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FAIR REGULATORY ENFORCEMENT

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Tax Office Prosecutions: Firm and Fair Regulatory Enforcement?

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Introduction

In recent years, the Australian Taxation Office has gone to some pains to present itself as a responsive, cooperative, almost friendly, bureaucracy. At the same time, however, the Tax Office has also publicized its ongoing efforts to get tougher on those citizens who evade tax. The combined effect of these campaigns is to send the message that while the Tax Office prefers to interact with taxpayers in a cooperative, and non-coercive way, it is also ready and willing to take tougher action when this is called for. In many respects this dual track approach is sensible. Tax collection depends to a large extent on voluntary compliance. A regulatory approach that expresses trust in honest taxpayers, as well as a preparedness to firmly deal with dishonest taxpayers, can do much to boost compliance. However, firm enforcement is not as easy as it seems. The effectiveness of prosecution is undermined, by a lack of concern – whether real or perceived – for procedural injustice, the informal effects of formal penalties, and possible enforcement biases. The first part of this paper describes the Tax Office’s dual approach to tax collection. The second outlines the benefits of this approach, while the third outlines some of the possible pitfalls of such an approach, drawing on interviews with Australians who have been prosecuted and imprisoned for tax offences. The fourth section suggests some of the implications for compliance activities in the tax arena, and the final section explores the relevance of this study for the responsive regulatory theory on which Tax Office practice is partly based.

1. Assisting and Punishing

The Tax Office’s main goal, as its strategic statement puts it, is ‘To optimise collections and make payments under the law in a way that instils community confidence that the

¹ Thanks to Valerie and John Braithwaite, Jenny Job, and Tina Murphy for comments on an earlier draft. Thanks also to Jodie Houston for assistance with analysing Tax Office press releases, and for preparing Fig 1.

system is operating effectively.’ (ATO 2005). One way in which the Tax Office attempts to meet these goals is by helping taxpayers pay their tax with a minimum of fuss and delay. Making the ‘tax experience easier, cheaper and more personalised’ has become the mantra, espoused widely by Michael Carmody, the Tax Office Commissioner, as well as by countless Tax Office publications. To this end, the Tax Office has spent considerable time and money developing policies and systems that make life easier for taxpayers. These goals conjure up the image of a tax office that is friendly, helpful and cooperative. At the same time as the Tax Office has been emphasizing these qualities, however, it has also gone to pains to emphasize that it is prepared to enforce the law firmly. The strategy behind these different messages is set out in the Compliance Program, an annual Tax Office publication outlining the compliance issues facing the Tax Office, and its responses (ATO 2003b):

Our compliance strategies seek to maximize the number of people who choose to comply by making it as easy as possible for people to understand and meet their obligations and by ensuring there are approaches in place to deter non-compliance. We look to ensure our responses are proportionate to what we find, including the firmest possible enforcement responses to those who deliberately set out to avoid their obligations.

In recent years, the Tax Office has signaled its intention to increase its commitment to ensuring that those taxpayers who fail to pay tax receive the ‘firmest possible enforcement responses’. In a number of public statements the Commissioner has indicated the Tax Office’s intention to place increasing emphasis on punishment. The intention to increase attention on serious non-compliance has also been flagged in recent annual reports (2004a, Part 2.4; 2003a, Part 2.4). This rhetoric is matched by an increased financial investment. In 2003, the Tax Office created the Serious Non-Compliance unit, which brought together various Tax Office operations, and in 2004 the Tax Office increased by 600 the number of officers engaged in what the Tax Office calls ‘active compliance’ (tasks involving investigation and prosecution, as well as risk identification and reviews, audits, debt collection and lodgement enforcement) (Carmody 2004, ATO 2004b).

This new enthusiasm for punishment is borne out by figures showing a steady increase in DPP prosecutions of tax offences, from 121 in 2001-02 (60 of which resulted in prison sentences) to 172 in 2003-04 (81 of which resulted in prison sentences) (ATO 2002, 2004a). Moreover, Tax Office officials argue that these figures do not show the extent of their commitment to dealing with serious non-compliance. The Deputy Commissioner for serious non-compliance has told journalists that ‘the sheer number of prosecutions and investigations does not tell the full story, because we are finding that tax matters are becoming more complicated. And a lot of attempted frauds are being stopped by the controls we have in place’ (Lawrence 2005: 13).

Media releases issued by the Tax Office reflect this new concern for punishment. In 1999, it was unusual for the Tax Office to issue a press release announcing a successful prosecution. Headlines instead tended to contain warnings and reminders. Five years on, almost half of all headlines contain mention of jail or fraud. This rapid increase in reporting of jail sentences is clearly evident in Figure 1, which shows for each year the number of Tax Office press release headlines using the word jail or illegality.

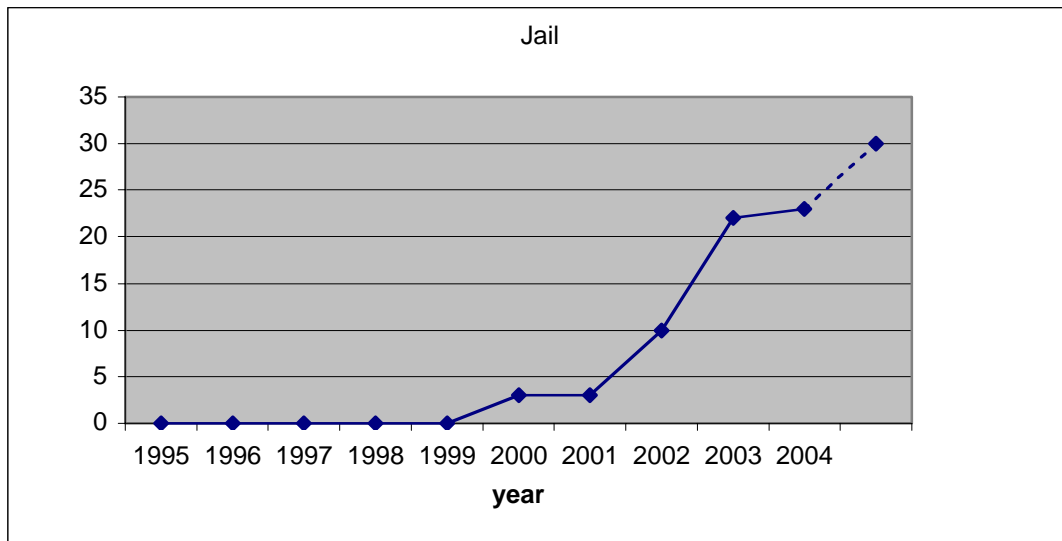


Fig. 1 – Graph showing number of Tax Office press releases with the word jail in the headline.

Australian financial journalists have reported the change in policy (eg Gottliebsen 2005a, 2005b, Lawrence 2005). A recent article in *BRW* reported that (Lawrence 2005: 13):

Thousands of taxpayers and their advisers have been unnerved by a succession of highly publicised jail sentences in recent months for tax crimes. These sentences, of up to six-and-a-half years, are finally burying a widely held myth that the worst that can happen for tax offences is a heavy fine.

It appears that this enthusiasm for firm enforcement is not about to abate. The Commissioner recently announced in the first of what are to be regular online updates (Carmody 2005):

You can expect us to be tougher on serious fraud and evasion. Bringing together our serious non-compliance operations has resulted in substantial prosecutions. We are also working with the Australian Crime Commission, the Australian Federal Police and the Commonwealth Director of Public Prosecutions. We will focus on, and take tougher action against, habitual non-payers who are avoiding paying tax and thereby gain a competitive advantage over businesses who are doing the right thing.

2 The Benefits of Firm Enforcement

All of the above suggests that the Tax Office is engaged in a phase of tough enforcement. There are also reasons to think that this upswing in tough enforcement is not confined to the Tax Office. Based on extensive survey research in the UK, Rob Baldwin (2004: 351, 352) has identified an 'apparent new zest for 'punitive' approaches to regulation in 'new governmental statements of philosophy; the introduction of sets of newly severe powers; and a number of newly aggressive or adversarial stances being set forward by some regulators'. It is a sentiment shared by interviews with senior staff in leading British companies, 96% of whom considered that their firm's exposure to punitive regulatory risks had increased in recent years (Baldwin 2004: 360).

There are a number of possible benefits a regulator may gain by increasing its commitment to, and investment in, tough enforcement. In particular, tough enforcement may be an effective strategy for boosting compliance. Regulatory scholars have written extensively about the ability of regulators to achieve considerable self-compliance through self-regulation and informal regulation (eg Ayres and Braithwaite 1992). Many people are happy to comply with laws either because they agree with them, or respect

their legitimacy. Furthermore, their commitment to compliance may be boosted when they feel that regulators trust them.

At first glance an emphasis on tough enforcement may seem at odds with these gentler approaches. However, non-coercive forms of regulation only work effectively when they are used against the threat of more coercive regulation. If a person perceives that a regulator is incapable of taking firm action against them for non-compliance, his or her conscience provides the only incentive to comply. Regulation is most effective when the threat of punishment reinforces a person's personal commitment to comply. 'Speak softly and carry a big stick' was how US President Theodore Roosevelt described his preferred approach to achieving compliance (Miller 1994). John Braithwaite advocates a similar approach, albeit expressed slightly differently. His theory of responsive regulation advocates that regulators attempt to use informal approaches as much as possible, while at the same time communicating a willingness to escalate to progressively more coercive measures if a person refuses to comply. To be taken seriously regulators need to be able to convince others that they have a big stick and are not afraid to use it.

It is important for all regulators to communicate a capacity and willingness to take firm action, but especially so in the case of the Tax Office, which relies heavily in the first instance on voluntary compliance, in the form of self-assessment, to achieve its goal of optimising tax collections. Any other approach would not be feasible given the scale of their work:

The adoption of the self-assessment system reflects the reality that a system based on reviewing every transaction or event that may have a tax consequence would be too intrusive, time consuming and costly for everyone involved. The Tax Office is not, and never can be expected to be, resourced to review every transaction or event (ATO 2002).

Moreover, there are signs that the combination of soft and tough talking is working. According to the 2003-04 Annual Report, the Tax Office collected more than \$4.7 billion in compliance activities in 2003-04, an increase of more than 40% on 2002-03. Most of this increase was attributable to an increase in tax collected by big business. This increase is not a one-off: beginning in the 1990s company tax collections in Australia have

consistently grown faster than the economy, each year by a bigger amount (see figure 2). This phenomenon occurs at a time when tax collection rates in OECD countries, already low, continue to fall (Braithwaite 2005:29).

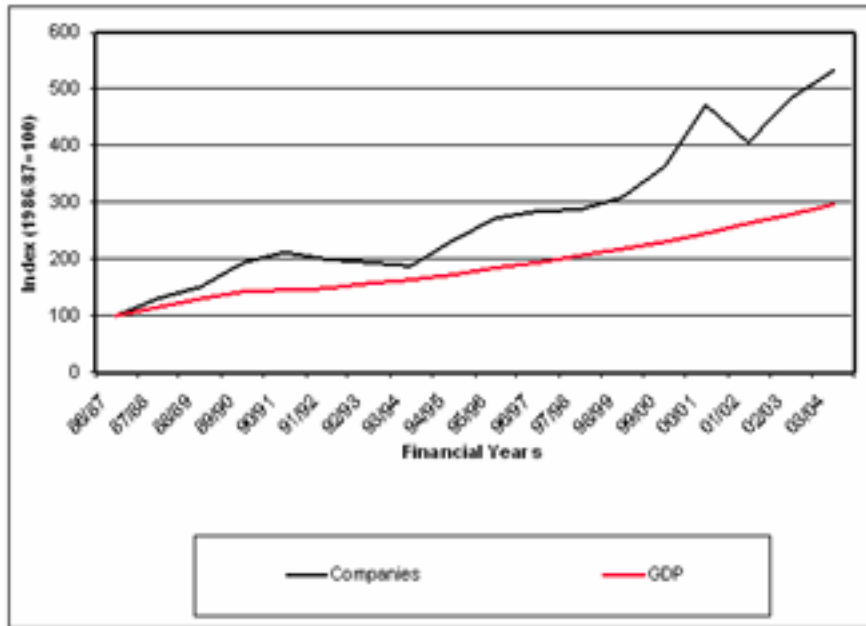


Fig 2: Growth in Australian company tax collection compared to GDP growth 1986-2004 (from Braithwaite 2005: 30).

So there are some obvious benefits to communicating an ability to take stiff enforcement action. But when regulators decide to take enforcement action, does it matter how they wield the big stick? In Part 3, I examine this question, drawing on interviews with people who have been imprisoned after committing tax offences in Australia.

3. Perspectives of the Prosecuted

Instilling community confidence that the tax system is operating effectively is part of the Tax Office's central mission. As the Tax Office (2004a, Pt 2.7) explains:

Instilling community confidence is an ongoing objective that aims to ensure we have a sustainable revenue collection system. This guides how we do our work, the choices we make in optimising collections under the law, the efficiency of our processes and the professionalism of our contact with the community.

To this end, each June since 1996 the Tax Office surveys a random group of Australian taxpayers to ascertain their satisfaction with the Tax Office. Previous research by CTSI colleagues has measured the satisfaction of those taxpayers who had invested in tax schemes that were subsequently declared illegal by the tax office. However, little is known about the views of those who have been prosecuted and imprisoned for a tax offence. In fact, with only a few exceptions (eg Benson (1985)), there has been very little research of any kind based on interviews with ‘white-collar’ offenders.

From internal records, the Tax Office identified a group of 34 people who had been prosecuted and imprisoned for a tax offence. The Tax Office sent each person an invitation from the ANU to participate in an interview. Enclosed in each envelope was a reply card and a self-addressed envelope. The ATO records only contained a person’s last known address, or in many cases, the address of the person’s tax agent (7 letters addressed to tax agents were returned to sender, unopened). Two reminder letters were sent, reiterating the invitation to participate, and enclosing fresh reply cards and self-addressed envelope. The first reminder yielded additional replies, but the second did not.

10 people eventually replied up the invitation to be interviewed, a response rate of just under 30%. Though low, this rate compares reasonably favourably with other research with sensitive populations. In this case there was the additional problem that it is not known precisely how many letters reached their intended recipients.

It is also difficult to know to what extent those who responded were representative of those who did not. On the one hand, the original group consisted of people who had been prosecuted for a fairly wide variety of offences, and expressed a variety of views on their experiences. On the other, as we will see, there were also some common themes that emerged strongly from the interviews. Moreover, the later interviews did not reveal any attitudes that had not been revealed in earlier ones. In qualitative social science research this is usually taken as a sign that the researcher has captured the essence of subjects’ experiences, and how they made sense of them.

All interviews were conducted via telephone, and lasted between 25 and 40 minutes each. Interviewees ranged from 30 to 60 years of age. All were male, and most were married or in defacto relationships. All had received custodial sentences for their offences. The time

interviewees spent in prison ranged from 3 months to 3 years. Interviewees had been prosecuted for their involvement in some sort of fraudulent scheme designed to minimize tax liabilities. Three of the respondents were tax agents. The various schemes included making false claims for GST refunds, failure to declare income, falsely claiming spousal credits, and overstating deductions.

Three themes emerged from interviews with former prisoners: one, the importance of procedural justice; two, the debilitating effect of informal sanctions on those prosecuted; and three, a widespread perception that the Tax Office fails to prosecute the most serious offenders.

These themes are discussed below in the context of what we already know about these topics and the operations of the ATO.

3.1 Importance of Procedural Justice

Perhaps surprisingly, most of the interviewees did not object to being prosecuted. Only two of the ten continued to protest their innocence. The rest accepted their guilt. As one respondent put it, 'I knew I was as guilty as hell'. Many said that they knew at the time what they were doing was illegal, or, at least, possibly illegal, and a number described a sense of inevitability that they were going to get caught, sooner or later. While it is difficult to know whether these views describe accurately their states of mind when the offences were committed, it was clear from the interviews that the overwhelming majority now accept the wrongfulness and illegality of their actions.

But although respondents did not object to the fact that they were prosecuted, many objected strenuously to the manner in which they were prosecuted. The most common complaint was about the length of time it took for a case to reach court. What particularly irked respondents was the delay between admitting their offence to an ATO officer and receiving a formal summons to attend court. In the most extreme case a period of five years elapsed, and three other cases the reported delay was more than three years.

Most respondents described the anxiety caused by these extended delays. One respondent who had reported waiting some time for the summons said that he did not mind the lengthy delay, on the basis that 'the longer they drag it on, the longer I'm out', but this

view was not shared by any of the other respondents. Everyone else who complained about delay described the experience of waiting to be prosecuted and imprisoned as burdensome and unpleasant. People said their lives were put on hold while they waited to find out what was going to happen to them. One said of his two-year delay, 'I was effectively in prison for a couple of years more'. Another said his biggest complaint was 'the way they handled it – they should have just gone bang, bang, bang; instead, it dragged on and on and on'.

Some respondents also complained about the attitude of Tax Office investigators. Respondents alleged that investigators were 'overzealous', 'vindictive', and 'over-the-top'. One respondent said 'Most of my friends all think they (the Tax Office) were vindictive. I wouldn't say that ... but it did seem as if they were working on commission'. Another alleged 'they wanted to make things as hard as possible for me'. Respondents also made specific complaints about the way investigators questioned respondents' wives, and searched their homes.

Complaints against the Tax Office were not confined to the investigation and prosecution process. Respondents complained about procedural matters after their conviction. One respondent claimed that after he had been released from prison he had been unable to ascertain from the Tax Office exactly how much money he owed them:

The hardest thing is to get in touch with them: totally, absolutely, unequivocally impossible. They have this phone menu but there's nothing on it about owing them money ... I'll probably end up having to sue them, and take them to court. That's the only way you can meet them, in court.

By contrast, he declared Centrelink (the government agency responsible for unemployment benefits), to whom he also owed money, 'a dream to work with'.

All these complaints must be interpreted with considerable caution. As for complaints about overly vigorous, or intrusive investigations, it is important to bear in mind that there could be good reasons for these sorts of actions. Unannounced visits to suspects' home may be essential to gather evidence before it is destroyed. Furthermore, not all respondents made these complaints. A number of respondents described their investigators as fair and reasonable. One respondent spoke at some length of his

begrudging admiration for his investigator: ‘I tried to bullcrap him, but he didn’t buy it – he was one of these old copper types – you know, dogged. He just kept asking sensible bloody questions, that I couldn’t answer’.

Similarly, complaints about delay should be interpreted with a degree of caution. For one thing it is possible that respondents were lying or mistaken. Unfortunately, it was not possible to compare respondents’ claims with Tax Office records to determine whether the claimed delays were as long as claimed, because interviews were conducted on the basis that responses would be kept anonymous. However, the fact that a number of respondents complained about this particular aspect of their treatment suggests there is some basis to their complaints. Respondents’ claims about Tax Office delays are also supported by the judgment of the New South Wales Court of Criminal Appeal in *Regina v Gay* [2002] NSWCCA 6, which dealt with a similar complaint. In Mr Gay’s case, charges were not laid until three years after he had made a full admission in an interview.

Of course, a number of factors influence the speed with which a case can be dealt with, including the behaviour of the defendant him or herself. Defendants and their lawyers have been known to adopt delaying tactics with the aim of frustrating, or at least postponing, criminal prosecution. Certainly, in this group a number of these respondents admitted that they had denied offences in their initial contact with Tax Office or Federal Police officers. Delays can also be attributed in some circumstances to the Director of Public Prosecutions, who is responsible for conducting Tax Office prosecutions, or to courts. But none of this properly accounts for extended delays between the making of an admission and the laying of charges.

Delay appears to have been a problem for the Tax Office not just in prosecution, but also in other areas of compliance. In surveys and interviews conducted by Tina Murphy (2002) tax scheme investors expressed their unhappiness at the length of time the Tax Office took to declare the schemes in which they invested illegal. Reports by the Commonwealth Ombudsman (CO 2001a, 2000b) into the Tax Office’s handling of these and other tax investor schemes described the length of time it took to audit taxpayers and issue amended assessments as unfair, unreasonable, and constituting defective administration.

But even if it is the case that delays do occur within the Tax Office, is this necessarily a problem? After all, it could be argued that an alleged tax evader is not entitled to complain about the speed with which his or her case is brought to a conclusion. Some people might even take the view that delay is desirable if it prolongs and heightens the discomfort an alleged tax evader suffers. But from a legal, and a compliance perspective, there are powerful reasons to regard delay as a serious problem.

From a legal perspective, delay undermines the right to a fair trial, one element of which is the presumption of innocence. It is clearly inconsistent with the presumption of innocence to tolerate delay or any other form of punishment that occurs before a person has been proven guilty. A number of Australian appellate courts have also made it clear that ‘delay which is not attributable to the offender, of course, constitutes a “powerful mitigatory factor”’ in sentencing (*R v Schwabegger* [1998] 4 VR 649). In *R v Schwabegger*, the Victorian Court of Appeal held that ‘a legitimate sense of unfairness can develop when the criminal justice proceeds in what can be perceived as too leisurely a fashion’. In *R v Gay*, Mason P of the New South Wales Court of Criminal Appeal commented in these terms on the three-year delay experienced by the appellant:

One hopes that the present circumstances are fairly unique. If they are not, then the practice of the Australian Taxation Office and/or the Office of the Commonwealth Director of Public Prosecutions must change. It is bordering on the unconscionable for three years to elapse between a police interview which results in full admissions and the laying of ensuing charges. The fact that administrative penalties are imposed (prior to the police interview) and substantially met with all of their attendant burdens upon the defaulting taxpayer and his family makes it even more imperative that a sentencing court take the delay into account. The public interest as well as the legitimate private interests of the offender require a matter such as this to be brought to justice quickly. A failure by the authorities to do so will mitigate an otherwise appropriate sentence.

But even if we put to one side these basic legal objections to using, or accepting, delay as a defacto form of punishment, there are other problems. One is the random and arbitrary effect of punishment by process. There is not necessarily any relation between the

seriousness of the (alleged) crime and the process-related punishment. In fact - if anything - any relationship is likely to be an inverse one: serious cases are more likely to be prioritised ahead of less serious ones, subjecting those accused of less serious offences to longer delays than those accused of more serious offences.

The final reason for regulators to take delay seriously is an instrumental one. There is considerable empirical psychological evidence that if people perceive their treatment by authorities to have been unfair, the risk of them reoffending increases (eg Tyler 1990, Murphy 2003, Murphy 2005, Tyler & Huo 2002). The implication of this is that if a regulator is interested in encouraging future compliance, it should ensure that it enforces the law in a way that is perceived as fair. This includes ensuring that enforcement is swift.

3.2 Informal Sanctions

The second theme to emerge clearly from interviews is that the most painful part of criminal prosecution is often not the formal punishment itself, but the repercussions of the process of prosecution, conviction and imprisonment for an offender's relationships, employment prospects, and psychological wellbeing. None of the respondents in this study rated prison as the most difficult aspect of their experience with prosecution. In two cases, respondents had already served time in prison for previous, unrelated offences. As one of these interviewees responded when asked what was the most difficult aspect of the process: 'Well it wasn't jail – been there before, done that – no, jail would be on the bottom of the list'. Some interviewees complained about being sent to maximum-security prisons where they were imprisoned with violent offenders, but most of these also seemed adept at avoiding violence (in one case, by agreeing to do all his fellow prisoners' tax returns).

All interviews regarded the side effects, or by-products, of going to prison as worse than prison itself. One person put it, 'the hardest thing was not so much the jail time, but the time leading up to it, and the time after being released'. One recurring theme was the damage the experience had done to their relationships. In some cases, relationships had broken up. One interviewee, when asked whether his prosecution was connected with the break-up of his marriage, thoughtfully replied, 'I wouldn't say it was the lynch-pin - we

were having problems anyway – but obviously going to prison didn't help things'. Some reported that wives and partners had stuck by them. When I asked one interviewee why he thought his wife had stuck by him, he replied 'I don't know, I was surprised she did. She says it's because she loves me, and because she married me for better and for worse; she just didn't expect the worse to be this bad'.

Another recurring theme was the difficulty of finding employment with a criminal record. Respondents reported that employers were reluctant to employ them, because they 'didn't want the stigma of someone who had been prosecuted working for them'. 'No-one will touch me' was how one respondent put it. One of the tax agents interviewed lost his licence (the other had never had one). Some respondents had responded to these difficulties of finding employment by working for themselves, but even then they found a criminal record an impediment to establishing a business. For example, three respondents talked about the difficulty of obtaining insurance with a criminal conviction. As one interviewee commented wryly, 'defrauding the Commonwealth doesn't sound real flash on the application'. Difficulties finding employment compounded the financial difficulties many suffered as a result of having to pay tax, and penalties, and in some cases, for legal representation.

Respondents also described the deleterious effect of prosecution. Nearly all respondents described their battles with anxiety, depression, and anger (though, interestingly, not guilt). One respondent (who continued to profess his innocence) said 'I can understand how people who go through my experience commit suicide'. Another said 'they say what doesn't break you, makes you stronger. But I don't know about that; it just makes you different, and in my case, angrier'.

While there was consensus that informal sanctions were more painful than formal ones, there was also variation in the precise mix of informal sanctions that offenders suffered. For example, respondents had differing views about how difficult it was to find employment, even within the same industry. One person working in the construction industry asked whether he would ever reveal his criminal record to colleagues, replied 'Shit no'. However, another, working in the same industry, did not consider a criminal

record an obstacle to employment: ‘Crikey’, he said, ‘try and find someone in construction or on the waterfront who hasn’t got a criminal record’.

3.3 Enforcement Bias

The third theme that emerged from my interviews relates to the exercise of enforcement discretion. A common perception among the people that I interviewed is that the Tax Office does not prosecute the most serious tax evaders as vigorously as it prosecutes less serious tax evaders. As one respondent put it, ‘they pick the easy channel’.

Colleagues’ research at Centre for Tax System Integrity suggests that many taxpayers share this perception of the Tax Office. In Vivienne Waller’s (2005) study of Tax Office ‘walk-in’ registration visits to used-car dealerships, car dealers expressed the view that they ‘were the targets of disproportionate regulatory attention by the Tax Office’. One of the car dealers she interviewed complained that the Tax Office go after ‘the small fry’, as he put it, because ‘they are trying to make themselves look good’. Similarly, interviews with 27 small business owners in the construction industry revealed that similar views. As one subject commented simply, ‘the public perceives them to be just a bully’ (Shover et al 2003: 159).

These views are not restricted to people who have been prosecuted or investigated by the Tax Office. The community surveys commissioned annually by the Tax Office also point to a similar perception. One of the questions asked of respondents each year is whether they agree with the statement ‘the Tax Office spends too much time clamping down on ordinary people and lets the real tax cheats get away’. In 2003-04, 72% of respondents agreed with the statement. However, this figure has fallen each year for the last five years, from 82% in 1999-00, suggesting that the Tax Office is making some inroads in tackling this widespread perception (ATO 2004, Pt 2.7).

Implicit in offenders’ claims that the Tax Office hounds small offenders rather than bigger ones, is a self-perception of themselves as insignificant offenders. As I mentioned earlier, all but two admitted their guilt to me, but this is not the same as admitting the harmfulness or wrongfulness of their actions. ‘I only affected the tax office. I didn’t steal money from people’ was how one person put it. Offenders held these views despite their tax evasion running into tens, and in two instances, hundreds of thousands of dollars.

It is clear that the Tax Office is not neglecting the most serious forms of tax evasion. As mentioned earlier, tax receipts from both large businesses and high wealth individuals have risen considerably in recent years. But it is also the case that criminal prosecution is much less frequently used against these sorts of taxpayers. Prosecution figures suggest that there is a significant bias in favour of individuals (over corporations), and summary offences (over indictable offences) (DPP 2003, 2004). Earlier research shows that this is a longstanding pattern (Grabosky and Braithwaite 1986: 162).

There are no doubt good reasons for this pattern of prosecution. The types of offences for which participants in this study were prosecuted are less sophisticated than the tax schemes used by high wealth individuals and big businesses, and are consequently easier both to investigate and prosecute. Excise offences relating to tobacco farming, the other area in which the DPP has conducted numerous prosecutions for the Tax Office in recent years (DPP 2003, DPP 2004), are also arguably easier to investigate and prosecute than the more sophisticated tax evasion schemes of the most wealthy.

However, just as people assess the fairness of the tax burden by comparing themselves with others, so too do they consider the fairness of enforcement by comparing the action taken against them with the action perceived to be taken against others. People expect some rough proportionality in enforcement, that is, that it is the most serious offences that should warrant the toughest enforcement. As with complaints about delay, these perceptions should concern tax authorities, as the perception that enforcement has not been proportionate is a factor that can undermine future compliance.

4. Implications for tax practice

The big stick is an important part of the regulatory tool-kit. To be effective all regulators must be able to take firm and decisive action against those who refuse to comply with the law. However, regulators need to think carefully about the manner in which they use the big stick. In particular, if firm enforcement is to be effective, it must also be fair. In the following section I discuss the significance of these findings for tax regulatory practice. A number of the matters raised above raise questions not just for the Tax Office, but also for the Director of Public Prosecutions, courts, the legal profession, prison authorities, and the media. However, in the following section I concentrate mainly on the

implications of this finding for tax authorities, before discussing implications for the theory of responsive regulation.

4.1 Avoiding delay

At the level of the principle, the Tax Office recognises that fairness is critical to the development and maintenance of community confidence: ‘A key component of community confidence is being open and fair in the way we treat people, within the framework set by the law.’ (ATO 2004, Pt. 2.7). Fairness is also enshrined in the Taxpayers’ Charter, under which taxpayers have the right to be dealt with fairly, and the Tax Office commits to resolve any concerns or complaints fairly and as quickly as possible.

The Tax Office has also adopted a range of practical reforms designed to improve the service it provides. The refrain of the Commissioner and other officials is that the Tax Office aims to provide ‘easier, cheaper and more personalised interactions’. To this end, in 2002 the Tax Office conducted a ‘Listening to the Community Exercise’.

Consultations showed that ‘individuals and tax agents said they wanted better, faster phone services, letters that were easier to understand, and more certainty’ (Carmody 2005b). In response to these complaints the Tax Office adopted a raft of reforms: increasing staff, priority queuing for tax agent calls, improved telephone infrastructure, and the establishment of a new tax agents’ portal (Carmody 2005c).

But many - if not all - of these measures are directed at assisting people before they have a problem; far less attention appears to have been given to how to continue to provide a prompt service once a taxpayer comes under the attention of the Tax Office. This balance is understandable, as more up-front support can help prevent problems arising. However, it is also inevitable that there will be cases of suspected and actual non-compliance. The commitment to ‘easier, cheaper and more personalised interactions’ should be carried through to cases involving audit, investigation and prosecution. Guilt, or perceived guilt, is not a reason for procedurally unfair treatment.

To begin to address this problem it needs to be reinforced that the Taxpayers Charter applies to all citizens, not just the ones who pay their tax. One way to do this would be to insert into the Taxpayers’ Charter a commitment to finalize an investigation as quickly as

possible. To honour a commitment like this would require some strategic thinking about prosecutorial policies. In particular, careful thought should be given to the number of cases that can be prosecuted in a timely fashion. If current resources cannot support current caseloads, funding needs to be increased, or caseloads reduced. The latter approach requires careful sorting of cases to select those most suitable for prosecution, as well as a preparedness to consider other enforcement strategies for the cases that cannot be prosecuted in a timely fashion.

4.2 Informal punishment

There is insufficient debate among regulators, criminal justice professionals, and the community at large about the effect of informal sanctions, notwithstanding that numerous research studies with offenders (this one included) have concluded that the informal effects of punishment are often more burdensome than the formal ones.

The question of informal punishment is a complex one: some sanctions may be unacceptable (such as delay), but some may be desirable, within certain limits. Research on the deterrent effect of punishment suggests that informal sanctions have a much stronger effect on deviance than formal legal sanctions (Braithwaite 1989: 69). So, if punishment is to deter the offender from re-offending for example, the shame of friends and family may be a painful but necessary part of that punishment. But other effects may be completely counterproductive from a compliance point of view. Longitudinal studies of offenders show, for example, that people in stable relationships and regular employment are less likely to commit crime (NCP 1999).

The informal nature of these sanctions makes them hard to calibrate and limit. Nevertheless, regulators, policy-makers and politicians can give more thought to how formal punishment can deliver the appropriate condemnation, and trigger the appropriate shaming mechanisms, without destroying the social ties that bind people to law-abiding communities. Interviews suggested that the key to regaining employment after prison was finding someone prepared to trust a former prisoner. In some cases, this was finding work with someone who already knew them, but in three cases offenders and their families had left the cities in which they had committed the offences, and moved to regional towns and cities where they were able to find work and where the local community accepted them.

Increased use of formal punishments such as weekend detention may give prisoners a better chance of maintaining or rebuilding the trust of their communities.

The Tax Office does not have direct responsibility for the types of sentences imposed on offenders. It does, however, have responsibility for its media strategy. Its current strategy appears in relation to serious non-compliance appears to consist almost solely of issuing repetitive press releases. Each time an offender is imprisoned, the Tax Office issues a release summarizing the sentence imposed, the offender's crime, the judge's sentence and the Commissioner's reaction. A constant stream of this type of release is only of marginal value. Journalists tire quickly of repetitive stories, and soon stop reporting them.

Moreover, this study suggests the prison sentences imposed on offenders are not even the most significant repercussion for offenders. A move towards trying to place feature stories, based on interviews with ex-offenders, would be more likely to deter others, especially if these articles were placed in relevant professional and industry publications. Longer feature stories would also give the Tax Office the ability to send more than one message. For example, at the same time as emphasizing the painful repercussions of criminal prosecution, the Tax Office could also call on employers to give ex-offenders an opportunity to rebuild their careers.

4. 3 Enforcement Bias

This research suggests that tax offenders, as well as the wider community, harbour resentment that the tax office prosecutes less serious offenders more vigorously than more serious ones.

The Tax Office needs to send the message that it is prepared to escalate for all types of offences. One way of doing this is targeting more serious cases for prosecution.

Traditionally negotiation has been the favoured regulatory tactic for dealing with large-scale corporate tax evasion, but more thought needs to be given to bringing criminal prosecutions, either against company directors or companies. Well-publicized prison sentences for senior executives and large fines could start to change the perception that the tax office is soft on the big end of town.

There are well-known difficulties, however, in obtaining criminal convictions, most notably the requirement to prove guilt beyond reasonable doubt. But there are other ways that the Tax Office could attempt to ensure that serious tax evaders do not escape

censure. One is to use a wider variety of civil actions, where the standard of proof is the lower balance of probabilities. Regulatory scholars have written about how regulators can increase their clout by networking with a variety of private and public bodies (eg Castells 2000). This suggests the Tax Office's increasing interagency cooperation is a particularly important development. The Tax Office could also increase its clout by assisting and encouraging professional bodies to take action against its members who consistently refuse to pay tax. This tactic was used with success when the New South Wales Bar Association took action against wealthy barristers who used bankruptcy laws to avoid their tax liabilities. Taking public action would not only counter the perception that less serious matters are punished more than serious ones, but it would also help counter the more widespread and corrosive attitude that tax offences – whatever their seriousness – are not punished as severely as other types of crime (eg Bright 1978).

5. Implementing responsive regulation

In Section 4 I suggested some specific reforms that could be debated in light of the themes that emerged from interviews with tax offenders and other related evidence. In this final section, I consider how the experience of the tax office can enhance our understanding of regulatory theory, and the challenges involved in its successful implementation.

The Tax Office presents two faces to the outside world: one is that of the helpful and cooperative tax collection agency, the other that of the tough regulator. The friendly face is there to reassure honest taxpayers, the tough face to deter would-be tax evaders. For example, Commissioner Michael Carmody's public reaction to the jailing of a West Australian tax agent is typical of the message the Tax Office sends 'Most tax agents are competent and ethical and we support their efforts but we will not hesitate to act where we identify tax agents who break the law.'

The Commissioner for Taxation explains the rationale behind this approach (Carmody 2005):

We need to differentiate our treatment of taxpayers according to their approach to meeting their tax responsibilities and the circumstances they face in doing it ... we differentiate our responses to the needs and risk profiles of different market

segments. For some segments, there is a stronger emphasis on enforcement approaches, for others it is more about education and information and supporting those advisers who are dealing directly with taxpayers.

This approach is broadly consistent with the views of regulatory scholars who argue that matching regulatory responses to different types of behaviour is the essence of smart regulation. Braithwaite's (Ayres and Braithwaite 1992) theory of responsive regulation urges regulators to use the least interventionist form of regulation that will deliver compliance. Braithwaite explains this approach in an enforcement pyramid.

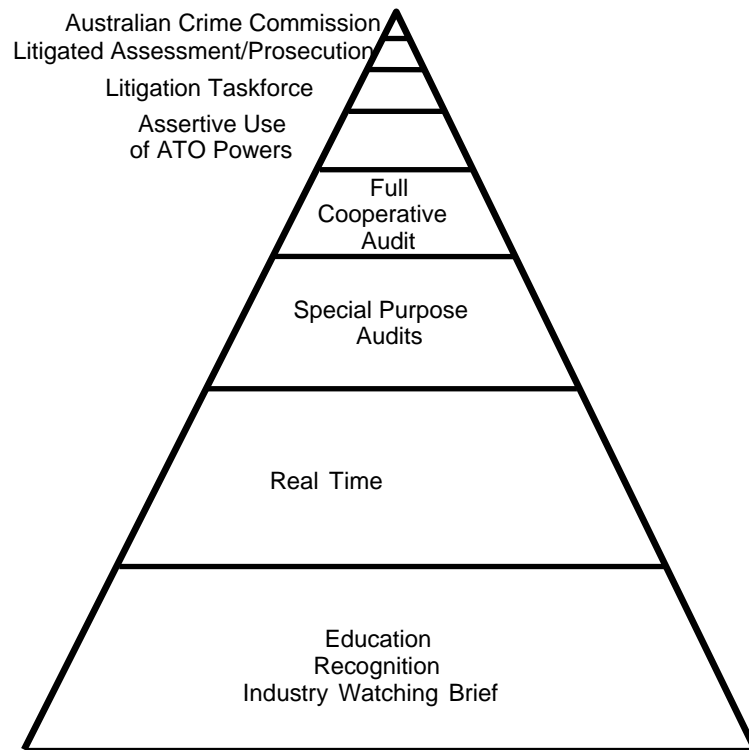


Fig 3 – ‘One illustration of a large business compliance pyramid’ (reproduced from Braithwaite 2005: 77)

The pyramid's wide base represents the part of the population can be successfully regulated by informal, less coercive means. More coercive forms of regulation higher up the pyramid should be reserved for circumstances in which less intrusive regulatory interventions have failed. The Tax Office's own management model – the Compliance Model – is based both on responsive regulatory theory, as well as on Valerie

Braithwaite's work on motivational postures (Braithwaite and Braithwaite 2001; V. Braithwaite 2003).

However, the experience of the Tax Office suggests that three finer points of the theory need careful emphasis, if they are not to be lost in the implementation of responsive regulatory strategies.

The first is that responsive regulation is a dynamic form of regulation. One aspect of this is that regulatory strategies should be reviewed on a regular basis. Regulators are required to do more than just divide a market into segments, and then select a once-and-for all strategy for dealing with each segment. Instead, regulators should regularly reassess and revise their regulatory strategies in light of their success in achieving compliance.

The second point is that coercive enforcement should be used only where less coercive means fail. The idea behind the pyramid is not that less serious crimes should be dealt with at the base, and more serious one at the peak. Regulators should attempt to push all offenders down to the base of the pyramid. The higher levels of pyramid are reserved those offenders who prove to be resistant to less coercive forms of regulation. One implication of this is that the Tax Office should look for less coercive ways to deal with all tax offenders, including ones that have committed criminal offences. Another implication is that in responding to the criticism that it is too lenient on serious tax offenders, it would be a mistake for the Tax Office to select more serious cases for prosecution simply because they are more serious. The better way to build a reputation as a fair enforcer is to be able to demonstrate a preparedness to escalate against all offenders who do not respond to less coercive forms of regulation.

The third point is that all regulatory action must adhere to certain procedural requirements. By dividing the world into different market segments, and tailoring regulatory action to the characteristics of each segment, we can lose sight of the principles that should guide all regulatory action. Everyone, regardless of whether they are perceived to be honest or dishonest, is entitled to be treated fairly. It cannot be viewed as a courtesy extended to those taxpayers perceived to be honest, nor as something that can be withheld as a punishment from those perceived to be dishonest. In fact, from an instrumental perspective, procedural justice is arguably more important when dealing

with those perceived to be dishonest, as research demonstrates that offenders who perceive themselves to have suffered procedural injustice are more likely to continue offending.

6. Conclusion.

The Australian Tax Office has undergone a series of reforms, simultaneously streamlining the service it provides to most Australians, while getting tougher with those taxpayers who refuse to pay tax. This article critiques these reforms, drawing on the perspectives of those who have been imprisoned for tax offences. Their views remind us that tough enforcement is not a simple matter. If enforcement is to be an effective regulatory strategy, careful thought should be given to who to prosecute, how to prosecute, and how to report their prosecution. To be seen as a fair and strong regulator, the Tax Office must be seen as prepared to take tough action against all types of tax evaders, not just those who are easiest to prosecute. In this respect, there is an important role for interagency cooperation. Prosecution and conviction processes inevitably place the Tax Office in conflict with taxpayers, and taxpayers and their lawyers may make it difficult for the Tax Office to do their job. However, this research suggests that the Tax Office must nevertheless strive to extend the same prompt, courteous treatment it extends to the majority of Australians. If it does not, it risks decreasing, not increasing, the likelihood that offenders can be turned into compliant taxpayers. Finally, effective regulation does not end with prosecution. This research suggests a variety of ongoing problems. By adopting a more sophisticated media strategy that raised the profile of these problems, Tax Office could simultaneously publicize the difficulties suffered by offenders, as well as seek to ameliorate the more destructive impacts of prosecution.

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