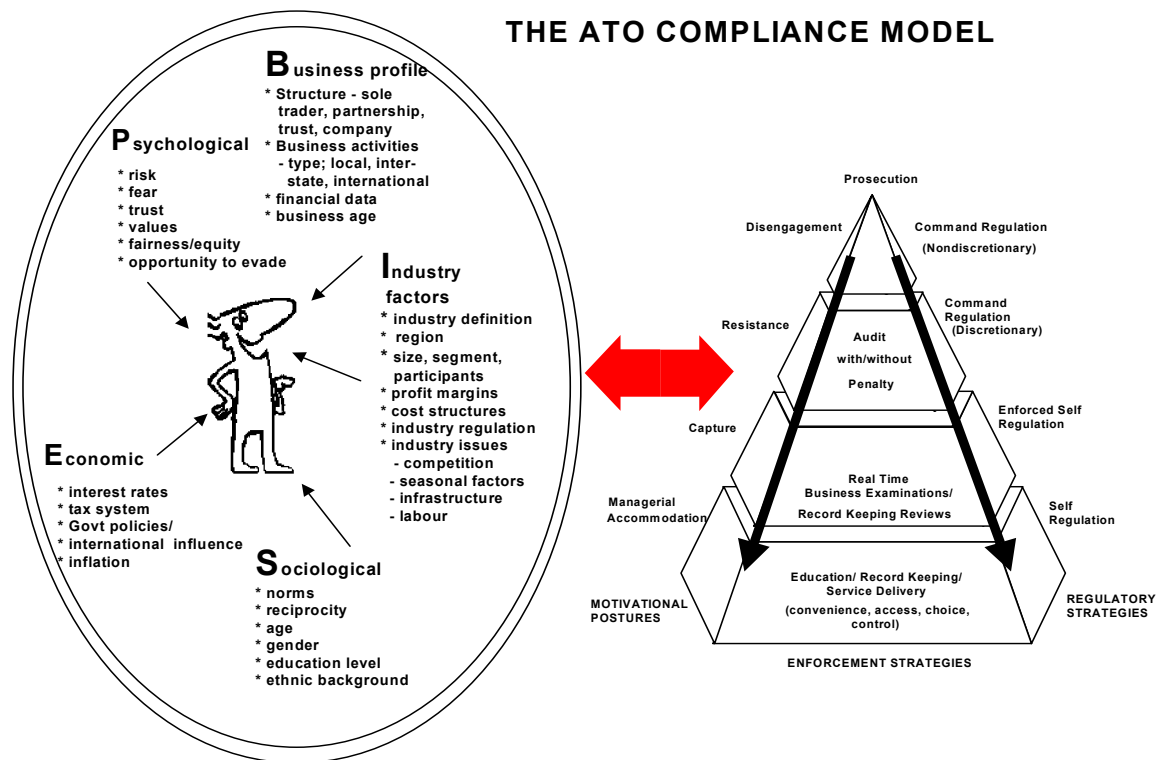
### **Section B: What has our past research told us?**

Not surprisingly, in our early research into this case study it was found from both in-depth interviews and survey results that scheme investors as a group could be distinguished from the general taxpayer population by the level of resistance they exhibited towards the Tax Office. Degree of resistance was able to be measured through Valerie Braithwaite's concept of motivational postures (Braithwaite, 1995). Motivational postures represent the ways in which individuals can position themselves in relation to a regulatory authority, and according to Braithwaite, they are predispositions to compliant or non-compliant conduct. Braithwaite has found evidence that five different types of motivational posture can be adopted by taxpayers in relation to the tax system and a tax authority. These include the postures of commitment, capitulation, resistance, disengagement and game-playing (for a discussion of these five different postures see Braithwaite, 2003).

The Australian Taxation Office is familiar with the concept of motivational postures and has actually incorporated the concept into their Compliance Model.<sup>3</sup> From Figure 2 it can be seen that the motivational posture of resistance is located on the left hand side of the enforcement pyramid, which makes up a major part of the Tax Office's Compliance Model (for a detailed discussion of the Compliance Model see Murphy, 2004a).

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<sup>3</sup> The Compliance Model provides tax officers with a guide for how they should communicate with compliant and non-compliant taxpayers. It is therefore used by tax officers as a regulatory management tool.



**Figure 2: The Australian Taxation Office's Compliance Model**

According to Braithwaite, the attitude of resistance represents those taxpayers who actively resist the self-regulatory system. Individuals who adopt a resistant stance are likely to view the Tax Office with antagonism because they feel they actively pursue taxpayers to 'catch them out' rather than to help them. Resisters are also likely to believe that people should take a stand against the Tax Office (Braithwaite, 2003). This may involve trying to avoid meeting their compliance obligations or being uncooperative with Tax Office requests. So in other words, resistant taxpayers tend to have concerns about the system and will avoid their obligations if given an opportunity to do so.

In the general population, it has been found that 55% of taxpayers tend to endorse a posture of resistance towards the tax system. In other words, 55% hold highly resistant views about the Tax Office or the tax system. When analysing survey data collected in 2002 from 2292 tax scheme investors, it was found that an overwhelming 87% of the

investors were found to be highly resistant (Murphy & Byng, 2002). Hence, on average, significantly more scheme investors were resistant towards the Tax Office than taxpayers from the general population.

In earlier research I was particularly interested in trying to explain why so many of these taxpayers may have held such resistant views about the Tax Office. Was it simply the fact that they had tax debts they did not want to pay back? Or was there something more to it than money? Was it something about the type of person these taxpayers were or was it something to do with the Tax Office's handling of the situation that may have led to the widespread resistance?

### *The role of procedural justice*

In exploratory interviews conducted in October 2001 with 30 scheme investors I found that taxpayers kept referring to how they felt they had been treated by the Tax Office. All those interviewed felt they had been treated poorly by the Tax Office and that the way the Tax Office had handled the schemes situation was unfair. Investors talked about how they felt the Tax Office had treated them all as tax cheats, how the Tax Office had not consulted with them over their decision to disallow scheme investments, and how they felt the wealthy had been able to get away investing in schemes for years without having been touched by the Tax Office. Investors were also upset by the fact that the Tax Office had not attempted to pursue the promoters and marketers of the schemes (see Murphy, 2002a for an in-depth discussion of these findings). All of these findings led me to the literature on procedural justice.

Procedural justice concerns the perceived fairness of the procedures involved in decision-making and the perceived treatment one receives from a decision-maker. Research into procedural justice has demonstrated 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; 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 more inclined to accept its

decisions and follow its directions (Lind & Tyler, 1988; Tyler & Degoey, 1996). It has also been found that people are most likely to challenge a situation collectively when they believe that the procedures are unfair (Tyler & Smith, 1998).

Research in this area has also shown that even when people's outcomes are unfavourable, they will be more likely to follow an authority's rules and decisions if the procedures are seen to be fair. This has been demonstrated in a range of different contexts, including policing, criminal justice, workplace relations, tax, nursing home regulation, and environmental regulation.

The exploratory interviews conducted with tax scheme investors suggested that perceptions of procedural injustice may have been an important element in taxpayers' reactions towards the Tax Office (Murphy, 2003). However, given that the interviewed group was relatively small (N = 30) and came from a remote mining community in Western Australia – mainly blue collar workers and perhaps a particularly resistant group – it was of interest to explore whether similar findings could be obtained from a national sample of scheme investors.

A national survey of 6000 tax scheme investors was therefore conducted in 2002, with the assistance of the Tax Office. A total of 2292 investors participated in the study. In an analysis of that data, it was found that those investors who were more resistant towards the Tax Office were significantly more likely to feel that the Tax Office had treated them and other taxpayers in a procedurally unfair way. It was also found that taxpayers who felt they had been treated unfairly by the Tax Office were also less likely to trust the Tax Office (Murphy, 2004b). Thus, the findings obtained in the interview study conducted in Kalgoorlie, Western Australia, were supported by the 2002 survey results.

It should be noted at this stage that procedural justice theory does NOT suggest that punishment should not be used. In fact, procedural justice theory suggests that punishment should be used if appropriate. Some have also criticised the work of the Centre for Tax System Integrity as always advocating a soft and naïve approach to dealing with offenders. We have never suggested that offenders should not be punished. Instead, we suggest that it

is the way in which this punishment is implemented by regulators that is important. If enforcement processes are handled in a procedurally unfair manner, then this can lead to negative compliance outcomes in the future, as well as increasing problems for staff having to deal with resistant taxpayers.

### **Section C: The present study**

As discussed above, survey data was collected from a national sample of tax scheme investors in 2002. Shortly after the survey was in the field the Tax Office put forward a settlement offer to scheme investors. The settlement was offered by the Tax Office partly in response to a Senate Committee's recommendations (see Senate Economics References Committee, 2001), but primarily as a way to finally resolve the long-standing dispute that had been continuing between taxpayers and the Tax Office.

The settlement offer included acknowledging that many investors had been the victims of unscrupulous scheme promoters and it gave investors the opportunity to settle their debt without having to pay the interest and penalties on the debt (this served to decrease most taxpayers' debts to half their original level). Taxpayers were given a 2-year interest free period in which to pay back the outstanding amount.<sup>4</sup> Shortly after the settlement offer was announced a number of scheme-related court cases were also finalised. Most ruled in favour of the Tax Office's interpretation of the law, and therefore justified the Tax Office's position and action against the scheme investors. As a result, the settlement offer proved to be highly successful, with 87% of all investors finally agreeing to pay back their scheme-related debts.

Given investors' attitudes and behaviours had been measured just prior to the Tax Office's final settlement offer (and just prior to the court decisions), this offered the perfect opportunity to compare investors' views both before and after the issue was resolved. Did investors views towards the Tax Office change after the settlement offer or did they remain the same? The study reported in this paper will answer this question using survey data that

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<sup>4</sup> A small number of accountants, lawyers and financial planners were ineligible to take up the offer as the Tax Office argued that they should have been aware of the true taxation implications of their investments.

was collected from 659 taxpayers who completed both the original survey in 2002 and a new follow-up survey in 2004.

## **Section D: Methodology**

Using Tax Office case files, a 27-page survey booklet was posted to a nationwide random sample of 6000 tax scheme investors in January 2002 (Murphy, 2002b). The sample was drawn using probability proportional to size sampling within each State and Territory of Australia.<sup>5</sup>

The survey package posted to taxpayers included a cover letter, a survey booklet, and a reply-paid envelope. The cover letter explained the purpose of the study and guaranteed participants strict confidentiality. It also referred participants to a free call number should they have any questions. Non-respondents were followed up over time using a method based on the Dillman Total Design Method (Dillman, 1978).<sup>6</sup> Follow-up of non-respondents was accomplished using an identification number that was affixed to each survey booklet, which was in turn linked to the sample name at the Tax Office.

In order to protect taxpayers' identities, the Tax Office was responsible for all mailings of the survey and the reminder letters. Participants who agreed to participate were then asked to return their completed surveys back to the Centre for Tax System Integrity at the Australian National University (ANU) for analysis. The ANU then provided the Tax Office with the identification numbers of returned surveys. This procedure ensured that the researchers did not have access to the names of any taxpayer without their consent, and it also ensured that the Tax Office did not have access to their individual survey responses. A total of six mailings were made, and after a period of 7 months, a total of 2292 useable surveys were received. When adjusted for out-of-scope taxpayers who had died, moved address, or who were incapable of completing the survey (N = 677), this resulted in a response rate of 43%.

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<sup>5</sup> Which means that if 40% of the overall scheme investor population resided in Western Australia, 40% of the sample drawn came from Western Australia, and so on for the other States and Territories.

<sup>6</sup> The Dillman method involves sending non-respondents a series of reminder letters encouraging them to complete and return a survey.

In the original 2002 survey, 1250 taxpayers indicated that they would be willing to participate in a follow-up study and provided ANU researchers with their contact details<sup>7</sup>. In August 2004 (2½ years after the original survey), these 1250 taxpayers were re-contacted and asked to fill in a 28-page survey that contained many of the same questions that were measured in the first survey (Murphy, 2004c). Using a similar procedure as the 2002 survey, a total of 659 useable surveys were finally received. When adjusting for people who had moved address, had died, or were incapable of completing the survey (N = 146), the overall response rate to the 2004 survey was 60%. Survey data from the original and follow-up surveys were then merged using the participants' unique identifier number.

## **Section E: Findings**

Of particular interest to the present study was being able to compare those taxpayers who were highly resistant in 2002 and in 2004, to those who were highly resistant in 2002 but who were no longer resistant in 2004. When investors were categorised into these two groups, it was found that 125 of the 659 survey respondents were highly resistant in 2002 but not in 2004. This group will be referred to as the Non-resister group. It was found that 289 of the 659 survey respondents were highly resistant in both 2002 and 2004. This group will be referred to as the Resister group. Hence, 44% of the survey respondents continued to be resistant towards the Tax Office over time, whereas 19% of the respondents changed from being highly resistant to non-resistant over time. The question of interest was: Why was it that some people continued to hold resistant views towards the Tax Office whereas others became less resistant over time? What factors may have led to these differences?<sup>8</sup>

## ***Demographics***

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<sup>7</sup> This process enabled the researchers to contact the taxpayers directly without having to go through the Tax Office.

<sup>8</sup> It should be noted that the remaining taxpayers who completed the survey fell into two additional groups not examined in the present paper: those who were non-resistant in both 2002 and 2004 (N = 165; approx. 25% of the sample) and those who were non-resistant in 2002 but who became highly resistant in 2004 (N = 69; approx. 11% of the sample). These two groups were not included in the analysis because the author was interested primarily in trying to answer why it might be the case that one group of taxpayer remained resistant over time while the other became non-resistant over time.

Demographic differences between the two groups were first explored. For example, were the two groups different from each other in terms of their age, their education, their income level, their level of tax debt, or whether they were eligible to take up the settlement offer? Table 1 presents the means and standard deviations for both groups for all demographic variables measured.

As can be seen in Table 1, the resister and non-resister groups did not differ significantly on any of the demographic variables measured. It was therefore not the case that those who continued to be resistant over time had significantly higher tax debts. Likewise, those who earned less money—and who may not have been able to afford to pay back a tax debt—were not more likely to continue to be resistant. Finally, there were no differences between the two groups in terms of whether they were eligible to take up the settlement offer. These findings suggest that the differences in their degree of resistance over time could not be explained by financial self-interest issues.

**Table 1: Differences between the Resister and Non-Resister Group on a number of Demographic variables**

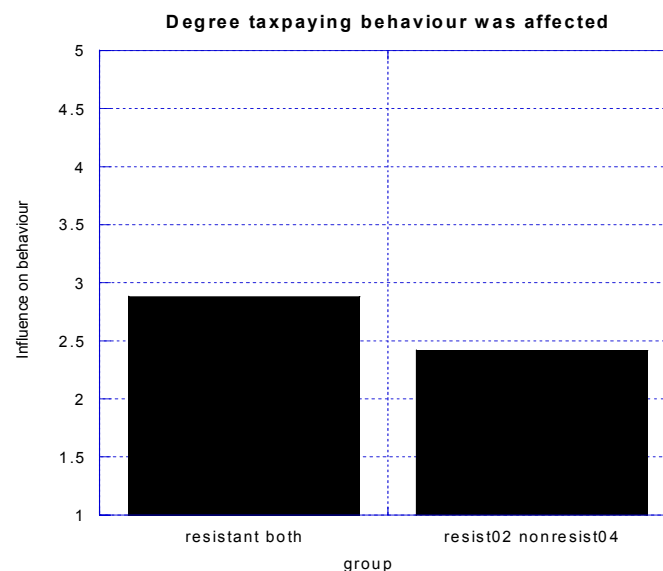
Variables	Group	Mean	SD	Significant Difference
Age	Resistant02 only	49.91	8.75	No
	Resistant both	50.97	8.66	
Income (\$'000s)	Resistant02 only	83.42	55.03	No
	Resistant both	78.36	55.93	
Education (1 = no education to 8 = postgraduate education)	Resistant02 only	5.94	1.63	No
	Resistant both	5.74	1.67	
Tax Debt (\$)	Resistant02 only	47286.76	49717.49	No
	Resistant both	56829.24	65296.84	
Eligibility for offer (1 = yes, 2 = No)	Resistant02 only	1.13	0.43	No
	Resistant both	1.12	0.40	

Note: Significant at the \*p<0.05; \*\*p<0.01; or \*\*\*p<0.001 level



### ***Compliance behaviour***

Compliance behaviour was also compared between the two groups. One question in the 2004 survey asked scheme investors whether they thought their scheme-related experience had affected their taxpaying behaviour in a negative way. Taxpayers were asked to respond on a ‘definitely not’, ‘not really’, ‘somewhat’, ‘yes’, ‘definitely yes’ scale. It was found that the Resister group (those who were highly resistant in both 2002 and 2004) felt their taxpaying behaviour was affected more so than those who became less resistant over time. Figure 3 illustrates this finding.



**Figure 3: The degree to which taxpaying behaviour was affected by investors’ scheme-related experience**

All taxpayers were asked to expand on how they felt the experience may have affected their taxpaying behaviour. They were provided with 6 options.

- I now try to avoid paying tax as much as possible
- I no longer declare all my income
- I now use the tax system in a negative way to recoup the financial losses I incurred
- I am now more defiant towards the Tax Office

- I now look for ways to purposefully cheat the tax system
- I now look for many ways to recoup my financial losses

Responses to all six of these questions were combined to form an overall tax compliance scale (again measured on a five point scale). The group who remained resistant over time were significantly more likely to report they did these things than taxpayers who became less resistant over time ( $M = 2.20$ ,  $SD = 0.77$  vs.  $M = 1.84$ ,  $SD = 0.68$ , respectively;  $t(409) = -4.56$ ,  $p < 0.001$ ).

Actual tax compliance behaviours in both 2002 and 2004 were also assessed. In both the 2002 and 2004 surveys, taxpayers were asked whether they had engaged in any of the following acts of non-compliance in the past 12 months: missed lodging their tax returns, made illegitimate tax deductions in their tax returns, worked for cash without paying tax on it, or had an outstanding tax debt with the Tax Office. Those who scored 4 out of 4 were deemed to be extremely non-compliant whereas those who responded 0 had been completely compliant with their obligations in the past 12 months. Table 2 presents the findings from these questions.

**Table 2: Differences between the Resister and Non-Resister Group on a number of tax compliance variables**

Variables	Group	Mean	SD	Significant Difference
2002 evasion	Resistant02 only	0.73	0.67	No
	Resistant both	0.86	0.65	
2004 evasion	Resistant02 only	0.38	0.59	Yes**
	Resistant both	0.59	0.73	
Cash declared	Resistant02 only	99%	2%	Yes**
	Resistant both	65%	46%	

Note: Significant at the \* $p < 0.05$ ; \*\* $p < 0.01$ ; or \*\*\* $p < 0.001$  level

From Table 2, it can be seen that in 2002 there was no significant difference in the tax compliance behaviour between the resister and the non-resister group. In 2004, however, while there was an overall drop in non-compliance behaviour when compared to 2002

behaviour, it was found that the resister group was significantly more likely to have engaged in tax evasion in 2004.

Those who indicated they had worked for cash income in the past 12 months (N = 19 for the non-resister group, N = 62 for the resister group) were also asked to estimate how much of this income they had declared in their most recent tax return. Ninety-nine per cent of the cash income earned by the non-resister group was declared, whereas only 65% was declared by the resister group. This difference was highly significant,  $t(79) = 3.28$ ,  $p < 0.002$ .

These findings suggest that taxpayers who hold resistant views towards the Tax Office and tax system are significantly more likely to engage in tax non-compliance than non-resistant taxpayers. In other words, there seems to be a relationship between one's attitudes and their actual compliance behaviour.

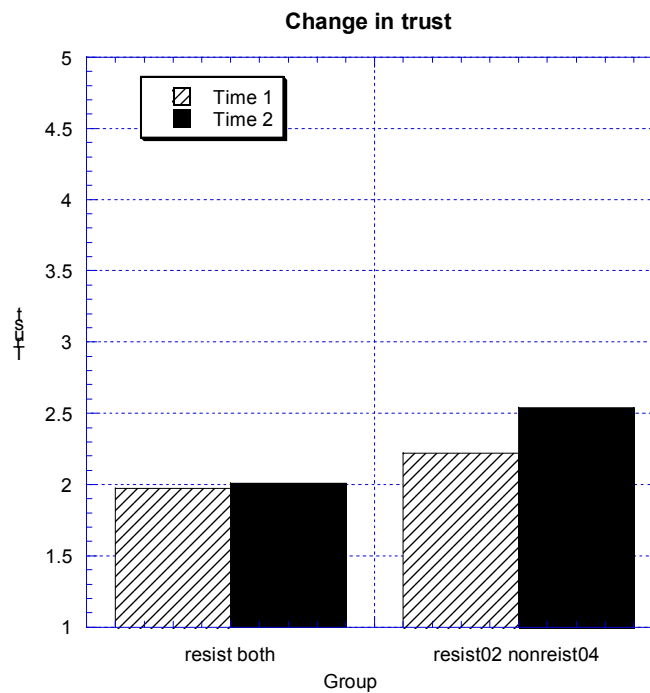
### ***Changes in attitudes***

There were also various attitudinal questions in common between the survey conducted in 2002 and the survey conducted in 2004. For example, in 2002 taxpayers were asked a series of questions about how much they trusted the Tax Office. These same questions were present in the 2004 survey. By having the same group of questions in both surveys, I was able to explore whether one group of taxpayer had a greater attitude change over time compared to the other group. Perceptions of procedural justice, level of trust in the Tax Office, the perceived legitimacy of the Tax Office and taxpayers' obligation to obey Tax Office decisions and rules were of interest (all items measured on a 1 to 5, 'strongly disagree' to 'strongly agree' scale, with 3 being the neutral midpoint). Figures 4 to 7 illustrate the findings.



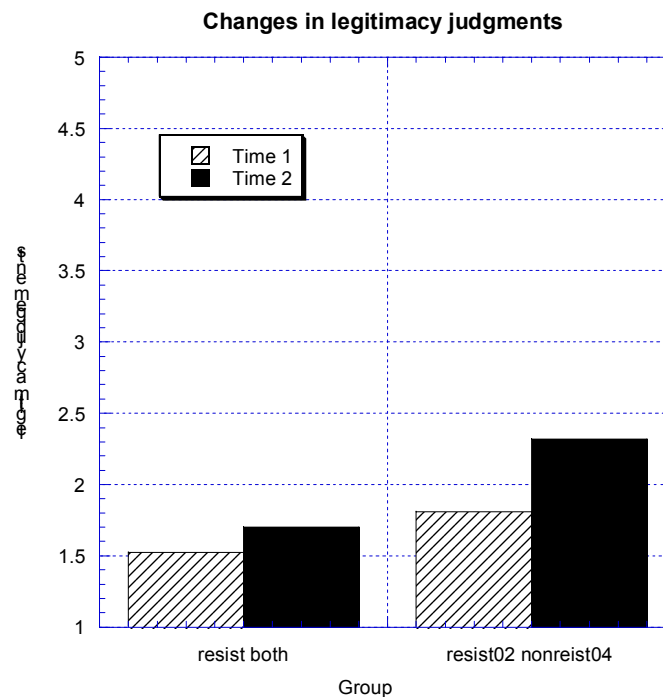
**Figure 4: Degree of change in procedural justice judgments between 2002 (Time 1) and 2004 (Time 2)**

It can be seen from Figure 4 that for the resister group there was no change in the way they responded to the procedural justice items at Time 1 or Time 2. In both 2002 and 2004 they rated the Tax Office poorly on measures of procedural justice. For the taxpayers who became less resistant over time, however, we can see that they became slightly more positive in their procedural justice judgments over time. While they are still quite negative in their judgments overall, the important thing to note is that they became significantly more positive in their judgments from Time 1 to Time 2 than the resister group,  $t(412) = -3.57, p < 0.001$ .



**Figure 5: Degree of change in trust in the Tax Office between 2002 (Time 1) and 2004 (Time 2)**

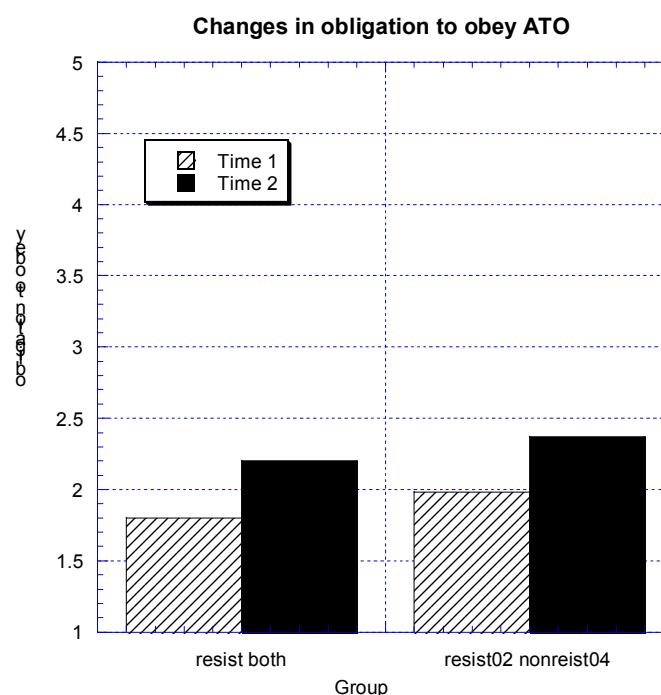
Figure 5 also shows that the resister group had no change in their level of trust towards the Tax Office between 2002 and 2004. The non-resister group, however, did have a significant change. They were more likely to trust the Tax Office in 2004 than they were in 2002. Hence, the non-resistant group had a significantly greater change in their trust levels than taxpayers who continued to hold resistant views towards the Tax Office,  $t(407) = -4.1$ ,  $p < 0.001$ .



**Figure 6: Degree of change in legitimacy judgments of the Tax Office between 2002 (Time 1) and 2004 (Time 2)**

Figure 6 also reveals that the non-resister group had a significantly bigger change over time in their views of the Tax Office's legitimacy,  $t(404) = -4.03$ ,  $p < 0.001$ . Legitimacy here refers to the belief that authorities do their job well and are entitled to be obeyed. So in other words, the non-resister group felt the Tax Office had significantly more legitimacy in 2004 than they did in 2002. There was no difference in judgments over time for the resister group.

Finally, as can be seen in Figure 7 below, taxpayers' feelings of obligation to obey the Tax Office were assessed in both 2002 and 2004 (this is another measure of perceived legitimacy). It was found that both the resister and non-resister groups felt more obligation to obey the Tax Office in 2004 compared to 2002. There was no difference in the degree of change between the two groups,  $t(401) = 0.144$ ,  $p < 0.89$ ; in other words, the non-resister group did not change more in their views than did the resister group.



**Figure 7: Degree of change in feelings of obligation to obey the Tax Office between 2002 (Time 1) and 2004 (Time 2)**

### *Views on the settlement offer*

From the previous section it can be seen that the taxpayers who became less resistant over time had greater changes in their level of trust towards the Tax Office, they had greater changes in their views about the Tax Office's legitimacy, and they had more positive changes in the procedural justice judgments they made about the Tax Office. Could these changes have had anything to do with how they viewed the settlement process?

In the 2004 survey, taxpayers were asked to comment about how they believed the settlement process was handled by the Tax Office. This included asking them: whether they felt the outcome was fair; what they thought about the procedural justice aspects of their treatment during the settlement process; whether they were satisfied with the Tax Office's handling of the settlement process; whether the settlement offer had gone some way to alleviating their concerns over the Tax Office's initial handling of the schemes

situation; whether the settlement offer had allowed them to put the matter behind them; and finally, whether they had more respect for the Tax Office as a result of the settlement offer. Table 3 presents the mean ratings for each of these questions for both the resister and non-resister groups.

The first thing to notice from Table 3 is that, in general, taxpayers were still relatively unhappy about the settlement process and its outcome (this was the case for both resisters and non-resisters). However, the important thing to note is that on all measures, those taxpayers who became less resistant over time were significantly more likely to rate the Tax Office's handling of the settlement process in a more positive manner.

For example, those who remained highly resistant towards the Tax Office over time (that is, resisters) were significantly less likely to think the settlement offer gave taxpayers a fair outcome, they made more negative judgments about the procedural justice aspects of the Tax Office's handling of the settlement process, and on average they were less satisfied with the Tax Office's handling of the settlement process than those who were no longer resistant in 2004.

It can also be seen from Table 3 that those who became less resistant over time (that is, non-resisters) had higher scores on the remaining three measures. Compared to the resister group, non-resisters were more likely to feel the settlement offer alleviated their concerns over the Tax Office's original handling of the schemes situation, they were more likely to feel that the offer allowed them to put the whole matter behind them, and as a result of the settlement offer, they were more likely to have respect for the Tax Office.



**Table 3. Differences between the Resister and Non-Resister Group on views of the settlement offer (higher values represent a more favourable rating; all items measured on a 1 to 5, ‘strongly disagree’ to ‘strongly agree’ scale, with a score of 3 representing the midpoint)**

Variables	Group	Mean	SD	Significant Difference
Outcome fairness	Resistant02 only	2.15	1.25	Yes***
	Resistant both	1.67	0.98	
Procedural fairness of ATO’s handling of settlement process	Resistant02 only	2.03	1.01	Yes***
	Resistant both	1.59	0.76	
Satisfaction with ATO’s handling of settlement process	Resistant02 only	2.03	1.10	Yes***
	Resistant both	1.63	0.89	
Alleviated original concerns over ATO’s handling of schemes	Resistant02 only	2.08	1.09	Yes***
	Resistant both	1.57	0.86	
Offer allowed me to put matter behind me	Resistant02 only	2.76	1.43	Yes***
	Resistant both	2.22	1.19	
Now have more respect for ATO	Resistant02 only	2.19	0.97	Yes***
	Resistant both	1.73	0.88	

Note: Significant at the \*p<0.05; \*\*p<0.01; or \*\*\*p<0.001 level

### ***Summary of findings***

To summarise the findings, those taxpayers who continued to be highly resistant towards the Tax Office even after the settlement offer were significantly more likely to be non-compliant than taxpayers who were no longer resistant after the settlement offer. It was also found that taxpayers who were no longer resistant after the settlement offer, unlike the resistant group, had significant changes over time in their level of trust towards the Tax Office, whether they believed the Tax Office was a legitimate authority, and their general feelings about the Tax Office’s treatment of taxpayers. In general, the non-resisters views became more positive after the settlement offer. Those who continued to be highly resistant over time continued to make just as negative comments about the Tax Office as they did in 2002.

Although it is hard to prove causality using the statistical methods employed in the present paper, the findings seem to suggest that how one felt about the settlement offer may have

determined whether they continued to be highly resistant towards the Tax Office. Those who were more likely to think the settlement offer was fair and handled well were less likely to hold onto resistant views towards the Tax Office.

## **Section F: Implications of the findings**

So what do all these findings suggest? There are several points that should be made about the findings before moving on to talk about their implications.

The first point is that the findings demonstrate that people's motivational postures are fluid and changeable over time. There was one group of taxpayer who was highly resistant when surveyed in 2002 and who continued to be highly resistant in 2004. The other group was highly resistant in 2002 but was no longer resistant when tested in 2004. So out of the total 659 taxpayers surveyed in both 2002 and 2004, 44% remained resistant over time, while 19% changed from a resistant posture to a non-resistant posture.

The second point to make is that the findings suggest that the way in which a regulator handles a case can have serious ramifications for the way people view that regulator, as well as for their actual compliance behaviour in the future. The Tax Office's initial correspondence and enforcement action against scheme investors began in 1998. Yet for the majority of taxpayers surveyed, they still held highly negative views about the Tax Office in 2004 (six years after the initial enforcement action was taken). Our past research has shown that this is partly due to taxpayers feeling they had been treated in a procedurally unjust way. It was also found in the present study that those who continued to be highly resistant towards the Tax Office in 2004 were significantly more likely to engage in subsequent forms of tax evasion behaviour compared to taxpayers who became less resistant over time.

These two points have important implications for the way the Tax Office interprets and uses their Compliance Model. The Compliance Model provides tax officers with a guide for how they should communicate with compliant and non-compliant taxpayers. In viewing the Compliance Model again (see Figure 2), it can be seen that the motivational posture of

resistance is relatively high up on the left hand side of the regulatory enforcement pyramid. In using the Model, some tax officers may make the assumption that because someone has not complied with their tax obligations in the past, or has been resistant to requests in the past, they are likely to be resistant all of the time. The result of this assumption is that tax officers can often be tempted to use quite severe sanctions against taxpayers they believe to be resistant or disengaged. Their reasoning is that such an approach should bring taxpayers back into compliance and deter them from engaging in forms of non-compliance in the future. While this may be true to a degree, the research conducted by the Centre for Tax System Integrity, as well as previous research in different regulatory arenas, in fact suggests that deterrence-based models of enforcement can sometimes produce reactance and resistance if used in the initial stages of an enforcement encounter. In the case of the schemes situation, for example, this clearly seems to be the case. By using an initial punitive deterrence-based strategy in 1998—without first giving taxpayers the benefit of the doubt that they had made a mistake in their tax affairs—many taxpayers developed highly resistant attitudes towards the Tax Office and its handling of the schemes situation. The problem with an initial deterrence-based enforcement strategy is that it opens the way for people to be critical of the regulator's procedures.

Ayres and Braithwaite (1992) suggest that regulators should always start their enforcement strategies softly by using co-operation and persuasion. They suggest that persuasion should be the strategy of first choice because preserving the perception of fairness is important to nurturing voluntary compliance. As mentioned earlier, Tyler's work in the context of policing and court systems has found that people are able to handle negative outcomes as long as they feel the procedures that are used to handle the case are fair and respectful (Tyler, 1990). An educative and respectful enforcement encounter is more likely to be interpreted as procedurally fair than one based initially on a deterrence-based philosophy.

As mentioned earlier, the findings of the present study also suggest that the Tax Office may be able to change taxpayers' views for the better if they use strategies that are procedurally fair. All taxpayers felt the Tax Office's handling of the settlement offer process was procedurally fairer than their initial enforcement approach. And 19% of taxpayers were found to become less resistant after the final settlement offer was made to

taxpayers. These findings provide support for the suggestion that a cooperative and respectful first approach with non-compliant taxpayers (even if they may be resistant to begin with) might prove to be more fruitful in encouraging long-term voluntary compliance behaviour. If regulators such as the Tax Office can learn to change the attitudes of even 19% of the population they are dealing with, then such an outcome would yield significant gains in relation to both present and future administrative costs.

## **Conclusion**

In conclusion, it is suggested that regulators should try to prevent sparking resistance towards their decisions and rules. The findings of the present study suggest that a regulatory enforcement strategy that is based on principles of procedural justice is likely to be helpful. In making these suggestions, however, it should be noted that such an approach does not preclude deterrence and punishment. Deterrence is important and clearly regulators need to have a reputation for being able to catch and punish those who deserve to be punished. For example, someone who deliberately makes false claims on their tax returns or who shifts their money offshore to avoid tax should be reprimanded and punished. However, the manner in which the punishment process is handled should still be done in a way that is both respectful and fair. If regulators can learn to better manage the way their laws are administered, as well as learning to better manage public reactions to their laws, they will be able to turn some resisters into long-term compliers.

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