

THE THEORETICAL BASE FOR THE ATO COMPLIANCE MODEL

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The ATO Compliance Model was developed by the Cash Economy Task Force between 1996 and 1998 (Commonwealth of Australia, 1998a). The model drew on two theoretical frameworks from regulation – responsive regulation (Ayres and Braithwaite, 1992; Braithwaite, 2002 based on fieldwork described in Braithwaite, 1985; Grabosky and Braithwaite, 1986) and motivational posturing (Braithwaite, Braithwaite, Gibson, and Makkai, 1994; Braithwaite, 1995). Both theoretical frameworks are grounded in data from surveys, observations and interviews relating to regulators and regulatees in action. These data, collected in different settings, were interpreted against a background of social science theory, most notably reactance theory (Brehm and Brehm, 1981), procedural justice theory (Tyler, 1990, 1997), self-categorisation theory (Turner, 1987), defiance theory (Sherman, 1993) and reintegrative shaming theory (Braithwaite, 1989; Ahmed, Harris, Braithwaite and Braithwaite, 2001). Ideas and data were then pulled together to develop the theoretical frameworks described in more detail below.

Responsive Regulation Theory

Responsive regulation theory provides an account of how a regulator should go about regulating a person or entity to achieve certain outcomes. It is both normative in that it makes assertions about how people's rights should be respected in a democracy, and it is

explanatory in setting out why a regulatory strategy that is incremental in its capacity and willingness to apply sanctions is superior to one off strategies that ignore the interplay between regulator and regulatee. At this point, the primary constraints on the application of responsive regulation should be noted. Responsive regulation applies to situations in which the regulated entity is likely to have repeated encounters with regulators. It does not apply to regulatory regimes which are based on one-off on the spot fines where compliance history is irrelevant.

A second constraint is that responsive regulation is built around the notion that self-regulation is both practicable and desirable from the perspective of the democracy. In other words, its use is restricted to contexts in which compliance can be justified not only in terms of a legal framework, but also in terms of a moral framework consonant with the democratic will. If “following the rules” cannot be morally grounded in the regulatory community, responsive regulation cannot be implemented to achieve compliance.

Responsive regulation assumes that most people recognise within themselves some interest in doing the right thing and are responsive to a regulatory authority that moves them in this direction. Most people therefore are located at the base of what is called a regulatory pyramid (for a variant on this position within taxation see (Braithwaite, J., 2003)). Those regulatees who stray from this base at any one time are generally the minority. As regulatees resist compliance and move up the regulatory pyramid, a regulatory agency will use persuasion, moral appeal and deterrence to talk them down to the bottom again. In most cases the regulatory authority will succeed if the base is strong - although some may need more regulatory work than others before they find their way

down. If there is no moral base to the pyramid, however, there is nothing of substance to draw regulatees in to the cooperative community in the longer term – to express it in more psychological terms, the base of the pyramid no longer represents shared social standards associated with acting in the spirit of the law that will enhance our self-worth in our own eyes or through the eyes of others.

Taxation has proven to be an interesting area in which to introduce the idea of responsive regulation. In some respects tax offices are structured along the lines of one-shot encounters with taxpayers; something that taxpayers often complain about when they have no way of going back to the person who gave them advice last time. A second reason for why taxation provides an interesting context for the implementation of responsive regulation is that moral obligation is contested in some quarters. The thriving tax avoidance industry illustrates the way in which a significant proportion of taxpayers see taxation as a context where they obey the letter of the law and play with the spirit of the law. As taxation becomes less morally grounded, more complicated, and as taxpayers' dealings with tax authorities take on new dimensions (e.g. superannuation, child support, student loans depending on the jurisdiction), it has become clear that tax authorities and taxpayers have intermittent, if not continuing relationships, in which they expect each other to show knowledgeable and sophisticated management capacity. Most importantly, taxpayers regard their history as being known and relevant to their dealings with the authority. Responsive regulation provides a framework for how to manage these relationships reasonably and fairly.

At this point a distinction should be made between acts of non-compliance and the management of non-compliance (see Braithwaite, V., 2003). Responsive regulation is a theory that relates to the management of acts of non-compliance. It tells us a great deal about why non-compliance may persist, but it does not identify specific initial drivers of non-compliance. The ATO Compliance Model has introduced the concept of the drivers of non-compliance (e.g. opportunity, ignorance, financial hardship, compliance costs, political opposition to paying tax) through the BISEP profile. The BISEP profile captures what is known from academic and field settings about who engages in acts of non-compliance and who does not. The BISEP profile enables the tax authority to engage with taxpayers about their non-compliance in a knowledgeable, holistic and understanding way. Through understanding the context of non-compliance, strategies for dealing with it (e.g. knowing the right steps for escalation and de-escalation of sanctions) are likely to become more effective over time.

In responsive regulation (RR), the compliance management strategies meet the following conditions:

- (a) the regulatory strategy is reasonable in that the intervention proposed through regulation does not exceed the level of interference necessary to gain compliance. (Illustration of a problem that can be addressed with RR – If a person discloses that they have failed to declare something on their tax, they are indicating a willingness to fix things up. They do not need the same level of intervention as someone who refuses to acknowledge responsibility after they have been caught

at considerable taxpayer expense. History is taken into account in deciding treatment.)

- (b) the regulatory strategy is fair in that it is made clear to regulatees what the steps in the regulatory process will be – “if you fail to cooperate, we will escalate the costs (social and/or economic) of non-compliance and if you cooperate we will de-escalate the costs”.

(Illustration of a problem that can be addressed with RR – If a person is audited, and he/she has no idea how this happened or what the next step will be, a major distraction for the taxpayer is likely to be making sense of the context of the audit. Amid this uncertainty, tax authorities rarely come out well, eliciting feelings of victimisation in the taxpayer and/or perceptions of incompetence by the tax authority. Victimisation springs from the lack of procedural justice and perceptions of unfair treatment at the hands of the tax office. Perceived incompetence is another way of making sense of the uncertainty – things are uncertain because the tax office does not know what it is doing. The taxpayer response may be to lie low hoping for and expecting the tax office to just go away. The central problem that has prompted the audit is swamped by other newly created problems that all reduce the likelihood of future compliance. RR helps keep the main issue, the audit, the centre of everyone’s attention, with the bigger issue being regulatory responsiveness, that is, the pattern of taxpayer action and tax authority reaction.)

- (c) the steps represent escalating levels of interference or intrusiveness in response to a violation where interference and intrusiveness translate into sanctioning. RR

incorporates theoretical understanding of the subjective appraisal of a sanction be it legal, social or moral. Working out the sanctioning steps that apply to any situation therefore involves discussions with field staff, taxpayers and industry groups. The steps are designed to be responsive to the problem. As such, RR is a means of keeping a tax authority listening to its communities of taxpayers. (Illustration of a problem that can be addressed with RR – Repeated non-compliance can be dealt with through nagging without decisive action or through silence and then after a period of time, with a highly punitive sanction. Neither approach is likely to build confidence in the system and an understanding of how sanctioning works. RR encourages the development of a hierarchy of sanctions that are well known in the regulated community e.g. non-compliance with regard to a request for payment might be followed by notice that payment has not been received, followed by a warning letter, followed by charging of interest, followed by application of penalty, and perhaps finally in some situations, automatic deduction from a citizen rebate or some such payment. If deterrence is to work, taxpayers need to know of the sanctions that could be used at higher levels and to believe that the tax authority has both capacity and willingness to follow through.)

The theory behind the effectiveness of responsive regulation comes from a number of sources but can be summarised in terms of the economic and social imperatives for compliance.

- (a) >From an economic self-interest perspective, the regulatee becomes aware that the costs associated with non-compliance are increasing all the time and that the

regulator can and will continue escalating the costs until the problem is resolved (as in the example above). The escalating costs encourage regulatees to resume dialogue at a lower level of the regulatory pyramid, the reason being that from a self-interested perspective, it is too costly to escalate the conflict to a higher level.

(b) >From the theoretical perspective of procedural justice and reintegrative shaming theory, compliance and future self-regulation are most likely to occur if the relationship between regulator and regulatee remains respectful and communication channels remain open. If principles of respect and procedural justice are not observed and if warning of the sanctioning process is not made public, regulatees are more likely to turn their anger toward the regulator, cut themselves off from attempts by the regulator to change them, increase their social distance and seek alliances with others opposed to the regulator (predictions that follow from self-categorisation, defiance, reactance and reintegrative shaming theories). Maintaining dialogue is advantageous to both regulator and regulatee. Regulators quickly become aware of problems with the law, policy or administration that make non-compliance more likely. Regulatees gain an understanding of the regulatory purpose and process and are ideally located to inform others about the integrity (or otherwise) of the tax system.

Motivational posturing theory

Motivational posturing theory emerges from empirical analyses of regulatees and how they see those (specifically authority figures) who try to regulate them. Theoretically, motivational posturing theory draws on three bodies of research: Merton's (1968) theory

of modes of adaptation which recognises how socially valued goals can be blocked and how individuals will use various means, orthodox and unorthodox, legal and illegal, to achieve the socially valued goal. The second theoretical tradition on which motivational posturing theory leans is the procedural (and distributive) justice literature which introduces the notion that social bonds play an important role in determining regulatory effectiveness. The framework for bringing goals and relationships together is attitude (Rokeach, 1973) and stress (Lazarus and Folkman, 1984) theory. Anything that threatens an individual's sense of self (a blocked goal or a disconcerting social interaction) gives rise to appraisals of the threat and to coping responses that protect the self (Lazarus and Folkman, 1984; Rokeach, 1973). The coping responses that assume centre stage in motivational posturing theory are those that allow social distancing from authority such that "pro-compliance messages" can not be heard, or at least not processed in relation to the protection or promotion of one's sense of self-worth. The task for those using responsive regulation, therefore, is to reduce social distance from those who are being regulated, so as to maximise opportunity for influence, or at least constructive two-way dialogue about the problems being faced.

Motivational posturing theory asserts that:

- (a) people signal to regulators how much social distance (as conceptualised by Bogardus, 1928) they wish to place between themselves and the regulator at any particular time.
- (b) theoretically, motivational posturing is understood in terms of the degree to which an authority threatens an individual's sense of self. As the threat to self increases,

social distance increases, and motivational postures change. Within the context of a regulatory pyramid, de-escalation corresponds to reduction in threat and the emergence of more cooperative postures. This is why de-escalation is a desirable regulatory objective.

- (c) each of us has a repertoire of motivational postures at our disposal that we display at different times in response to different signals from authority. These postures are not mutually exclusive in that we can be cooperative and non-cooperative all within a very short space of time. Regulatory authorities, because they often have power to threaten our sense of self, can elicit different postures within us through their actions, that is, the regulatory authority itself can trigger escalation or de-escalation through its own conduct.

(Illustration of a problem understood through motivational posturing – withdrawal of procedural justice by an authority in its dealings with taxpayers might trigger escalation up the regulatory pyramid. The result is that the authority now has to deal with more resistant and defiant taxpayer postures that require far more intensive and costly intervention than would have been necessary if procedural justice principles had been followed.)

- (d) motivational postures provide information about the degree to which regulatory goals are shared by regulator and regulatee as well as the degree to which the regulatee trusts the regulator to abide by principles of procedural justice and to act in a trustworthy fashion. Motivational postures are summary position statements to be read by others in the regulatory community.

- (e) motivational postures as concepts of social distance determine the degree to which an individual likes an authority, assigns the authority status, and therefore is open to its influence (Braithwaite, 1989; Kelman 1961; Sherman, 1993). Influence includes not just turning non-compliance into compliance, but also broader objectives of governance such as eliciting cooperation with a new policy, for example, a new tax system (Commonwealth of Australia, 1998b).
- (f) social distance increases across the motivational postures of commitment (lowest social distance), capitulation, resistance, and disengagement (highest social distance). A new posture, highly relevant to the taxation regulatory context called game playing, has resulted in a re-conceptualisation of social distance in terms of two dimensions.
- (g) the two dimensions of social distance that are now being investigated are cooperation-resistance and dissociation. Cooperation-resistance is defined by cooperation and capitulation at one end, and resistance at the other. This dimension corresponds to the traditional dimension assumed to underlie the way citizens see democratically elected government. The government has authority, but citizens differ in how much they like or want to cooperate with the authority. Dissociation is defined by disengagement and game playing. The dimension of dissociation represents a new kind of relationship between citizens and government. Citizens see the power of government as irrelevant to their lives. The choice is whether they acknowledge the authority or step outside its reach.
- (h) the second dimension of dissociation poses a challenge to the regulatory pyramid in circumstances where individuals have managed to cut themselves off entirely

from the authority. If self is not tied in any way to the actions of the authority, that self is in a sense free of regulatory constraints by that authority. In these contexts, the only regulatory option left to an authority is to make non-compliance impossible.

The following points represent the key findings from the current research on posturing and tax systems.

- (i) The degree to which cooperation rather than resistance occurs is shaped by taxpayer characteristics and perceptions of tax authority actions. Cooperation is high when individuals do not see taxation seriously interfering with their material well-being, when their sense of moral obligation is strong (they believe they should pay tax, they believe they will be caught for not paying tax and they feel pride in being an honest taxpayer) and when they see high integrity in the way the tax office conducts itself.
- (j) Dissociation is driven by aspirations for wealth and status, rejection of the image of the honest taxpayer, active interest in tax avoidance, and the desire to affiliate with those who know the tricks of avoidance. For those high on dissociation, trust in the tax office is low and the possibility of developing trust in the future is not a credible option.

The public response of dissociation has the potential for posing a major threat to the regulatory effectiveness of tax authorities, and more broadly democratic governance.

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