

**An examination of taxpayers' attitudes towards the Australian tax system: Findings
from a survey of tax scheme investors**

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Running Head: Aggressive tax planning

Abstract

In recent years, the number of Australian taxpayers involved in aggressive tax planning has more than doubled. This aggressive form of financial planning poses a serious threat to the integrity of Australia's tax system. In order to deal with the problem, the Australian Taxation Office (ATO) announced in 1998 that they would be implementing a number of initiatives aimed at combating aggressive tax planning. Part of the ATO's crackdown on aggressive tax planning involved issuing amended assessments to the 42,000 Australians who invested in mass marketed tax schemes. The majority of scheme investors, however, resisted the ATO's attempts to recover scheme related tax debts. This paper discusses the findings of an empirical study that shows that the widespread resistance exhibited by scheme investors was due partly to the manner in which the ATO dealt with the schemes issue. Using survey data collected from 2301 tax scheme investors, and 2040 taxpayers from the general population, it will be shown that those who invested in tax schemes are more disillusioned with the tax system, are more hostile and resistant towards the ATO, and are more likely to resent paying tax as a result. Suggestions for the way regulatory authorities such as the ATO should deal with non-compliers, and possible solutions for how tax authorities might deal with the increasing problem of aggressive tax planning, will be discussed.

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Introduction

In an ideal world, all taxpayers would voluntarily pay their taxes and comply with all of their tax obligations willingly. But let's face it, no one enjoys paying tax, and at the end of each financial year some people's thoughts turn to how they can best arrange their affairs to pay as little tax as possible. This may simply involve making use of strategies that allow one to legally minimise tax (for example, increasing superannuation contributions or negative gearing an investment property). These strategies are what the Australian Taxation Office (ATO) would consider to be non-aggressive tax planning strategies. Alternatively, however, there are strategies that may involve non-compliant or fraudulent activity that could be most appropriately described as tax evasion (for example, creating false expenses or shifting money offshore). There is also a third type of strategy used by some taxpayers that falls somewhere between these two extremes. These are the tax avoidance strategies that the ATO commonly refers to as aggressive tax planning strategies. They are 'aggressive' as they seek to exploit deficiencies or uncertainty in the law¹. Aggressive tax planning by its very nature involves finding ways to accomplish compliance with the letter of the law while totally undermining the policy intent or spirit behind the words.

Aggressive tax planning used to be a secret, well kept by high priced tax lawyers and accountants and, as a result, used to be primarily reserved for the very wealthy. In recent years, however, thousands of 'ordinary' Australians have been cashing in on this new form of financial planning². For example, during the 1990s, an estimated \$4 billion in tax revenue was lost as a result of 42,000 Australians becoming involved in aggressive mass marketed tax schemes. Scheme related tax deductions were found to increase from

¹ Australian Taxation Office, *Australian Taxation Office Annual Report 1998-1999* (1999). Canberra: Commonwealth of Australia, at xiii.

² Australian Taxation Office, *Australian Taxation Office Annual Report 199-2000* (2000). Canberra: Commonwealth of Australia.

\$54 million in 1994 to over \$1 billion in 1998³. These figures highlight the threat apparent to the tax base, especially when one considers that mass marketed tax schemes are not the only form of aggressive tax planning available to taxpayers. A multitude of strategies that seek to exploit deficiencies in the law are continuously being devised each year in the Australian market place⁴. This has been coupled with an increased number of taxpayers taking advantage of their tax ‘benefits’ each year. There is therefore no doubt that aggressive tax planning poses a serious threat to the integrity of the Australian tax system.

Explaining non-compliance: Deterrence or attitudes?

Understanding why taxpayers do not comply with their tax obligations is a topic of interest to most revenue authorities around the world. Much of the early research that has examined tax compliance behaviour and taxpayers’ tendencies to evade or avoid tax has used a deterrence theory framework to explain their behaviour⁵. Deterrence theories are rooted in economics⁶ and portray people as ‘amoral profit-seekers whose actions are motivated wholly by rational calculation of costs and opportunities’⁷. According to the deterrence view, people carefully 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-compliance⁸.

It was in the late 1960s that researchers became particularly interested in the effects of deterrence on compliance with laws. A number of researchers reported inverse

³ K Murphy, Procedural Justice and the Australian Taxation Office: A study of scheme investors, *Centre for Tax System Integrity Working Paper No. 35*, (2002a). Canberra: The Australian National University.

⁴ J Braithwaite, *Aggressive Tax Planning: Marketing local and global shelters in New York, Sydney and Melbourne*, Unpublished book manuscript (2003), Centre for Tax System Integrity, The Australian National University.

⁵ For reviews see: BR Jackson & VC Milliron, Tax compliance research: Findings, problems and prospects, *Journal of Accounting Literature*, 5 (1986), 125-165; JA Roth, JT Scholz & AD Witte (Eds.), *Taxpayer Compliance Volume 1: An Agenda for Research* (1989), Philadelphia: University of Pennsylvania Press.

⁶ A Lewis, *The psychology of Taxation* (1982). Oxford: Martin Robertson.

⁷ RA Kagan & JT Scholz, The criminology of the corporation and regulatory enforcement strategies. In K Hawkins & JM Thomas (Eds.), *Enforcing Regulation*, (1984). Boston: Kluwer-Nijhoff Publishing, at 69; see also E Kirchler & B Maciejovsky, Tax compliance within the context of gain and loss situations, expected and current asset position, and profession, *Journal of Economic Psychology*, 22 (2001), 173-194.

⁸ For a discussion see Kagan & Scholz, *supra* note 7.

relationships between the threat of legal punishment and the volume of crime⁹. Both Gibbs (1968) and Tittle (1969) reported evidence of a relationship between the certainty of legal sanctions and crime rates, and Jensen (1969) reported evidence of a relationship between perceived risk of legal sanctions and self-reported delinquency in juveniles. These findings were taken by some to suggest that individuals will only comply with rules and regulations when confronted with harsh sanctions and penalties.

Deterrence research conducted in the tax arena has continued to reveal conflicting results. While there is some evidence to suggest that fear of detection acts as a deterrent to tax non-compliance¹⁰, there is little evidence to suggest that the severity of penalties or prosecuting taxpayers deters non-compliance in the long-term¹¹. An Australian study, for example, showed that levels of tax non-compliance between 1985 and 1996 were not influenced by the increased severity of statutory fines or by the increased number of jail terms being handed out to tax offenders over this time¹². Another Australian study showed that prosecuting non-compliant taxpayers also had a limited effect on influencing their long-term compliance behaviour¹³.

A limitation of the deterrence model, therefore, is that it does not satisfactorily explain the high levels of voluntary compliance observed in many situations. The tax system in Australia is based largely on self-assessment and voluntary compliance by taxpayers. The probability of receiving an audit by the ATO is considerably low. The chance of being caught blatantly avoiding or evading tax is also unlikely, and if a

⁹ For example: JP Gibbs, Crime, punishment and deterrence, *Southwestern Social Science Quarterly*, 48 (1968), 515-530; GF Jensen, Crime doesn't pay: correlates of a shared misunderstanding, *Social Problems*, 17 (1969), 189-201; CR Tittle, Crime rates and legal sanctions, *Social Problems*, 16 (1969), 409-422.

¹⁰ For example, AD Witte & DF Woodbury, The effect of tax laws and tax administration on tax compliance: The case of the US individual income tax, *National Tax Journal*, 38 (1985), 1-15; J Slemrod, M Blumenthal & C Christian, Taxpayer response to an increased probability of audit: Evidence from a controlled experiment in Minnesota, *Journal of Public Economics*, 79 (2001), 455-483.

¹¹ KA Kinsey, Theories and models of tax cheating, *American Bar Foundation Working Paper No 8717*, (1988); Witte & Woodbury, *supra* note 10; R Williams, Prosecuting Non-lodgers: To persuade or punish?, *Centre for Tax System Integrity Working Paper No. 12*, (2001). Canberra: The Australian National University.

¹² K Devos, *Penalties and sanctions for Australian taxation crimes and their effect on taxpayer compliance – are they adequate and effective?* Paper presented at the 5th International Conference on Tax Administration, ATAX, Sydney, 4-5 April (2002).

¹³ Williams, *supra* note 11.

taxpayer is caught, the culpability penalties are relatively minor. Yet the majority of taxpayers still comply with their obligations and pay their tax with good will¹⁴. In fact, there is now a growing amount of empirical evidence to suggest that an appeal to a taxpayer's conscience can have a greater effect on their subsequent compliance behaviour than the threat of legal sanctions¹⁵.

It is for these reasons that many tax researchers have questioned the deterrence theory framework as the most appropriate model for explaining taxpayer behaviour. These researchers, instead, suggest that taxpayer attitudes towards the tax system and paying tax need to be incorporated into theoretical accounts of non-compliance. A number of investigations of attitudes toward, and beliefs about, taxation and its evasion have now been undertaken¹⁶. The findings of these studies suggest that taxpayer attitudes towards the tax system, and the way taxpayers feel treated by a tax authority are important in explaining taxpayer non-compliance¹⁷.

While there is not room in this paper to discuss the many studies that have examined taxpayer attitudes over the years, for the purposes of the present article a handful of studies deserve particular mention. With respect to the tax system itself, there is specific evidence to suggest that perceptions of unfair tax burdens can affect taxpayers' views about paying tax and can go on to affect their compliance decisions. According to

¹⁴ V Braithwaite (Ed.), *Taxing Democracy* (2003). Aldershot, Ashgate.

¹⁵ For example see: R Schwartz & S Orleans, On legal sanctions, *University of Chicago Law Review*, 25 (1967), 274-300; H Grasmick & W Scott, Tax evasion and mechanisms of social control: A comparison with grand and petty theft, *Journal of Economic Psychology*, 2 (1982), 213-230; P Hite, Identifying and mitigating taxpayer non-compliance, *Australian Tax Forum*, 14 (1997), 155-176; M Wenzel, Misperceptions of social norms about tax compliance: A field experiment, *Centre for Tax System Integrity Working Paper No. 8*, (2001). Canberra: The Australian National University.

¹⁶ For recent studies in the Australian context see: V Braithwaite, M Reinhart, M Mearns & R Graham, Preliminary findings from the Community Hopes, Fears and Actions Survey. *Centre for Tax System Integrity Working Paper No. 3*. (2001). Canberra: The Australian National University; IG Wallschutzky, Possible causes of tax evasion, *Journal of Economic Psychology*, 5 (1984), 371-384; IG Wallschutzky, *Issues in research methods: With reference to income tax research*, Unpublished manuscript, University of Newcastle, Australia (1996); A Wearing & B Headey, The would-be tax evader: A profile, *Australian Tax Forum*, 13 (1997), 3-17.

¹⁷ For those interested in a more detailed discussion of the deterrence versus attitude approaches to tax compliance behaviour they are directed to: M. McKerchar, Why do taxpayers comply? Past lessons and future directions in developing a model of compliance behaviour. *Australian Tax Forum*, 16 (2001), 99-134.

Betty Jackson and Valerie Milliron, tax fairness seems to involve at least two different dimensions¹⁸. The first relates to the benefits one receives for the tax dollars given. The second dimension involves the perceived equity of the taxpayer's burden in reference to that of other individuals. This second dimension relates to taxpayers' perceptions of the vertical equity of the tax system¹⁹. If a taxpayer were to feel that they pay more than their fair share of tax when comparing themselves to wealthy taxpayers (that is, perceived vertical inequality), they are more likely to see paying tax as a burden than a taxpayer not concerned about these issues.

In an experimental study, Spicer and Becker (1980) had participants make hypothetical tax evasion decisions²⁰. It was found that participants increased the amount of taxes evaded when they perceived themselves to be the victims of vertical inequity. It was also shown that they decreased the amount of tax evaded when they perceived themselves to be the beneficiaries of vertical inequity. Similarly, Kinsey and Grasmick (1993)²¹ found that changes in attitudes towards tax cheating were due in part to perceptions of increased vertical inequality in the US tax system over time.

Research into procedural justice has also shown that taxpayers are generally more compliant when they think a tax authority has treated them fairly and respectfully²². For example, in a Swiss study, Feld and Frey (2002) presented empirical evidence to suggest that tax compliance increased when taxpayers were treated as trustworthy in the first instance by tax authorities²³. 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

¹⁸ *Supra* note 5.

¹⁹ KA Kinsey & HG Grasmick, Did the Tax Reform Act of 1986 improve compliance? Three studies of pre- and post-TRA compliance attitudes, *Law and Policy*, 15 (1993), 239-325.

²⁰ M Spicer & L Becker, Fiscal inequity and tax evasion: An experimental approach, *National Tax Journal* (1980), 171-175.

²¹ *Supra* note 19.

²² For a review see M Wenzel, Tax compliance and the psychology of justice: Mapping the field. In V Braithwaite (Ed.), *Taxing Democracy* (pp. 41-70), (2003). Aldershot: Ashgate.

²³ L Feld & B Frey, Trust breeds trust: How taxpayers are treated. *Centre for Tax System Integrity Working Paper No. 32*, (2002). Canberra: The Australian National University.

they thought that they had been treated fairly and respectfully by the ATO²⁴. What the findings presented in this section suggest is that taxpayers' attitudes towards the tax system, and how they feel they have been treated by a tax authority, do play an important role in influencing their decision to comply or not.

The Present Study

To date, there has been little empirical research conducted on the attitudes and beliefs of taxpayers actually known to be engaged in aggressive tax planning²⁵. Most of the attitudinal studies in the tax arena have been limited to examining the attitudes and beliefs of taxpayers sampled from the general population. The reasons for this are twofold. First, there are difficulties associated with using self-reports of deviant behaviour. Due to fear of future retribution against them, few taxpayers engaged in illegal forms of tax avoidance are likely to fully admit to their non-compliant behaviour. In order to deal with this problem, many of the survey studies conducted have instead attempted to measure taxpayers' propensity to evade or avoid tax²⁶.

Second, obtaining records of those taxpayers who have knowingly been involved in tax avoidance, either through aggressive or non-aggressive tax planning techniques is extremely difficult. Like all regulatory authorities in Australia, the ATO is bound by its obligations under the *Australian Privacy Act 1988* and the *Australian Income Tax Assessment Act 1936*. The secrecy provisions set forth in the Acts prevent the ATO from disclosing the details of a taxpayers' compliance record in all but the most general of

²⁴ M Wenzel, The impact of outcome orientation and justice concerns on tax compliance: The role of taxpayers' identity, *Journal of Applied Psychology*, 87/4 (2002), 629-645.

²⁵ For the exception see: K Murphy, *supra* note 3; K Murphy, Trust me, I'm the taxman: The role of trust in nurturing compliance, *Centre for Tax System Integrity Working Paper No. 43*, (2002b). Canberra: The Australian National University; K Murphy & K Byng, A User's Guide to the Australian Tax System Survey of Tax Scheme Investors, *Centre for Tax System Integrity Working Paper No. 39*, (2002a). Canberra: The Australian National University; K Murphy & K Byng, Preliminary findings from the Australian Tax System Survey of Tax Scheme Investors, *Centre for Tax System Integrity Working Paper No. 40*, (2002b). Canberra: The Australian National University; K Hobson, 'Say No to the ATO': The cultural politics of protest against the Australian Taxation Office, *Centre for Tax System Integrity Working Paper No. 37*, (2002). Canberra: The Australian National University; R Williams, Mass marketed schemes and self-assessment: Shifting the goal posts, *Centre for Tax System Integrity Working Paper*, (forthcoming). Canberra: The Australian National University.

²⁶ For example, IG Wallschutsky (1984), *supra* note 16; A Wearing & B Headey, *supra* note 16.

circumstances. It is for this reason that studies using ATO data are not very common in the Australian tax compliance literature.

What sets the present paper apart from other previous Australian tax studies of taxpayer attitudes is that it uses a large sample of taxpayers who have actually been accused by the ATO of engaging in aggressive tax planning to illegally avoid tax²⁷. This paper reports the findings of a research project that examines the beliefs, attitudes and motivations held by a national sample of tax scheme investors. Specific issues that will be examined are (a) scheme investors' attitudes toward paying tax and whether these differ from views of the general population, (b) their views of the Australian tax system, and (c) their views of the ATO. This paper will also provide, for the first time in Australia, a demographic profile of those taxpayers who invested in mass-marketed tax schemes. While these findings will not be able to tell us definitively what motivated taxpayers to invest in aggressive tax planning schemes in the first place, it is hoped that they will be able to shed some light on why such a large number of tax scheme investors subsequently chose to resist the ATO's attempts to recover their scheme related tax deductions. Before presenting the methodology used and the findings obtained from the present study, however, the history surrounding the mass-marketed tax scheme issue will first be discussed.

A brief history surrounding the mass-marketed tax scheme issue

In response to the increasing problem posed by aggressive tax planning during the 1990s, the Australian Commissioner of Taxation announced in 1998 that the ATO would be implementing a series of initiatives aimed at combating aggressive tax planning²⁸. Part of the ATO's crackdown on aggressive tax planning involved issuing amended assessments to the 42,000 Australians who invested in mass marketed tax schemes during the 1990s. According to the ATO, many scheme participants' investments were largely

²⁷ The reader should be reminded at this point that the term 'aggressive tax planning' in the context of the present article is used to refer to the strategies that the ATO refers to as illegal tax avoidance behaviour.

²⁸ M Carmody, *Beware the magic pudding*. Paper presented to the Australian Society of CPAs, 12 June, Darwin (1998).

funded through tax deductions (relatively little private capital was at risk). The ATO believed that these schemes exploited loopholes in the law and were designed in such a way to illegally avoid tax (see Appendix A for a description of the schemes referred to in this paper). The anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936* were applied to scheme related investments and action was taken against investors to recover the tax owing.

Investors, however, claimed that the schemes they invested in had been sold to them, sometimes by their accountants or financial planners, as a means by which they could legally minimise the tax they were required to pay while still being involved in a viable long-term investment²⁹. Since investors believed they had done nothing wrong, the majority initially defied the ATO's demands that they pay back scheme related tax debts³⁰. In fact, more than three years after amended assessments had first been issued in 1998, fewer than 50 per cent of scheme investors had entered into settlement arrangements with the ATO to pay back their tax debts³¹.

The schemes issue received wide media coverage in the late 1990s, and in 2000 the matter was referred to the Senate Economic References Committee for investigation. In response to both the continued resistance exhibited by investors, and the recommendations put forth by the Senate Economic References Committee, the ATO finally put forward a settlement offer in February 2002 whereby interest and culpability penalties would be waived for those scheme investors who could prove they had been the victims of aggressive marketing and bad advice. Investors were given until the end of June 2002 to make a decision about whether or not they would settle their scheme related debts under these terms, and as of 30 June 2002, only 5,300 investors had not yet settled (Source: Australian Taxation Office, personal correspondence).

²⁹ Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection: Interim Report*, (2001). Parliament of the Commonwealth of Australia; Murphy (2002a), *supra* note 3.

³⁰ Murphy (2002a), *supra* note 3; Murphy (2002b), *supra* note 25.

³¹ Murphy & Byng (2002b), *supra* note 25.

Several ATO funded court cases relating to various tax schemes were also conducted in 2002. The three cases that were decided upon have all confirmed the ATO's interpretation of the law—that scheme related tax deductions in franchise schemes (see Appendix A) 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). These judgments confirm that the ATO's opinion that mass marketed tax schemes are aggressive in nature, and exploit unintended loopholes in tax law, was warranted. However, while the courts may have agreed with the ATO's opinion that tax schemes exploited deficiencies in tax law, knowing why scheme investors actively resisted the ATO's attempts to recover tax owing is a little more difficult to ascertain. This study attempts to provide a partial answer to this important question.

Method

Participants

The data used to examine tax scheme participants' views of the Australian tax system and of paying tax comes from *The Australian Tax System Survey of Tax Scheme Investors*³². The 27-page survey was posted to a random sample of 6,000 Australian tax scheme investors who had been selected from the ATO's case files. A total of 32,493 names and addresses were available for selection, and the sample of 6,000 was drawn using probability proportional to size sampling within each state and territory in Australia (approximately 42 per cent of all scheme participants resided in Western Australia, so 2,549 investors were randomly selected from this state)³³.

After repeated appeals for participation, 2,301 completed surveys were received. When adjusted for out-of-scope taxpayers who had died, moved address, or who were

³² K Murphy, *The Australian Tax System Survey of Tax Scheme Investors*, (2002c). Canberra: Centre for Tax System Integrity, Research School of Social Sciences, The Australian National University.

³³ Due to privacy issues, the sampling was conducted by an ATO officer.

incapable of completing a survey (N=677), a response rate of 43 per cent was obtained. While appearing to be somewhat low, this response rate compares very well with experiences from other tax surveys conducted in Australia³⁴. Ian Wallschutzky in fact argues that tax surveys of the general population cannot be expected to yield higher than a 30 to 40 per cent response rate³⁵. However, when one considers the resistance exhibited towards the ATO in relation to mass-marketed schemes, a response rate of 43 per cent in the present context was considered to be extremely successful³⁶.

Procedure

Survey data were collected over a seven-month period between January and July 2002. The initial survey package was posted to each taxpayer in the sample and comprised a covering letter, the questionnaire and a reply-paid envelope. The covering letter explained the intent of the study, specifically that the researchers were interested in hearing from taxpayers whose tax assessments had been amended by the ATO. The letter also guaranteed participants strict confidentiality of responses, and referred potential respondents to a free-call number should they have any questions³⁷.

The follow-up of non-respondents after the first mailing was accomplished using an identification number attached to each questionnaire, which was in turn linked to the sample name at the ATO. In order to protect investors' privacy, the ATO was responsible for all mailings of the survey and reminder letters. Investors who agreed to participate were asked to return their completed questionnaires in a reply-paid envelope to the Australian National University (ANU) for analysis. This procedure ensured that researchers at the ANU did not have access to the names or addresses of sampled

³⁴ Braithwaite, Reinhart, Mearns & Graham, *supra* note 16; Wallschutzky (1984), *supra* note 16; Wallschutzky (1996), *supra* note 16.

³⁵ Wallschutzky (1996), *supra* note 16.

³⁶ Other more recent Australian tax surveys have yielded higher response rates than the present study (for example, M McKerchar, The effects of complexity on unintentional noncompliance for personal taxpayers in Australia, *Australian Tax Forum*, 17/1 (2002), 3-26). However, it is unclear whether these high response rates were due to differences in the methodologies used or due to the length of the surveys used.

³⁷ It should be mentioned that a large number of phone calls were received from survey recipients expressing concern over the true motives of the survey. Some were worried that the information would be used against them by the ATO in court and were therefore reluctant to participate.

investors. It also ensured that the ATO did not have access to individual taxpayers' survey responses. A total of six mailings were made and by the end of July 2002, a total of 2,301 completed surveys had been received.

Using the limited amount of demographic data available from the ATO's case files (state of residence and sex)³⁸, it was found that the sample of scheme investors who completed the survey was representative of the overall scheme investor population³⁹. A regression analysis also revealed that there was no response bias from late respondents to the survey. Finally, upon examining the completed surveys it was found that sixteen respondents might have engaged in strategic answering of their surveys (that is, groups of respondents got together and answered the survey in exactly the same way, thus biasing their results). On closer inspection, nine of these surveys were chosen for deletion. Thus, the data analyses presented in this paper are based on only 2,292 surveys.

Findings

The Investors' Survey consisted of a number of different sections that were designed to assess tax scheme investors' demographic profile, their attitudes and opinions towards the Australian tax system and paying tax, and their attitudes towards the ATO. This paper highlights some of the more interesting findings from each of these sections⁴⁰.

Throughout this paper, comparison data collected from taxpayers from the general population will also be presented. The purpose of this comparison will be to highlight important differences between taxpayers who engaged in aggressive tax planning and those who did not. The comparison data comes from a tax survey called the *Community Hopes, Fears and Actions Survey* that was conducted between June and October 2000⁴¹. A total of 2,040 completed questionnaires (29 per cent of those respondents who could be

³⁸ It should be noted that this demographic data was provided to researchers in de-identified form only.

³⁹ For detailed information on the survey's methodology see Murphy & Byng (2002a), *supra* note 25.

⁴⁰ For a summary of all findings from the Investors' Survey see Murphy & Byng (2002b), *supra* note 25.

⁴¹ Braithwaite, Reinhart, Mearns & Graham, *supra* note 16.

contacted) were received from this community survey⁴². The comparison between the two surveys was considered acceptable because the Investors' Survey shared many questions in common with the Community Survey.

Demographic profile of scheme investors

A number of demographic variables have now been shown to affect levels of tax compliance or attitudes towards tax compliance. For example, a number of international studies have shown that those most likely to not comply with their tax obligations are male, are younger, are more educated, and earn more⁴³. The Investors' Survey contained a number of socio-demographic questions designed to examine the profile of Australian taxpayers who invested in aggressive tax planning schemes.

It was found that most of the respondents to the Investors' Survey were male (82 per cent) and 17 per cent were female (1 per cent did not provide their sex). These figures were found to be representative of the overall scheme investor population (for the Community Survey, 47 per cent of all respondents were male and 53 per cent were female). The average age for both men and women responding to the Investors' Survey was 46 years old, with men ranging from 24 to 76 years of age and women ranging from 25 to 81 years of age (the average age of respondents to the Community Survey was 48 years). Most of the respondents to the Investors' Survey were found to be married or be in de facto relationships (82 per cent). Another 11 per cent had been married but were now divorced or separated, and 6 per cent had never been married. 72 per cent of the respondents were born in Australia whilst the remainders were born overseas. Of the 28 per cent of overseas-born respondents, 40 per cent of these were from non-English speaking countries; primarily Malaysia, Germany, Italy, India and the Netherlands (76 per cent of respondents to the Community Survey were born in Australia).

⁴² A check on the Community Survey data revealed that 27 respondents reported having used tax schemes to minimise their tax. These taxpayers were excluded from the statistical analyses presented in this paper.

⁴³ For a review of this literature see Jackson & Milliron, *supra* note 5.

When examining labour force status it was found that most scheme investors were working—81 per cent worked full time and 8 per cent worked part time. 6 per cent were retired and the remaining 5 per cent were either unemployed, keeping house or studying. For those who did work either full-time or part-time, 58 per cent were privately employed, 22 per cent were self-employed, in partnership or had their own business, 18 per cent worked for either local, state or the federal government, and 2 per cent worked in other non-profit organisations (for example, universities).

Respondents to the Investors' Survey were also found to be highly qualified, especially in comparison to Australia-wide education levels. Very few respondents had limited schooling, with less than 1 per cent indicating they had no schooling or only primary level. It was also found that 43 per cent held a bachelor degree or higher qualification (16 per cent had attained a postgraduate qualification). The figures from the Community Survey were 7 per cent, 24 per cent and 6 per cent respectively. Current income levels disclosed by scheme investors were also found to be very high. The average personal income was reported to be \$73,000 and the average family income was reported to be \$93,000 (this compares to \$27,000 and \$48,000 in the general population). These findings taken together are particularly interesting because many of the stories printed in the media over the years have highlighted the plight of scheme investors by indicating that they are Aussie battlers on average incomes trying to get ahead in life⁴⁴. The results from the Investors' Survey instead suggest that scheme investors, as a group, are considerably wealthier and more educated than taxpayers from the general population. Given that scheme investors' income and education levels were found to be much higher than taxpayers from the general population, all of the remaining comparisons between the two taxpayer groups statistically controlled for the effects of these variables.

⁴⁴ Couple fear losing home, *The Kalgoorlie Miner*, March 6 (2001a); Inquiry told big tax bills led to bankruptcy, *The Kalgoorlie Miner*, March 20 (2001b); Tax Office is pure Lewis Carroll, *The West Australian*, April 10 (2001).

Taxpayer attitudes towards the tax system

As discussed in the Introduction section of this paper, a number of researchers have shown that taxpayers' attitudes and beliefs about the tax system can affect their propensity to avoid tax. While there is no way of determining from the Investors' Survey whether scheme investors' attitudes and beliefs about the Australian tax system led them to become involved in aggressive tax planning schemes in the first place, the survey results can tell us how investors' now view the tax system and the ATO, especially after having had action taken against them by the ATO. These post-event views can also give an insight into why such a large number of scheme investors actively resisted the ATO's attempts to recover their scheme related tax debts (all scales used in this paper can be found in Appendix B)⁴⁵.

Of particular interest was whether perceptions of vertical inequity were higher among scheme investors than the general population, and whether investors thought the tax-funded benefits they received were inadequate based on the amount of tax they paid each year. Perception of vertical inequity was measured by asking survey respondents to rate the extent to which 16 societal groups paid their fair share of tax. These 16 groups included high status (for example, doctors and judges), middle status (for example, small business owners) and low status (for example, factory workers) occupational groups. Following a procedure used by Michael Wenzel, a standard deviation over these ratings was calculated for each survey respondent⁴⁶. A higher standard deviation on this measure indicates a larger difference in perceived vertical inequality. When examining the mean of all standard deviation scores it was found that perceived vertical inequality was higher among scheme investors ($M = 1.07$, $SD = 0.41$) than taxpayers from the general population ($M = 1.01$, $SD = 0.44$). After statistically controlling for the effects of family income and education levels, this difference was still found to be significant, $F(1, 3891) = 16.20$, $p < 0.001$.

⁴⁵ Given the number of statistical tests conducted in this paper, an adjustment to the alpha level was used within each section of the results to control for inflations in Type I error rates. Thus, the resulting alpha level used to assess taxpayers' attitudes towards the tax system and paying tax was 0.01, and for attitudes towards the ATO it was 0.004.

⁴⁶ Wenzel, *supra* note 24.

A two-item scale was then measured to assess whether survey respondents thought they themselves paid their fair share of tax (scores out of 5; 1=much more to 5=much less). Again, after controlling for income and education level, it was found that scheme investors as a group ($M = 2.25$, $SD = 0.77$) were significantly more likely to think they paid more than their fair share of tax than taxpayers from the general population ($M = 2.61$, $SD = 0.71$; $F(1, 3866) = 82.90$, $p < 0.001$).

Perceived unfairness in the tax system was also measured using a third item that was designed to ask taxpayers whether they thought the tax they paid was fair given the goods and services they received from the government. Scheme investors were found to score significantly lower on this measure ($M = 2.44$, $SD = 1.17$) than taxpayers from the general population ($M = 2.79$, $SD = 1.13$; $F(1, 3914) = 54.90$, $p < 0.001$), indicating that scheme investors were still more likely to think the tax they paid was unfair given the goods and services they received.

These three findings taken together indicate that scheme investors, in comparison to taxpayers from the general population, are more likely to view the tax system as an unfair system. While the reader may be thinking at this stage that these findings are not unexpected given the income level of scheme investors, it should be noted that even when income level and education level were statistically controlled for across groups, scheme investors as a group were more dissatisfied with the tax system than even wealthy or highly educated taxpayers from the general population.

Taxpayer attitudes towards paying tax

Scheme investors' actual views about paying tax were also assessed using two scales. The first scale was modeled on Trevor Sutton's material loss index⁴⁷ (see Appendix B). This index was designed to ask taxpayers how they felt about paying tax

⁴⁷ T Sutton, *Child support questionnaire: National telephone survey April-May 1997*, (1997). Canberra: Child Support Agency.

and whether they believed paying tax removed the incentive to earn more income. It was found that scheme investors were somewhat negative in their opinion towards paying tax ($M = 3.23$, $SD = 1.05$) as their mean score fell slightly above the midpoint on the 1 to 5 scale. Further, scheme investors' negativity towards paying tax was more extreme than the negativity exhibited by taxpayers from the general population ($M = 3.08$, $SD = 0.87$). Even after controlling for income and education levels between the two taxpayer groups, this difference was found to be statistically significant, $F(1, 3889) = 58.61$, $p < 0.001$. Taxpayers' commitment towards paying tax was assessed via a second scale. Taxpayers scoring high on the 8-item commitment scale (scores range from 1 to 5) were more likely to feel a sense of moral obligation towards paying their taxes. While scheme investors appeared to be committed to paying tax in their own right ($M = 3.75$, $SD = 0.48$), it was found that taxpayers from the general population ($M = 3.85$, $SD = 0.54$) were significantly more committed to paying tax, $F(1, 3928) = 64.73$, $p < 0.001$. This was the case even after controlling for their income and education levels.

Taxpayers' views about the equity and fairness of the tax system were then correlated with their views about paying tax. As can be seen in Table 1, views about the unfairness of the tax system were significantly correlated with taxpayers' views about paying tax; this was the case for both scheme investors and the general population. In particular, those taxpayers who were more likely to perceive the vertical inequity in the tax system to be great, to think they were paying more than their fair share of tax, or who were more likely to think the goods and services they received for their tax dollars were inadequate, were less committed to paying tax. Likewise, they were also more likely to think paying tax removed the incentive to earn more income. Not surprisingly, these findings clearly suggest that there is a direct link between one's views about the fairness of the tax system and views about paying tax.

Table 1. Correlations between taxpayers' views about the fairness of the tax system and their views about paying tax

	Views towards paying tax			
	Scheme Investors		General Population	
Perceived fairness of the tax system	Commitment to paying tax	Paying tax is seen as a material loss	Commitment to paying tax	Paying tax is seen as a material loss
Vertical inequity	-0.06*	0.28**	-0.07*	0.22**
Does taxpayer feel they pay fair share of tax	0.15**	-0.34**	0.21**	-0.24**
Goods & Services fair for tax dollars given?	0.27**	-0.41**	0.34**	-0.38**

*p<0.01; **p<0.001

Taxpayer attitudes towards the ATO

The previous two sections examined taxpayers' views about both the tax system and paying tax. Given the long-standing dispute between the ATO and scheme investors, this section examines taxpayers' attitudes and views towards the ATO itself. Of specific interest were scheme investors' perceptions of the procedural fairness aspects of their encounter with the ATO. These views were considered to be particularly important because negative views of an organisation's procedures are often associated with a decline in institutional trust, perceived power, and perceived legitimacy of that organisation⁴⁸.

Procedural Fairness

As discussed earlier, the ATO experienced a great deal of hostility and resistance from scheme investors, with the majority of investors refusing to pay back their tax debts for several years. Of particular interest to the present study was why investors may have

⁴⁸ Legitimacy is 'the judgement that authorities are competent and honest, and that their professional role entitles them to make decisions which ought to be deferred to and obeyed' (TR Tyler, Trust and democratic governance, In V Braithwaite & M Levi (Eds.), *Trust and Governance*, (1998) at 273. New York: Russel Sage Foundation.

reacted in such a negative way towards the ATO. A number of researchers⁴⁹ have shown that when people evaluate authorities they often refer to the procedural justice aspects of their encounter with that authority when making judgments; if they feel they have been treated poorly by an authority, people are likely to judge the procedural justice aspects of their encounter as unfair. Alternatively, if they feel they have been treated well by an authority, people are likely to judge the procedural justice aspects of their encounter as fair. This is the case even if a decision is made that goes against the citizen's own interests⁵⁰. Three multi-item scales adapted from Tom Tyler's research were used in the Investors' Survey to measure the importance of procedural justice perceptions in the context of the scheme's situation⁵¹. These scales were labeled 'ATO is fair', 'neutrality', and 'respect'. The 'ATO is fair' scale was designed to assess whether taxpayers believed the ATO considers the concerns of average citizens and tries to be fair when making their decisions. The 'neutrality' scale measured whether taxpayers believed the ATO is impartial when making decisions, and the 'respect' scale assessed whether taxpayers thought the ATO treated them with respect and dignity. Also measured were two additional procedural justice scales designed by John Braithwaite and Toni Makkai⁵². They were 'ATO engagement in the consultation process', and 'the degree to which the ATO communicates to taxpayers that they consider them trustworthy'. Once again, all scores on these five scales ranged from 1 to 5.

As can be seen in Table 2 the ATO was rated below the midpoint on all but one of the measures of procedural justice. When comparing all of the figures with those from the Community Survey—and after controlling for income and education levels—it can be seen that scheme investors were significantly more critical of the ATO on all procedural justice measures than taxpayers from the general population. According to scheme investors, the ATO performed particularly poorly on the consultation measure, suggesting

⁴⁹ Murphy (2002a), *supra* note 3; Murphy (2002b), *supra* note 25; TR Tyler, *Why people obey the law*, (1990). New Haven, CT: Yale University; Wenzel, *supra* note 22.

⁵⁰ Tyler, *supra* note 49.

⁵¹ TR Tyler, The psychology of legitimacy: A relational perspective on voluntary deference to authorities, *Personality and Social Psychology Review*, 1/4 (1997), 323-345.

⁵² J Braithwaite & T Makkai, Trust and compliance, *Policing and Society*, 4 (1994), 1-12.

that the ATO did not appear to consult widely with taxpayers involved in schemes before issuing amended assessments⁵³.

Institutional trust

Taxpayers' level of trust in the ATO was measured through an eight-item scale⁵⁴. Scores on the scale ranged from 1 to 5, with a high score indicating greater levels of trust in the operations and behaviour of the ATO. The scale incorporated items such as whether respondents thought the ATO could be trusted to administer the tax system fairly, whether it met its obligations to Australians and whether it took advantage of people who were vulnerable. It was found that scheme investors were somewhat distrusting of the ATO ($M = 2.41$, $SD = 0.68$) as their mean score fell slightly below the midpoint on the 1 to 5 scale. Scheme investors' trust in the ATO was also found to be lower than the trust exhibited by taxpayers from the general population ($M = 3.17$, $SD = 0.65$). After controlling for income and education levels, this difference was still found to be statistically significant, $F(1, 3920) = 721.37$, $p < 0.001$. In order to evaluate whether this decrease in trust was a direct result of the ATO having taken action against them in relation to their scheme related investments, scheme investors were asked the following question: "As a result of your amended tax return, do you have more or less trust in the Tax Office?" 90 per cent of all investors surveyed claimed they now had less trust in the ATO as a result of having their tax returns amended⁵⁵.

Perceived power

The perceived power of the ATO was also measured through two multi-item scales. The first scale represents the degree to which the ATO is seen as being powerful in its capacity to regulate small business, wage and salary earners, and self-employed

⁵³ In this regard, investors appear to be unaware of the extensive consultation that the ATO had undertaken with the promoters and advisers who represented investors.

⁵⁴ Scale developed by Braithwaite, Reinhart, Mearns and Graham, *supra* note 16.

⁵⁵ In an in-depth analysis of these variables, I have shown in an earlier paper that the decrease in trust among scheme investors was a direct result of the ATO's procedures being perceived to be procedurally unjust (see Murphy (2002b), *supra* note 25). I also argued that this decrease in trust resulted in the widespread resistance exhibited by tax scheme investors towards the ATO.

individuals who defy it. The second scale represents the ATO's capacity to use power to bring large businesses and high wealth individuals back into line. Both scales again ranged from 1 to 5, with higher scores reflecting higher perceived levels of power. It was found that scheme investors as a group thought the ATO had a lot of power in dealing with small business/wage and salary earners who defied them ($M = 4.35$, $SD = 0.57$) but were sceptical about the ATO's power to regulate defiant large businesses or wealthy individuals ($M = 2.85$, $SD = 1.21$). In contrast, after controlling for income and education levels, taxpayers from the general population were significantly less likely to think the ATO had a lot of power to deal with small business owners and wage and salary earners ($M = 4.11$, $SD = 0.67$; $F(1, 3917) = 42.78$, $p < 0.001$). Taxpayers from the general population were also significantly more likely to think the ATO had power to regulate large business or wealthy individuals who defied them ($M = 3.15$, $SD = 1.21$; $F(1, 3914) = 42.42$, $p < 0.001$). These findings again support the notion that perceived inequity in the tax system is higher among scheme investors because they are more likely to think the rich get away with not paying their fair share of tax. This perception was despite the fact that scheme investors were relatively high-income earners themselves.

Legitimacy

Within political psychology, procedural justice is widely hypothesized to be an antecedent of legitimacy. Researchers have argued that people who feel they have been fairly treated by an authority regard their authority status as more legitimate⁵⁶. It has also been shown that if an organisation is perceived to be legitimate, people are generally more likely to follow and accept their decisions⁵⁷. Two measures of legitimacy were assessed in the Investors' Survey. The two measures were taxpayers' 'obligation to accept ATO decisions' and their 'evaluation of the ATO'. These two multi-item scales were designed to specifically assess the perceived legitimacy of the ATO. As can be seen in Table 2, scheme investors strongly questioned the legitimacy of the ATO (indicated by low scores on the two measures). They also questioned the legitimacy of the ATO more

⁵⁶ Tyler, *supra* note 51; TR Tyler & EA Lind, A relational model of authority in groups. In M Zanna (Ed.), *Advances in experimental social psychology* Vol 25, (1992). New York: Academic Press.

⁵⁷ Tyler, *supra* note 51.

so than taxpayers from the general population. These findings support Tom Tyler's work that has shown that people who feel they have been unfairly treated by an authority will regard that organisations' authority status as less legitimate, and subsequently, will be less likely to follow that organisation's rules and decisions⁵⁸.

Table 2. Respondents' mean scores on procedural fairness and legitimacy scales. Standard deviations are presented in brackets

Scales	Scheme Investors	General Population
<u>Procedural Fairness</u>		
Tax Office is fair*	2.14 (0.78)	3.04 (0.76)
Neutrality*	2.48 (0.75)	3.26 (0.67)
Respect*	3.13 (0.52)	3.23 (0.82)
Trustworthy treatment from the ATO*	2.37 (0.88)	3.19 (0.79)
Consultation*	1.98 (0.66)	2.68 (0.71)
<u>Legitimacy</u>		
Evaluation of the ATO*	2.03 (0.69)	2.74 (0.67)
Obligation to accept ATO decisions*	1.98 (0.83)	2.67 (0.83)

Scale range from 1(strongly disagree) to 5(strongly agree); * means difference between groups is statistically significant at the $p < 0.001$ level, even after controlling for income and educational differences between the groups

In summary, what all of the findings of the present section tell us is that regulators will need to acknowledge the importance of procedural justice in their dealings with taxpayers or else run the risk of undermining levels of trust in the community, undermining their own power, and undermining their legitimacy. The risk of this occurring is that it could lead to widespread resistance among those being regulated.

General Discussion

The aim of this paper has been to provide the reader with an insight into how taxpayers involved in aggressive tax planning now see and view the Australian tax system, the ATO and paying tax. Using data collected from a large-scale survey of tax

⁵⁸ Tyler, *supra* note 51.

scheme investors, it has been shown that those who engaged in aggressive tax planning schemes during the 1990s are more highly educated and earn significantly more than taxpayers from the general population. Further, they are more disillusioned with the tax system, are more likely to resent paying tax, and are more hostile and resistant towards the ATO. The following sections discuss the implications these findings have for both policy initiatives in the tax context and for the deterrence theory of non-compliance.

Policy Implications

The rise and fall of aggressive tax planning

Although not presented in the Findings section of this paper, the Investors' Survey revealed that 94 per cent of tax scheme investors said they would no longer consider investing in a tax scheme that did not have a valid Product Ruling⁵⁹ from the ATO to say it was legitimate. Further, 52 per cent of respondents indicated that they would be less prepared to go in for a scheme that relied for its success on loopholes in the law. These two figures suggest that the ATO's moves to discourage future marketing and investment in such arrangements have been somewhat effective. For example, the findings specifically suggest that former scheme investors are using the ATO's Product Ruling system. Whether this is true for Australian investors in general is yet to be seen.

One point that should be noted, however, is that these findings do not suggest that involvement in aggressive tax planning has been stemmed altogether. As the Commissioner of Taxation recently stated in a newspaper interview, "Despite some positive signs, and the apparent demise of the 90s-style mass marketed schemes, it would be wrong to proclaim the death of aggressive tax planning"⁶⁰. It has been well documented that aggressive tax planning has been around for many decades⁶¹ and while

⁵⁹ Product Rulings are intended to provide certainty for potential investors by confirming the tax benefits of the investment. They apply to all participants in an investment. A Product Ruling only applies, however, if the arrangement is carried out in accordance with the information provided to the Tax Office.

⁶⁰ S Marris, There's no avoiding it....foreign tax havens the trendy scam, *The Australian*, 30 July (2002).

⁶¹ M Levi, *Of rule and revenue* (1988). Berkeley: University of California Press; J Braithwaite, *supra* note 4.

the general anti-avoidance legislation may have recently gone some way to stemming the problem of aggressive tax planning—at least in relation to tax schemes—it does not appear to have gone far enough. It is proposed here that a whole of government approach is needed to come to grips with the problem. Suggestions for how this could be done are presented below⁶².

As noted in the Introduction to this paper, most scheme investors claim they got the idea to invest in tax schemes from financial advisers and tax professionals⁶³. Results from a number of other studies have also pointed to lower compliance and more aggressive avoidance strategies among taxpayers who use tax preparers⁶⁴. Further, recent reports⁶⁵ indicate that foreign tax havens are now replacing mass-marketed schemes as the leading tax avoidance method ‘being pushed by aggressive tax agents’⁶⁶. These findings clearly suggest that more needs to be done to regulate those who possess the expertise to assist clients in exploiting opportunities for tax non-compliance. Formal guidelines and accreditation procedures that aim to protect taxpayers from advisers who (1) may misinterpret their clients’ wishes, or (2) lack the ability or integrity to prepare accurate and correct tax returns, may go a long way to stemming aggressive tax planning in general. Moves to further regulate the advice given by financial advisers would also be prudent⁶⁷, so too would moves to amend legislation to introduce financial penalties for the promoters and marketers of aggressive tax planning schemes⁶⁸. These moves are deemed necessary because without placing some onus of responsibility on the promoters, financial advisers or even the professionals who assist taxpayers to prepare their tax returns, aggressive tax planning will continue to evolve and flourish in the future; this can

⁶² See also J Braithwaite, *supra* note 4.

⁶³ For empirical data see Murphy & Byng (2002b), *supra* note 25.

⁶⁴ B Erard, Taxation with representation: An analysis of the role of tax practitioners in tax compliance, *Journal of Public Economics*, 52/2 (1993), 163-197; S Klepper & DS Nagin, The role of tax practitioners in tax compliance, *Policy Sciences*, 22 (1989), 167-192.

⁶⁵ Marris, *supra* note 60.

⁶⁶ In fact, recent international estimates put the total funds being invested in foreign tax havens at \$6 trillion (A Edwards, *Review of Financial Regulation in the Crown Dependencies: A Report*, (1998). London: Home Office).

⁶⁷ Australian Securities and Investments Commission, *Compliance with advice and disclosure obligations: ASIC report on primary production schemes*, (2003). Canberra: Australian Securities and Investments Commission.

⁶⁸ See also Braithwaite, *supra* note 4.

already be seen by the recent rise in ordinary Australians becoming involved in foreign tax havens⁶⁹.

Luckily, there are indications that moves such as those proposed above are already being considered by government. For example, the *Financial Services Reform Act 2001*, which will become fully effective in March 2004, aims to impose more stringent rules by which financial planners must abide. The Commissioner of Taxation also recently indicated that a move to introduce promoter penalties would be considered so as to protect taxpayers from becoming the future victims of unscrupulous tax scheme promoters (the Commissioners' proposal is currently awaiting government consideration). Not only is it proposed that these moves will have an impact on aggressive tax planning, but they will also go on to improve both the integrity of Australia's tax system and citizen confidence in the ATO.

Theoretical implications

Findings from the Investors' Survey can also inform us about whether traditional enforcement strategies used by tax authorities are effective in gaining compliance. Not surprisingly, the deterrence theory framework has significantly influenced the style of enforcement used by most tax authorities around the world. As discussed in the introduction to this paper, deterrence theories see taxpayers as being motivated purely by rational costs and opportunities. Advocates of the deterrence view therefore believe that harsh sanctions, penalties and legal coercion should be used when dealing with non-compliant taxpayers. The situation surrounding the mass-marketed schemes issue, however, demonstrates that the use of such a deterrence based strategy—in addition to being more expensive to implement—can actually be counter-productive⁷⁰. In particular,

⁶⁹ M Carmody, *Issues confronting Australia's tax system*. Paper presented to the Financial Review Leaders' Luncheon, 29 July, Sydney (2002); Marris, *supra* note 60.

⁷⁰ I Ayres & J Braithwaite, *Responsive regulation: Transcending the deregulation debate*, (1992). New York: Oxford University Press; E Bardach & R Kagan, *Going by the book: The problem of regulatory unreasonableness*, (1982). Philadelphia: Temple University Press; J Braithwaite, *Restorative justice and responsive regulation*, (2002). New York: Oxford University Press; K Hawkins, Compliance strategy, prosecution policy and Aunt Sally: A comment on Pearce and Tombs, *British Journal of Criminology*, 30/4 (1990), 444-466.

the ATO's initial use of threat and legal coercion with 42,000 tax scheme investors appeared to produce the opposite behaviour from that sought. Instead of complying, the majority of tax scheme investors actively resisted the ATO's attempts to recover tax owing on their scheme related tax debts.

Using in-depth interview data from 29 scheme investors, Murphy (2002a) argued that this widespread resistance was a direct result of the ATO's initial enforcement strategy with investors being perceived to be procedurally unfair⁷¹. Perceptions of unfair treatment were also expressed by the 2,292 scheme investors surveyed in the present study (see Table 2). When compared to taxpayers from the general population, it was found that scheme investors were more critical of the procedural fairness aspects of ATO encounters, and as a result they were less trusting of the ATO, were more likely to question the power of the ATO, and were more likely to question the legitimacy of the organisation. Further, it was found that investors were less committed to paying tax, were much more likely to believe paying tax removed the incentive to earn more income and were more likely to see vertical inequity in the tax system (this was even the case when their income and education levels were controlled for). These findings taken together suggest that perceptions of unfair treatment can go on to affect a person's subsequent views and behaviour. In the case of scheme investors, the ATO's handling of the schemes issue appears to have led to widespread taxpayer resistance against their decisions and procedures.

The findings presented in this paper also suggest that a theory of compliance that is based purely on deterrence is unlikely to tell us with much confidence whether a taxpayer will comply willingly with a regulator's decisions. If it did, then we would have expected to see the majority of scheme investors agreeing to settle their tax debts when the ATO first took action against them in 1998. It is therefore proposed here that regulatory agencies such as the ATO will need to acknowledge the importance of procedural justice in their dealings with taxpayers if they wish to avoid widespread resistance against their decisions. One obvious and practical way this can be achieved in

⁷¹ Murphy, *supra* note 3; see also Murphy, *supra* note 25.

the ATO is for management to encourage staff that deal with taxpayers to genuinely adopt the principles underlying the ATO Compliance Model.

The ATO Compliance Model—only introduced into the ATO in 1998—aims to incorporate many of the key features of procedural justice. The style of enforcement emphasised in the Model is to first take into account the problems, motivations, and conditions behind non-compliance⁷². The Model suggests that taxpayers should initially be given the benefit of the doubt and the ATO's trust in their honesty should be brought to the foreground of a regulatory encounter. Strong emphasis should be placed on educating taxpayers about rules and assisting them in efforts to comply, while programs that rely principally on threats and the mechanical imposition of penalties should be de-emphasized⁷³. It is only when taxpayers then continue to be uncooperative that more interventionist strategies (for example, more severe sanctions) should be considered.

While only in its infancy, the evidence to support the effectiveness of this style of 'responsive' regulation is growing. For example, in a study of compliance with Australian nursing home care standards, researchers found that when facility managers felt that inspectors were cooperative and trusting of them in the first instance, rather than accusatory and coercive, compliance increased⁷⁴. In another study, Scholz (1991) found that the Occupational Safety and Health Administration in the US could increase the effectiveness of their regulatory enforcement by initially administering less stringent sanctions and penalties⁷⁵. The empirical evidence collected by the Investors' Survey also suggests that if the ATO had have made an earlier commitment to implement the principles underlying the Compliance Model in the schemes situation, then they may have achieved a more effective compliance outcome.

⁷² V Braithwaite & J Braithwaite, An evolving compliance model for tax enforcement, In N Shover & JP Wright (Eds.), *Crimes of Privilege*, (2001). New York: Oxford University Press; K Hobson, Championing the Compliance Model: From common sense to common action, *Centre for Tax System Integrity Working Paper No. 28*, (2002). Canberra: The Australian National University; J Job & D Honaker, Short-term experience with responsive regulation in the Australian Taxation Office, *Centre for Tax System Integrity Working Paper No. 30*, (2002). Canberra: The Australian National University.

⁷³ Ayres & Braithwaite, *supra* note 70; Braithwaite, *supra* note 70.

⁷⁴ Braithwaite & Makkai, *supra* note 52.

⁷⁵ JT Scholz, Cooperative regulatory enforcement and the politics of administrative effectiveness, *American Political Science Review*, 85 (1991), 115-136.

Conclusion

While this paper did not directly assess what motivated scheme investors to become involved in aggressive tax planning in the first place⁷⁶, it has attempted to provide the reader with a broader understanding of how citizens may react towards a regulatory authority who accuses them of purposefully breaking the law. The results have specifically demonstrated that the beliefs and attitudes held by a national sample of tax scheme participants differ substantially from those of the general population. In particular, it was found that scheme investors were more critical of the Australian tax system, the ATO and of paying tax.

These findings have direct implications for any regulatory authority charged with enforcing citizen compliance with the law. What the findings specifically tell us is that regulators will need to move beyond enforcement strategies linked purely to deterrence if they wish to avoid widespread resistance against their procedures. It is suggested here that regulatory authorities who deal with non-compliers will instead need to move towards a more responsive strategy that takes into account the fact that sometimes people are motivated by costs and benefits, but that at other times they are motivated by a sense of social responsibility. In this way, regulators will be more likely to nurture the good will of those with a commitment to compliance, while still having the ability to escalate to more interventionist forms of regulation if abuse of trust occurs and persists⁷⁷.

In making these conclusions, however, it is acknowledged that the present study certainly has its limitations, mainly due to its survey methodology. There is a sense among non-social scientists in particular that self-report methods of recording attitudes and behaviour are untrustworthy, especially when the information sought is sensitive,

⁷⁶ For those interested in this topic they are directed to: Murphy, *supra* note 3; Hobson, *supra* note 25.

⁷⁷ See also Murphy (2002b), *supra* note 25.

potentially incriminating or embarrassing⁷⁸. For example, in the case of scheme investors, it is possible that survey respondents may have exaggerated perceptions of unfair treatment by the ATO in order to bring more attention to their cause⁷⁹. Thus, wherever the present paper findings were put in terms of causal directionality (for example, that the ATO's unfair procedures caused widespread resistance), such interpretations stemmed from the underlying theory used. When considering the findings in this context, the study therefore yielded some significant and instructive findings.

⁷⁸ DJ Hessing, H Elffers & RH Weigel, Exploring the limits of self-reports and reasoned action: An investigation of the psychology of tax evasion behaviour, *Journal of Personality and Social Psychology*, 54/3 (1988), 405-413.

⁷⁹ The ATO's final settlement offer had not been presented to investors at the time that this survey first went into the field in January 2002.

Appendix A

To date, three categories of mass marketed schemes operating in the Australian market have been identified by the ATO⁸⁰. 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, to receive a tax refund from the ATO of up to \$19,400 (Source: Oracle International Pty Ltd Prospectus, p3). 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 \$9,400.

Several aspects of the investment were of concern to the ATO. 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 \$9,400). Another concern for the ATO 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.

⁸⁰ Australian Taxation Office, *supra* note 2.

Appendix B

Below is a complete list of the items used for the various scales presented throughout the paper. The list also details the original scale formats and the recoding of the data if applicable.

Views about the tax system

Vertical Inequity

“In your opinion, do the following groups pay their fair share of tax?” (1=pay much more, 2=pay a bit more, 3 =pay about their fair share, 4=pay a bit less, 5=pay much less): (1) workers whose primary income is wage and salaries; (2) families earning less than \$20,000 a year; (3) unskilled factory workers; (4) trades people; (5) farm labourers; (6) waitresses; (7) farm owners; (8) small business owners; (9) families earning more than \$100,000 a year; (10) owner-managers of large companies; (11) senior judges and barristers; (12) doctors in general practice (GPs); (13) chief executives of large national corporations; (14) tax agents and advisers; (15) surgeons; and (16) people who make a lot of money from investments.

Does taxpayer feel they themselves pay their fair share of tax?

“In your opinion, do the following groups pay their fair share of tax?” (1=pay much more, 2=pay a bit more, 3 =pay about their fair share, 4=pay a bit less, 5=pay much less): (1) you, yourself; (2) your industry/occupation group.

Goods and services fair for tax dollars given

“Do you think that the tax you pay is fair given the goods and services you get from the government?” (1=No!!, 2=No, 3=?, 4=Yes, 5=Yes!!).

Views about paying tax

Paying tax seen as a material loss

“I would be better off if I worked less given the rate at which I am taxed”; “Paying tax removes the incentive to earn more income”; “Paying tax means I just can’t get ahead” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Commitment to paying tax

“I feel a moral obligation to pay my tax”; “Overall, I pay my tax with good will”; “I resent paying tax” (reverse coded); “I accept responsibility for paying my fair share of tax”; “I think of taxpaying as helping the government do worthwhile things”; “Paying tax is the right thing to do”; “Paying tax is a responsibility that should be willingly accepted by all Australians”; “Paying my tax ultimately advantages everyone” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Attitudes towards the ATO

Institutional trust

The ATO; “ has misled the Australian people” (reverse coded); “acted in the interests of all Australians”; “turned its back on its responsibility to Australians” (reverse coded); “caved into pressure from special interest groups” (reverse coded); “is trusted by you to administer the tax system fairly”; “takes advantage of people who are vulnerable” (reverse coded); “meets its obligations to Australians”; “is open and honest in its dealings with citizens” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Power to regulate small business and wage & salary earners

“The Tax Office can’t do much if a small business decides to defy it” (reverse coded); “The Tax Office can’t do much if an ordinary wage and salary earner decides to defy it” (reverse coded); The Tax Office can’t do much if a self-employed taxpayer decides to defy it” (reverse coded) (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Power to regulate large business and high wealth individuals

“The Tax Office can’t do much if a large company decides to defy it” (reverse coded); “The Tax Office can’t do much if a wealthy individual decides to defy it” (reverse coded) (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Procedural Justice

ATO is fair

“The Tax Office considers the concerns of average citizens when making decisions”; “The Tax Office cares about the position of taxpayers”; “The Tax Office tries to be fair when making their decisions”; (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Respect

“The Tax Office respects the individual’s rights as a citizen”; The Tax Office is concerned about protecting the average citizen’s rights” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Neutrality

“The Tax Office gives equal consideration to the views of all Australians”; “The Tax Office gets the kind of information it needs to make informed decisions”; “The Tax Office is generally honest in the way it deals with people” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Consultation

“The Tax Office listens to powerful interest groups, not to ordinary Australians” (reverse coded); “The Tax Office is more concerned about making their own job easier than making it easier for taxpayers” (reverse coded); “The Tax Office consults widely about how they might change things to make it easier for taxpayers to meet their obligations”; “The Tax Office goes to great lengths to consult with the community over changes to their system” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Trustworthy treatment from the ATO

“The Tax Office treats people as if they can be trusted to do the right thing”; “The Tax Office treats people as if they will only do the right thing when forced to” (reverse coded) (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Legitimacy

Obligation to accept and follow decisions

“People should follow the decisions of the Tax Office even if they go against what they think is right”; “I should accept decisions made by the Tax Office even when I disagree with them” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

Favourable evaluation of the ATO

“The Tax Office has too much power” (reverse coded); “The Tax Office’s decisions are too influenced by political pressures” (reverse coded); “The Tax Office does its job well” (1=strongly disagree, 2=disagree, 3=neither, 4=agree, 5=strongly agree).

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