Tax and democracy: Bygone ideas or time for reinvention?

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Bad days, good data - democracy and tax in crisis?

It's a wonderful time to be working on tax. Recent world events show tax to be not just about taking, but also giving. The global financial crisis and the strain it placed on the public purse underlined the message that a well-functioning tax system where everyone pays their tax is essential for a flourishing democracy. In many democracies, complacency around taxpayers has been evident. Not paying tax generally is seen as a relatively trivial offence. But not paying one's fair share is another matter, particularly when governments struggle to find the revenue to meet their commitments to voters. As inequalities grow and public grievances mount, critical eyes fall on those who are not paying their fair share, in particular, the very wealthy and large corporations. Governments have every reason to strengthen their tax and democratic systems.

Tax and democracy have a symbiotic relationship. Without democracy, tax can be arbitrary and oppressive. History has taught us that lesson, so well in fact that even non-democratic governments are wary of imposing taxes that might result in taxpayer revolts. In liberal democracies today, revolts are orchestrated through the ballot box. Between elections, defiance against unfair tax finds myriad means of expression. Fear of public reaction has stifled even sensible tax reform (Smith 2004).1

Just as tax is at its most contestable in democracies – and I would argue that overall is a good thing insofar as tax needs democracy to keep it fair and productive, it is also the case that democracy needs taxation. It is trite to say that taxation pays for government. However, with the global financial crisis came new insights into how government uses taxpayers’ money. What many citizens had not come to grips with on such a grand scale was that taxation rescues not just the “have-nots” through a social welfare budget, but also rescues the “haves” when they mismanage their income. Bailing out the banks was only possible through governments having tax revenue to draw on. Without these bail-outs, the threats to world economic stability would surely have posed a greater threat to democratic governance than we have seen for some time. Taxes have proven a safety net at both ends of the wealth spectrum. They have served to stabilise the social order and provide security economically. At the same

time, the public continue to look to government to use their taxes to provide the basics of housing, transport, health services, education, and advisory and support services. The expectations that citizens have of their democratically elected governments demand a healthy tax system.

Given that the health of democracy and the tax system are intertwined, it is a sobering historical moment to reflect on how so called mature democracies are functioning. Empirical data collected over decades show trust in democracy and its institutions continuing to fall.\(^1\) This applies not just to trust in government but to trust in the private sector as well. On the tax side, tax minimization can extend to the edges of technical legality and at times beyond, merging with tax avoidance. Such activity has become increasingly familiar to those with sufficient income. Having a financial planner is not the province of the very rich any longer, and minimizing tax through negative gearing on property, charitable donations, trusts, and superannuation are recognised as normal tax saving measures. Recognition of legitimate means of reducing tax among the ‘haves’ is likely to create a casualness about the illegitimate means used by the ‘have nots’. Cash economy activity is more than likely to receive a ‘tolerance boost’ in public perceptions: It almost seems fair to offer cash in hand payments when wealthier members of society are benefitting from carefully crafted financial advice. As the social democratic contract of governance for the benefit of all citizens breaks down, all institutions are likely to find that their authority is viewed with increasing cynicism and defiance.

If both systems – democratic governance and tax collection are under threat, how do we reverse current trends and bring to them stability and security? The answer I would argue is simple in conception, challenging in execution. Authorities need to listen and be responsive to those whom they supposedly control. Authorities need to set limits on inappropriate action (business as usual), but they also need to provide pathways to appropriate action and engage in dialogue about action desirability, with readiness to change and acknowledge shortcomings in the dialogic process. One might be forgiven for thinking that this is fundamental to any social contract based on mutual respect. So why does it not happen? The answer lies in a conception of

governance that is outmoded, along with social change that has redirected attention from looking after people to building institutions that primarily serve the interests of the privileged.

Authority does not automatically command respect and deference. Hobbesian ideas of sovereign, rule and law, which set the stage for thinking that law is the command that must be obeyed or face dire consequences, does not impact individual or group behaviour as was once assumed. Within democracies and non-democracies, people might appear to obey authority – and they might obey most times, but when aggrieved they will find ways of asserting their rights as they see them, of pushing back against the state, working around law, even sabotaging law if they can’t change it. Tax minimization schemes are such an example. So too are the games that are played around election time by politicians and their apparatchiks to conceal donations and the influence of lobbyists. Human behaviour, taxpaying being just one example, is not completely under the control of states and their laws and agents; less so when there is a groundswell of defiance and the state is unresponsive to citizen expectations and needs. Authorities need to understand and respond to citizens, seek cooperation, and not just command and expect obedience through legislative mechanisms.

Learning to listen and respond: Motivational postures

One way of approaching this challenge and changing the status quo is through teaching those in authority to read and respond to motivational postures (Braithwaite 2003, 2009). Motivational postures were empirical discoveries. Since seeing them operate at first in the context of the regulation of aged care, and subsequently in the tax compliance context, I regard them as a way of improving dialogue between the state and its citizens (Baithwaite 2009; Braithwaite, Makkai and Braithwaite 2007). My position is that if you can understand and engage with motivational postures you can influence behaviour and improve cooperation, all the while being respectful of democratic processes and individual needs.

So what are motivational postures? Motivational postures are the signals that we send to authority, be it a tax authority, a government agency, a work health and safety authority or, indeed, the workplace boss. They represent the social distance between
self and authority in two respects: (a) how much do I like this authority? (b) how much deference am I willing to show to this authority? The less positive I am, the more socially distant I am. The answers to these two questions are not necessarily the same. I might like my boss very much, but decide to follow my own judgment and defy her rules. Although liking and deference are likely to correlate, conceptually it is important to recognise the difference. There are different kinds of defiance and they need to be managed differently, as described below.

We express our answers to the above questions about liking and deference by drawing on sets of shared beliefs and common discourses that we can articulate to others. Through expressing our position we signal to ourselves, others and to authority where we stand. Motivational postures come to the fore when we sense threat. We congregate together psychologically against the source of threat, establish social distance and plan our defence. Australia’s recent Centrelink debacle when tax return data were incorrectly used to reassess welfare payments showed forces of different kinds mobilising against unfair government action. The implications for taxpayer cooperation with the tax authority in filing future tax returns remains to be seen. Past research (Ahmed and Braithwaite 2004) warns that social distancing from Centrelink may well be extended to the Australian Taxation Office. Certain taxpayers will want to “balance the books” as they use their discretion to declare income and claim deductions in the cooperatively based self-assessment system.

Defiance may be possible, but we learn from the time we come into this world that authorities can respond by hurting us. They can use their power to stop us from fulfilling our needs and wants and also punish us when we make our grievance known. From early in life, we learn ways of managing power. We develop a repertoire of motivational postures that we can use strategically to protect ourselves or further our interests in various contexts. The postures will change somewhat from context to context to be fit for purpose.

There are five postures that we find recurring regardless of who the authority is (Braithwaite 2003, 2009). The first two are postures that are friendly to the authority, we might call them accommodating postures. First is commitment, a posture that expresses support for the mission of the authority, for instance commitment to paying
one's fair share of tax and the belief that paying tax is our moral obligation that we should all share.

Second is capitulation, which means that we think the tax system works well enough and we will do what we are told to do, but really have no great interest in how it works other than to make sure we stay out of trouble. Capitulation sends the message, “Tell me what you want and I will do that.” The meaning of the act or what it signifies doesn’t matter too much.

Then we have three oppositional postures, or defiance postures. Resistance is protesting against the way an authority is using its power to oppress, while being wary of the authority’s power to victimise. Resistance has a strong focus on unfairness and is not infrequently voiced in relation to tax reforms and unreasonable or unfair crackdowns on groups in the community. Resistance responds to procedural fairness with the goal of establishing mutual respect.

Disengagement is the next defiant posture. It is distinctive in being a state of mind in which we detach ourselves from the authority structure, we are signalling that we do not like, nor will we defer to the authority. The message is “Do what you will, we do not care.” Failure to cooperate, even to the point of not paying fines or penalties, suggests a posture of disengagement.

The final posture of defiance is game playing. Whether one likes or dislikes the authority is irrelevant, the focus instead is on competing and contesting the authority’s power. The signal that is being sent is “I know how to win against you”. Sophisticated tax avoidance is one of the clearest behavioural manifestations of game playing.

The postures typically vary in strength in a predictable way in a democratic society. Commitment and capitulation tend to be strong because in a democracy there needs to be consensus around the goals of the authority even if the authority’s operational processes are flawed and criticised. Of course, operational processes are never trouble free so one might expect that resistance will be endorsed by a sizeable minority, even when the authority is performing reasonably well. On the other hand,
when a sizeable majority expresses resistance, the authority should be reflective about its performance and what it is doing to attract such criticism. Both disengagement and game playing are expressed far less commonly, primarily because relatively few are willing to openly refuse to defer to authority.

The contribution that postures make to tax administrators is that they are a red flag that warns of the complexity of people’s responses to authority. Some people will want to correct their errors without fuss. The tax administration can ease that pathway without elevating stress levels and resistance. By respecting the postures of commitment and capitulation, differences can be resolved efficiently. Some taxpayers will be enraged by what the tax authority is asking of them and will demand their say. When the posture of resistance is dominant, attention is the appropriate response. More often than not, differences can be settled with time through respectful treatment and offers of a reasonable and fair pathway forward. In other words, tax administrators can intervene constructively if they choose, saving themselves the pain of repeated non-compliance further down the track. Even so, some taxpayers will decide to never give up in their fight against taxation. The tax authority needs to fight back, fairly and with integrity.

The resource intensive fights for a tax authority are likely to occur when the least commonly expressed postures of disengagement and game playing come to the fore. They are difficult postures to handle, precisely because they are dismissive of authority. The traditional response is better enforcement, stiffer penalties and tightening up law, all of which are important, but they have been tried for decades without ever putting tax authorities in a position of being on the front foot. These measures have only met with limited success in curbing defiance. And the reality is that most commonly a negotiated position is reached in these cases, simply to contain the costs of prolonged complex legal action. Whatever the situation, tax authorities have found it difficult to stop tax avoidance. And while they have found it difficult to manage the ‘top end of town’, the lower end have become disenchanted by being the low hanging fruit that tax authorities can crack down on more easily and successfully.

Tax authorities, to their credit, have responded by broadening their repertoire, recognising that many taxpayers are prepared to be cooperative if they are given a
chance (Braithwaite 2003, 2009). They have in effect recognised postures of commitment and capitulation in the taxpaying population and that taxpayers can behave with ignorance and carelessness. As a result, a more proactive approach has been adopted in many countries around the provision of service as articulated in Taxpayers’ Charters, provisions to reduce tax burden and making compliance easier. On the front line, however, it has not been so easy to reconcile a traditional enforcement message with a modern service message (Widihartanto and Braithwaite 2016). Sanctioning and helping seem contradictory rather than complementary regulatory processes. Postures help in this regard. An example: If I have broken the tax law I might be angry at being caught and fined. I might show resistance. But if the tax auditor listens to me, she might detect a degree of shame and belief in doing the right thing. She might tell me exactly how to make things right, make it easy for me to do so, and express confidence that I will do the right thing in future. All being well, my anger will dissipate, I will reflect on what I have done (as opposed to perseverate on being unfairly treated and increase my rage), and decide that I will pay my tax in future. I may stray again, but at least I have good intent. And most importantly, my resistance has not been fuelled to the point where I slide into disengagement and game playing. Fair enforcement and good interpersonal skills combine to build taxpayer cooperation as well as public perceptions of the integrity of the tax authority. They deal with taxpayers with respect and reasonableness.

On the front line, the coexistence of enforcement and service is best taught through story telling about cases and the posturing observed. The world is not full of good apples and bad apples. We are all a mixture of good and bad and authorities do their jobs more effectively when they appeal to our better selves, our postures of commitment and capitulation (Braithwaite 2009). This is the change that is required at the interface where authorities enter private lives. We know this approach works from our research with street level bureaucrats, who engage face-to-face with those being regulated. But what of those up the hierarchy, who are setting broader level agendas? How may they take the insights from postures into the pathways they carve for policies and programs? A broader framework is needed to bring about this change of mindset and integrate old with new governance principles.
The Wheel of Social Alignments

Like front line staff, senior managers need to understand public needs and expectations so that they can design and implement policy that will not meet with high levels of resistance and will not increase the prevalence of disengagement and game playing. They also need to appreciate their role in safeguarding the legitimacy of their authority. The Wheel of Social Alignments is a schematic device designed to help senior managers integrate what are often separate, if not competing, parts of tax administration. The Wheel captures traditional ideas about administrating tax systems, as well as new ideas about how authorities need to reach out to their constituents and convince them of their legitimacy and integrity. The Wheel also brings to centre stage the role of alternative authorities in shaping taxpayer behaviour, sometimes making the tax authority’s job easier, sometimes harder.

The Wheel of Social Alignments grew out of a review of the tax compliance literature (Braithwaite and Wenzel 2008). We observed that predictors of tax compliance, as well as theoretical explanations of tax compliance, could be grouped around five broad themes. These themes appear in the diagram of the Wheel below.
Figure 1: The Wheel of Social Alignments for Taxpayer Cooperation and Compliance (Braithwaite 2009b)

The rim of the Wheel brings together what we generally refer to as tax technical parameters, including the law, legal interpretation, rulings, Taxpayers’ Charter, auditing procedures and protocols, designs for filing tax returns, and penalty regimes. It also includes policy directives from government and information for taxpayers. The rim of the Wheel represents the legal and administrative heartland of taxation. The rim of the Wheel frames what can be done to encourage cooperation and compliance. Changing these parameters can affect cooperation and compliance.

The inner circle of the Wheel labelled ‘the other’ represents alternative authorities, alternative sources of power that shape how we interpret our tax obligations as defined by the tax authority. The most visible alternative authority in taxation are the professional groups of lawyers and accountants who offer tax advise and prepare and file tax returns for the clients. They may interpret tax law and tax
rulings so that they are in tune with tax authorities (particularly likely when the law is clear), or they may challenge tax authorities, usually through taking advantage of ambiguities.

While tax practitioners are the most obvious ‘other’ authority, they are not the only contenders for a place in the inner circle. Lobby groups, media commentators, financial advisors, international tax advisory groups and high status celebrities who make pronouncements on tax (for example, the late Kerry Packer, Warren Buffett) form part of this inner circle of ‘others’ with power to serve as an alternative authority, sometimes supporting the tax system, sometimes undermining it. In a globalised world, ‘the other’ is a crowded space. What happens here can weaken state control and foment defiance.

The band that is segmented into three parts in the middle of the Wheel diagram represents taxpayers, be they individuals or businesses. Tax compliance research repeatedly has brought the focus back to three broad conceptual categories of psychological perceptions involving benefits, justice and moral obligation. Those who complied or were prepared to cooperate with tax authorities believed they and others had a moral obligation to pay tax, they believed that the system was distributively, retributively and procedurally fair, and they could see benefits to groups that they cared about, which may or may not include themselves. This led to identifying these concepts as the key talking and action points for authorities if they wished to win support from the population around how they exercised their responsibility to pay tax.

Moving forwards: Eliciting compliance with the Wheel of Social Alignments

So how does the Wheel of Social Alignments work? How does the dynamic come into play which can send us spiralling down into dysfunctionality or help us build credibility and legitimacy for the tax system and the democracy bit by bit? If law, administration and enforcement is basically sound, those involved in tax policy and collection should be willing and able to listen, discuss and debate the relative merits of what is being asked of taxpayers during periods of tax reform or at other times when non-compliance appears to be on the rise. Issues of fairness can be considered and changes to the system may result. Clarity can be gleaned around benefits, who benefits
and why and who is being harmed. Through the process of giving time and listening to taxpayers, it is also possible to communicate appreciation to taxpayers who show moral obligation and cooperate in taxpaying. If all of this is proceeding well, the Wheel will move forward. Yes, we will encounter non-compliance and hit snags, but the majority will understand and will feel they have had a fair hearing and will go along with the authority. Tax systems function best when they avoid mass protests and high levels of non-compliance (for an example of such problems see Murphy 2005). An enforcement swamping problem through being overloaded with non-compliant cases harms tax authorities and their legitimacy.

Respectful engagement of taxpayers is at the heart of the dialogue that brings forward momentum. Administering the tax system through the Wheel of Social Alignments means that the moral majority will be supportive of the system and will be willing to tolerate rough patches on the road. Pulling levers of deterrence, service or clever design cannot provide this moral majority unless efforts have been made to impress upon taxpayers the context of respectful taxpayer engagement.

It is worth noting here that if an alternative authority from the ‘other’ circle seizes the moral high ground and does battle with the tax authority, the good work of the tax authority on benefits, fairness and moral obligation can be seriously undermined. To have any substantial effect on a mass of taxpayers, however, the ‘other’ has to be well organized and credible. When we see upswings in aggressive tax planning and particular types of schemes being marketed we are seeing a sophisticated ‘other’ authority making a pitch to taxpayers in the middle circle who may want to reduce their tax.

That desire to reduce tax is, in part, attributed to failure to see benefits, failure to see fairness in the system and failure to feel any moral obligation to pay tax. We can link these mental states to motivational postures of resistance, disengagement and game playing (Braithwaite 2009). A very important part of any tax administration’s brief, therefore, is to routinely engage in benefit, justice and moral obligation conversations, review commentaries and make sure the tax system is satisfying all three criteria for the vast majority of taxpayers. In motivational posture terms, tax administrators have the job of bringing to the fore postures of commitment and
capitulation and putting the postures of resistance, disengagement and game playing on the back burner.

This same responsibility for monitoring benefits, justice and moral obligation through reading and discussing postures is essential in other regulatory domains as well, including among those with responsibility for safeguarding the democracy. Authority has no substance if it cannot convince people that power is being used to provide benefits to the society, acts with justice and integrity, and shows appreciation to those who defer and ‘do the right thing’. The big jolts to political expectations from democratic processes, as seen most recently in Brexit and the US election campaign, can be viewed through the lens provided by the Wheel of Social Alignments. When mainstream political actors become careless with resistance, fail to discuss benefits and justice with communities, and take moral obligation for granted, alternative authorities will see opportunity to exert influence and harness public support for an alternative agenda.

**Sliding backwards: ‘deregulation’, globalisation and the outsourcing of moral tax authority**

The measures that can be taken to change culture and promote respectful high integrity conversations with taxpayers and electors are represented through motivational posturing and the Wheel of Social Alignments. What has not been yet addressed is why has this been so difficult for public servants and politicians to do?

Two sources of social disruption for government have been globalization and regulatory capitalism. Globalisation has meant that governments are often responding to overseas events that are not of interest domestically. Governments themselves may not understand fully the implications of these events or how they should respond to protect their citizens. For this reason, open conversations can be difficult.

Regulatory capitalism refers to something that government has fostered deliberately, arguably without realising that they were unleashing alternative regulators who could end up competing with government for influence. With the deregulation movement, starting with Margaret Thatcher in the UK and Ronald Reagan
in the United States, has come an explosion in regulatory activity beyond the state (Levi-Faur 2005). Those who took on rowing while the state steered needed their own regulatory structures. Professional codes of conduct, accreditation boards, international standard setting bodies, and insurance requirements are among the plethora of regulatory controls that have been put into play beyond the state. These regulatory requirements are not necessarily consistent with each other, but each commands networks of support and influence, including influence over government. For tax administrations, OECD-led reforms on disclosure around Base Erosion Profit Shifting (BEPS) require a serious investment of resources that have to be pulled from other areas of activity. So while an argument can be made that governments and revenue authorities should both be talking more to the public and listening to their concerns, the reality is that they are too busy dealing with all of these new external pressures that are changing the way in which they do business and that demand priority status. Ordinary citizens have fallen by the wayside as pawns on a chess table.

**Looking to possible standard raisers and flagbearers: the role of tax practitioners**

This raises the important question of who is going to do the talking about benefits, justice and moral obligation and convey the message that adjustments are needed if the Wheel is to continue rolling forward? One answer is politicians. Another answer is all of us. Barak Obama expressed this sentiment in his farewell presidential speech: “Change only happens when ordinary people get involved, get engaged, and come together to demand it.” One target for change identified by Obama was “the task of rebuilding our democratic institutions.”

But realistically, a goodly part of the knowledge that is needed to rebuild or reform an institution is specialised. At the very least reliable sources are required to correct misinformation when reforms are planned. Within the field of taxation, the most likely sources of information and leadership on discussions of benefits, justice

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and moral obligation are tax practitioners. Their capacity to play that role, however, is tempered by where they sit in the market of tax advice.

Elea Wurth (2013) conducted a survey of over 1,000 Australian tax practitioners in which she asked them how confident they were that the claims they made on behalf of their clients were compliant and not exploitative of tax law. The findings of a cluster analysis of tax practitioner responses were represented as a teardrop model of tax practitioner compliance (See Figure 2).

![Figure 2: The teardrop of tax practitioner compliance with the revenue authority’s expectations (Wurth 2013)](image)

At the bottom of the teardrop are duteous, ultra cautious tax practitioners. They sought clarification and did not allow their clients to go down the path of playing with ambiguity.

At the top of the teardrop were the aggressive practitioners. A small extreme group of practitioners labelled outliers appeared disconnected from what the tax authority expected and asked for. The large group of aggressive tax practitioners were particularly ready to exploit less visible items on the income tax schedule, that is, those
items where third party reports were not available. They were ready to take their
chances with ambiguity across all items on the tax schedule.

In the middle were the largest group called the contingent practitioners. They
were watching for signals from the tax authority, clients, markets, professional
associations and colleagues. They would stay on the right side of the law and its
interpretations, advising their clients against taking unnecessary risks and only
exploiting ambiguities when they considered it was safe to do so.

These findings suggest that tax practitioners who are known to have close and
lasting relationships with their clients are probably highly valuable intermediaries for
tax authorities wanting to be more responsive to taxpayer needs. The largest group
have a vested interest in knowing what is going on and are likely to carry the
knowledge and experience both of clients and the tax authority. That said, tax
practitioners, while fewer in number than taxpayers, are still going to use the full array
of motivational postures discussed previously. Importantly, they are not going to be
necessarily subservient to how the tax authority thinks and acts.

Tax practitioners and their taxpayer clients form a close dyad defined by trust and
interdependence. Taxpayers find in the market the tax practitioner who suits their
needs (J. Braithwaite 2005). Tax practitioners are listening to many voices, there are
many 'other' authorities influencing and shaping their behaviour. Figure 3 represents
just some of those significant 'others' that have been discussed in the literature:
promoters operating in aggressive tax markets as well as their professionally
conservative peers, revenue authorities and the cases they are taking to court, the Big 4
accounting firms (KPMG, Ernst & Young, PriceWaterhouseCoopers and Deloitte) that
can set benchmarks for the profession and draw away clients through the services and
specialties they offer, and the policies of government, including overseas tax
agreements, that may change the visibility of certain financial transactions. Through
unpacking the influences on the tax practitioner-taxpayer dyad, it becomes apparent
that while their insights are invaluable to a tax authority, they are also going to have
deficiencies. That said, the views of tax officials and tax practitioners may be deficient
in different ways so that together they can complement each other and lead to better
communication between tax authorities and the public.
There is no easy, simple answer to institutionalizing superior dialogue between tax authorities and taxpayers around the benefits, justice and moral obligation of taxpaying, what this means for the quality of our democracy, and what the quality of our democracy means for the reasonableness, fairness and integrity of the tax system. Maybe the best we can hope for at this stage is taking the first step. And that is having government authorities recognise that people are complex, strategic and essentially social actors who expect the democratic social contract to be honoured by those whom they elect to parliament and by the larger group of government officers whose salaries they pay.
References


Why is regulation associated with domination? Why do people see regulation as a cost or burden? Why isn’t regulation something that we want to understand and value, seeing it as useful social scaffolding for improving quality of life? The broad aim of this project is to assemble empirical evidence to explain why we often waver in our trust and confidence in regulatory systems and to consider what is needed to improve regulatory effectiveness and to establish respectful relations with communities. We are examining the relationships that regulators have with regulatory communities in eight domains: higher education, work safety, child protection, taxation, environmental protection, charitable organizations, employment equity, and financial planning), comparing the regimes in terms of how disconnected they have become from communities, and exploring how we might engage in conversations to reconnect them with the people they serve.

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