Should the Taxman be Responsive?
The Responsive Regulatory Model of Tax Compliance

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Abstract:
Why do people obey the law? This is a baffling question and poses a challenge to determine an appropriate answer. Compliance behaviour remains a mysterious trait of human character, particularly given that defiance and disobedience appear to be innate in humans. More particularly, why taxpayers comply and why not is subject to research. Various theories and models have been propounded by the researchers in an attempt to explain taxpayers’ compliance behaviour. The present paper suggests that the responsive regulatory (the ATO model) can be adopted by Bangladesh income tax administration to ensure taxpayers’ voluntary compliance.

Keywords: Tax, Voluntary Compliance, Responsive Regulatory Theory, Australian Taxation Office.
I: Introduction

Why do people obey the law? This is a puzzling question and it is a challenge to determine an appropriate answer. Compliance behaviour remains a mysterious trait of human character; particularly given that defiance and disobedience appear to be innate in humans. More particularly, why taxpayers comply and why not is subject to research. Various theories and models have been propounded by the researchers in an attempt to explain taxpayers’ compliance behaviour. As with research on compliance behaviour regarding general law, tax compliance has also been studied elaborately.1 The schools of thought researching tax compliance are divided into two groups. The first emphasises the theory of crime and punishment, which posits that taxpayers decide to comply or not comply based on the probability of being caught and the benefit achieved through noncompliance. This is popularly known as the ‘economic deterrence theory’ of tax compliance. The second school is based on theories of psychology and sociology that explain the varying levels of taxpayer compliance. There are some theoretical models that try to explain taxpayers’ compliance behaviour. For example the responsive regulatory model of tax compliance, the slippery slope model and OECD Compliance Risk Management Model.

The purpose of this article is to critically analyse the responsive regulatory model of tax compliance. The paper suggests that the responsive regulatory model is currently the best approach to deal with taxpayers’ non-compliance. Countries like Australia, East Timor and other countries have adopted this model in their tax administrations to tackle the problem of tax non-compliance. The model can be introduced in Bangladesh to deal with the problem of tax compliance in the income tax department of Bangladesh. Part II of the paper refers to some of the important research done so far in the field. Part III critically discusses the responsive regulation model of tax compliance which is known as the ATO model of tax compliance. Part IV gives a concluding remarks with the proposal that responsive regulatory model should be introduced in the direct tax administration of Bangladesh.

II: Literature Review

Based on the neoclassical theory of crime and punishment proffered by Becker in 1968,2 Allingham and Sandmo3 state that tax noncompliance is a rational decision taken by defiant taxpayers who weigh profit and gain against punishment in the event of being caught, and successful escape from detection. Consequently, a rational taxpayer attempts to evade or avoid tax if the gain outweighs the probable punishment for this law-defying, undesired demeanour. A number of researchers find support for this theory, including Srinivasan;4 Kolm;5 Yitzhaki;6 Spicer and Becker;7 Clotfelter;8 Beck and Jung;9 Klepper and Nagin;10 Beck, Davis and Jung;11 and Hasseldine and Bebbington.12

Although there are theoretical arguments and empirical evidence that deterrence works, the economic deterrent theory has its limitations. First, Skinner and Slemrod observe that this model ignores the number of honest taxpayers.13 Second, Sheffrin and Triest argue that the theory fails to provide strong predictions about the socioeconomic determinants of tax evasion.14 Third, Weigel, HESSING and ELLERS state that the absence of a motivational concept remains one of the weaknesses of the economic deterrence model.15
Finally, Lederman argues that, although the economic model of tax compliance is important in expounding some variables of the tax compliance behaviour of taxpayers, it cannot explain all tax compliance issues that encompass income from all sources. This is somewhat true that some taxpayers base their compliance on the probability of being caught and the cost of punishment, it seems that not all patterns of tax compliance behaviour can be explicated by this deterrent theory. There are taxpayers who pay tax considering that as their duty without preference to profit and loss from tax evasion. The following theories try to explain tax compliance behaviour from perspective other than deterrent theory.

The social and psychological theories of tax compliance view compliance from a social and psychological perspective, rather than an economic perspective. According to Lederman, research on taxpayers’ behaviour reveals that taxpayers’ compliance occurs in response to a norm. According to Wenzel, perceived social norms about tax compliance affect taxpayers’ compliance decisions, and misperceptions about the social norm of compliance might generate a detrimental effect on taxpayers’ behaviour. Scholz argues that there is a contract between taxpayers and the state. Taxpayers contribute to the government treasury, and the government provides benefits and services to the people. This is the tax contractarian theory of tax compliance. Feld and Frey extend the contractual obligation to what they call the ‘psychological contract’. Some of the offshoots of social and psychological theories are the shame and guilt theory, procedural fairness model, motivational posture model, organisational culture model, social identity theory, positive incentive theory, prospect theory and religious theory. Alm, Sanchez and Juan use an experimental method to determine the major economic and non-economic factors that influence tax compliance behaviour. While acknowledging that reliable data on individual income tax compliance cannot be easily procured, they report strong evidence that both economic and non-economic factors play a vital role in shaping compliance behaviour. Factors such as detection and punishment, the burden of taxation, public good provision, overweighting of low probabilities, and social norms influence compliance decisions. However, the authors acknowledge that these identified factors do not form an exhaustive list of the influences outside the laboratory. Many other factors may play an important role in compliance behaviour, such as religion, morality and guilt. Alm, Sanchez and Juan conclude by suggesting that governments create a multifaceted compliance strategy that embraces both economic and non-economic factors, including detection, punishment and social and psychological considerations.

III: Responsive Regulation Model

The responsive regulation model of tax compliance presents a framework of tax compliance in the tax administration. This model is also known as the ‘ATO model’ because the ATO adopted this framework in 1998 to ensure voluntary compliance in Australia. This model is also used by tax jurisdictions in the UK, New Zealand, East Timor, Indonesia and Pennsylvania. Before switching to the responsive regulation model of tax compliance, the ATO followed a long-established, traditional style of command-and-control administration and tax enforcement. As a result, the ATO was considered unfair, lacking in integrity and out of touch with commercial reality. A lack of community tolerance had developed for the blanket approach to enforcement that was harsh, inflexible and bullying. Thus, change was inevitable under this critical juncture.
Against this backdrop, the ATO began to explore responsive regulation as a possible alternative to the old approach to tax compliance.

The concept of responsive regulation was first presented by Ayers and Braithwaite in 1992. Responsive regulation is an interdisciplinary approach that originated from the discipline of psychology. Compliance is generally a problem for tax administration around the world. According to Braithwaite, responsive regulation is effective when compliance is not easy, automatic or straightforward. The responsive regulation model was based on the idea that the government should choose when to intervene and when not to intervene by adopting a philosophy of responsiveness to ‘industry structure’, ‘the differing motivations of regulated actors’ and ‘industry conduct’. Before escalating punishment, dialogue is employed by regulators. Typically, responsive regulation seeks to maintain a balance between persuasion, friendliness and providing assistance to taxpayers, with an interventionist approach that emphasises punishment or a command-and-control approach. The responsive regulation model seeks to build a moral commitment to comply with the law.

This model posits that if taxpayers make mistakes through ignorance or poor financial planning and are prepared to come forward and acknowledge their mistakes, they should be helped. If they are prepared to be cooperative when anomalies are identified, they should be assisted to correct the issues and move on. Persistent and consistent attention should focus on the difficult cases and the ‘big fish’, not the ‘low hanging fruit’. The initial goals of the compliance model were to:
1. understand taxpayer behaviour
2. build a cooperative relationship with the community
3. encourage and support compliance
4. introduce a range of sanctions that escalate in severity and are known to taxpayers so that difficulties can be settled before the costs became too great for both parties
5. reduce the time-consuming handling of complaints about procedural injustice
6. implement the Taxpayers’ Charter.

This model is graphically represented in the form of a regulatory triangle and accompanying circle of influencing factors. The pictorial representation of this model is shown in Figure 4.2.

Figure 4.2: Responsive Regulation Model

Figure 4.3: The Australian Compliance Pyramid

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29 Taxation is not the only field where responsive regulation theory is applied—before it was imported to the taxation arena, the theory was applied in the health and environment sectors. Charlotte Wood et al, ‘Application of Responsive Regulation in Australia and Overseas’ (Occasional Paper No 15, The Australian National University 2010) <http://ctsi.anu.edu.au/publications/index.html>.
31 Ian Ayres and John Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (Oxford University Press, 1992).
At the very base of the enforcement pyramid are the willing and compliant taxpayers who need support from the authority to comply. These taxpayers form the majority.35 The second group up needs more help or persuasion to comply. The third group up are the resistant people, who tend to avoid complying and need to be detected. The taxpayers at the top of the pyramid are those engaged in tax evasion, who show disrespect to the tax authority. They cannot be persuaded or coaxed to comply, and the ATO compliance model suggests that the full force of the law should be used against them to make them compliant.

The model considers the basic economic model, while also recognising other factors, such as the way that society, morality and ethics affect taxpayer behaviour, and particularly the manner in which the taxpayer–tax administration relationship affects compliance.36 The most important contribution of the responsive regulation theory is that it enhances understandings of regulatory enforcement and its effect on compliance, recognising that different people have different motivations for complying or not complying with the law, and that the same person or firm can have multiple, potentially conflicting motivations for compliance.37 By following this model, the ATO attempts to establish a cooperative and friendly relationship with taxpayers, while also using deterrence when necessary.38

The ATO model is being replicated by other tax jurisdictions, such as the UK, Canada, New Zealand, East Timor and others.39 However, it faces several criticisms. Haines contends that enhancing sanctions in response to serial noncompliance might help regulatory authorities shape enforcement policy, but also shapes the behaviour of regulated firms.40 The escalation of enforcement measures and serious action against a firm might aggravate the relationship between the regulators and regulated, and create distrust of regulators. Gunnigham, Grabosky and Sinclair argue that responsive regulation is not compatible with the rule of law, and has inherent constitutional problems that create judicial and doctrinal challenges.41 It is difficult to apply to corporate taxpayers, encourages tax corruption and creates disequilibrium in treatments.33 Due to the constitutional and political sensitivity of tax collection and the complexity and relative indeterminacy of tax legislation, it is difficult to apply the responsive regulation model to tax.44 Baldwin and Black present criticisms that mounting up through the enforcement pyramid might not always appear appropriate because of serious fractions of regulations and the adversarial relationship between the regulators and the regulated make it difficult to glide through the pyramid.45

The success of responsive regulation depends on a number of factors, including the agency’s resources, size of the regulated population and types of standard imposed.46 In a developing country such as Bangladesh, the bureaucracy is not free from political interference.47 Actions may not be taken or less action may be taken against one person, while stern action may be taken against others due to media and political pressure.48

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38 Levine, above n 36, 386.
39 Fiona Haines, Corporate Regulation: Beyond Punish or Persuade (Clarendon Press, 1997).
48 Baldwin and Black, above n 45, 9.
In addition, the model is thought to cause regulatory capture, which leads to situations of exploitation by the authority for private gains. Evidence of such capture has already been found by the progenitors of the model.

The model is also criticised because it was crafted for a developed country to address the regulatory debate in such countries, rather than in developing countries. To solve this problem, third-party participation and qui tam provision are suggested. Another major weakness of the model is that it encourages corruption due to the frequent interaction between the regulators and regulated, where tax officials might develop a desire to please those who they are supposed to be regulating, as Grbich notes. This can be dangerous for developing countries such as Bangladesh. Heimer argues that corrupted regulatory systems can sometimes masquerade as being responsive systems.

Ayres and Braithwaite suggest republican tripartism to solve the problem of corruption; however, Scholz, Khademian, and Burton criticise republican tripartism on various grounds. Besides, the confidential nature of tax matters always indicates bipartite negotiation. Since the responsive regulatory model considers law as determinate, the indeterminacy of taxation law remains the ‘Achilles’ heel’ of the model. Picciotto and Freedman agree that income tax law is indeterminate. Thus, the model suffers from a constitutional shortcoming because it ignores the constitutional values of proportionality and consistency, which are ingrained in the right to equal and fair treatment. Yeung states that the model prefers administrative settlements to judicial settlements, and this might stop the regulatory pyramid halfway because it is less coercive and persuasive. It is argued that the responsive regulation theory has a narrow strait of operation decreasing compliance.

IV: Conclusion

This paper has critically discussed some of the existing tax compliance theories with special emphasis on the responsive regulatory theory. It has observed that no one theory or model is sufficient to provide a comprehensive solution to the problem of tax noncompliance in its totality. However, it is argued that the responsive regulatory theory adopted by the ATO is currently the best option to manage this problem. Therefore, the ATO compliance model is suggested for Bangladesh as a pragmatic and future tax compliance model. However, since the model has a developed country approach, it is pertinent to consider whether it would work in a...
developing country, such as Bangladesh. The major obstacles to implementing the model were identified in as organisational barriers and resistance, lack of political commitment, and corruption in the tax administration. However, despite its shortcomings, this model offers the best solution to the problem of tax noncompliance the successful use of this model in different countries highlights its effectiveness. Thus, Bangladesh should implement this model in its income tax administration.

Bibliography


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