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Taxation and Business Law

# **Tax compliance costs in New Zealand: An international comparative evaluation**

**Professor Chris Evans**

**School of Taxation and Business Law  
UNSW Australia**

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# Overview of presentation

## 1 Introduction

## 2 Conceptual issues

- What are compliance costs
- Methods used to measure them
- What the research shows

## 3 How New Zealand compares

- Non-business taxpayers
- SMEs
- Large business

## 4 Conclusions



# 1 Introduction

**Concern about regulatory costs**

**The NZ regulatory framework**

**International regulatory trends**

**Tax a critical component of regulatory burden**



## 2. Compliance costs: What are they?

- Compliance costs are the costs (monetary and time) that taxpayers incur in complying with the tax system
- They are the costs that would disappear if the tax disappeared
- Usually comprise
  - ✓ Value of time spent by T/Ps on complying
  - ✓ Monetary costs spent on advisers
  - ✓ Incidentals (postage, software, office, travel etc)
  - ✓ Psychological? (stress, anxiety etc)



## 2. Where do the boundaries of compliance costs lie?

- Computational/unavoidable/involuntary versus planning/avoidable/voluntary
- Preventable versus inevitable
- Commencement/once only versus recurrent/regular
- Core accounting costs versus tax costs
- Total/gross/social (of interest to Treasury and the economists) versus net/taxpayer compliance costs (of interest to taxpayers, lobbyists and revenue authorities)

The difference is accounted for by:

- Cash flow benefits
- Tax deductibility of certain compliance costs
- Managerial benefits



## 2. Research into compliance costs

- 1970s: the “hidden” costs of taxation
- Research has flourished in last 40 years
- Over 100 major studies since 1935
  - National and (less so) cross national
  - Developed and (less so) developing nations
  - All taxes and all types of taxpayer
  - Variety of methodologies: primarily quantitative paradigm (survey and modelling), but increasingly qualitative approaches also being used

## 2. How are compliance costs measured?

- Sandford methodology and refinements
  - Large scale surveys
  - See next slide for formula
- PWC Paying Taxes approach
- Estimating/simulating techniques
  - Standard Cost Model
  - Individual Taxpayer Burden Model et al (IRS)
  - Various others in Sweden/Switzerland/Germany etc
  - Complexity index

## 2. How are compliance costs measured?

$$TCC = \sum \sum N_{kl} [EC_{kl} + IC_{kl}] - \sum \sum N_{kl} 0.5(1 + p_{kl}) t_{kl} \times [EC_{kl} + IC_{kl}] \\ - \sum \sum CB_{km}$$

where

$TCC$  = business taxpayer compliance costs

$k$  = business size (small, medium, large)

$l$  = legal form (sole trader, partnership, trust, superannuation fund, company)

$N$  = total number of business taxpayers in that category

$t$  = marginal tax rate

$EC$  = average external tax adviser costs

$IC$  = average internal labour costs

$p$  = proportion of taxable business taxpayers in that category

$m$  = tax types/collection mechanisms

$CB$  = cash flow benefits/costs



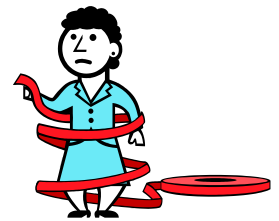
## 2. What the research tells us (1)

- Tax compliance costs are significant and high:
  - 2%-10% of revenue yield
  - Up to 2.5% of GDP
  - A multiple of 2 to 6 times administrative costs
- Tax compliance costs are extremely regressive
  - SMEs carry disproportionately high compliance costs
  - Particularly VAT/GST
  - Caused by diseconomies of scale/high fixed costs/learning curve effect
- Tax compliance costs are not diminishing over time
  - In absence of policy action (or in spite of policy action?)
  - Except in NZ??



## 2. What the research tells us (2)

- Business size is the main determinant of tax compliance costs for SMEs and large corporations
- The number of taxes is also a significant determinant
- Legal form and industry sector less important
- Businesses usually cite the perceived drivers as:
  - Complexity (and uncertainty) of tax laws
  - Frequency of tax changes
  - Administrative requirements imposed by revenue authority
  - International exposure (large business only)
- The nature of the tax makes a difference: simpler taxes (fewer rates/exemptions etc) lead to lower TCCs
- TCCs also impact upon tax compliance: the lower the levels of complexity, the higher the levels of voluntary compliance



# 3. How New Zealand compares

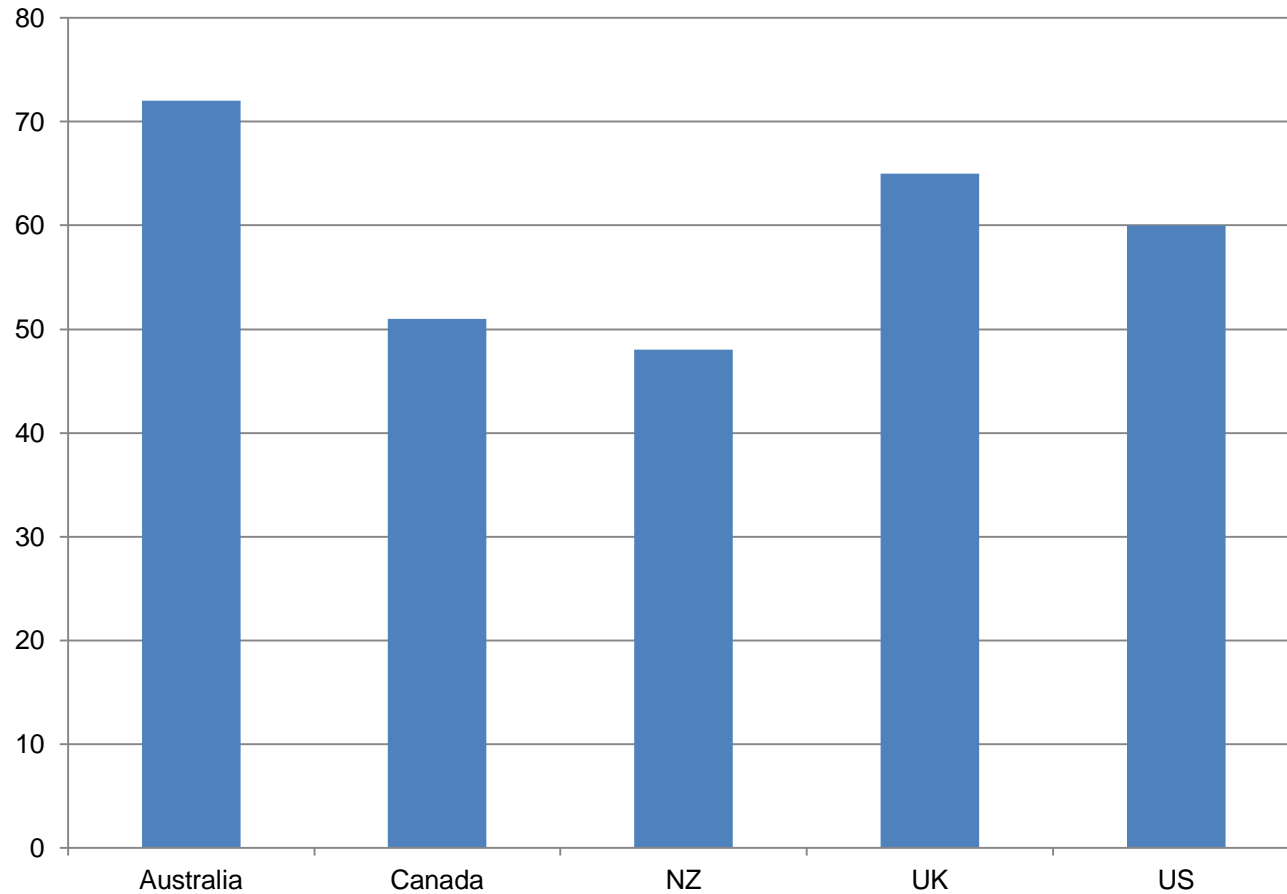
- **International comparisons**
  - fraught with difficulties
  - should be used thoughtfully and sparingly
- **Comparative international studies**
  - Business driven: PwC Paying Taxes ranking
  - Academic: Bannock and Albach (1989), Evans (2003), Cordova-Novion & de Young (2001), Evans et al (2014)
- **NZ experiences in an international context**
  - Personal taxpayers
  - SME taxpayers
  - Large business taxpayers

# 3. Personal taxpayers

- No empirical studies in NZ available
- But not surprising: little interest because
  - Widespread taxation at source
  - Virtually no work related deductions
- Hence relatively low ratio of personal taxpayers who are required to submit income tax returns
- Also low tax agent usage by personal taxpayers (based on OECD data: next slide)
- TCCs most likely to be low (both absolutely and relatively) by international standards



## Individual taxpayers tax agent usage 2011 (%)

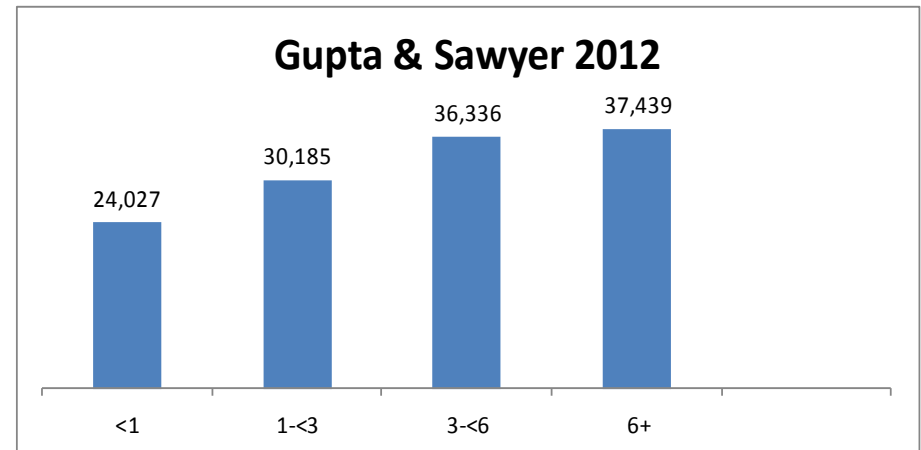
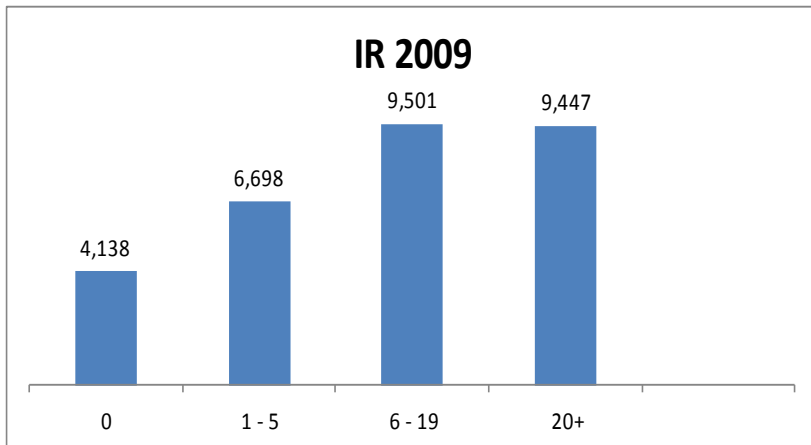
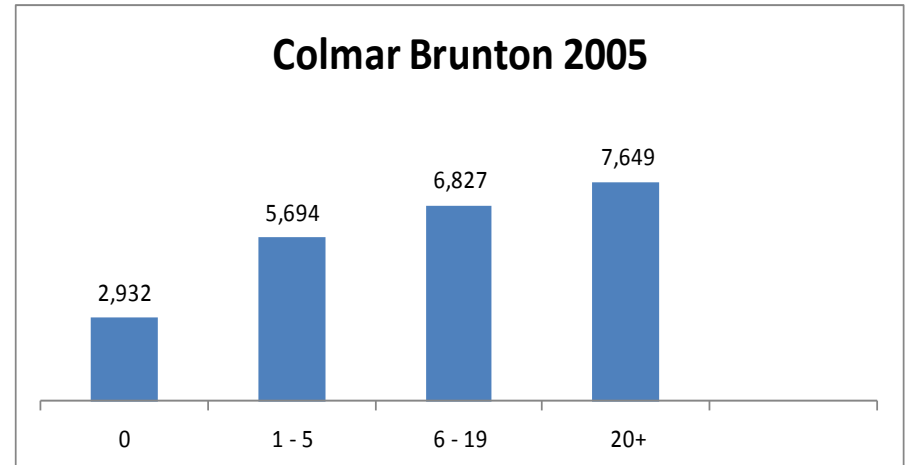
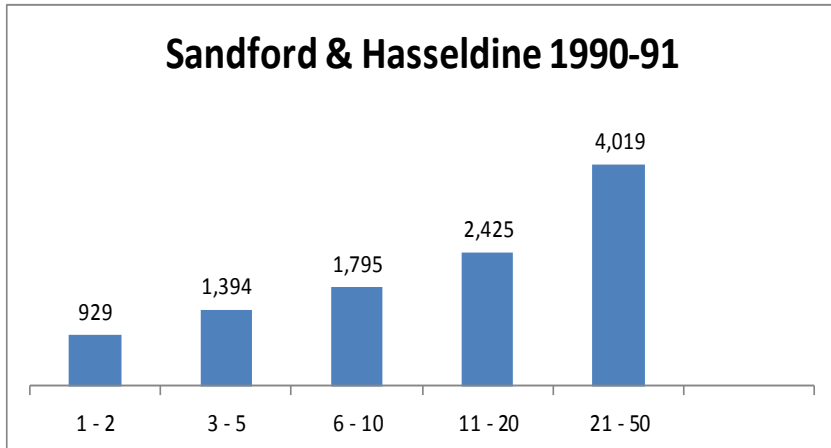


# 3. SMEs

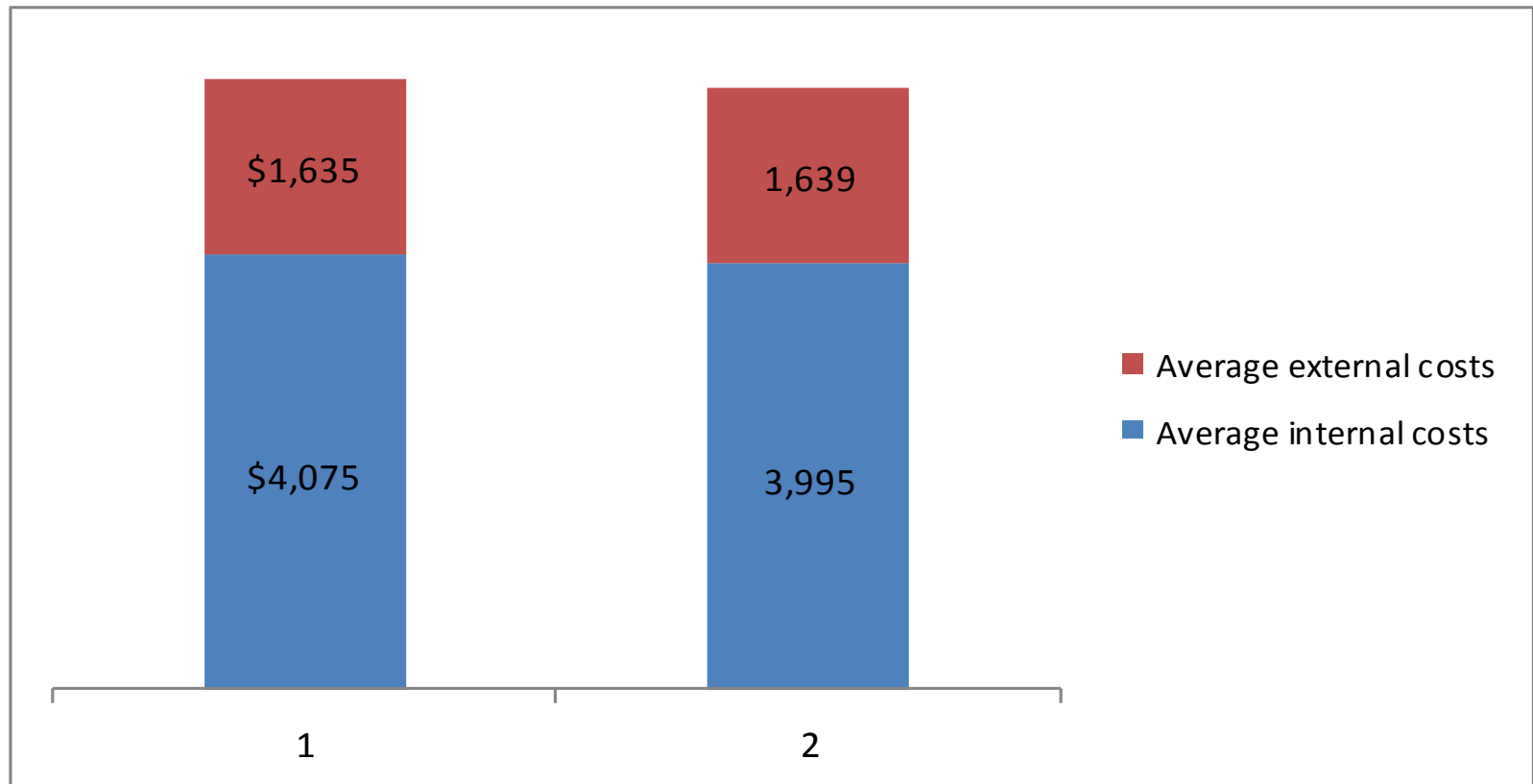
- Focus of much more empirical (and qualitative) study in NZ
- Usually defined by reference to number of employees (Small = up to 20; Medium = 20 to 49)
- Sometimes turnover used for SMEs (NZ\$20m to 2003; NZ\$30m thereafter)
- Four major quantitative studies (excluding current IR study):
  - Sandford and Hasseldine 1990-91
  - Colmar Brunton (for IR) 2005
  - IR 2009
  - Gupta and Sawyer 2012



# 3. SME taxpayers

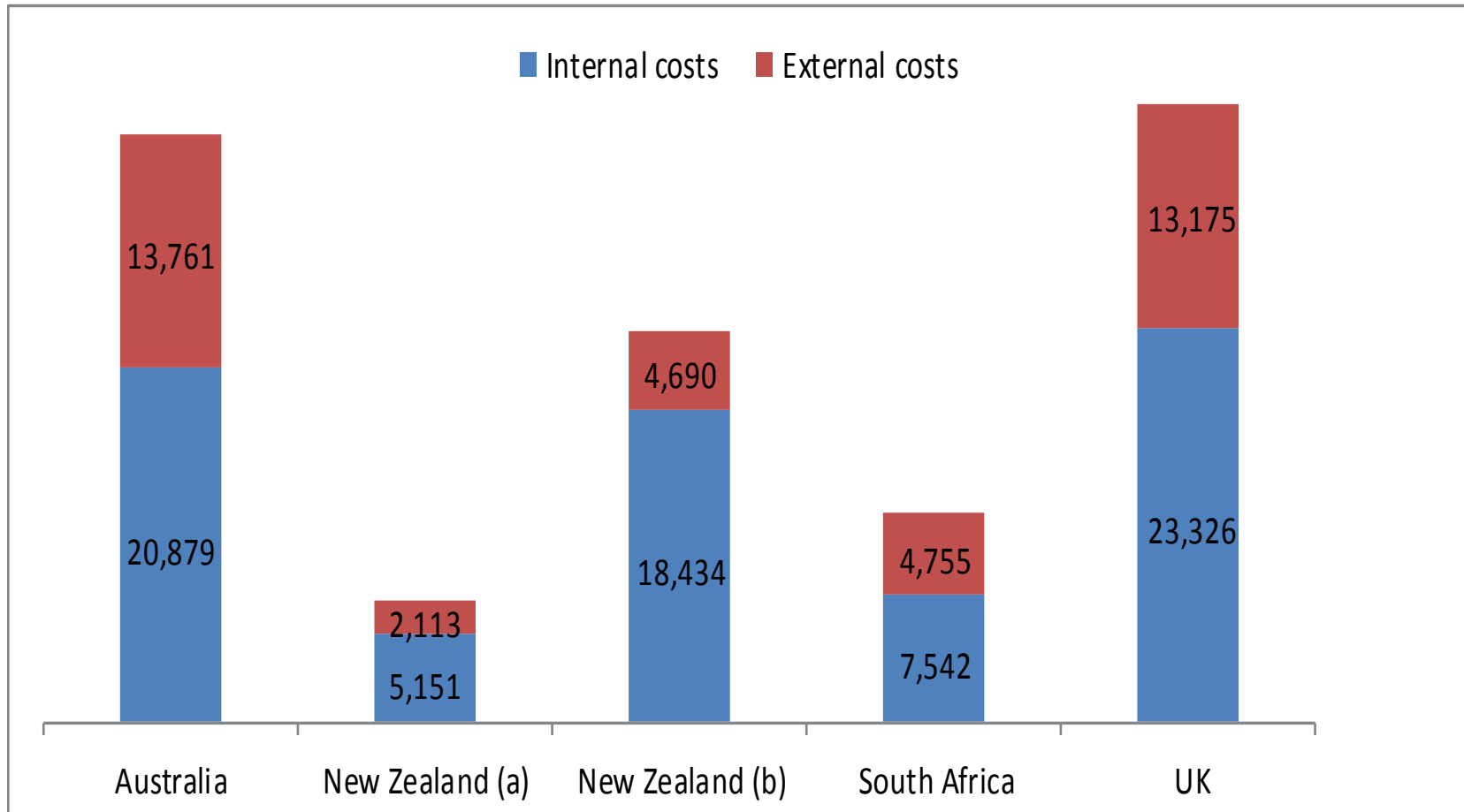


## Comparisons of 2004 and 2009 NZ survey results (constant \$)

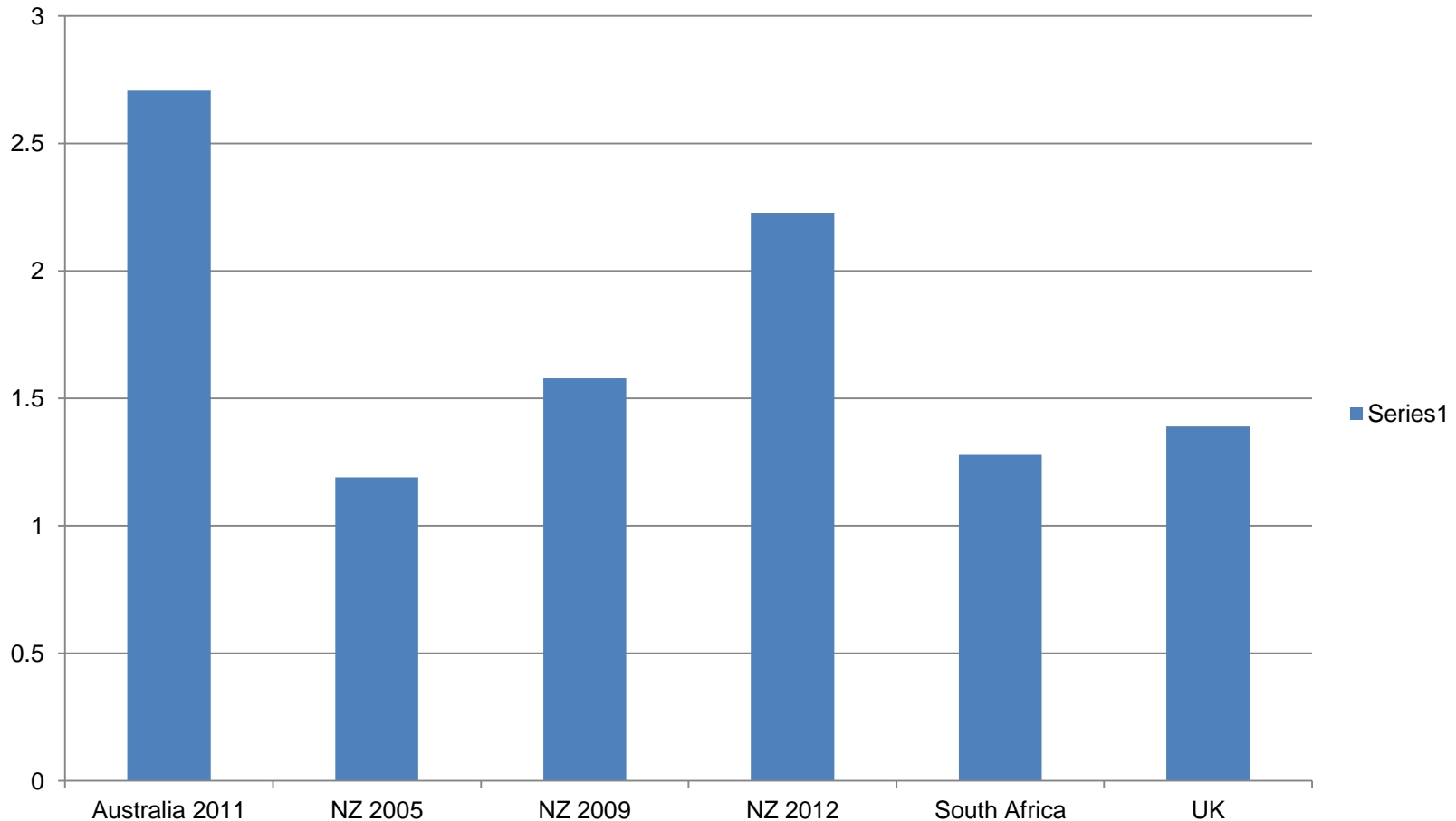




# International comparison of SME tax compliance costs 2010-11 (constant US\$)



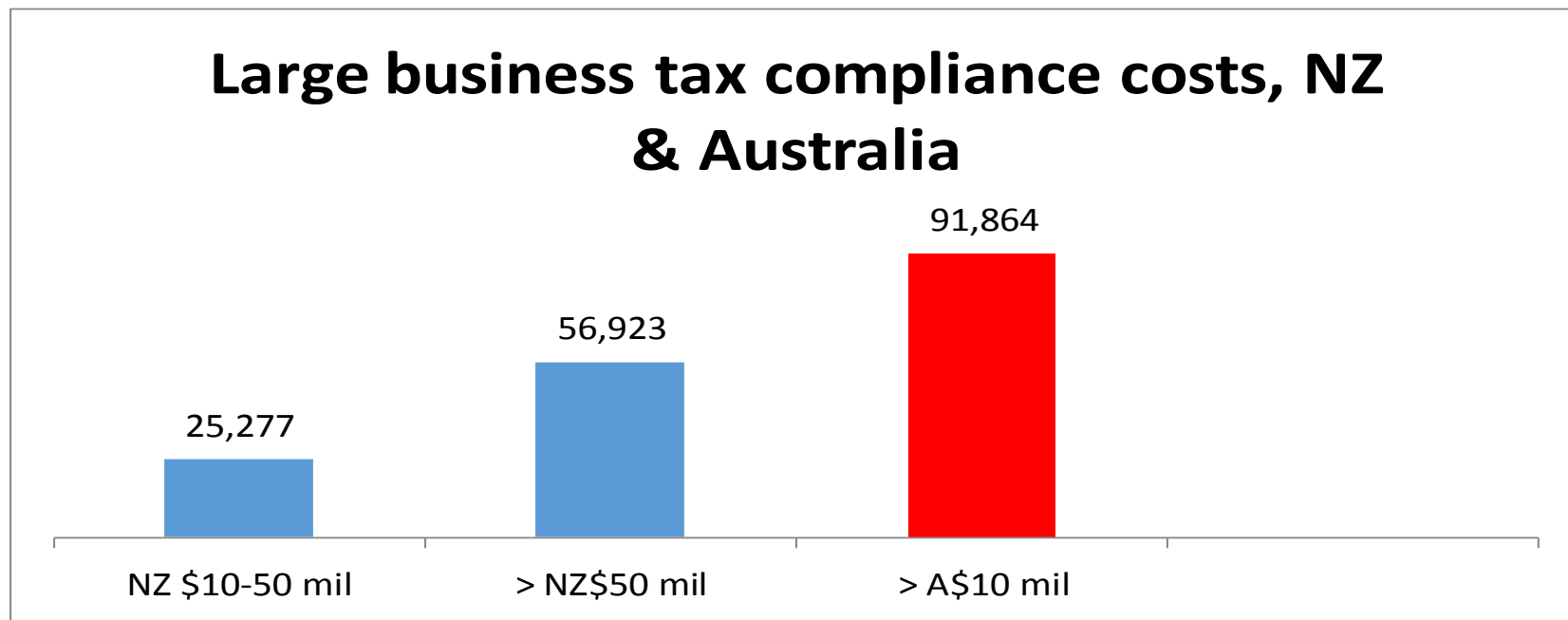
# Ratio of GST internal costs to income tax internal costs (various countries and years)



# 3. Large business taxpayers

Limited empirical evidence in NZ: Sandford & Hasseldine 1990-91; Prebble 1995; IR 2011

Comparison 1990s (below) suggests NZ significantly lower than Australia at that point



# 3. Large business taxpayers

## Comparison of relative tax compliance costs of large business by tax type

	PAYE to tax revenue	FBT to tax revenue	PAYE & FBT to tax revenue	PAYE & FBT to GDP	Business Income Tax (BIT) to tax revenue	BIT to GDP
<b>Australia</b>	2.5	17.1	3.2	0.38	15.8	1.08
<b>NZ</b>	1.9	1.7	1.9	0.21	19.6	1.80

Sources: Evans et al (1997: Table 5.8: 74 and Table 5.9: 76).

# 3. Large business taxpayers

More recent NZ 2011 qualitative research suggests:

- Factors driving large business compliance costs are complexity of legislation, frequency of tax law changes, shift of payroll tax activities, employee tax issues
- The most costly tax **types** (descending order) are
  - PAYE
  - GST
  - FBT
- The most costly tax **activities** (descending order) are
  - Interpreting and keeping up to date with tax law
  - Accommodating changes to the tax environment
  - Managing tax risk
  - Tax planning
- Important to include psychological costs in total compliance costs

# 4. Conclusions

- (1) Comparisons difficult and confined mainly to SMEs
- (2) Personal TCCs likely to be low compared to OECD comparators at both individual and aggregate levels
- (3) TCCs of SMEs are low by international standards and may even be “bucking the trend” by not increasing over time
- (4) TCCs of large sector may also be low comparatively, but lack of empirical evidence (and some concerns)

# 4. Managing complexity and tax compliance costs (OECD 2008)

- (1) Adjusting tax policy settings
- (2) Re-engineering government processes for data and revenue collection
- (3) Implementing citizen and business-centric approaches to tax administration
- (4) Leveraging advances in technology
- (5) Optimising the use of third party information
- (6) Re-designing compliance interventions

# 4. And a few thoughts of my own

- (1) Accept justifiable complexity and rough justice (better to be approximately right than precisely wrong)
- (2) Remove duplication/seek harmonisation
- (3) Ensure legal rules are predictable, proportional and consistent
- (4) Manage change: do it once and do it right
- (5) Be wary of choice
- (6) Remember the trade off between administrative costs and taxpayer compliance costs (incidence)



**THANK YOU**

**Any comments or questions?**

