Meta Risk Management and Responsive Regulation for Tax System Integrity*

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Risk society and reflexivity as themes in contemporary sociology are brought together in a concrete way in the concept of meta risk management. Two case studies of the risk management of corporate risk management systems by the Australian Taxation Office are used to argue that meta risk management can be a cost-effective and responsive regulatory strategy, at least in the context of a complex risk environment such as business taxation. Meta risk management is a promising strategy when risks are volatile and difficult for the regulator to comprehend when the risks are effectively under the control of an organization over which the regulator has leverage.

I. THE RISK PARADIGM IN COMPLIANCE ADMINISTRATION

By meta risk management I mean the risk management of risk management. Drawing together a number of long-standing themes in the regulation literature with more recent writing on neoliberal governmentality, Peter Grabosky (1995) developed the theme of meta regulation, which he called “meta-monitoring” – government monitoring of self-monitoring. He further elaborated on these ideas with Neil Gunningham and Darren Sinclair (1998) in Smart Regulation: Designing Environmental Policy. The most sustained development of this approach is in Christine Parker’s (2002) The Open Corporation: Self-Regulation and Democracy. The penultimate chapter of that book is entitled “Meta-Regulation: The Regulation of Self-Regulation.” Parker jointly explores notions of meta-regulation and meta-evaluation, that is the evaluation of corporations’s self-evaluations of their compliance systems. A somewhat different version of meta regulation of the regulatory activities of one part of the state by another is found in Morgan (2002). In this article, I seek to

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give these ideas more of a risk-management orientation and one specifically attuned to tax administration.

According to Ulrich Beck’s (1992) influential book, *Risk Society: Towards a New Modernity*, societies have become more reflexive about risk. Tax authority risk management systems can be seen as an example of tax administration reflexively remaking tax administration in a risk paradigm. To date, however, tax office risk management systems have been rather conventional cases of regulatory organizations becoming more analytical about the risks the organization must confront. A further step toward a reflexive risk paradigm is for a tax office to monitor and seek to remake the risk management systems of the organizations it regulates. This is a move from a tax office developing its own risk management system to influencing the risk management systems of other important organizations in its risk environment.

II. THE DEVELOPING PRACTICE OF META RISK MANAGEMENT

One of the earliest shifts of this kind was with nuclear safety regulation after the Three Mile Island near-meltdown in 1979 (Rees 1994). One cause of the accident was that nuclear power plant operators had become rule-following automatons rather than strategic thinkers about risk management systems. When something went wrong that was not covered by a rule, operators lacked the systemic wisdom – the risk analysis intelligence – to think systemically about what needed to be done. As a result, the nuclear regulation paradigm has changed to being less about government inspectors checking compliance with rules. An important part of the new paradigm became regulatory scrutiny of risk management systems and reintegrative shaming, within the nuclear professional community, of companies that failed to improve those systems. Within a decade safety-related automatic shut-downs of nuclear plants (SCRAMS) fell from seven per unit, per year to an average less than one per year in the U.S. and then in the next decade fell to 0.1 per year (Braithwaite & Drahos 2000:302).

Another important shift of this type occurred following the Piper Alpha disaster when one hundred sixty five lost their lives in 1988 on a North Sea offshore oil rig. Following the recommendations of Lord Cullen’s Inquiry on the disaster, regulation of offshore oil and gas production worldwide became based on the rig operator developing a “safety case” (a safety management system) that it submitted to the regulator for analysis and approval (Great Britain. Department of Energy 1990). Instead of government inspectors directly enforcing rules, they moved to checking that the operator was both self-enforcing its safety management system and continuously improving it. Beck (1992:232) discusses this kind of feature of Risk Society as “externally monitored self-coordination.”

The most recent debate about this regulatory paradigm shift occurred after the Asian financial “meltdown” of 1997–98. The twentieth century approach to assuring that banks did not collapse was to insist that banks had a certain
ratio of loans to gold in its vaults – enough capital to withstand a run on the bank and nonrepayment of loans. Over time, the required capital ratios became more complex. Bonds of an OECD government counted for more than bonds in a private company. But, in a crisis these capital adequacy ratios did not always make sense. For example, in the midst of the Asian meltdown, were General Electric or Microsoft bonds really less secure than bonds with the South Korean government (an OECD member)? Many experts began to believe it would be better to require banks to disclose to national and international regulators their risk management systems and their risk assessments of their portfolio of reserves according to those systems. Moreover, they should test these systems by seeking proof that they could cope with major shocks. For example, the regulator might ask: “Run your risk-management software and show me what will happen if there is a 40 percent fall in the value of the yen at midnight tonight.” While the complexity and volatility of financial risk in a world of derivatives and rapidly fluctuating currency markets would seem to make this regulatory paradigm shift vital, in practice regulators are finding it difficult to design a reflexive system for evaluating the assessment of financial risk that will work with both sophisticated global banks and banks with lesser risk analysis capabilities. Nevertheless, there seems little doubt that this is the direction prudential regulation will move (Mayes 2001).

Globalization and the new financial engineering of purpose-built financial products renders risk to tax authorities more complex and volatile (Tanzi 2001). Yet I think it is also true that new information technologies make possible more sophisticated monitoring of such risks than have been possible in the past. It follows that a shift is needed in tax compliance strategy to risk analysis of the risk management systems of taxpayers and tax agents.

Hence, my objective in this article is to help understand how a tax authority can move from an organization with a comparatively sophisticated approach to shaping its own risk management system to an organization which is also sophisticated in shaping the risk management systems of other organizations in the taxpaying environment. As a first step toward achieving this objective, we set out to discover where a shift to meta risk management is already occurring in the Australian Taxation Office (ATO). By publicizing such shifts and interpreting them as meta risk management, we can help others to grasp the possibilities of the paradigm shift. We will do this by describing two innovative ATO projects as instances of meta risk management: first, the Registered Software Project and, second, the Transfer Pricing Record Review and Improvement Project.

III. THE REGISTERED SOFTWARE PROJECT

Business tax returns, and many individual returns, are based on computations undertaken by accounting software. Such software can be designed to minimize error, make anomalies visible, and assure the correct computation of tax
liability. The idea of the Registered Software Project is to develop specifications that software would have to meet to be registered by the ATO as approved for calculating tax obligations such as Goods and Services Tax, capital gains tax, and so on through the range of types of taxation. Not only is it hoped that this will directly improve compliance and reduce its cost, it is also hoped it will reduce the cost of auditing compliance. When a software product is registered, ATO auditors will only have to check inputs and outcomes from the program (assuming that the computer has got all other stages right between input and outcome and that all transactions were input in the first instance).

The ATO has put these specifications on to a website (see www.ato.gov.au/rsf) together with a number of test scenarios that provide detailed financial data on real-world tax situations. The website won first place in the Australian Interactive Multimedia Industry Association’s Internet Best Practice Award for 2000. By early 2001, 170 software products were registered on the site. To get registration, the software manufacturer must run the required test scenarios through their software. If they come up with the same answers as the ATO and otherwise meet the specifications, they certify themselves as meeting the registration requirements. They then post their self-certification to the ATO website. After a twenty-four hour delay that gives an opportunity for the ATO to check or question the self-certification, the software product is registered as ATO-approved for this or that kind of tax, or for several on a matrix of approved taxes.

While the ATO will occasionally check that false self-registrations are not being made, the scheme is largely self-enforcing. That is, competitors “dob in” (squeal on) software manufacturers who claim that their product meets the specifications and therefore gets the right answers on the test scenarios when, in fact, it does not. Effective sanctions are available to the ATO for non-compliance with the self-registration arrangements. Software manufacturers would lose business if they replaced an “approved” entry on the website with an “under review” entry. Emblazoning “approval suspended” or “approval revoked” across a posting to the website could do serious damage to the confidence of accounting firms in not only that product, but in the manufacturer.

The Registered Software Project satisfies the four key components of the ATO Compliance Model (Braithwaite & Braithwaite 2001): understanding taxpayer behavior, building community partnerships, increasing flexibility in ATO operations to encourage and support compliance and more and escalating regulatory options to enforce compliance.

1. Understanding Taxpayer Behavior

The registered software strategy is based on the three following observations: first, most small business and all large business taxpayers use software to calculate their various tax liabilities; second, over 90 percent of businesses choose that software on the advice of their accountants or tax preparer; and third, accountants and tax preparers desire some quality assurance for software products.
2. Building Community Partnerships

The strategy was developed collaboratively with the Australian Information Industry Association and was initially floated by the commissioner in a meeting with tax advisers, who responded warmly to the idea. Brainstorming meetings with software experts are under way to see if they can come up with ideas for designing specifications so that financial manipulations to avoid tax liabilities become more visible, and so that what once might have been concealed becomes transparent, so that transactions are channeled in to playing the accounting game with a straight bat.

3. Increasing Flexibility in ATO Operations to Encourage and Support Compliance

This meta risk management approach is more flexible than ATO production of approved software. Self-registration with periodic checks is more flexible than the British approach of government accreditation of software products.

4. More and Escalating Regulatory Options to Enforce Compliance

No software manufacturer is forced to participate in the registration scheme. So, at the base of the regulatory pyramid is a free market of highly informed accountants and advisers who know how to check the registration website and are likely to desert unregistered products. Next there is escalation to an “under review,” “approval suspended,” and “approval revoked” entry on the website. Followed by the fear of private tort litigation against software manufacturers who misrepresent the facts about their registration. This risk is signaled by an ATO disclaimer on the website that the manufacturer who posts the registration to the website is responsible for the veracity of the claims made about the software. At the peak of the enforcement pyramid is criminal prosecution for fraud.

In sum, accounting software is designed to manage business risks. The Registered Software Project sets up a form of self-enforced self-regulation of that risk management to ensure it meets ATO standards. At a distance, indirectly, and at low cost, the Tax Office risk manages the risk management of accounting software. Hence the Registered Software Project is an example of meta risk management.

IV. THE TRANSFER PRICING RECORD REVIEW AND IMPROVEMENT PROJECT

More than half of world trade is between subsidiaries of the same multinational enterprise group. This increases opportunities for shifting profits from one part of the group to another. Transfer pricing arises, for example, when a subsidiary of a multinational company in country A sells something to another in country B. If country A has high taxes and B low taxes, then it is rational to sell at a low price from the A to the B subsidiary. This means that
less profit will be recorded in country A (which has high taxes) and more profit will be made in country B (which will tax it less). The global profitability of the multinational company will thereby be increased at the expense of country A. A recent study estimated that transfer pricing accounted for $45 billion in U.S. taxes avoided by multinational corporations (Godfrey 2001). Examples of artificially high transfer prices revealed by the research were $5,655 per toothbrush, $5,000 for a flashlight and $2,306 for a hypodermic syringe. Instances of underpriced goods were $1.58 for a ton of soybeans, $528 for a bulldozer and $0.82 for a prefabricated metal building.

Australia, like most nations, seeks to combat this profit shifting by having transfer pricing rules to enforce an arm’s length principle. The arm’s length principle uses the pricing behavior of independent parties as a guide or benchmark to determine the allocation of income and expenses in international dealings between associated enterprises.

In 1997 and 1998, new ATO Transfer Pricing Rulings were introduced, TR 97/20 and TR 98/11. These rulings tell taxpayers what they have to do to set arm’s length prices and what sort of methodologies and documentation they must have in place to assure the ATO that they are not shifting profits out of Australia. TR 98/11 also explains how the ATO will assess whether profits recorded by the Australian enterprise are “commercially realistic” or “less than commercially realistic.” A matrix (Figure 1) defines the risk of audit in terms of the intersection between the assessment of the quality of transfer pricing processes and documentation and the commercial realism of the taxpayer’s outcomes. TR 97/20 sets out a number of acceptable methodologies for setting or reviewing the international dealings with associated enterprises. This ruling endorses all of the OECD methodologies: comparable uncontrolled price method, resale price method, cost plus method, profit split method, and transactional net margin method. ATO analysts rate from one to five on a number of criteria the quality of a taxpayer’s processes and documentation.

This new approach to profit shifting is a case of meta risk management because the ATO risk manages the risk management methodologies taxpayers use to ensure that they do not engage in profit shifting. We will see that the Transfer Pricing Record Review and Improvement Project is the most striking element of this new meta risk management. The interesting thing about TR 98/11 is that it is unusually transparent about just how the ATO will assess the taxpayer’s risk management. This feature reinforces the reflexive quality of meta risk management. The ATO shows business that if corporations manage their risks of breaching the arm’s length principle in ways the ATO specifies or through some other persuasive methodology of their own, then they will be left alone. We will risk manage you benignly if you manage your risk in the image of our standards of risk management. Obversely, the ATO leaves itself open to absorbing new risk management approaches from business into its risk management paradigms. Tax Office risk management constitutes corporate risk management and corporate risk
management constitutes ATO risk management. It is a clear case of the risk management of risk management.

In one respect, TR 98/11 involves meta-meta risk management. Steps 1 to 3 as outlined in chapter 5 of TR 98/11 involve the implementation of a process for setting or reviewing their international dealings with associated enterprises in accordance with the arm’s length principle. Step 4 involves the risk management of this risk management insofar as it strongly recommends that the company install a review process to ensure that adjustments are made when the environment changes. Then the ATO comes in with its risk management of the company’s internal risk management of its transfer pricing risk management. This is Parker’s (2002) idea of moving from double loop to triple loop.

Soon after the promulgation of TR 98/11, the ATO widely distributed three booklets on the new approach, sent letters to relevant companies, and conducted a number of public and private seminars for the clients of major accounting firms. There were also consultation meetings with the transfer pricing partners of the largest accounting firms. At these seminars and
meetings the Transfer Pricing Record Review and Improvement Project was foreshadowed.

One hundred and ninety companies, mostly with total income between AUS $50 million and AUS $500 million\(^1\) and at least $30 million in international-related party transactions, were selected for the Transfer Pricing Record Review and Improvement Project. A new audit product was developed to be trialed on them, the Transfer Pricing Record Review (TPRR) – to roll out the risk management approach revealed in TR 98/11. Program staff visited the selected companies to conduct the review. At the end of the review, each of the companies received a letter advising them of whether their transfer pricing processes and documentation were assessed as of high, medium, or low quality and whether their profits were commercially realistic or less than commercially realistic.

Depending on the risks assessed by the ATO, a hierarchy of risk management responses was deployed as revealed in Figure 2. At the base of this enforcement pyramid were cases assessed as such low risks that they did not require direct ongoing contact from the ATO. When they had finished in the program they simply received a letter advising them that their risk had been assessed as low.

Fifty-six cases at the next rung of the pyramid were also of sufficiently low risk as to warrant no more than a letter prior to the next year’s tax return urging them to continue to observe arm’s length pricing. Thirty-four cases with somewhat higher risk were asked to send their next tax return and Schedule 25A as well as a “letter of explanation advising how your company’s current transfer pricing practices and documentation comply with the arm’s length principle”. This material was to be sent to a named ATO officer (a signal of more focused scrutiny).

Thirty-two cases of still higher assessed risk were told that they clearly had a problem and would be subjected to another Transfer Pricing Record Review for their next return. This indeed happened in all cases. This was a signal of a last chance being given. The forty-six highest risk cases from the one hundred ninety reviewed were sent a letter notifying them of intention to audit.

All companies at the top three rungs of the pyramid were given the option of de-escalating down to an Advance Pricing Arrangement (Advance Pricing Agreements [APA] in the U.S.). The APA is an arrangement negotiated between the company and the ATO (and in some cases involving the company’s associated enterprises in other countries and the relevant revenue administrations in those countries) on the methodologies that will be used to calculate transfer prices on the company’s future international dealings with associated enterprises. It is a risk management arrangement on profit shifting tailored to the goods and services to be traded in the future by a particular company.

What the APA does for the Tax Office is that it gets the firm to do the ATO’s risk management for it. What the APA does for the firm is give it
certainty, gets the ATO off its back, and relieves it of the need to pay large fees, which can approach a million dollars, to accounting firms for transfer pricing work. Twelve of the audit cases applied for APAs. This had been an objective of the project – to get more high risk firms into APAs. Consistent with the meta risk management strategy, the resource investment in the Transfer Pricing Record Review (TPRR) program was quite modest. The idea was to get the firm to do most of the risk management work. Three to five days at the company’s premises by two officers was all that was required for the initial review. TPRRs on the one hundred ninety companies were completed in less than six months, which was significantly less than previous transfer pricing risk assessment products.

The amount of tax paid in the year of the review increased by 32 percent (from $70 million in 1996 to $91 million in 1997 – the year under examination in most cases) even though the income for these companies actually fell by 5 percent in this year. Seemingly $21 million in extra tax for less than half a million in Tax Office resources. Table 1 shows that the tax paid by companies in the program jumped much more sharply in the post-review year, 1998, to be 139 percent higher in the post-intervention year than the pre-intervention year. Not surprisingly, there was some erosion of this effect in the three subsequent years. But even with this erosion, across the three latest
Table 1: Total Income and Net Tax of Companies in the Transfer Pricing Record Review and Improvement Project for 1998–99 (1997 generally the return first reviewed) and 1999–2000 (1998 generally the return first reviewed)

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<td><strong>1998–1999 TPRR n = 190</strong></td>
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<td>Net tax all companies</td>
<td>70</td>
<td>91</td>
<td>167</td>
<td>125</td>
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<td>Net tax per surviving company</td>
<td>3.7</td>
<td>4.8</td>
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<td>Total income all companies</td>
<td>34,209</td>
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<td><strong>1999–2000 TPRR n = 74</strong></td>
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<td>Net tax all companies</td>
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years, these 190 companies had settled down to paying about double the tax they were paying before the program. The biggest benefit of the program, therefore, with some modest erosion over time, seemed to be less in the year where returns were subject to direct ATO scrutiny and much greater in subsequent years when the firms had subjected themselves to intensified self-scrutiny through improved risk-assessment methodologies. One of the problems with this method of simply adding the net tax paid from all companies in the program is that some firms went bankrupt during this six-year period. Therefore, Table 1 also presents the average tax collected per surviving company – with bankrupt companies dropped from the study. The pattern of the results is the same: average collections were up 30 percent in the intervention year, and on average by 114 percent in the four post-intervention years compared to the pre-intervention year.

This was also the pattern of results in the bottom section of Table 1, which relates to the second tranche of seventy-four companies that went into the TPRR in 1999–2000. This second tranche of corporations were much larger on average and were harder to improve because they were already paying a higher proportion of their income in tax than the first tranche, perhaps because of ATO monitoring they had already been subjected to in the past. Here, the return subject to review was generally 1998, so 1997 is the pre-intervention year in the bottom section of Table 1. Tax collected in the intervention year, 1998, was only 17 percent higher than in the pre-intervention year, and only 51 percent higher on average in the three post-intervention years. It understates the reduction in the success of the program on the larger corporations in the second tranche to say that a doubling in tax collected from the smaller companies in the first tranche is reduced to a 50 percent increase, because acquisitions of corporations that were not paying a lot of tax by some of the second tranche corporations pushed up their revenues substantially in 2000 and 2001. This new element in the last two years of the second tranche make the results hard to interpret for these years. For net tax per surviving company, the second tranche improvement was 18 percent in the intervention year and averaged 56 percent for the three post-intervention years.

The results from the larger second tranche companies, while much less impressive in percentage improvement terms, are much more impressive in extra dollars collected for the effort invested. The intervention year increase in collections was $21 million for the first tranche, $110 million for the second. The first three post-intervention years returned an extra $211 million for the one-hundred ninety smaller companies, $965 million for the seventy-four larger ones. Subsequently, (for the three and a half years to March 2002) the commissioner was claiming that the Transfer Pricing Record Review and Improvement Project resulted in more than $2 billion in tax adjustments (a different measure from the total increase in net tax paid). However you measure success, it seems huge; roughly of the order of a billion for a million, a billion in extra tax for every million in extra expenditure of tax office resources on the program.
With the second tranche of companies, as with the first, results are consistent with the main effect of the program being a meta risk leveraging effect in the post-intervention years more than a direct monitoring effect for the intervention year. So we have a natural meta risk management experiment with a natural replication that delivers the same pattern of results.

While the patterns in the data are consistent and the effects consistently big, unfortunately they have seemed so big that it has been impossible to persuade the ATO to randomly assign a control group of targeted companies to non-intervention to compare with the effects of the TPRR intervention. Such randomized controlled trials are what are needed now to advance evidence-based meta risk management.

In addition to the increase in tax collected, the program was part of a strategy to improve the level of compliance across all firms that trade internationally by getting the message out to apply the transfer pricing rulings TR 97/20 and TR 98/11. It was also part of a meta risk management strategy to reduce compliance costs. The project also had an intelligence function in showing that the quality of transfer pricing documentation was very poor, and poorer than expected. In a second round of the program in 1999–2000, the level of ATO-assessed quality of documentation and processes did improve, with 35 percent of companies assessed as having documentation of high or medium-high quality, compared to 16 percent in the previous year. There was also a modest fall in the ATO-assessed audit risk rating. Overall, the program got the message out that the ATO was willing to get more serious about profit shifting than it had been in the past.

The Transfer Pricing Record Review and Improvement Project satisfies the four key components of the ATO Compliance Model.

1. **Understanding Taxpayer Behavior**

   Under TR 98/11, step 1 of the method for selecting an appropriate transfer pricing methodology is for the taxpayer to “Accurately characterize the international dealings between the associated enterprises in the context of the taxpayer’s business and document that characterization.” When the taxpayer does this well, simply by reading this documentation the ATO will acquire a much enhanced understanding of taxpayer behavior. At the third rung of Figure 2, the required written explanation of the relationship between the company’s transfer pricing and the commercial realities of its business has also helped understanding of complex forms of taxpayer behavior. This proffered understanding also changes the nature of audit. One senior ATO manager described the written explanation as a “thesis on the relationship between what’s really happening and the accounts. An audit then becomes more directed as a test of that thesis.”

2. **Building Community Partnerships**

   The Transfer Pricing Record Review and Improvement Project is a collaborative one with major accounting firms and corporate clients. It was seen in the words of one ATO manager, as a move from “policing to
partnership.” The objective of shifting resources from transfer pricing audits to APAs was seen as a shift from “the angst of audit to the better tone of APA negotiations.” Profit shifting enforcement in the past had been “crafted on a canvas of suspicion.” The remarkable transparency of the TR 98/11 approach was crafted to build trust. Meta risk management means a risk management partnership here. The Project succeeded in enrolling some of the major accounting firms to persuading their clients that indeed the partnership offered in the project was superior to audit. In the words of one tax office accountant I saw their interest in “sending the message that unless you employ us to get your methodology in order you’ll be audited eventually.” Wisdom in selecting targets is also important in this area. Selling the idea of an APA to one lead multinational from a particular country may bring to the negotiating table many other companies from that country who are in the first company’s network. Other networks are based on the industry sector, such that when a leading corporate player from that sector signs up to an APA, others in that sector are given confidence to do likewise.

3. Increasing Flexibility in ATO Operations to Encourage and Support Compliance

TR 97/20 endorses a number of different pricing methodologies to be used. The APA is a highly flexible approach, tailoring compliance requirements to the activities of the specific company. In fact, it is an enforced self-regulation (Ayres & Braithwaite 1992) strategy of meta regulation.

4. More and Escalating Regulatory Options to Enforce Compliance

Figure 2 shows that a regulatory pyramid the ATO can escalate up and down is very much in play here. One criticism of APAs that may have merit is that they divert resources to cooperative corporations and away from corporations that engage in aggressive tax planning. While this might be a generally valid criticism of APAs, it is not a valid criticism of the deployment of APAs in the context of the Transfer Pricing Record Review and Improvement Project. This is because in this project, the most aggressive companies who spurn the APA all get a transfer pricing audit, a more intensive intervention than the APA. Hence, there is fidelity to the principle of the compliance model that cooperation must be associated with movement down the enforcement pyramid and combative tax planning with movement up.

V. CONCLUSION

The ATO has experienced a considerable shift from checking returns to find breaches of the law followed by a pretense of consistent enforcement – the Token Enforcer of Grabosky and Braithwaite’s (1986) study. This change has been to a culture of risk analysis, where the ATO scans its environment for the greatest risks and moves resources to where those risks can be
managed. This is the shift from reactive law enforcement to proactive risk management (where law enforcement provides just some of the tools in a regulatory pyramid). Meta risk management is a further stage in this strategic change process. It is the move to the risk management of risk management. While proactive risk management can be more strategic than reactive enforcement, even more strategic leverage might be achieved by asking how the ATO can lever others to do fruitful risk management.

Self-assessment captures the above basic intuition. Instead of using ATO staff time to check the arithmetic of taxpayers, trust taxpayers to do the arithmetic. However, trust and verify by developing strategies for educating taxpayers on how to check themselves and by educating preparers to check their checking. ATO resources can then shift from direct checking to meta-monitoring (Grabosky 1995), as by shifting enforcement resources to the clients of preparers who are risk takers rather than risk checkers.

For any given risk to the revenue, being sensitized to the meta risk management option means asking the following questions:

1. Is there someone who has under their control better levers of that risk than the Tax Office?
2. Can the fact that the other party is successfully leveraging the risk be made transparent to the Tax Office?
3. Can the Tax Office work with them to persuade them to pull those levers?
4. Are there levers the Tax Office can pull to get the other party to pull their risk leveraging levers?
5. Can the Tax Office organize its levers into a pyramid that escalates up from trust and persuasion at the base of the pyramid?
6. Does Tax Office leveraging of the other party’s leveraging reduce risk at lower cost than direct monitoring and enforcement?

The “other party” can be the taxpayer themselves, as in self-assessment; they can be third parties like software manufacturers as in the Registered Software Project; they can be tax preparers or internal corporate compliance systems as in the Transfer Pricing Record Review and Improvement Project. Or they could be a parish priest who a persistent non-lodger nominates as their supporter in honoring their commitment to get their tax return lodged in future as part of a lodgement prosecution settlement. Meta risk management is about encouraging creativity in finding the best levers for the hardest cases and the most effectively automatic levers for the routine cases. This means creative self-enforcement where entrenched resistance to compliance is found, automatic self-enforcement where routine compliance can be expected (e.g., where third party deductions at source are possible).

Often we will find that the answer to question 6 above is that there is no cost-effective meta risk management strategy. Because regulators are only beginning to learn how to ask questions 1 to 5, we will more often find meta risk management strategies are out there waiting to be discovered if only we
can become creative enough to craft them. Equally, of course, there is a risk that thinly resourced regulatory bureaucracies will insufficiently invest in the monitoring part of meta-monitoring. The result can be that something like an APA can become so flexible as to be captured by business interests and to seriously undermine the general basis for criminal prosecutions. In the case of the Transfer Pricing Record Review and Improvement Project, the evidence seems unusually compelling that the program has not been captured by business interests to erode their tax obligations. Of course there is no worry about affording the needed investment in monitoring with a tax enforcement program that repays its cost a thousand fold. While in principle meta risk management might be just as capable of working well with environmental regulation, in practice the very investment in the research reported herein that suggests a huge risk leveraging effect might never be funded by a struggling environmental agency. Capture by business interests to erode obligations probably is the more likely outcome in domains where there is a willingness to invest in trust but not in verification.

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NOTES

1. All subsequent prices are in Australian dollars which at the time of writing is valued at U.S. $0.67.

2. With respect to criminal prosecutions for transfer pricing, in Australia there is nothing to undermine here, since, like most countries, Australia never moves criminally against transfer pricing. The concern is nevertheless a worry because the theory of the enforcement pyramid suggests that other countries might do better to follow the U.S. example in this respect and, even if only rarely, prosecute criminally some of the worst transfer pricing abuses.

REFERENCES


LAWS CITED

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