

DEMOCRATIC SENTIMENT AND CYCLICAL MARKETS IN VICE

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Aggressive tax planning is found to be a cyclical phenomenon in Australia and the United States. While people strongly disapprove of it, mass participation in aggressive tax planning occurs during cyclical upswings, probably at a level involving well over 100,000 Australians in illegal schemes during the late 1990s. We analyse these cycles as a market in the vice of tax scheme promotion that is countered by widespread virtuous sentiments in the democracy. Community attitudes to tax cheating are therefore not seen as the problem, but as crucial to its solution. There is a democratic demand for tax system integrity. This demand creates a market for honest tax advice professionalism. Sophisticated regulators can use these community attitudes as the crucial resource for flipping markets in vice to markets in virtue. Cycles occur because markets in virtue and vice dominate at different periods of history.

Aggressive tax planning is broadly defined here as a scheme or arrangement put in place with the dominant purpose of avoiding tax. This definition encompasses a range of activities from large corporations minimizing their tax by moving profits from one tax jurisdiction to another, often in conjunction with artificially creating losses, to exquisitely crafted boutique schemes for a select group of wealthy investors, to more pedestrian mass-marketed schemes that are developed to provide high-income earners with opportunities to control the amount of taxable income they must declare to the government. The range of activities that fall under the label are constantly in creation and appear limitless given the ever increasing complexity of tax law and the opportunity that detailed complexity creates for legal loopholing and patch-working (McBarnet 2003; Picciotto 2005; Rawlins 2005).

While our definition captures the essence of the phenomenon succinctly, it camouflages a significant part of the difficulty for tax authorities in managing aggressive tax planning. Complicated law and smartness in manipulating it are but one part of the story in which the technical competencies of tax authorities and others are pitted against each other in a world in which business is global and tax is national (Avi-Yonah 2000). The other part of the story, and in one sense the bigger picture, is that aggressive tax planning takes tax authorities to the edge of their technical legal competence and rubs against understanding what it means to have business acumen. Apart from the dimension of smartness in understanding tax law, there is the complicating dimension of understanding business risk. Capitalism thrives through innovative business ventures that may seem ludicrous to the cautious and strokes of genius to the adventurous. Tax breaks to encourage innovation and nudge the more cautious into taking a risk are standard practice as governments throughout the world look to steer private enterprise toward seeking competitive advantage through innovation. It is at the intersection of business initiative and taxation law that the biggest challenge lies for tax authorities

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trying to contain the aggressive tax planning market. It is not always easy for the state to discriminate the risky venture that falls in a hole from the venture carefully crafted to cascade losses in order to avoid tax.

Effective regulation in highly complex areas of this kind rarely is achieved through simple command and control strategies. A suite of regulatory approaches are required that encourage responsible self-regulation, that increase transparency and accountability, and that increase the credibility of what is perceived to be legitimate enforcement (Gunningham and Grabosky 1998). ‘Regulatory capitalism’ (Levi-Faur 2005; forthcoming) is characterized by a kind of arms race in which regulators of markets invent more sophisticated regulatory techniques only to see the rocket scientists of fields like tax planning reinvent new forms of international arbitrage, new engineering of financial products and other inventions to thwart new laws or new regulatory techniques. In order to achieve better regulatory outcomes, there must be a theoretical base that is both normative and explanatory in setting out why aggressive tax planning must be contained and how this can be achieved without jeopardizing the forms of innovation and entrepreneurship that make capitalism flourish. This article therefore has two goals: (a) to provide a theory of aggressive tax planning that signals the value of regulatory interventions that flip the incentives to undermine the tax system (a market in vice) into incentives to pay one’s way (achieved through a professional market in virtue); and (b) to demonstrate that flipping incentives, perhaps implausible in the eyes of some, becomes very plausible once regulators become outward-looking, responsive to the democratic sentiment, and seriously engaged with evidence-based tax administration.

Why Does Aggressive Tax Planning Pose a Problem? The Australian Story

Contrived tax shelters are a threat to the sustainability of tax systems throughout the democratic world in several respects (see Braithwaite 2005 for extended discussion), pre-eminently through inflicting substantial loss to the revenue. It is impossible to estimate the size of the loss with any credibility. Our data give good reason for believing that most, if not all, Fortune 500 companies were engaged in using such tax shelters during the late 1990s (Braithwaite 2005: 105–06) and that this is a fundamental reason for corporate tax collections in the United States falling from a peak of 7 per cent of GDP to its current trough of around 1 per cent.

Two reasons why contrived tax shelters should concern us stand out as important if our objective is a well functioning democracy. Our argument is supported by Australian data collected at the time of the downturn in the most recent boom in aggressive tax planning (the end of the 1990s). While generalizability should never be blindly assumed in these contexts, the data of Northern hemisphere colleagues give us little reason to think that Australia is an outlier among Western nations in its tax attitudes (Schneider and Bajada 2005; Torgler and Murphy 2004).

First, tax systems are becoming increasingly regressive, especially in the comparison between the very rich and everyone else. Large businesses and very wealthy individuals are able to wipe out their tax liabilities altogether, leaving those on lesser incomes to shoulder the tax burden. We show below that perceptions of professionals, business managers and the wealthy not paying their fair share of income tax are rampant in Australia (Rawlings 2003; J. Braithwaite 2003). A high 89 per cent of Australians place ‘ensuring that large corporates pay their fair share’ as the highest priority for tax

reform, with 66 per cent wanting to prioritize a progressive tax system, by placing very high or the utmost importance on 'ensuring that people who are wealthier pay more tax'. For comparative purposes, it is of note that the much touted priority of 'keeping taxes as low as possible' was prioritized by 60 per cent of Australians (Braithwaite *et al.* 2001).

In places where the social norm is for a more progressive tax system and where highly successful corporations and wealthy individuals are expected to pay back society for the benefits gained through access to public infrastructure, the avoidance of tax by the privileged creates social discontent; and a distancing from government and its agents occurs that is associated with loss of trust and cooperation (V. Braithwaite 2003; 2004; Braithwaite and Reinhart 2000; Braithwaite *et al.* 2003; Rawlings 2003; Taylor 2003).

Associated with this is a second concern for tax sustainability when individuals do not perceive taxation as delivering benefits to them (Kirchler 1998). Population surveys have shown that over 60 per cent of Australians either have doubts or do not believe that the public goods and services they receive are fair compared with the tax they pay. Even more Australians perceive those around them as being critical: 85 per cent hold the view that others have doubts about the benefits of paying tax (Braithwaite *et al.* 2001). Because tax systems depend so heavily on community cooperation in democratic societies, there is danger that as perceived benefits are reduced, resistance to taxpaying will increase (Scholz and Lubell 1998). While the vast majority of taxpayers do not have the resources to hide their taxable income as well as the very wealthy, they have numbers on their side. The weight of numbers is felt by tax authorities when the upper-middle-class stampede into mass-marketed tax-avoidance schemes or create very bad press for the government and the tax authority, or do both, as has happened in Australia in two waves of middle-class participation in tax schemes in the late 1970s and the late 1990s.

Murphy has documented and examined the causes of taxpayer resistance to the Australian Tax Office's (ATO) crackdown on mass-marketed schemes in the 1990s (Murphy 2002; 2003*a*; 2003*b*; 2004; see also Hobson 2002). Perceptions of deficiencies in procedural justice (Tyler 1990) and slowness on the tax authority's part to take action lie at the heart of Murphy's analysis. Some 42,000 taxpayers had their tax affairs scrutinized, in some cases for the past six years, and were required to pay monies owing on disallowed expenses. Our qualitative fieldwork leads us to expect that at least several times this number were not caught in the net. Many who were caught could not pay, a taxpayers' fighting fund was formed and the ATO came under attack from many quarters, including politicians from the ruling party. By no stretch of the imagination could this saga be described as good government. While government inquiries advocated changes to improve the fairness and reasonableness of further ATO crackdowns, the more fundamental challenge is preventing the public stampede into these schemes in the first place. This means understanding the dynamics of how and why they occur. Before presenting a theory grounded in an account of how both the Australian and New York markets in aggressive tax planning have expanded and contracted since 1970, it is useful to locate the approach taken in this work within the extensive body of tax compliance research.

Moral Obligation and Democratic Values

The feeling of obligation to pay tax can come about in different ways. Some are persuaded that contributing to a tax system is a good way of providing the public

infrastructure that improves quality of life for everyone. Others have substantial doubts about the integrity of the system, but have a strong allegiance to the law and believe that they and others should be law abiding, even if they are not persuaded of its inherent value. A third way in which moral obligation is manifested is at the level of social identity. People identify with the image of the honest taxpayer. To be a member of this group is to be spared tax authority sanctions and scrutiny. And to be a part of the honest taxpaying community is to accept a moral obligation to pay tax.

All three kinds of obligation were measured in three large national surveys conducted in Australia between 2000 and 2005 (the years immediately after the collapse of the 1990s upswing in mass-marketed aggressive tax planning) (Braithwaite *et al.* 2001; Braithwaite and Reinhart 2005*a*; 2005*b*). Participants were drawn randomly from the electoral rolls (voting is compulsory in Australia) and numbered 2040 in 2000, 2326 in 2001, and 1138 in 2005. Within these samples was a panel dataset of 509 respondents. The response rates to the random surveys were low, but not unexpected, ranging from 29 to 34 per cent. Such rates are typical of population surveys with a tax focus. Of those who remained in the panel with contactable addresses, 69 per cent were successfully followed up in 2001 and 51 per cent in 2005. Given the relative lack of appeal that tax surveys have among the general population, extensive comparative analyses are essential in order to test for sources of sample bias (Mearns and Braithwaite 2001). These analyses revealed an under-representation of young people and an over-representation of higher socio-economic groups that appeared in all three surveys, but not of an order that was discordant with similar biases reported in non-tax mail surveys. The attitudinal data reported in this paper were taken from the panel dataset, so that comparisons could be made across time. The results would not have been substantively different if the cross-sectional data from each survey had been reported instead. Comparisons across datasets showed that the results presented here were not affected to any notable degree by known sample biases.

The percentage of respondents who said that they believed that taxpaying was a responsibility that should be willingly shared by all Australians because it advantaged everyone and helped the government do worthwhile things was consistently high: 94 per cent in 2000, 95 per cent in 2001, and 92 per cent in 2005. Our first observation is that the strength of support for the tax system is so strong that there is considerable latitude for the tax authority to survive difficult times. This base of support, which undoubtedly is typical of many traditional institutions, provides the tax authority with the moral authority to do what they must to protect the revenue. The percent of respondents who believed it was wrong to cheat on tax and that the authorities should take action to catch tax cheats was over 70 per cent in the three surveys. The percentage of respondents who expressed pride in being an honest taxpayer and reported that this identity was important to them was also consistently high: 92 per cent in 2000, 90 per cent in 2001 and 93 per cent in 2005. The vast majority of Australians revealed a desire to align with a 'safe' category of taxpayer, as word was getting out that the ATO was serious about cracking down on mass-marketed scheme participants.

During the period of this research, Australia had a Conservative government that espoused strong ideological commitment to a free-market philosophy. An increase in support for free markets and small government was observed from 2000 to 2005. The measure used to monitor this increase involved indicating level of agreement with two statements taken from Dryzek's (1994) discourses of Australian democracy: (a) free

markets work because individual people, cooperating peacefully and voluntarily through markets, can achieve much that politicians and bureaucrats cannot achieve using compulsion and direction; and (b) the true function of government is to maintain peace and justice: this does not include interfering in national or international trade or commerce, or in the private transactions of citizens, save only as they threaten peace and justice. Free-market, small-government ideology was acceptable to 38 per cent initially and rose to 46 per cent at the end of the study. This was one of the larger changes observed over this period. The survey findings reveal awareness, indeed acceptance, of a world that is changing to be more market-driven.

Yet, there was disenchantment with the process and longing for a system of government that showed a little more concern and respect for those it governed. Disillusionment with Australian democracy was measured by a scale comprising six items.¹ The percentage of Australians endorsing quite extreme statements about a dollar democracy replacing a peoples' democracy were remarkably high across the five years of the study. A substantial 86 per cent (in 2000) and 85 per cent (in 2005) expressed concerns about democracy's losing 'its original meaning' and admitted to feeling 'cynical about government processes' and how the government was moulding society in the direction of profit-oriented capitalism. While acceptance of free markets increased over time, respondents did not lose hope of a more caring society. A remarkable 94 per cent in 2000 and 92 per cent in 2005 clung to an ideal of greater equality and greater humanity in the way Australian society functioned, through endorsing two items: (a) our society will be more secure and attractive if it is also more equitable and humane, as well as more productive and efficient; and (b) our community and nation should appeal to a spirit that each person is important, and has a way of influencing things.

Perceptions of How Others Are Responding

Measures of what others were *perceived* to be doing in this climate of tax avoidance were taken in 2000 and 2001. The primary interest was in how privileged groups were perceived: were groups such as lawyers, judges, CEOs, tax advisers and doctors judged to be paying their fair share of tax? How did they compare with owners of smaller businesses and farms? And then were wage earners like waitresses, farm labourers and unskilled factory workers who were more likely to receive tips and cash payments paying their fair share? The results of these analyses are reported in Table 1. Consistently, respondents saw high-income groups as not paying their fair share and low-paid workers as contributing more than they should, even when they were in jobs in which cash work was reputed to be common. When asked to judge themselves in terms of whether or not they were paying their fair share, most thought that they were about right, with about a third believing that they were paying more than their fair share, and few claiming to be paying less than their fair share.

In 2001, a question was asked about the popularity of aggressive tax planning schemes. Respondents indicated whether people were more prepared to enter them

¹ Respondents expressed level of agreement with the following: (a) democracy is a term that has lost much of its original meaning; (b) there's a dollar democracy that runs through our supposed democracy; (c) in Australia, the rich have virtually unlimited access to the legal system and the capacity to use it to achieve their own ends; (d) I don't think we have enough input into legislation and the decisions that are important; (e) our government is attempting to mould our society to the needs of a profit-oriented market; (f) I'm always cynical about government processes.

TABLE 1 *Percentage of total sample of respondents who judged (a) professionals and CEOs, (b) small business owners and farmers, (c) low-paid workers, and (d) themselves as paying their fair share of tax in 2000 and 2002 in parentheses*

Occupational group	Is a fair share of tax being paid? Percentage saying that the group is paying . . .		
	More	About right	Less
Professionals and CEOs	8 (7)	15 (16)	77 (77)
Small business owners and farmers	34 (36)	32 (35)	34 (29)
Low-paid workers	44 (46)	50 (49)	6 (5)
You, yourself	36 (33)	59 (64)	5 (3)

than five years ago or less prepared. Most respondents answered ‘more prepared’ (32 per cent) or ‘the same’ (30 per cent). The remaining response categories were ‘less prepared’ (12 per cent) and ‘don’t know’ (26 per cent).

These findings show the kind of sensibility on which scheme contagion thrives. It thrives on a strong sense of unfairness that the privileged can use avoidance measures not available to others, and on an increased awareness of the community’s willingness to enter these schemes and avoid tax if possible. Of importance here is that the attitudinal data also show that it is not about mass attraction to the role of tax game player. Tax game players are people who enjoy looking for loopholes in the law, talking to friends about it and coming up with strategies for tax minimization. Interestingly, the number who showed enthusiasm for the game-playing craft remained consistently low: 10 per cent in 2000, 8 per cent in 2001 and 9 per cent in 2005. When asked about their ideal kind of tax agent, 77 per cent of Australians report that they rely on agents to help them with their tax and most Australians (88 per cent) wanted a low-fuss, honest tax agent in 2000, as they did in 2001 (85 per cent), and 2005 (87 per cent) (see also Sakurai and Braithwaite 2003). Attraction to using tax advisers who promoted tax minimization—both those who were aggressive in the advice they gave and those who were more cautious—was considerably lower. Cautious minimizing agents were idealized in 2000 by 29 per cent, falling to 20 per cent in 2005. More aggressive tax advisers were the preferred option of 22 per cent in 2000, falling to 18 per cent in 2005. Enthusiasm for an adviser who could make use of a range of tax minimizing strategies showed a statistically significant reduction in these years, when the ATO was attacking aggressive tax planning in the courts.²

The Traditional Rational Choice Analysis of Tax Evasion and Avoidance

Tax evasion and avoidance activities have been predominantly understood in terms of rational individual decision-making models. Initially, the focus was on economic factors and weighing up estimates of the taxes to be saved against the costs of getting caught (Allingham and Sandmo 1972). The rational calculus, however, produced outcomes that did not match reality. The rational economic model predicted that most people would not be paying their tax, in contradiction to data showing that they were

² For US data that give a more mixed picture of the senses in which tax preparers are agents for compliance or cheating, see Klepper *et al.* (1991) and Klepper and Nagin (1989).

(Andreoni *et al.* 1998): something else was clearly going on. Developments in recent years in the field of tax research have seen models expanded to include other variables (Alm *et al.* 1995; Cullis and Lewis 1997). Perception of social norms has attracted attention in some quarters (Sigala *et al.* 1999; Wenzel 2002; 2003; 2004), while moral obligation has been of interest in others (Frey 2002; Schwartz and Orleans 1967; Torgler and Murphy 2004). As the models increased in complexity, one thing remained constant in the thinking in policy communities. Tax evasion and avoidance continue to be seen as rational decisions that individuals or groups make as a consequence of the incentives and constraints that they observe as operating in their environment, as it was seen in earlier perceptual deterrence research (Grasmick and Bursik 1990; Grasmick and Scott 1982; Scott and Grasmick 1981).

The investment that has been made in this approach has been enormous, but explanatory capacity for what is going on in individual taxpaying behaviour remains limited. The variance that can be accounted for in individuals' decisions to avoid or evade are consistently small, hovering around the 10 per cent mark, even in the most sophisticated quantitative studies (see, e.g. Wenzel 2004). Part of the explanation lies in problems of measurement, particularly the measurement of evasion and avoidance (Webley *et al.* 1991). But part is also likely to lie in under-theorizing the cultural tides that sweep some people up in their path and leave others standing on dry land. The nature of the cycles of cultural tides is the topic of the next section of this article.

Individual characteristics are not necessarily part of the story of who gets caught up in the tide of change and who does not: those who are left untouched by the tide may be no different from those who are swept up in it in terms of their ethics, moral obligation, perceptions of community norms, assessments of tax loss and tax risk. For example, two lawyers could both have a moral obligation to offer tax advice that complies with the spirit of the law, and they both may see the community norm as one of being cautious in taxpaying behaviour. But one may be working in a firm that is an early mover into a wave of aggressive tax planning and the other may be working in a firm in which such activity is seen as a passing fad that will end in disaster for those involved. In the first setting, social contagion will challenge our lawyer's belief in moral obligation and her judgment about the law-abiding nature of community norms. The movement of the herd around her will make her have doubts about whether she has assessed the situation correctly, and hold fears that she may be left behind career-wise when the dust settles. Will she put her moral and social sensibility on the shelf and go with the flow to show how smart she is at finding loopholes in the law and preserve her career prospects; or will she resist the tide and part company with the aggressive tax planning advocates, holding firm to her principles and the norms she sees as operating in the community? For the second lawyer, no such decision has to be made. The routinized practices of the past prevail because the situation is one of business as usual. The accountant's moral obligations and perceptions of social norms will more than likely be compatible with routinized practices grounded in past socialization, but they will not be foremost in his mind, making their presence felt with each and every decision. Moral obligations and perceptions of social norms will remain on the shelf, gathering dust. They will not be taken off the shelf because they are not needed; no new dilemma or challenge has presented itself.

Two inferences can be drawn from this example. First, context and opportunity matter and, therefore, one cannot expect individual perceptions and internal attributes to

explain well who gets caught up in aggressive tax planning schemes and who does not. Second, there is need for a theoretical account of what is meant by context and opportunity in relation to aggressive tax planning. Some have argued for an empirical approach that narrows down context and values specificity in independent and dependent variables (Collins *et al.* 1992). The alternative is to look for a macro theoretical account of the tides as they come and go, focusing less on who is being caught and more on how the tide comes into being. It is with this latter approach in mind that we turn to our theory of cyclical markets in vice and virtue within the context of aggressive tax planning.

Cyclical Markets in Vice and Virtue

At the heart of this theory is the notion of social contagion (Bikhchandani and Sharma 2000). Human beings follow the herd into activities that they observe others doing and that appear to be rewarding; and they charge out again when they see others abandoning the activity, and when they view it as less rewarding than it used to be. This core premise is consistent with the theories of human behaviour that guide market research (Neal *et al.* 2004) and with the parts of Keynes' (1981; originally published 1936) general theory most neglected by the discipline of economics. In the marketing context, demand is built through creating or appealing to an emotional need in individuals that can be satisfied intermittently through supply of the good or service in question. The appeal increases as the product gains rational substantiation: The product works; it gives us what we want. But price and quality appeals do not initiate product allegiance; they sustain it. The psychological intervention that is at the heart of building a market can be used to benefit us, individually or collectively, or to harm us. The market may be in education or health, or it may be in illicit drugs or nuclear materials. For this reason, the intervention that involves creating a market should be neither unreservedly condemned nor praised. It is part and parcel of how a society innovates and adapts. The important question is what is being demanded and supplied, and from the perspective of regulators, with what consequences for the well-being of the society.

The question of how a society decides on the moral worth of a market is clearly not unproblematic. A play in the aggressive tax planning market may be an act of desperation by a small business needing enough money to pay a tax bill, or one of greed by a business resenting handing over any money to the government. The moral issues are salient in both contexts and demand democratic deliberation. Part of this process is engaging actively with the democratic will through any number of mechanisms that have been developed in recent years, apart from the standard route of parliamentary debate to the regulatory agency. Democratic deliberation in a restorative justice circle, for example, can be expected to take a rather different path when a small business enters a tax shelter to pay a tax debt than when it enters the shelter to avoid the need to pay any tax.

Democratic deliberation over vice and virtue demands time and energy and negotiation. Arguably, what requires more ingenuity from tax authorities is working out the mechanisms for flipping the market from one of vice to one of virtue. It is through regulatory intervention that successfully flips markets of vice into markets of virtue—a market in aggressive tax planning into a market in paying tax honestly—that the cyclical nature of vice and virtue markets comes into being.

According to J. Braithwaite's (2005) Sydney, Melbourne and New York data, aggressive tax planning markets grew in these places between 1970 and 2005 from an insular, exclusionary activity of an elite few, to being an idea that is shared among a relatively privileged social network. At this point, the idea gains a following, and opportunistic promoters seize the chance of re-packaging the idea so that it can be mass-marketed for a second financial killing. Braithwaite has argued that this market is both supply- and demand-driven. Initially, it is supply-driven, but as the idea catches on and is packaged for wider consumption, it acquires a sense of safety in people's minds (everyone else is doing it with great success) and appeals to their desire to be a success (I'll look and feel like a loser if I'm left behind). It is at the point of development and distribution of a second-level product that a switch in the market occurs from being largely supply-driven to demand-driven.

Promoters and financial institutions compete to outdo each other in designing complex schemes that can wipe out the tax bills of large corporations and the very wealthy and significantly cut the tax bill of high-income earners. As word spreads, taxpayers ask their advisers and accountants what they can do to reduce their tax bill: 'Is there a product for me?' If none is available at the time, the race begins to find one. At this stage, schemes are modified to take new forms, not always with the cleverness and care of the original design. Care is at a premium with the initial swell of 'boutique marketing' to the rich (tailor-made for the few), low-key marketing kept under the radar screen. Hype is the premium with mass marketing to the not-so-rich by second-generation promoters who understand that they are riding a wave that will crash on the shore because of the very mass nature of the wave. Carelessness in shelter crafting is not discernible to the less sophisticated taxpayer, but eventually it becomes apparent to the tax authority. Enforcement activity follows, the boom comes to a halt, and all will be seemingly quiet as scheme designers and promoters wait for the next opportunity to make their running with mass-marketed shelters. During the long lull, designers of boutique shelters for the rich apply lessons from the devastation that law enforcement wreaks on the lives of the not-so-rich left washed up on the shore by the crash of the last wave.

As the market builds up, tax authorities too often stand by, flat-footed, locked into a rational-legal analysis of a situation that they regard as a static compliance problem—is this tax-avoidance activity inconsistent with the law, does the authority have the power to take action, and, if so, would the authority be successful in stopping the activity through the courts? As time elapses with these deliberations, a mass tax planning industry has ample time to establish itself, cultivate clients, demonstrate its value to business and intimidate tax authorities through creating problems of enforcement swamping and political backlash. Sometimes, the nightmare scenario unfolds for the tax system—a shelter becomes too big to fail. It becomes politically impossible for law enforcement to attack it and politicians ultimately change the law to make it perfectly legal.

Both American and Australian tax authorities have therefore learnt since 2000 that legal conservatism is a disastrous policy response to aggressive tax planning. Tax officials cannot be like night-fighting soldiers who huddle in the dark waiting for a more aggressive enemy to take the risk of coming out before dealing with them. In well understood environments, warriors 'sense, categorise and respond'. In complex environments, however, they must 'probe, sense and respond', only comprehending the environment retrospectively after probing into it. In utterly chaotic environments, the

best choice for the warrior may be to act in an attempt to stabilize the environment, then sense and respond (Warne *et al.* 2005). This is the metaphor of ‘fire-aim-ready’ that business strategists, including in the tax planning domain, also deploy. In practice, this has meant that instead of suffering the analysis paralysis of the past, the ATO and IRS (Internal Revenue Service, US) now move more smartly to probe–sense–respond by calling on the elite of the tax advice industry to gauge reaction when the government signals an intention to launch an attack on a shelter. Or, they act–sense–respond by an announcement that anyone who enters into a particular shelter after the date of the announcement will be attacked in the courts. And they keep this promise.

Qualitative interviews in Sydney, Melbourne and New York with lawyers, accountants, promoters, tax administrators, advisers to high-wealth individuals and others who knew about the aggressive tax planning industry ($n = 104$) identified a range of regulatory actions and decisions that can fuel or dampen growth in the market. Again, a note of caution about generalizability is warranted. The drivers and dampeners of aggressive tax planning in these three markets may be very different from those in leading European markets like London, that lie between New York and Sydney–Melbourne in their tax planning sophistication and aggression (according to our interviews).

At the supply stage, a number of interventions are proposed that stem from recognition of the fact that off-setting the buzz of inventing a new scheme is the risk of its not working. Among the extraordinarily talented elite who supply the tax planning market with ‘outside the box’ ideas, reputation is rather important. Reputation protects business interests and protects egos. Systems of private rulings offered by tax authorities, therefore, reduce risk at the supply stage for the creator, adviser and the investor, providing an assurance that the scheme is a success at least for a limited period. On the other side, the tax authority gains much needed intelligence on how the tax planning market is operating at the most sophisticated levels. While not all will reveal their hand to a tax authority on all occasions, knowing what some of the people are doing some of the time is intelligence worth having.

There are two main policy risks here, however. In getting the intelligence to prevent a clever boutique scheme from mutating into a more widely marketed scheme, the tax authority protects the tax avoidance of the very wealthy clients of the most clever designers who are capable of inventing new products that lawmakers are yet to imagine. Second, corruption is a risk in a strategy of ruling ‘yes, you get a payout for successfully finding a way around the law’ because you have told us about it so we can prevent others from getting that payout. The reason scheme promoters can be attracted to this deal is that it is in fact uncertain whether the courts would agree that their shelter ‘works’. For the same reason, such a policy might open the way for a tax official to approve a payout to a shelter that clearly will not work in return for a bribe. One senior Australian tax official has been unsuccessfully prosecuted on precisely such allegations.

Based on the interviews, it was of interest that many in the aggressive tax planning industry had experience working in tax authorities. In this field, the revolving door seems constantly in motion, raising concerns about capture, but also providing opportunity for finding out about new developments. Networks of professionals share gossip, form strategic alliances to get the tax decision they want, and are constantly on the lookout for information on what the tax authority knows and what it will target next. For tax authorities, being part of these information exchange networks seems imperative. In areas as specialized, dynamic and innovative as these are, partnerships of various

kinds between the private and public sector need to be forged to give tax authorities a chance of understanding the activity that they are trying to regulate. In this respect, task forces such as those set up by the Australian Taxation Office for specializing in high-wealth individuals and for promoters provided an institutional space for sharing views and developing strategies to protect the revenue without destroying business incentive. This strategy seems to have worked. Before its introduction, companies controlled by high-wealth individuals paid less tax than other companies; after its introduction, they paid considerably more (J. Braithwaite 2003).

While there might be some pragmatic effectiveness with such strategies, where does the virtue come in? A number of informants involved in the aggressive tax planning industry were not ignorant of, or dismissive about, the value of taxation and held strongly to the view that the tax authority needed to close down the more abusive instances of gaming the law. Nowhere was this more so than among New York lawyers, who saw the aggressive market for tax advice as having created a problem of abusive tax shelters that needed to be cleaned up. In the interviews, some of these lawyers went so far as to articulate ‘a deep sense of personal regret that this level of code gamesmanship goes on’ (Holden 1999: 369). The notion that a tide of activity can rise, while even participants hold moral objections to its existence, is an empirical finding whose significance is often belittled. Self-confessed moral objections are too often discounted as ‘motherhood’ statements—offered in case the mother is listening, or as attempts to manufacture a defence in the case of imminent arrest. These are but two ways in which we might anticipate this utterance to be re-interpreted to fit a rational actor view of the world. From a social-psychological perspective, however, the utterance has greater credibility: multiple selves and multiple roles are essential to social functioning (Goffman 1969; Tajfel 1981), and with different contexts, different selves and roles assume dominance.

Ethical Identity and Institutions of Integrity

Harris (forthcoming) has put forward the notion of an ethical identity to refer to that part of ourselves that captures the capacities and the character attributes of which we are proud. Naturally, we all have identities of which we are less proud. Ethical and not-so-ethical identities can be segregated by an individual in the way he constructs his life, but they can be brought together ‘to face each other’ through institutional arrangements such as restorative justice conferencing. Harris argues that once the setting forces the individual to confront these two identities that do not sit well together, tension is felt, and psychological resolution is necessary. Once the process of resolution is complete, a state of personal integrity is attained—an important step for human development. While Harris does not develop this possibility, corporations as well as individuals need to confront those parts of their ethical identity of which they are not proud with those parts of their collective identity that do induce pride.

The broader implication of Harris’s finding for aggressive tax planning is that the sophisticated segregation that is engineered into institutions of finance liberates individuals from their personal integrity battles. For example, a question of personal honesty is institutionally defined as a legal question: ‘Here is a letter from a QC to say this is legal, who are you to question it?’ This when the letter was obtained by opinion shopping on the part of a scheme promoter until a QC desperate enough for business is

persuaded to sign the letter. Flipping the market, therefore, involves reversing the institutional segregation and allowing the integrity battle to take place.

Sceptics might still shake their heads. How many of the Wall Street elite reflect on their moral shortcomings and who will break down the barriers that insulate them against self-scrutiny and self-doubt? One institutional response to this question is law: law that incorporates a general anti-tax-avoidance principle,³ that prosecutes promoters and not only investors, and that makes insurance companies accountable if they enter into the trade of insuring tax benefits from a shelter are all ways in which moral standards can be flagged to players in the tax industry.

Restorative justice comes into its own in a world in which there are many different kinds of gatekeepers of corporate morality. Consider what could have been done before the event to prevent the frauds leading to the collapses of Enron, Worldcom and HIH in Australia. A common element in these corporate crime disasters was that Arthur Andersen was the auditor and neglected their ethical responsibilities. Arthur Andersen was well known to national tax authorities as a legal game player. We interviewed two senior Australian tax officials who had had the following experience. A major accounting firm partner got one of their wealthy clients into a lot of trouble for tax non-compliance. A more senior partner then visited the senior ATO officer handling the matter and said: 'This is a rogue partner and we are going to get rid of him. We would hate you in the ATO to think that other partners condone what he did.' Such an encounter creates the opportunity that the tax authority needs to tackle the ethical climate in the major accounting firms and investment banks. The senior ATO officers could have replied:

That's good that your other partners do not condone this and I'm pleased to hear it because we at the ATO were disturbed by the non-compliance that occurred here and are always concerned with something of this gravity that it might reflect a culture of non-compliance in your firm. Could we have a meeting to discuss this with all your partners?

In such a case and if they agree to this, as regulatory experience with restorative justice elsewhere suggests they would, a request would be made for a restorative justice practitioner to facilitate the meeting. This facilitator would insist that the 'rogue' partner who was about to be moved out also attend. She would be the first person asked to speak by the facilitator. She would be asked to tell in her own words how the incident that had got her into hot water had occurred. It might turn out, if this were Arthur Andersen, that the 'rogue' partner was not a rogue partner at all, but a fall-guy who was actually following the culture of the firm. The conversation would conclude by focusing on the harm done by the incident, with everyone in the restorative justice circle being asked to contribute ideas for preventive action to ensure that the problem did not arise again. If the suggestion had not already been made, the Tax Officer could propose an audit of the firm's systems for compliance with ethical standards. An independent evaluation of compliance systems would be conducted by an external consultant whose independence enjoyed the confidence of both the firm and the Tax Office. Its recommendations would be reported back to a reconvened meeting of the restorative justice circle, which would discuss whether they went far enough. A year later, the circle might be convened again to receive a report from the accounting firm and the independent

³ For a British perspective on this, see Freedman (2004).

consultant on how thoroughly the reforms to the compliance culture had been implemented. In Harris's (forthcoming) terms, the restorative justice circle forces the accounting firm's ethical identity to confront face to face the unethical parts of its identity in a process that holds out the prospect of cultural transformation to an organization with ethical integrity.

It would be easier to motivate active engagement of tax scheme promoters with such restorative justice processes in a world in which promoter penalties were credible and in which the Tax Office could effectively threaten the licence of an Arthur Andersen or a major investment bank to offer tax advice. Legal aid support for class actions by investors against promoters would be another possible lever for getting promoters into a settlement circle.

Going beyond the law, and working with tax professionals to instil codes of conduct that resist success fees (as when the tax professional's fee is 30 per cent of the tax she saves the client), and institutionalize fee-for-service as the appropriate charging method, expands the suite of strategies that can be initiated under a principled government-industry partnership against abuse of tax law.

Avoiding Drift: Confronting Aggressive Tax Planning

Once the market becomes demand-driven, there is urgency in tax authorities taking a stand, including urgency from a community with the disapproving attitudes toward aggressive tax planning discussed in the early part of this article. The effectiveness of this stage of the regulatory process depends heavily on the acceptance of law, justified by a moral sensibility to obey the law. For an authority to display delay or diffidence to a community that is stampeding into mass-marketed schemes is to betray an institutional responsibility to set standards and to draw the line clearly and firmly in the sand. The process of de-legitimation that can occur when the authority does not move quickly enough is illustrated by the ATO's poor management of Australia's mass-marketed schemes in the late 1990s. We have seen that the organization learnt from this experience to issue early warnings of possible enforcement targeting of a scheme and inform taxpayers of the arrangements that they are monitoring. This means a willingness to risk a mistake by announcing that continued investment in a particular tax shelter might be imprudent because the tax authority is inclined to the view that the shelter is illegal and therefore is preparing to test that view in the courts. The general anti-avoidance provision that Australia has in place, combined with the more sympathetic response that the ATO has received from the courts in recent years, has given the tax authority a more credible enforcement capability to deal with upswings in the aggressive tax planning market.

In this article, we have not discussed all elements of the model developed from the Australian and US data (J. Braithwaite 2005: 140). We have not discussed how more aggressive competition in markets in which accountants, tax lawyers, financial planners and investment banks (which once had separate roles) now aggressively compete as a result of deregulation of the professions and of the finance sector. Nor have we described how the corporate tax department can become a profit centre during booms in shelter activity, so tax ceases being an obligation and aggressive tax management becomes a business opportunity (Kleinbard 1999). These conditions of contemporary capitalism combine with the new financial engineering and globalization to create

aggressive competition on the supply side of aggressive tax planning. This, in turn, entices demand, which ultimately becomes a contagion, when many people start thinking that almost everyone in their situation is getting into this. But as we have seen in the survey data summarized above, even as tens of thousands of taxpayers stampede into illegal schemes, attachment to the morality of tax law remains widespread. Many enter shelters with the attitude that it is a pity that we live in the kind of society in which you have to do this kind of thing if you are not to be left behind or trampled by the herd.

These conditions of moral ambivalence are precisely what make it possible for law enforcers to be effective through Harris's (forthcoming) strategy of forcing the ethically valued side of our identity to confront its ethically questionable side. A few high-profile court cases can be all it takes for 90 per cent of those who stampede into aggressive tax planning to stampede out as soon as the tax authority offers them a settlement. Their own moral ambivalence makes them fearful of the public shame associated with being targeted as one of the recalcitrants who go to court. Their search for ethical integrity motivates them to make a clean break with what was questionable in their past. Because mass participation in illegal tax schemes represents herding behaviour more than a catastrophic breakdown in tax morality (at least in Australian society), those who cheat know full well that if their cheating appears in the media, they will suffer deep community disapproval. The same fear of public scandal was prominent in the Wall Street tax interviews (J. Braithwaite 2005). For these same reasons, a tax authority that has a seemingly impossible enforcement swamping problem—thousands of new entrants into tax schemes every month—can bring this to an almost total halt with an announcement that while it does not have the resources to prosecute all who have entered the schemes, it will attack all those who do so from the date of the announcement of the crackdown.

The recent Australian crackdown on mass-marketed schemes provides further evidence of moral self-reckoning lurking in the wings when illegality is suggested. Notwithstanding their anger and resistance to the tax authority, investors taken to court for their involvement in mass-marketed schemes were desperate to assert their identity as honest taxpayers (Braithwaite *et al.* forthcoming). The Tax Office may have been hateful and unworthy of respect in their eyes, but not even the tax authority was seen to have the right to impugn a taxpayer's integrity. So why does it matter? If avoiding tax is clever, and paying tax is one step away from extortion, why do taxpayers care so much about how the Tax Office judges them? Participants in mass-marketed schemes in Australia won many financial concessions: they were generally successful in having their fines waived through political agitation, giving many of them, in effect, an interest-free loan for six years at the taxpayers' expense. One explanation for why it still matters to these investors is that, like it or not, the tax authority is an instrument of government and of the democracy. Tax enforcement is one way in which the people speak and cast their judgment on others. And it is not a good feeling to be in a position in which the people speak against us.

Conclusion

Some tax authorities have been more adept than others at responding to tax schemes and some scheme promoters have been more responsive to legal constraints than others. Both these factors work to slow down growth in the aggressive tax planning market, and

taxpayers become more cautious while tax promoters sit back to survey the regulatory landscape and wait. Eventually, the attention of the tax authority will be diverted elsewhere, and the time will be right for a new outbreak of a new generation of aggressive tax planning. In general, with each new wave of aggressive tax planning, shelters move up a notch in sophistication. One knock-on effect of this is to move much of the problem beyond the reach of the criminal law. The dominant schemes of the 1970s wave of aggressive tax planning in Australia were criminal; it is doubtful that much that would have been found criminal by Australian courts was involved in the 1990s schemes and even less in the 1990s US schemes. This simply reflects the fact that criminal law becomes obsolete particularly quickly when subjected to sophisticated technical assault. It also indicates that any enforcement strategy that is criminal alone will be effectively gamed. The damage to the moral and economic fabric of Australian society was every bit as profound in the 1990s wave as in the 1970s criminal wave of aggressive tax planning.

The paradox of the criminological perspective is that it tends to be mobilized only when an aggressive tax planning wave has become so advanced that utterly shady and incompetent promoters jump in with schemes that are so technically bad that they make criminals of their clients. As with many other types of crime, the most effective preventive techniques will be non-criminal and early in a developmental sequence. They will involve mobilizing in smart ways control theory's 'belief in the law' or reintegrative shaming theory's constitution of the shamefulness of predation upon other citizens. We have argued that restorative justice is one of the strategies with potential to repair disintegrated ethical identities.

In the increasingly marketized world of regulatory capitalism, effective prevention will also seek to regulate by flipping markets in vices like aggressive tax planning into markets in virtues like honest taxpaying. More of the history of crime is like this than we might first think. In the late-nineteenth century, a German pharmaceutical company participating in a virtuous market for curing disease synthesized heroin. In the 1950s, idealistic Western nuclear scientists promoted 'atoms for peace' in the belief that a virtuous nuclear market would produce power so clean and cheap that it would hardly be worth charging domestic consumers for the cost of their electricity. We know now that markets in vice—in recreational heroin that destroys countless young lives, in nuclear materials that might be used in terrorist dirty bombs—were lurking as potential perversions of that virtue. As markets infuse a growing share of productive activity, the criminological imperative to embrace the regulatory science of how to flip markets in vice into markets in virtue will increase.

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