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Tax Compliance Costs in New Zealand:

An International Comparative Evaluation

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Abstract

The focus of this article is on the burden imposed by all aspects of compliance with tax obligations in New Zealand (NZ). It explores the levels of research into tax compliance costs undertaken in NZ and the outcomes of that research, and compares this data with comparable international experience. It establishes that NZ has a sound track record of research into tax compliance costs, at least at the government level, and certainly so far as research into business tax compliance costs is concerned. The outcomes of that research also suggest that NZ compares favourably with many other developed countries including its OECD counterparts in terms of the compliance cost burden faced by business and non-business taxpayers.

1.0 INTRODUCTION

Governments impose a variety of regulations, including taxation, on businesses and on the community more broadly. Inevitably such regulations generate costs upon those affected. While estimates of costs of regulation are difficult to obtain, there have been continuing concerns, at community, industry and government levels, that regulations are excessive.[1] They can cause undue concern for non-business taxpayers and can impede productivity and growth for the business sector[2]. This perception has in turn given impetus to the drive for ongoing programs of regulation/tax simplification around the globe.

In New Zealand (NZ), businesses and (often) non-business sectors are currently facing a variety of regulations administered by many different authorities. These include, for example, taxation, employment, workplace safety, environmental, and business and trade law.[3] Businesses in NZ have argued that "government regulation is increasing at an alarming rate" and "the regulatory burden in New Zealand is holding back business and economic growth".[4] As a response, Prime Minister John Key launched, in March 2012, the *Better*

[1] This suggestion does not receive universal support. For example, the United States Office of Management and Budget (USOMB) has produced estimates showing that the aggregate monetised benefits of major US federal regulations far exceed their aggregate monetised costs; see USOMB, *Draft 2012 Report to Congress on the Benefits and Costs Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities*, (2012, USOMB, Washington DC) at 13, accessed 22 June 2014 <http://www.whitehouse.gov/sites/default/files/omb/oira/draft_2012_cost_benefit_report.pdf>.

[2] Organisation of Economic Co-operation and Development (OECD), *Businesses' Views on Red Tape: Administrative and Regulatory Burdens on Small- and Medium-Sized Enterprises*, (2001, Paris, OECD); European Commission (EC), *Models to Reduce the Disproportionate Regulatory Burden on SMEs: Report of the Expert Group*, (2007, Brussels, Enterprise and Industry Directorate General); and DST Global Solutions, *FSC–DST Global Solutions CEO Report*, (2012, Sydney, DST Global Solutions).

[3] Statistics New Zealand, *Business Operations Survey: 2012*, (2013, Wellington, Statistics NZ) at 1.

[4] Business NZ, *Regulation Perspectives*, (2006) at 3, Business NZ, Wellington. To put this claim in context, NZ is currently ranked third out of 185 countries in terms of ease of doing business; see World Bank, *Doing Business 2013 Smarter Regulations for Small and Medium-Size Enterprises*, (2013, Washington DC, World Bank) at 3.

Public Services programme with clear objectives and targets.[5] In particular, the target for Result 9 of the programme has been stated as follows:[6]

> Business costs from dealing with government will reduce by 25% by 2017, through year-on-year reduction in effort required to work with agencies.

New Zealand is not alone in its attempt to simplify regulations affecting businesses and other parts of the community. Many developed countries have been actively pursuing programs to reduce red tape for businesses and others.[7] In fact, NZ's regulatory simplification initiative and target are strictly comparable to and consistent with a previous policy of the European Union (EU). In 2007, the EU launched an Action Programme for reducing administrative burdens stemming from EU legislation.[8] The target of this Action Programme was to reduce these burdens by 25 per cent by 2012. New Zealand's Result 9 is clearly comparable to the EU's Action Programme both in terms of time frame and reduction target.

Considerable empirical evidence suggests that a significant part (usually the major part) of the regulatory burden in developed countries arises from taxation. For example, according to an international study by the OECD[9], tax compliance costs constituted about 46 per cent of all regulatory compliance costs in 1998–1999. More recently, in the NZ context, a 2009 Discussion Paper suggested that tax comprised 42.6 per cent of the overall regulatory compliance burden. [10]

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[5] Ministry of Business, Innovation and Employment (MBIE), *Better Public Services for Business* (2012, Wellington, MBIE) at 1.
[6] See n 5 at 7.
[7] See, for example, OECD, *From Red Tape to Smart Tape: Administrative Simplifications in OECD Countries*, (2003, Paris, OECD) and OECD, *Cutting Red Tape: Comparing Administrative Burdens across Countries*, (2007, Paris, OECD).
[8] EC, *Europe Can Do Better – Best Practices for Reducing Administrative Burdens*, (2012, Brussels, EC) at 2.
[9] OECD, *Businesses' Views on Red Tape: Administrative and Regulatory Burdens on Small- and Medium-Sized Enterprises*, (2001, Paris, OECD) at 53.
[10] Business NZ/KPMG, *Summary Tables and Graphs of the Business NZ–KPMG Compliance Cost Survey October 2008* (2009, Wellington, Business NZ–KPMG) at 35. The other components of the regulatory compliance burden were "employment" (25.8 per cent), "environment" (15.1 per cent) and "other" (16.5 per cent).

In view of the role of taxation as the most significant contributor to red tape, the focus of this article is on the burden imposed by all aspects of compliance with tax obligations. It explores the levels of research undertaken in NZ and the outcomes of that research, and compares this data with comparable international experience. It establishes that NZ is at the forefront of tax compliance research, at least at the government level, and certainly so far as research into business tax compliance costs is concerned. This is due to deliberate efforts by Inland Revenue (IR) to generate estimates of business tax compliance costs through carefully planned large scale surveys of small and medium sized enterprises (SMEs) conducted at regular time intervals. The first two such surveys were conducted in 2004 and 2009 (considered in further detail in Section 3 of the article) and a further study has recently been conducted (results not yet publicly available). As a result, IR possesses reliable, comparable and up-to-date time series data on SME tax compliance costs at the national level, and that research suggests SME tax compliance costs in NZ may be less onerous than for other comparable jurisdictions.[11] Less research has been conducted into the tax compliance costs of the non-business sector, but even here the evidence that does exist suggests that NZ compares more than favourably, in terms of the compliance costs burden imposed upon personal and other non-business taxpayers, with many other developed countries including its OECD counterparts.

The paper is structured as follows. Section 2 identifies some conceptual issues relating to tax compliance costs, including what we mean by such costs and how, typically, they have been identified and measured. Section 3 considers how NZ compares, in terms of evidence about its tax compliance costs, with data available from other comparable countries. The section considers, respectively, the tax compliance costs incurred by individuals not in business, the costs incurred by the SME business sector, and the costs incurred by larger

[11] Data availability has also been a key issue that has accompanied the NZ Government's initiatives for reducing tax compliance costs for SMEs; see, for example, M Cullen and P Dunne, *Reducing Tax Compliance Costs for Small and Medium-Sized Enterprises*, (2007, Wellington, Policy Advice Division, IR).

corporations. Section 4 draws the analysis together with concluding comments and observations.

2.0 IDENTIFYING AND MEASURING TAX COMPLIANCE COSTS

2.1 WHAT ARE TAX COMPLIANCE COSTS?

Tax compliance costs refer to the **direct** costs incurred by businesses in complying with the legal requirements of the tax system. They are "all the costs borne by businesses and individuals for complying with tax regulation, excluding the costs of the taxes themselves".[12] Note that the emphasis is upon the "direct" burden. Taxation (and other regulations) may also generate indirect costs to businesses. For example, it is conceivable that some businesses may deliberately reduce sales to stay below the Goods and Services Tax (GST) registration threshold because they wish to avoid dealing with the GST.[13] Such behavioural distortions will cause losses in total output. These output losses are known as the indirect costs of tax compliance and they lie outside the scope of this article.

The literature makes a distinction between gross (sometimes also referred to as total or social) tax compliance costs and net (sometimes referred to as taxpayer) tax compliance costs. The former represents the costs to the economy (and is a figure likely to be of greater interest to Treasury and economists). The latter can be taken as the costs directly borne by taxpayers (and is therefore the figure which is likely to be of greatest interest to the business or other taxpayer lobbies and to revenue departments). Each is considered below.

Gross tax compliance costs

The gross costs of complying with taxation obligations typically consist of monetary and psychological costs. Monetary costs refer to the value of resources expended by businesses

[12] EC, "A review and evaluation of methodologies to calculate tax compliance costs", *Taxation Papers: Working Paper N.40-2013*, (2013, Brussels, EC) at 3.

[13] There has been some empirical evidence to support such an idea. For example, a United Kingdom (UK) Open University Business School report claimed that nearly 18 per cent of companies surveyed in Britain were deliberately avoiding sales to stay below the (then) £50,000 threshold for Value Added Tax (VAT); see Small Business Research Trust (STBR), "VAT and compliance burdens", *NatWest SBRT Quarterly Survey of Small Business in Britain*, (1998) 14(1) 18 at 19.

and individuals to satisfy the requirements of government taxation and regulation. The conventional approach is to adopt the opportunity cost concept which is somewhat broader than the accounting cost concept. Under the opportunity costs approach both explicit costs (which involve monetary payments) and implicit costs (which do not involve monetary payments, e.g., time spent by business owners or unpaid spouses) are included. The monetisation of implicit costs can give rise to the time valuation problem, which may be overcome by the use of corresponding market information or self-reported values.

Psychological costs refer to the stress and anxieties experienced by business owners and individuals in having to satisfactorily deal with taxation and other regulations. These costs are particularly relevant to small businesses, especially sole traders and partners, since these businesses have rather limited opportunities or capacities to outsource the compliance obligations to third parties such as tax advisers or experts. They are also relevant to particular sectors of society with tax obligations, such as the aged, as they may stress more about complying with their tax obligations than others. Psychological costs are problematic because there is no objective and consistent way to monetise these costs across taxpayers and over time. Thus, it is not possible to add monetary and psychological costs to arrive at gross costs of tax compliance.

One plausible approach is to capture psychological costs (or the change in such costs) by the use of a suitable Likert scale.[14] Strictly speaking such a scale is an ordinal measure, i.e., from such data we can say whether psychological costs have changed or not, but not by how much.[15] This point has been recognised by the IR in its analysis of the 2009 tax compliance

[14] See, for example, B Tran-Nam and J Glover, "Estimating the transitional compliance costs of the GST in Australia: A case study approach", *Australian Tax Forum*, (2002) 17(4) 499 at 533; IR, *SME Tax Compliance Costs 2009, Evaluation Reports 1, 2 and 3*, (2010, Wellington, Evaluation Services) at 11.

[15] In order to validly determine the percentage change of psychological costs over time we need a ratio scale. But being able to measure psychological costs on a ratio scale is equivalent to being able to monetise psychological costs, which cannot be done in principle.

costs data.[16] From now on, therefore, unless otherwise stated, tax compliance costs refer to monetary costs only.

The monetary components of gross tax compliance costs have been well canvassed in the literature.[17] Suffice to say that gross monetary tax compliance costs are the sum of labour and non-labour costs where labour costs include both the costs of internal labour (owners, employees, contractors or unpaid spouses/friends) and external labour (payments to tax practitioners and for other tax services). There is strong international evidence that labour costs constitute by far the bulk of gross tax compliance costs of individual taxpayers[18] and it is entirely plausible to extrapolate this finding to the case of business taxpayers.

Internal labour costs are normally obtained by multiplying the time spent (e.g. hours per year) on tax compliance activities by internal labour by their corresponding wage rate (e.g. NZ$ per hour). The wage rate is either based on market information (in the case of employees or contractors) or survey-reported (in the case of owners or unpaid spouses/relatives). In contrast, information on external labour costs is typically obtained from the survey in the form of a lump sum amount. Thus, it is generally not possible to disaggregate external labour costs into number of chargeable hours and charge rate by professional tax practitioners.

There are two types of non-labour costs that can be associated with tax compliance: recurrent costs (e.g. utilities, internet) and capital costs (e.g. investments to comply with tax obligations). Estimates of recurrent costs are often incorporated into surveys designed to capture the costs of tax compliance,[19] though that is not always the case. For example, the IR did not include non-labour costs in their attempt to estimate business tax compliance costs in

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[16] See n 14, IR at 95.

[17] See, for example, C Evans and B Tran-Nam, "The tax compliance costs of small and medium-sized businesses", *Report Prepared for Inland Revenue,* (2004, Sydney, Atax) at 8.

[18] C Evans, K Ritchie, B Tran-Nam and M Walpole, *A Report into Taxpayer Costs of Compliance*, (1997, Canberra, Australian Government Publishing Service) at 70.

[19] See n 18.

their 2005 and 2009 surveys.[20] In principle, excluding recurrent non-labour costs results in the under-estimation of the true level of gross tax compliance costs. However, if one is willing to entertain an acceptable assumption that recurrent non-labour costs are related to labour costs in a fixed proportion over time, the exclusion of recurrent non-labour costs from tax compliance costs does not affect the percentage change in tax compliance costs over time. Therefore it may not be problematic to exclude such recurrent non-labour costs from the estimation process.

Capital costs are more problematic to deal with, especially if the capital investment can be used for a variety of purposes (e.g., a laptop can be used for tax and other purposes). It is conventional to exclude capital costs from tax compliance costs.[21] In so doing, the difficult task of attributing the costs of multi-purposed assets to annual tax compliance costs can be avoided.

What constitutes tax compliance activities is also not straightforward. First, there is an issue about the overlap between accounting and taxation costs. This overlap is particularly pronounced for SMEs as, for these businesses, tax and accounting functions cannot be easily separated and internal staff members (e.g., an account clerk) are often employed to do both accounting and taxation activities.

Second, there is a debate about avoidable (voluntary) and unavoidable (involuntary) tax compliance activities where tax computation is regarded as unavoidable and tax planning as avoidable. This distinction, first introduced by Johnston[22], gave rise to an ongoing debate which can never be fully resolved.

Notwithstanding this debate (and also noting that if data on tax compliance costs have been collected in a consistent manner, these conceptual issues have little impact on the

[20] See n 16 at 6.
[21] See, for example, n 9 at 14.
[22] KS Johnston, "Corporations' federal income tax compliance costs: A study of small, medium-size, and large corporations, *Bureau of Business Research Monograph No. 110*, (1963, Columbus, Ohio State University) at 67.

percentage change of estimates of tax compliance costs over time), the authors of the article are of the view that the costs of all tax related activities should be included in the measurement of tax compliance costs. Hence, tax planning should be regarded as a legitimate activity of tax compliance. Similarly, tax dispute resolution should also be treated as a legitimate tax compliance activity and incorporated into any study of tax compliance costs.

A related and relevant issue is the distinction between preventable and inevitable costs of tax compliance.[23] Preventable tax compliance costs refer to those costs incurred by a business or other taxpayer because of inefficiencies in meeting tax legislative requirements, i.e. departures from best practice due to lack of knowledge. In contrast, inevitable tax compliance costs refer to those resulting even where taxpayers use best available practice. In the business context, preventable tax compliance costs are likely to be related to the age of the business or the age of the tax. Over its lifecycle, a business may learn to deal with its tax affairs more effectively. However, in collecting information about tax compliance costs it is not often possible to distinguish between those costs which are preventable and those which are inevitable. Therefore in practice no such distinction is usually made.

Net tax compliance costs

Tax compliance may generate offsetting benefits to businesses or to individuals. Net tax compliance costs are gross tax compliance costs less any offsetting benefits from tax compliance that may ensue to taxpayers. Three types of offsetting benefits have been recognised in the literature.[24] They are

- tax deductibility benefits: most business tax compliance costs and some non-business tax compliance costs are tax deductible;

[23] IR, *Reducing Compliance Costs: An Evaluation*, (1997, Wellington, Programme Evaluation Unit) at 75.
[24] See, for example, n 17 at 11.

- cash flow benefits that may arise (particularly to business taxpayers) from the mismatch in timing between when the tax is due and when it is remitted to the tax authority; and
- managerial benefits that may derive from improved financial decision making arising from better information being available as a result of more stringent record keeping requirements imposed by the tax system.

In addition to the above, taxpayers may enjoy one-off direct cash subsidies or on-going relief from the government.[25]

It is important to note that the all offsetting benefits except managerial benefits are in fact costs to the government and thus vanish from the social perspective. Only managerial benefits are genuine benefits to both specific taxpayers and the society as a whole. However, research in this area has been limited up to now, and conceptual and empirical monetisation of managerial benefits is only at a preliminary stage.[26]

2.2 METHODOLOGIES USED TO MEASURE TAX COMPLIANCE COSTS

Evans[27] has noted that studies into tax compliance costs have used both quantitative and qualitative approaches, though there is a far greater emphasis on quantitative data collection techniques. The studies have used a variety of specific research methodologies to research into aspects of compliance costs. These have included surveys conducted through a variety

[25] Some examples are one-off cash voucher of AUS$200 for businesses during the introduction of the GST in Australia; see B Tran-Nam, "The implementation costs of the GST in Australia: Concepts, estimates and implications", *Journal of Australian Taxation*, (2000), 3(5): 331 at 340; or the Chinese Government's practice of offering businesses a small proportion of tax revenue that they collect on behalf of the government; see B Tran-Nam, "The Chinese and Australian tax systems: A comparative overview", *Atax Discussion Paper Series No. 11*, (2002, Sydney, Atax) at 18.

[26] See, for example, P Lignier, "Measuring the managerial benefits of tax compliance: A fresh approach", *Australian Tax Forum*, 2009, 24(2): 117.

[27] C Evans, "Taxation compliance and administrative costs: an overview", in M Lang, C Obermair, J Schuch, C Staringer and P Weninger (eds), *Tax Compliance Costs for Companies in An Enlarged European Community*, (2008, Vienna, Linde Verlag and London, Kluwer Law International) at 456.

of means including commercial polling organizations, mail, email, telephone and internet; interview-based methodologies; diary and case study approaches; documentary analysis; and estimating/simulating techniques. Sometimes the studies have employed a combination of these approaches.

Whilst the large scale survey approach tends to dominate the field[28], principally using what has come to be known as the "Sandford" methodology (or refinements of it),[29] there has also been a lot of growth since the mid-2000s in the use of estimating/simulating techniques such as the Standard Cost Model (SCM). The SCM – also known as the Dutch model – applies a base formula (Activity Cost = Price (*tariff* × *time*) × Quantity (*population* × *frequency* × *rate*)) to measure the burden of tax regulation. The resulting estimate of costs is only a partial measure of full compliance costs (for example, it does not seek to measure voluntary compliance costs and a host of other costs) but nonetheless has shown itself to be a further useful methodology for benchmarking purposes.

The EC Working Paper[30] identifies a series of largely government endorsed or developed estimating models, some based upon SCM, currently in use. These include:

- the World Bank PwC Paying Taxes model;
- methodologies used by the United States Internal Revenue Service (IRS) including the Individual Taxpayer Burden Model (ITBM), the Small Business Burden Model (SBBM) and the Business Taxpayer Burden Model (BTBM);
- the Total Costs of Regulations to Businesses (TCR), which has been used by the Board of Swedish Industry and Commerce for Better Regulation;
- the Scanning Instrument Regulations of Other Compliance Costs (SIROCCO);
- the Regulatory Check-up model (RCM), used in Switzerland;

[28] See n 12 at at 10.
[29] B Tran-Nam, C Evans and P Lignier, "Personal tax compliance costs: Recent evidence from Australia", *Australian Tax Forum*, 2014, 29(1): 135 at 138.
[30] See n 12 at 9 and 22.

- the Guidelines on the Identification and Presentation of Compliance Costs (GIPCC), used by public authorities in Germany;
- the Cost driven Approach to Regulatory burden (CAR), a Dutch methodology developed by SIRA Consulting; and
- the Complexity Index (CI) used by the United Kingdom's (UK's) Office of Tax Simplification (OTS).

Whatever methods are used for identifying and measuring tax compliance costs, the research has tended to point to a number of consistently recurring outcomes, which are explored in the next section.

2.3 WHAT THE RESEARCH SHOWS

Three themes consistently emerge from tax compliance costs studies: tax compliance costs are large; they are regressive and they are not diminishing over time,[31] although many government agencies might seek to add – to the third of those conclusions – a rider to the effect that they are not diminishing over time "in the absence of policy action".[32] Unfortunately there may be an element of wishful thinking involved, as much research also suggests that they continue to rise inexorably despite policy action.[33]

For the SME business sector, research conducted in Australia[34] shows that business size tends to be the main factor determining the magnitude of tax compliance costs at the firm level. The number of taxes (both federal and state) that the business has to deal with is also a significant determinant irrespective of firm size. In addition, there is a clear perception

[31] See n 27 at 457.
[32] See n 12 at 8.
[33] See, for example, P Lignier, C Evans and B Tran-Nam, "Tangled up in tape: The continuing tax compliance costs plight of the small and medium enterprise business sector", *Australian Tax Forum*, (2014), 29(2): 217 at 217.
[34] See n 33, 217–247.

among SMEs that the complexity of tax laws, the frequency of tax changes and the administrative requirements imposed by the revenue authority are significant drivers of tax compliance costs for their business.

Simultaneous research in the large and international business sector in Australia[35] confirmed the SME findings that the size of the firm and the number of taxes it had to deal with were major determinants of tax compliance costs. In addition it established that three broad drivers of tax compliance costs were perceived by those responsible for the tax affairs of such firms: the complexity and uncertainty of tax rules; the administrative compliance requirements imposed by tax authorities; and international exposure.

In addition to these findings, research has established that tax compliance costs vary by reference to the nature of the tax. For example (and not surprisingly), simpler taxes (those with fewer rate differentiations, fewer exemptions etc) are likely to lead to lower compliance costs.[36] Tax compliance costs, the research also indicates, may have a bearing on tax compliance itself. In this case, the argument goes, the simpler the tax system, the lower the costs and the higher the expected degree of voluntary compliance.[37]

3.0 HOW NEW ZEALAND COMPARES: AN INTERNATIONAL ANALYSIS

This section seeks to compare NZ's tax compliance cost estimates with those obtained from comparable countries. Initially a brief overview of international studies/comparisons of

[35] C Evans, P Lignier and B. Tran-Nam, "The tax compliance costs of large corporations: Recent empirical evidence", paper presented at the *National Tax Association Conference* (21–23 November 2013, Tampa Bay, Florida, National Tax Association).
[36] See n 12 at 4.
[37] Ibid.

tax compliance costs is presented. The remainder of this section then focuses on considering NZ's experiences from an international perspective.

Despite the widespread use of empirical studies into tax compliance costs around the world in the past 20 years, there have been very few truly international comparisons or studies that have taken place during that same period. Traditionally, some of the national studies contain comparative sections where the outcomes for one country are compared with those in others.[38]

The lack of international comparisons is not surprising as the dangers of such comparisons are well known to most researchers. Sandford[39] identifies a number of reasons why such comparisons are more likely to mislead than enlighten. These include:

- they may involve a wide variety of taxes surveyed at different times;
- there may be significant differences in methodology, including issues such as sample frame, response rates or extent of validity testing;
- there may be different interpretations and definitions of what constitute tax compliance costs;
- there are also different tax structures involved;
- the composition of the tax population may differ;
- the rates of tax may differ;
- tax revenue fluctuations may cause comparisons based upon ratio analysis (for example, the ratio of tax compliance costs to revenue collected) to be misleading;
- compliance cost comparisons may not take into account the fact that in some countries some government spending takes place through the tax system (tax

[38] See, for example, n 18 at 58.
[39] See CT Sandford (ed.), *Tax Compliance Costs Measurement and Policy*, (1995, Bath, Fiscal Publications) at 405.

expenditures) whilst in other countries the same program (business or social) may be effected through direct expenditures; and

- tax compliance costs cannot always be usefully compared without reference to the tax administrative costs incurred by revenue authorities.

Not surprisingly, in an earlier publication, the same author offered the advice that "comparisons of … tax compliance costs or operating costs should be used sparingly, with the greatest care and with a comprehensive statement of their limitations". [40]

Some forms of international studies have nevertheless emerged in recent years. One example is the business-driven PricewaterhouseCoopers (PwC) Paying Taxes ranking, developed as part of the World Bank/International Finance Corporation's *Doing Business Project*. The ranking is intended to measure the ease of paying taxes in different countries over time. It is confined to taxes and mandatory contributions imposed by all levels of government (federal, state/province or local) on medium-sized companies.[41] The PwC Paying Taxes ranking is an arithmetic mean of the percentile rankings of each of the three indicators: total tax rate, time taken to comply with tax laws (hours per year) and number of payments per year. The PwC database currently covers values of the above three indicators for a large number of countries (increasing from 175 in 2005 to 189 in 2014) over a number of years (from 2005 onward).

While the PwC Paying Taxes ranking provides a convenient way for international comparison, its usefulness as an indicator of tax compliance costs appears to be limited for a number of reasons. First, its focus on medium-sized companies restricts the usefulness of the PwC Paying Taxes ranking, particularly because the definition of medium-sized companies

[40] CT Sandford, "International comparisons of administrative and compliance costs of taxation", *Australian Tax Forum*, (1999), 11(3) at 306.
[41] PricewaterhouseCoopers (PwC), *Paying Taxes 2014: The Global Picture*, (2014, PwC and World Bank/IFC) at 139.

appears to be somewhat arbitrary.[42] The majority of businesses in most countries are small businesses, while it is the large companies that may be of interest to international investors. Second, the total tax rate, however calculated, is more an indicator of tax burden rather than of tax compliance burden. Third, the time taken to comply with tax laws and number of payments are clearly inadequate proxies to capture the whole of the tax compliance burden. In particular, the omission of the costs of external tax advisers may bias the numerical results obtained. And finally, the statistical validity of the PwC approach and results is also a matter of some concern. Little information has been provided about its sampling procedure in each country under study and it is not clear how the PwC analysts deal with such issues as random and representative samples, non-response bias, etc.

In addition there have been a few international comparative studies in recent years which have focused more specifically on compliance costs themselves, though the number of countries involved has been considerably smaller than the coverage in the PwC survey. In earlier years Bannock and Albach[43] compared VAT compliance costs in Germany and the UK, whilst Evans[44] considered capital gains tax operating costs (compliance costs of taxpayers and administrative costs of revenue authorities) in Australia and the UK. In addition, Cordova-Novion and De Young[45] undertook a multi-country survey of business tax compliance costs in 11 countries for the OECD, and the EC[46] surveyed corporate compliance costs in 14 Member States.

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[42] See n 41 at 140.

[43] G Bannock and H Albach (1989), "The compliance costs of VAT for smaller firms in Britain and West Germany", in G Bannock and A Peacock (eds), *Governments and Small Business*, (2004, London, Paul Chapman).

[44] C Evans, *Taxing Personal Capital Gains: Operating Costs Implications*, (2003, Sydney, Australian Tax Research Foundation).

[45] C Cordova–Novia and C de Young, "The OECD PUMA multi country business survey – Benchmarking the regulatory and business environment", in C Evans, J Pope and J Hasseldine (eds), *Tax Compliance Costs: A Festschrift for Cedric Sandford*, (2001, Prospect, Sydney) 205.

[46] EC, "Taxation papers: European tax survey", *Working Paper 3/2004*, (2004, Luxembourg, Directorate General Taxation and Customs Unit).

More recently, an international comparative study has attempted to measure tax compliance costs and managerial benefits of small businesses in Australia, Canada, South Africa and the United Kingdom during the financial year 2010–11.[47] This is a coordinated international study which utilised broadly similar conceptual approaches and survey instruments. However, this international study still suffers from the data problem identified previously, i.e., there were significant variations between the participating countries in the quality of data compared in terms of sample frame, response rate and extent of validity testing.

Having briefly reviewed the status of international studies and comparisons, the article now focuses on NZ experiences. To this end, it separately considers the tax compliance costs of individual non-business, SME, and large enterprise taxpayers in turn.

3.1 THE TAX COMPLINCE COSTS OF NON-BUSINESS TAXPAYERS

To the best of the authors' knowledge, there exists no discrete study of the tax compliance costs of non-business individual taxpayers in NZ. Concern for tax compliance costs in NZ first arose in the late 1980s. As pointed out by Sawyer and Smith,[48] the first evidence of official recognition was the release in 1989 of the IR's *Consultative Document on Tax Simplification*. However, there has been little interest in estimating the tax compliance costs of non-business taxpayers for two reasons. First, since the tax reform in NZ in the second half of the 1980s, most personal taxpayers have been taxed at source through the widespread

[47] C Evans, A Hansford, J Hasseldine, P Lignier, S Smulders and F Vallaincourt, "Small business and tax compliance costs: A cross-country study of managerial benefits and tax concessions", *eJournal of Tax Research*, (2014) 12(2): forthcoming. New Zealand was also initially a part of this international project. However, for a variety of reasons, including the Christchurch earthquake in 2011, the NZ study could not be incorporated in the project and has subsequently been presented separately; see R Gupta and A Sawyer, "Tax compliance costs for small businesses in New Zealand: Some recent findings", paper presented at the *Australasian Tax Teachers Association Conference*, (20–22 January 2014, Brisbane, ATTA).

[48] AJ Sawyer and AMC Smith, "National report New Zealand" in M Lang, C Obermair, J Schuch, C Staringer and P Weninger (eds), *Tax Compliance Costs for Companies in An Enlarged European Community*, (2008, Vienna, Linde Verlag and London, Kluwer Law International) at 260.

use of withholding taxes, including on interest and dividends.[49] Second, as a result of tax reform, there have been no allowable work related deductions against employment income except for the fees paid to professional advisers for preparing tax returns and certain premiums for loss of earnings insurance. As a result, the percentage of NZ adults who are required to file annual tax returns has reduced from 75 per cent in the mid 1990s to 30 per cent in 1999 for those receiving income from employment, interest and dividends.[50]

While there have been no formal studies into personal taxpayer compliance costs, there has been some interest in the compliance costs of personal taxpayers using various tax refund organisations to assist them in obtaining overpayments of tax.[51]

In the absence of any formal study, it may be helpful to look at the percentage of individual income tax returns prepared by tax agents in some relevant and comparable countries, as this may help to explain the relative dearth of formal study into personal taxpayer compliance costs in NZ. According to the latest OECD publication, the reported figures of tax agent usage for individual taxpayers in 2011 for Australia, Canada, NZ, the UK and the US were 72 per cent, 51 per cent, 48 per cent, 65 per cent and 60 per cent respectively.[52] The NZ figure is clearly the lowest. Bearing in mind that "individual" taxpayers include both individual non-business and individual business taxpayers (such as sole traders, partners, etc), it seems plausible that the NZ figure for individual non-business taxpayers in 2011 would be substantially lower than 48 per cent and that the reduction in tax agent usage ratio would be larger than corresponding reductions in the other comparative countries. Moreover, the figures reported relate to tax returns prepared by intermediaries in 2011. In New Zealand (as in the UK) not all individuals are required to submit returns (and

[49] T Dalsgaard, "The tax system in New Zealand: An appraisal and options for change", *OECD Economics Department Working Paper No. 281*, (2001, Paris, OECD) at 5.
[50] See n 48 at 260.
[51] Private communication from Professor Adrian Sawyer to the authors.
[52] OECD, *Tax Administration 2013 Comparative Information on OECD and Other Advanced and Emerging Economies*, (2013, Paris, OECD) at 261.

less than half actually do). In contrast virtually all individuals in Australia, Canada and the US are required to submit a return (and virtually all do). This means that the “real” figure for NZ (as for the UK in regard to its 65 per cent) is far lower than the 48 per cent suggested by the OECD.

In short, while no formal study is available, it is safe to conclude that, as a result of tax policy simplification in the period from the late 1980s onwards, tax compliance costs of personal non-business taxpayers in NZ, whether measured in dollar terms or relative to tax revenue or GDP, are likely to be lower than corresponding estimates in other comparable countries.

3.2 THE TAX COMPLIANCE COSTS OF THE SMALL AND MEDIUM ENTERPRISE BUSINESS SECTOR

The SME sector has been the focus of empirical studies on tax compliance costs in NZ since the early 1990s. The definition of the SME sector in terms of number of employees has been relatively stable throughout that period, and also consistent with that of large businesses. For example, Statistics NZ[53] has defined small enterprises (including micro enterprises) as those having less than 20 full-time employees and medium enterprises as those having between 20 to 49 full-time employees. These definitions have been widely adopted in NZ empirical studies.[54] An alternative approach is to define SMEs in terms of an annual turnover threshold. Until 2003, the turnover threshold between SMEs and large enterprises was NZ$20 million according to NZ’s Financial Reporting Act 1993. It was raised to NZ$30

[53] See n 3 at 3.
[54] See, for example, IR, *The Cost of Business Tax Compliance*, (2010, Wellington, Evaluation Services) and n 47, Gupta and Sawyer.

million in the Financial Reporting Act 2003.[55] Researchers in NZ have tended to opt for the employment size approach to SME in their empirical investigations, although the turnover-based definition of business size has also been employed.

Over the years a number of studies into the tax compliance costs of NZ SMEs, using different data collection strategies, have been conducted. Their key features are summarised in Table 1.

[55] New Zealand Parliament Counsel Office, *Financial Reporting Act 2013*, *New Zealand Legislation*, accessed 25 May 2014 http://www.legislation.govt.nz/act/public/2013/0101/latest/DLM4632829.html?src=qs.

Table 1: Key features of NZ studies into the tax compliance costs of SMEs

	Year of study	Scope of taxes under study[a]	Definition of SME	Data collection strategy	Effective sample size[b]
Sandford & Hasseldine[56,c]	1990–91	PAYE, FBT, GST & BIT	Turnover[d]	Large-scale survey, postal questionnaire	1,887 (employment tax survey); 2,954 (GST and income tax survey)
Ritchie[57]	1998	PAYE, FBT & GST	Unstated	Case study, diaries & interviews	19
Alexander, Bell & Knowles[58]	2003	PAYE, FBT, GST & BIT plus other regulations	Number of employees	Case study, interviews & diaries	25
Colmar Brunton (on behalf of IR)[59]	2005	PAYE, FBT, GST & BIT	Number of employees combined with turnover	Large-scale survey, postal questionnaire	1,739 plus 275 tax agents
IR[60]	2009	PAYE, FBT, GST, BIT & KiwiSaver	Number of employees combined with turnover	Large-scale survey, postal questionnaire	1,728
Gupta & Sawyer[61]	2012	PAYE, FBT, GST, BIT & KiwiSaver	Number of employees	Large scale, online questionnaire	118

Notes:
[a] PAYE = Pay As You Earn; FBT = Fringe Benefits Tax, GST = Goods and Services Tax and BIT = Business Income Tax.
[b] Defined as number of usable responses received.
[c] This study was critically evaluated by the Business Research Centre[62] on behalf of the IR. The evaluation exercise found some minor errors and areas of disagreements but no significant flaws in the original study.
[d] Although this study did not focus on SMEs, estimates of compliance cost by turnover were available. Thus, it is possible to isolate the tax compliance costs incurred by SMEs.

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[56] CT Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*, (1992, Wellington, Institute of Policy Studies, Victoria University of Wellington).
[57] K Ritchie, "The tax compliance costs of small business in New Zeaalnd", in C Evans, J Pope and J Hasseldine (eds), *Tax Compliance Costs: A Festschrift for Cedric Sandford*, (2001, Sydney, Prospect) 297.
[58] WRJ Alexander, J Bell and S Knowles, "Quantifying compliance costs of small businesses in New Zealand", *Economics Discussion Paper No. 0406* (2004, Dunedin, University of Otago)
[59] C Brunton, *Measuring the Tax Compliance Costs of Small and Medium-Sized Businesses – A Benchmark Survey, Final Report prepared for Inland Revenue*, (2004, Auckland–Wellington, Colmar Brunton).
[60] See n 14, IR.
[61] See n 47, Gupta and Sawyer.
[62] Business Research Centre (BRC), *The Compliance Costs of Business Taxes in New Zealand: A Critical Review of the Sandford/Hasseldine Study*, (1993, Auckland, BRC)

Ritchie's study was only preliminary with little useful quantitative results while the study by Alexander et al did not produce separate estimates of the tax compliance burden. Thus, it is sufficient to focus on the mean of overall tax compliance costs derived from the remaining four studies in Table 1. These results are summarised in Table 2 where business size is principally classified on the basis of the number of employees. Note that results disaggregated by turnover are also available, but not reported here.

Table 2: Summary of estimates of tax compliance costs of NZ SMEs (current NZ$)

Sandford & Hasseldine[63] 1990–91		**Colmar Brunton[64] 2005**		**IR[65] 2009**		**Gupta & Sawyer[66] 2012**	
No. of employees	**Mean NZ$**	**No. of employees**	**Mean NZ$**	**No. of employees**	**Mean NZ$**	**Turnover NZ$m**	**Mean NZ$**
1-2	929	0	2,932	0	4,138	<1	24,027
3-5	1,394	1-5	5,694	1-5	6,698	1-<3	30,185
6-10	1,795	6-19	6,827	6-19	9,501	3-<6	36,336
11-20	2,425						
21-50	4,019	20+	7,649	20+	9,447	6+	37,439
		All	**4,024**	**All**	**5,557**	**All**	**31,096**

There is a certain level of consistency in the results of the first three of the four studies, with average compliance costs ranging from just under NZ$1,000 through to just under NZ$10,000 (in current dollar terms) across those three studies, but reasonably clustered when disaggregated by reference to the number of employees. However it is interesting to note that the fourth study, by Gupta and Sawyer, indicates substantially higher tax compliance costs incurred by NZ SMEs in 2012. Their estimates range from over $24,000 (for small businesses with annual turnover less than NZ$1 million) to over NZ$37,000 (for small businesses with annual turnover of NZ$6 million or more), with an overall average of over $31,000.

[63] See n 56 at 33 (Table 4.4).
[64] See n 59 at 98 (Table 9.4).
[65] See n 60 at 54 (Table A.1).
[66] See n 47 at 33 (Table 20).

There are two possible explanations for the apparent discrepancy between the outcomes of the Gupta and Sawyer study and the other three. In the first place it is not inconceivable that the compliance costs of the SME sector may have soared in the period 2009 through to 2012. But though it is not inconceivable, it is highly unlikely, particularly given that there were no seismic shifts or major changes in the composition and operation of the NZ tax system as it related to the SME sector in that period.

The second possible explanation, which may be more plausible, relates to the reliability of the outcomes of the Gupta and Sawyer study. It may be the case, as the authors themselves acknowledge, that the quality of the data from that study is somewhat uncertain. For example, it is not clear how representative of NZ SMEs their effective sample size was. Further, given the small effective sample size of 103, it may be very difficult to achieve valid generalisations for estimates of four different turnover categories. In addition, since the estimates of internal costs are extremely high, there may have been problems with time valuation. Thus, it may be sensible to treat the study by Gupta and Sawyer as representing the upper bound of possible compliance costs, and somewhat tentative while waiting for the publication of results from the 2014 survey by the IR, not yet publicly released. If there has been a significant upward trend in tax compliance costs since 2009, that survey will be likely to reflect any such trend and validate the outcomes of the Gupta and Sawyer survey.

Focusing, therefore, on just the first three studies in Table 2, how have NZ SME tax compliance costs in NZ changed over time? An initial review of the results suggests a steady upward trend in the period 1991 to 2009. For example, SMEs in the 6 to 20 employee category incurred average tax compliance costs of about NZ$2,000 in 1991, about NZ$7,000 13 years later in 2004, and about NZ$9,000 five years later in 2009.

However that is a view based on the current dollar values expressed in that table. A somewhat different picture emerges when constant dollars are considered. On the basis of the results presented in Table 2, there has been a suggestion that, after allowing for price adjustment, there were in fact reductions from 1991 to 2004 of approximately 40 per cent (from $5,000 to $3,000) for small businesses (up to 20 employees) and 50 per cent (from $9,000 to $4,000) for medium businesses (businesses with 20 to 50 employees). This claim was made by David Cunliffe,[67] Associate Minister for Finance, Revenue and State-Owned Enterprises, in July 2005. It is based on a table taken from the 2005 Colmar Brunton Report and reproduced in the Associate Minister's media statement. While any claim of such large reductions definitely requires more thoughtful scrutiny, it seems reasonable to accept that that there may have been a declining trend in tax compliance costs incurred by NZ SMEs from the early 1990s to the mid 2000s. In the period 2004 to 2009, taking into account inflation, tax compliance costs appear to be relatively stable.

The 2004 tax compliance costs survey was the first in a series of tax compliance costs research surveys sponsored/conducted by the IR as part of its long-term strategy to make it easier for businesses to meet their tax obligations and to increase their confidence in tax administration.[68] The 2004 survey was intended to be a benchmark survey that could be replicated every five years. The design of this survey also benefited from collaborative advice of a number of consultants, including the present authors[69] and past Atax surveys.[70] The private consulting firm Colmar Brunton was commissioned by the IR to undertake a mail survey of SMEs (based on number of employees and annual turnover) between October and December 2004 after extensive pilot testing and cognitive interviews of the questionnaire and

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[67] D Cunliffe, "Red tape radically reduced", *Media Statement 19 July 2005*, accessed 25 May 2014 <http://taxpolicy.ird.govt.nz/news/2005-07-19-tax-compliance-cost-research>.
[68] See n 59 at 13.
[69] See n 17.
[70] See n 18.

pilot data verification interviews. A tax adviser sub-survey was also conducted in December 2004 to apportion external tax adviser costs to different tax types.

The information about selection criteria, population size, send-out sample sizes, effective sample size and overall response rate is summarised in Table 3, contained later in this section. There were two versions of the questionnaire: a short one for SMEs paying income tax only and a full one for SMEs paying multiple taxes. In addition, letters of consent were first sent out by the IR and, based on taxpayers' responses, questionnaires were sent out by Colmar Brunton. The overall response rate reported in Table 3 (44 per cent) is based on the IR's send-out sample size. The survey was not anonymous as Colmar Brunton was able to make telephone reminders to business participants in order to maximise response rate.

Estimates of internal costs were derived by combining the internal time spent (annual hours) and value of time (NZ$ per hour). The value of time relating to owners and unpaid friends or relatives was based on survey responses while the value of time relating to paid employees was derived from Statistics NZ's Quarterly Employment Survey September 2004.[71] Annual tax compliance costs were obtained by adding internal and external costs. Note that estimated tax compliance costs were based on trimmed mean which excluded extreme values at the upper end (i.e. outliers).[72] Estimates of combined tax compliance costs were disaggregated by business size and tax type. In addition, psychological costs associated with tax compliance were captured by a seven-step Likert scale (with a "not applicable" choice). Further, there was also an attempt to measure the incidence of IR audit and related time and costs incurred by SMEs.

Estimates of various key components of tax compliance costs from the 2004 survey are summarised in Table 3. Consistent with previous international empirical findings, it is

[71] See n 59 at 54.

[72] This is not an unusual practice; see, for example, Evans et al, n 18 at 7. However, the trimmed means in Evans et al were generated by statistical software using a fixed rule approach (eliminating the largest five per cent and the smallest five per cent of observed values in the sample). It is not clear from the 2004 report how Colmar Brunton did the trimming.

evident that the combined tax compliance costs were regressive in relation to business size (Brunton 2004: 98). This regressivity is further confirmed by the results of the 2009 IR survey.

The 2009 tax compliance costs survey was intended to serve a three-fold purpose: (i) to estimate the tax compliance costs of SMEs in NZ in 2009, (ii) to measure the change in SME tax compliance costs since 2004, and (iii) to evaluate the effectiveness of GST and provisional tax alignment. In terms of policy context, there were several specific initiatives aimed at making tax compliance easier for SMEs. They included GST and provisional tax alignment, subsidised payroll intermediaries and a discount for early payment of provisional tax in the first year of business.[73] There were other changes impacting on GST, PAYE and FBT arising from the 2009 Business Tax Measures packages.[74]

To maximise comparability, the 2009 survey essentially adopted the 2004 survey methodology in terms of definitions of tax compliance costs, sample selection, questionnaire design and cognitive testing and survey conduct. Nevertheless, there were some differences that may impact on survey outcomes as briefly noted below.

First, the relevant population under study was divided into two sub-populations: SMEs paying income tax only and SMEs paying multiple taxes. In response to the cognitive testing results of the questionnaire, the sub-population of SMEs paying income tax only was further split into taxpayers completing IR 4, IR 6 or IR 7 forms. It is interesting to note that the ratio of SMEs paying multiple taxes over all SMEs increased significantly from 77.68 per cent in 2004 to 93.74 per cent in 2009.

Second, the 2009 survey was directly administered by the IR rather than through a research organisation.

[73] See n 60 at 4.
[74] For details refer to n 60 at 13.

Third, unlike the 2004 survey, an initial letter informing potential participants of the survey was not sent. There were two reasons for this: (i) there was no need for a letter of introduction as the IR administered the survey by itself, and (ii) the pilot test suggested that using a letter of introduction would not improve the response rate.[75] While not sending out an initial letter did save some resources, this may have impacted on the eventual rate of response as discussed below.

The conduct and findings of the 2004 and 2009 surveys are summarised in Table 3. To take into account the effect of price inflation, the 2009 survey is conveniently used as the base year. Thus, monetary values associated with the 2004 survey are expressed in both current (i.e. 2004) dollar and constant (i.e., 2009) dollar terms (the latter in parenthesis).

It is apparent that the two surveys are consistent and comparable in terms of sample selection, questionnaire design and survey conduct. The response rates were very high in both surveys. The higher overall response rate in the 2004 survey appeared to be mainly attributable to the more pro-active, two-stage approach in contacting participants in 2004. The lower response rate in 2009 may also result from the "survey fatigue" syndrome that has been observed in recent international surveys on tax compliance costs.[76] It is, however, interesting to note a clear difference in the response rates of full- and short-questionnaire respondents in 2009 which was not observed in 2004.

The empirical findings are interesting. After adjusting for the effect of price inflation, there was a small decrease in average internal costs and a negligible increase in average external costs, resulting in a 1.3 per cent decrease in average combined tax compliance costs from 2004 to 2009.

Four further points deserve mention. First, there were significant percentage decreases in all categories of labour in relation to internal time spent on tax compliance. However, these

[75] See n 60 at 21.
[76] See n 47, Evans et al.

decreases translated only to a small decrease in internal costs because the values of time for all labour categories have increased in constant dollar terms over the same period. This creates a conceptual difficulty because, while government policies directly affect internal time spent on tax compliance, they cannot influence the market or imputed wages of labour services in a market based economy such as that of NZ.

Second, between 2004 and 2009 the KiwiSaver was introduced. Had KiwiSaver been excluded, there would have been a more pronounced decrease in average combined tax compliance costs.

Third, the ratio of businesses paying multiple taxes over businesses paying income tax only in the effective sample was much higher in 2009 than in 2004. This rising ratio may partly explain why business tax compliance costs did not reduce much from 2004 to 2009. Fourth, together with the decrease in average monetary costs of tax compliance, there was also a small decline in stress level of tax compliance from 3.4 in 2004 to 3.2 in 2009.[77]

[77] In expressing the stress level as an arithmetic mean, it was implicitly assumed that the stress level variable is treated as an interval scale.

Table 3: Comparisons of 2004 and 2009 NZ surveys[78]

	2004 survey	2009 survey
Selection criteria	Less than 50 staff or annual turnover of less than NZ$10m	Less than 50 staff or annual turnover of less than NZ$12.5m
Population size	485,317	444,699
paying income tax only	108,338	27,856*
paying multiple taxes	376,929	416,843
Sample selection	Disproportionate stratified random sampling (legal form, tax type, turnover and number of employees)	Disproportionate stratified random sampling (legal form, tax type, turnover and number of employees)
Questionnaire development	Cognitive interviews (16), pilot testing & pilot data verification interviews	Cognitive interviews (21) & large-scale pilot testing (300)
Length of full questionnaire	Eight A4 pages	Nine A4 pages
Send-out sample size (letter)	5,338	None
short questionnaire	1,338	None
full questionnaire	4,000	None
Send-out sample size (survey)	4,848	5,000
short questionnaire	1,162	500
full questionnaire	3,686	4,500
Effective sample size	2,353	1,728
short questionnaire	604	117
full questionnaire	1,709	1,611
Response rate (overall)	44%	35%
short questionnaire	45%	36%
full questionnaire	44%	23%
Average value of time (per hour)*		
Owners/partners/directors/trustees	NZ$44 ($52)	NZ$61
Paid employees	NZ$20 ($23)	NZ$25
Unpaid friends or relatives	NZ$26 ($29)	NZ$33
Average annual hours spent		
Owners/partners/directors/trustees	66	55
Paid employees	20	18
Unpaid friends or relatives	4	3
Average internal costs**	NZ$3,002 ($4,075)	NZ$3,995
Average external costs**	NZ$1,022 ($1,635)	NZ$1,639
Average combined costs**	NZ$4,024 ($5,628)	NZ$5,557
Level of stress***	3.4	3.2

Notes:
* This figure was derived by adding number of sole traders completing IR 3 income tax returns (8,567) and number of businesses completing IR4, IR 6 or IR 7 forms (19,289).
** Monetary values in brackets are in 2009 dollars; see IR.[79]
*** Based on a 7-point stress level scale.

For a snapshot comparison, it is possible to compare NZ's 2004 and 2009 survey estimates with those obtained from the recent international study by Evans et al which obtained SME

[78] See n 59; n 54, IR; n 60.
[79] See n 54, IR.

data for Australia, South Africa and the UK,[80] and also with the outcomes of the much larger Australian SME survey conducted by Lignier et al.[81] Table 4 summarises these recent international findings on average tax compliance costs of the SME sector in comparable US dollars. The ratios of internal and external costs to combined compliance costs are in parentheses.

Table 4: International comparison of tax compliance costs of SMEs (US$) 2010–11

	NZ Inland Revenue[a]	NZ Gupta & Sawyer[b]	Australia Evans et al[82]	Australia Lignier et al[c]	South Africa Evans et al[83]	UK Evans et al[84]
Year of study	2009	2011–12	2010–11	2011–12	2010–11	2010–11
Internal costs	3,242	18,434	20,879	7,759	7,542	23,326
External costs	1,330	4,690	13,761	3,506	4,755	13,175
All costs	**4,573**	**23,124**	**34,640**	**11,266**	**12,297**	**36,500**
Ratio of internal costs to external costs	71:29	80: 20	60:40	69:31	61:39	64:36

Notes:
[a] Based on IR,[85] adjusted for price inflation from 2009 to 2010–11 (107%) and average exchange rate during 2010–11 (NZ$1 = US$0.7585).
[b] Based on Gupta and Sawyer,[86] adjusted for price deflation from 2012 to 2010–11 (98%) and average exchange rate during 2010–11 (NZ$1 = US$0.7585).
[c] Based on Lignier et al,[87] adjusted for price deflation from 2012 to 2010–11 (99%) and average exchange rate during 2011–12 (A$1 = US$1.0362).

Bearing in mind the difficulties associated with international comparison of tax compliance cost estimates, Table 4 suggests that New Zealand tax compliance costs compare favourably in constant dollar terms, with those from other countries – even when we are using the high estimates from the Gupta and Sawyer study. When the low estimates from the

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[80] See n 47, Evans et al. Canada was also involved in the study. However data limitations relating to the Canadian part of the study preclude its inclusion in this and subsequent comparisons.
[81] See n 33.
[82] See n 47, Evans et al Table 6).
[83] Ibid.
[84] Ibid.
[85] See n 60 at 54 (Table A.1).
[86] See n 61 at 33 (Table 20)
[87] See n 33 at 240 (Table 13).

IR's 2009 survey are used, NZ has the lowest tax compliance costs of all countries under study, including the less developed economy of South Africa.[88]

It is also interesting to note from Table 4 that NZ's relatively lower tax compliance costs are also associated with lower external costs as a percentage of combined costs. In both NZ studies the ratio of internal costs to external costs is significantly higher than in the two Australian, the South African and the UK studies. This seems to suggest that a possible determinant of lower compliance costs is the lower utilisation of external services by tax agents. That lower utilisation may, in turn, stem from a variety of factors in the NZ culture and tax system compared to these other countries, including (intuitively and entirely speculatively): less legislative complexity (or uncertainty); less administrative complexity/easier administrative and compliance processes that can be undertaken in-house rather than outsourced; and a lower propensity to engage in tax mitigation strategies.

Typically the GST/VAT is considered to be burdensome for the SME sector in terms of the internal resources of the business it consumes. The ratio of GST internal compliance costs to the income tax internal compliance costs for various countries under study can therefore also be compared. The results are presented in Table 5.

Table 5: Ratio of GST internal costs to income tax internal costs

Australia	NZ IR 2005	NZ IR 2009	NZ Gupta & Sawyer	South Africa	UK
2.71	1.19	1.58	2.23	1.28	1.39

Sources: Brunton[89]; IR[90]; Evans et al[91], Gupta and Sawyer[92].

[88] As a matter of interest, the rankings of Australia, Canada, New Zealand, South Africa and the UK in the 2014 Paying Taxes list were 44, 8, 23, 24 and 14, respectively; see n 41 at 165–166 (Table 1).
[89] See n 59 at 98 (Table 9.4).
[90] See n 60 at 54 (Table A.1).
[91] See n 47, Evans et al (Table 9.4).
[92] See n 61 (Table 10).

This empirical evidence suggests that the ratio has increased steadily over the years for NZ. Notwithstanding this steady increase, its ratio is currently well below that of Australia though it exceeds those of South Africa and the UK. The reasons for NZ's ratio exceeding the ratios in these two countries are not immediately obvious, but may lie in particular features of the NZ GST regime, such as registration threshold, reporting requirements etc. This suggests that this may be an area that could be explored further in order to establish whether simplification dividends are in prospect.

Overall, nonetheless, the international evidence suggests that the tax compliance burden of the SME sector in NZ compares favourably with its international counterparts. Even accepting that the IR studies in NZ may constitute the lower bounds of SME tax compliance costs and the Gupta and Swayer study the upper bounds, the tax compliance costs of the SME sector in NZ appear to be lower than, or roughly equal to, SME tax compliance costs in comparable regimes.

3.3 THE TAX COMPLIANCE COSTS OF THE LARGE BUSINESS SECTOR

There are two main approaches in defining a large business in New Zealand. The first approach, employed by Statistics New Zealand, defines a large business as one employing more than 50 full-time employees. The second approach is based on value of assets or revenue. According to NZ's Financial Reporting Act 2003, which has replaced the Financial Reporting Act 1993, a business is said to be large under this second definition if the total assets of the business and its subsidiaries exceed NZ$60 million or if the total revenue of the business and its subsidiaries exceeds NZ$30 million (NZ Parliament Counsel Office 2014).[93] The relatively low employment, asset and revenue thresholds used in the definition of large

[93] For incorporated subsidiaries of overseas companies to be classified as large, the asset and revenue thresholds are reduced to NZ$20 million and NZ$10 million respectively.

enterprises in NZ implies that even more caution must be exercised in comparing NZ estimates of tax compliance costs of large businesses with those derived from similar studies in comparable countries, where large business definitions often adopt higher thresholds.

There is very limited empirical evidence regarding the magnitude of tax compliance costs incurred by NZ large businesses. To the best of our knowledge, there are only three sources and none of them is entirely appropriate for our purpose at hand. The first source is the pioneering study by Sandford and Hasseldine,[94] later summarized in Hasseldine (1995).[95] The second is a study by Prebble (1995) commissioned by the NZ Treasury. The third is a more recent initiative on large enterprises tax compliance costs undertaken by the IR (2011). Each of these sources is briefly reviewed below.

Sandford and Hasseldine (1992)

The joint study by Sandford and Hasseldine, relating to the 1990–91 financial year, was not specifically designed to capture data on tax compliance costs of large NZ businesses. However, since business tax compliance costs classified by turnover are available from the study, it is possible to obtain some estimates of those costs for large businesses. Note that, defining in terms of number of employees, only 65 out of 1,583 (or 4.1 per cent) of respondents were businesses employing more than 50 employees; and defining in terms of revenue, only 58 out of 1,583 (or 3.1 per cent) of respondents were businesses having turnover of NZ$10 million or more. While the percentages may reflect the true distribution of large businesses in NZ at the time, the absolute size is insufficient for estimation by disaggregation and statistical generalisation. The gross tax compliance cost estimates of relevant business categories are summarized in Table 6.

[94] See n 56.

[95] J Hasseldine, "Compliance cost of business taxes in New Zealand", in CT Sandford (ed.), *Tax Compliance Costs Measurement and Policy*, (1995, Bath, Fiscal Publications) 126.

Table 6: Average compliance costs of business taxes (NZ$), NZ, 1990–91[96]

Business Size	PAYE	FBT	GST	BIT	Total	As percentage of turnover
$10–50 m	5,334	499	3,085	17,461	26,379	9
> $50 m	4,063	2,290	9,615	43,436	59,404	3

The most meaningful comparison of the above results is with the data derived from an Australian study conducted a few years later. Evans et al[97] found that the average gross compliance costs of large businesses in Australia (defined as those with annual turnover of A$10 million or more) in 1994–95 were A$91,864. Taking NZ inflation (GDP deflator indexed)[98] and the NZ-Australia exchange rate[99] into account, NZ$26,379 and NZ$59,404 in 1990-01 would be equivalent to A$25,277 and $A56,923 in 1994–95, respectively. Keeping in mind all the difficulties associated with international comparisons of tax compliance costs, this nevertheless suggests that gross tax compliance costs of large NZ business were well below corresponding figures in Australia at that point of time.

Unfortunately, a tax-by-tax comparison between the two countries is not possible because the study by Evans et al did not present estimates of large business tax compliance costs by tax type. Suffice to mention that in 1994–95 Australia still had a wholesale sales tax (WST) instead of a GST and the compliance burden of WST would fall principally on large business taxpayers. This may partially explain the much higher estimate of average tax compliance costs of large Australian businesses.

[96] See n 95 at 132 (Table 6.2).
[97] See n 18 at 52 (Table 4.11).
[98] From 1990-91 to 1994-95, NZ's GDP deflator index increased by 11.92 per cent from 93.65 to 104.81; see Statistics NZ, "GDP deflator index", *New Zealand Long Term Data Series*, accessed 25 May 2014 <http://www.stats.govt.nz/browse_for_stats/economic_indicators/NationalAccounts/long-term-data-series/national-income.aspx>.
[99] The average exchange rate in 1994–95 was A$1 = $NZ1.1680; see Reserve Bank of Australia (RBA), "F11 exchange rates", *Exchange Rate – Monthly – July 1969 to December 2009*, accessed 25 May 2014 <http://www.rba.gov.au/statistics/historical-data.html#exchange-rates>.

Prebble (1995)[100]

In 1991, Prebble was commissioned by NZ Treasury via the Institute of Policy Studies to conduct a study into the costs incurred by NZ companies in complying with the controlled foreign company (CFC) regime. Using a case-study approach, Prebble undertook, in 1991–92, in-depth interviews 14 of the largest 200 NZ company groups identified as having CFCs that would be subject to the CFC regime of NZ's income tax legislation. He found that the average start up and recurrent costs of the CFC regime of the 14 company groups were significant at about NZ$281,000 and NZ$227,000 respectively.[101] Similarly, the ratios of CFC compliance costs to turnover were much higher than overall business tax ratios obtained in Sandford and Hasseldine.[102] Given the specific nature, scope and methodology of Prebble's study, no further international comparison is made here.

Inland Revenue (2011)[103]

In 2010 the IR commissioned a study to gather information on large business views of their tax compliance costs, including KiwiSaver, and the possible magnitude of such costs. Initially 28 large businesses were interviewed face to face on their perceptions of tax compliance costs. Subsequently ten of the large businesses agreed to participate in a prototype survey to provide date about their actual tax compliance cost experiences. While the case-study results can be employed to design a future full-scale tax compliance cost

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[100] J Prebble, "Costs of compliance with the New Zealand controlled foreign company regime", in CT Sandford (ed.), *Tax Compliance Costs Measurement and Policy*, (1995, Bath, Fiscal Publications) 321.
[101] See n 101 at 345 (Table 15.2).
[102] See n 56 at 37 (Table 4.8), 64 (Table 6.7), 90 (Table 7.8) and 94 (Table 7.12).
[103] IR, *Large Enterprises Tax Compliance Costs*, (2011, Wellington, IR), accessed 25 May 2014 <http://www.ird.govt.nz/aboutir/reports/research/le-compliance-report/>.

survey of large NZ businesses, they do not provide statistically reliable results that can be generalised to the large business sector.

The full results of this preliminary study have not been made publicly available. However key qualitative findings have been reported as follows:

- the large businesses under study varied considerably by number of employees, ranging from under 50 to over 10,000 employees;
- underlying factors driving their tax compliance costs are complexity of legislation, frequency of tax law changes, the shift of payroll tax activities onto businesses, sorting out employees' tax matters;
- the most costly tax types in descending order are income tax, PAYE, GST and FBT;
- the most common and costly activities were interpreting and keeping up to date with tax law, accommodating changes to the tax environment, managing tax risk review, and tax planning; and
- psychological stress needs to be somehow included as part of tax compliance costs.

In conclusion, little is known about the actual tax compliance cost experiences of large businesses in NZ. For benchmarking (either as a time base or for international comparative purposes), it may be useful to conduct a specially designed survey to capture data and information on the tax compliance costs of large businesses in NZ, bearing in mind the qualitative results obtained in the 2010 study.

4 Conclusions

This article has noted that international comparisons of tax compliance costs are very difficult to make and need to be approached with considerable caution. Notwithstanding such caveats, a number of conclusions can reasonably be drawn in relation to how NZ compares, in terms of its compliance costs profile, with other developed countries.

The first and most obvious point that can be made is that empirical evidence of tax compliance costs in NZ is mainly confined to the SME sector. There are practically no studies of the tax compliance costs of personal and large business taxpayers in NZ. Nonetheless the compliance costs of NZ personal taxpayers are expected to be low at the individual level (essentially because income is taxed at source and virtually no tax deductions are allowed) and at the aggregate level (because of the low percentage of personal taxpayers required to submit tax returns and the relatively low levels of tax agent utilisation by those who do submit). These outcomes contrast strongly with personal income taxation in most other comparable OECD countries.

It is reasonably clear from the empirical evidence that does exist that the tax compliance costs of the SME sector in NZ are low by international standards. In part this may be attributable to the lower usage of external tax advisers. The observation can be made with some degree of confidence that the long term trend of stable (or possibly even declining) tax compliance costs incurred by SMEs in NZ stands in stark contrast with international experiences discussed previously. One simple explanation may be the NZ Government's commitment to (sometimes almost an obsession with) regulatory simplification (e.g., the Better Public Services programme), and the IR's willingness to devote considerable amounts of resources to monitoring the changes in business tax compliance costs. It is a shame that more international comparative data are not available, as if such data were available it would most likely confirm that a breakdown by reference to different types of tax (as opposed to the total compliance burden) would also show that NZ attracts relatively lower compliance costs compared to its international counterparts. Intuitively this is an expected outcome emanating from NZ's "purer" approach to tax design: simpler taxes and fewer rates, exemptions, preferences etc – the broad base low rate mantra.

More importantly, some of the evidence indicates that NZ SMEs appear to have been able to avoid the general international trend of increasing tax compliance costs (in constant prices) over time. It will be interesting to see whether the outcomes of the 2014 IR SME compliance costs survey confirm this trend.

The key strength of NZ appears to be its very lean business environment and (relatively) simple tax legislation. Continuous monitoring of the tax compliance burden by the IR suggests that there are no particular pressure points or problem areas that require immediate attention. Interestingly this is both positive and negative in its implications. The positive implications are obvious – NZ is doing very well on this front by international standards. However, based on the principle of cost-and-benefit analysis, to reduce tax compliance costs in NZ further through administrative reform measures or technological advances is likely to be costly to the society as a whole. Where compliance costs are high, reductions in that burden can be relatively easily garnered. It is much more difficult to achieve compliance costs savings where compliance costs are already relatively low. This may have significant implications for the achievement of the 25 per cent reduction target of the Better Service programme.

It is also worth stressing that NZ tax legislation is not entirely nor universally straightforward or simple, even on a relative comparable basis. There are areas of tax laws that are complex, especially in the context of multinational firms and their tax arrangements. This is an area where little is currently known, and future studies into the tax compliance costs of large businesses may prove to be more than useful in this area.

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