

Tax Compliance Costs of Small Businesses 2004: Improving the Estimates

*Prue Oxley and Stuart Turner, Inland Revenue, New Zealand; and
Charles Sullivan, Capital Research, Wellington, New Zealand*

A Benchmark of Tax Compliance Costs

Inland Revenue has an ambitious program of tax compliance cost research. It has two major aims:

- First, a prospective purpose of providing information to help forecast the expected compliance cost impact of proposed tax initiatives.
- Secondly, an evaluative one, measuring the impact of actual changes on the tax compliance costs faced by businesses. In particular:
 - by how much and in what direction do compliance costs change?
 - which elements of compliance costs change?
 - which groups of taxpayers are affected?

The research focuses on the tax compliance costs of small and medium-sized business (SME's) and it has been designed to respond to policy proposals as they arise over the next 5-10 years. The starting point was this major benchmark survey quantifying in dollar terms the tax compliance costs of small and medium businesses.

Because the work sits in an applied policy context, we found that its focus differs in small but important ways from previous compliance costs research. This paper describes some consequential conceptual and definitional subtleties involved in measuring tax compliance costs, some measurement issues, and response rate techniques. Finally, it summarizes the advances made and insights gained.

The Policy Context—Making Tax Easier for Small Businesses

The small and medium-sized business sector in New Zealand is important, as the majority of New Zealand businesses are indeed small:

- some 500,000 small businesses or self-employed business people
- 86 percent employ 5 or fewer staff
- 60 percent have no employees
- SME's account for 38 percent of the economy's output.¹

The government's tax simplification program recognizes that many small businesses struggle to comply with an increasingly complex set of tax laws. Key concerns for small businesses are the costs of compliance and the risks associated with noncompliance. The focus of the simplification program is on reducing the stress, uncertainty, and risks that these concerns place on small business.²

Design and Methodological Advances

Aspects that we were keen to refine or improve included:

- a survey responsive to the nature of small business in New Zealand
- achieving a more reliable response rate than the typical 30 percent-40 percent for business compliance cost surveys
- increased confidence in the number of hours recalled by businesses
- having information about external tax advisor costs allocated to different types of tax.

There is a large international body of tax compliance cost research that our exercise could build on, not least of which is the pioneering 1992 work of Sandford and Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*. Our current survey is the first comprehensive survey of tax compliance costs of businesses in New Zealand since that time. As well as learning from past experience, a strength of the work is its fitness for the local and current conditions—the design of the survey benefited from the collaborative advice of experts in tax compliance costs, in business, and in survey research.³

Definitions

The fact that this benchmark survey has an applied policy purpose has a number of implications for the definition and measurement of “compliance costs” adopted by Inland Revenue, a definition which differs from the more conventional one used in other surveys. It also forced us to construct a comprehensive and complex definition of “small business.”

Defining compliance costs

Inland Revenue's policy objective is to make taxpayer obligations as easy as

possible for those who wish to comply, and as difficult as possible to avoid for those who do not. This calls for a broad understanding of tax burdens and costs. A number of Inland Revenue's proposed initiatives aim to reduce the burden through easing cash flow or budgeting problems. It is important, therefore, to include a measure of cash flow benefit in the equation, in terms of dollars saved or foregone.

An example of such an initiative came into force on April 1, 2005. It gives an option of a discount of 6.7 percent for each dollar of income tax paid for self-employed people who pay provisional tax in their first year of business. Prior to this, taxpayers have not had the option to pay provisional tax in their first year of business. Instead, they pay tax on their first-year income in the second year of business when they are also paying tax for that second year. This can sometimes be a real financial strain for a new small business. The new option appeals to those worried about cash flow and encourages good budgeting and tax planning from the outset.

On the other hand, our calculation of tax compliance costs has excluded some less frequent tax activities that can generate unusually high compliance costs (e.g., costs associated with being audited). Similarly, activities where the tax component is not easily isolated (e.g., paying a payroll agency) were excluded. However, these costs were identified and quantified to varying degrees.

The foundation of the compliance cost definition adopted in this research is Evans's and Tran-Nam's "total compliance costs":⁴

(Direct monetary outgoings incurred by taxpayers + Imputed costs of time and resources spent by taxpayers) - (Managerial benefits to taxpayers + Cash flow benefits to taxpayers + Tax deductibility benefits to taxpayers + Cash grants from the government)

In practice, the definition for this benchmark quantifying exercise has had to trim off some of the less significant and less tractable elements:

$$\begin{aligned} \text{tax compliance costs} &= \text{internal time} + \text{external advisor costs} - (\text{cash flow benefits} + \\ \text{(benchmark)} & \quad \quad \quad \text{tax deductibility)} + \text{psychological costs} \\ & \quad \quad \quad \text{[The definition excludes audit costs, computing and other} \\ & \quad \quad \quad \text{internal nonlabor costs, external payroll provider costs]} \end{aligned}$$

where:

$$\begin{aligned} \text{internal time} &= \text{imputed costs of time spent by owners, staff, family, and} \\ & \quad \quad \quad \text{friends} \\ \text{external advisor} &= \text{direct monetary outgoings to tax advisers (regular and} \\ \text{costs} & \quad \quad \quad \text{occasional)} \\ \text{cash flow benefits} &= \text{financial benefits arising from the mismatch in timing} \\ & \quad \quad \quad \text{between when taxes are collected and when they are remitted} \\ & \quad \quad \quad \text{to the tax authority} \\ \text{tax deductibility} &= \text{for example, costs associated with using a tax advisor} \\ \text{psychological costs} &= \text{the level of stress associated with tax activities, including} \\ & \quad \quad \quad \text{finding the money; measures are not converted to dollars} \end{aligned}$$

Stress

Some tax simplification initiatives are clearly aimed at reducing taxpayer concerns about cash flow and budgeting. This emphasis prompted changes in the measures of psychological costs. Initially, we were careful to clearly separate the stress levels encountered in meeting tax obligations from stress involved in finding the money. This is consistent with traditional thinking about tax compliance costs as being costs separate from the money paid as tax. However, consideration of the initiatives aimed at ease of budgeting led us to specify that “finding the money” should be included as a source of stress in relation to specified revenues.

Defining small and medium business

We have been inclusive, representing what happens in the community rather than determining SMEs by tax arrangements. Some small businesses are very small—60 percent of businesses in New Zealand have no employees—and they needed to be included too.

The population of interest is small and medium businesses in New Zealand, including self-employed individuals with substantial incomes from business ~~activity but who pay no other business taxes (e.g., PAYE or GST)~~. The following dimensions were used to define an SME for the purposes of this quantitative survey:

1. business nature, indicated by
 - i. legal or business structure
 - ii. types of tax paid
2. business size, indicated by
 - i. number of employees
 - ii. annual turnover.

In general terms, SMEs were included if:

- they were registered for either GST or PAYE (as of June 30, 2004) as a company, partnership, trust, Maori Authorities, or self-employed individual, or
- they were registered for income tax only, and at least 50 percent of the income was from business (i.e., not rent, dividends, or investment income).

And excluded:

- on grounds of size, i.e., being too big—if they both employed 50 or more staff and had an annual turnover of \$10 million or more;
- where entities were not trading or virtually inactive.

Measurement Issues

This section describes efforts to refine some of the measures involved.

External tax advisor costs

Measuring external costs, particularly those of tax advisors, proved problematic in this project. Previous research shows these costs are substantial—around one-third of total business compliance costs (Sandford and Hasseldine, 1992). A similar pattern holds in Australia, as advised in our scoping report (Evans and Tran-Nam, 2004, p. 8).

In Inland Revenue's case, it is important to understand external costs in relation to specific policy initiatives, which in turn means in relation to specific taxes. Pre-testing indicated that some businesses regarded splitting external tax advisor costs by tax type as difficult or outright impossible and that going direct to the advisor was advisable.

After considering a number of options, in order to obtain more accurate costs, we proceeded with a separate survey of tax advisers linked directly to the businesses in the main survey, asking them provide the costs of the sampled business. This required consent from the sampled business which was forthcoming from only 32 percent of the businesses. Low levels of consent were identified with the pilot questionnaire, and the consent wording was modified to encourage greater consent, but refusals remained at a high level. Combined with the response rate of 50 percent from the accountants approached, only a relatively small number of completed questionnaires from tax advisers were received. For the many businesses who pay for tax advice for only one tax type (income tax), their own response concerning the external advice costs was considered acceptably accurate. Overall, we had data for 52 percent of the businesses that reported using external tax advice.

This project gained useful data and experience from surveying tax advisers. The data are useful for indicative estimates of the proportions of external advice costs associated with each tax type. The survey also provided data of international interest with respect to:

- Consistency between business estimates and external adviser estimates of total tax-related costs (we asked both businesses and ad-

visors about the total). There was a reasonably strong positive correlation,⁶ with, if anything, a tendency for agents to report higher than businesses.

- Consistency between business views and advisor views on whether or not the adviser would still be used to do annual accounts if New Zealand were tax-free (which contributes to understanding of the accounting/taxation overlap problem). Overall, both businesses and advisors were evenly split with half thinking they would still pay an advisor and half not. There were some differences by size and type of business structure—the “larger” small businesses and those with a company structure were more inclined to say they would stay with it. These differences were more exaggerated from the external advisors than the businesses.

Recalling time spent

Recalling time spent can be an approximate exercise, and yet it is most significant in the overall compliance cost calculations. To help control the scope for approximation, we adopted the Atax⁷ approach—we asked for it twice, in some detail, and broken down in two different ways. The main differentiation was tax type. First, for each tax type, we asked for time spent on different tax compliance activities (such as recording information); secondly, we asked how much time different people (ie, owner/partner, paid staff, unpaid family/friend) spent on tax in relation to each tax type. Steps taken to prevent discrepancies between the questions included:

- Totalling up the hours and minutes for each tax type, in each question.
- The instructions before the second question emphasized that “the total for each tax should be about the same as for [the previous question].”
- At the end of the second question, respondents were asked to check the totals for the two questions were similar and to tick “yes” or “no” accordingly; if “no,” they were asked to check and adjust.

We succeeded in preventing a major discrepancy: depending on the tax type in question, between 85 percent and 96 percent of answers were exact matches.

Other issues and decisions for strengthening the reliability of the core internal time questions are set out in Appendix 1.

Valuing time

The other element significant to the resulting compliance cost estimates is the value put on the time spent. We dealt with the following key components.

Conceptual issues

Labor costs have been valued at market wage rates where possible, and nonlabor costs (such as overheads) were excluded as they are expected to be negligible in most cases for small businesses.

Data sources

Data sources are a more difficult issue because of our focus on small business, and we expected most of the time spent will be that of owners/directors, not of employees (where the hourly wage rates provide a convenient estimate of opportunity cost). With business owners/partners, selecting a value to apply to their time is less objective because owners may do the tax compliance work in what would otherwise be leisure time.

We took the advice of previous research and cross-checked respondents' own valuations with external data (Sandford, 1995, p. 398; Evans and Tran-Nam, 2004, pp. 10-11). This led us to using:

- for paid employees: the Statistics NZ figure for average hourly earnings⁸
- for owners/partners: the respondents' valuation which was a middle-range estimate compared with external sources
- for unpaid friends or relatives: the respondents' valuation which was higher than any external proxies but similar to paid employees.

One extra consideration in choosing which average to use if there was no other compelling reason was to err on the high side—we did not want to have to defend criticisms of undervaluing time. For all three categories of person, there was little variation according to business size, and, so, the average for the person category was applied to all business sizes.

Calculations for valuing time

Should we use individual values of time for each business, or apply averages to groups of “like” businesses? We opted for the latter. The consequence of using external data (as we did for paid employees from Statistics NZ) is that

group averages will be used for translating the time recorded by individuals as spent on tax compliance into internal compliance costs (\$).

The use of group averages stands in direct contrast to the major previous survey of business compliance costs in New Zealand (Sandford and Hasseldine, 1992). They multiplied the hours spent by each business by the valuations of time provided by the same business.

The strengths of using group averages for our application are:

- Less risk of including unreasonably high values which may be inappropriately affected by respondent misunderstanding or intention to express irritation about tax. For example, extremes of \$1 per hour and \$5000 per hour were reported to us.
- Probably less variability (standard deviations and margins of error) around compliance costs. This will make it easier to detect statistically significant differences when comparisons are made between groups or between years, which is particularly important for this project, given that it intends to set a baseline for detecting change in future years.

The weaknesses of not using the individual respondent values are:

- Not assigning higher values to people/businesses with higher hourly rates. In contrast, using group averages will understate the value of time for high-priced individuals (e.g., lawyers charging \$400+) at the firm level.
- Relatedly, if tax simplifications enable businesses to delegate more tax work previously done by owners or senior staff with particularly high values of time to staff with lower hourly rates, group averages might understate the change.

Person types

We chose to collect hours involved in relation to three different types of people doing the work: owners/partners; paid staff; unpaid friends or relatives.

Unpaid helpers are particularly awkward in respect to valuation of time. First, they have no real market wage rate. Second, even asking businesses about the value of their time proved difficult for respondents—almost 1 in 3 people who used unpaid help valued their time at \$0. It is not immediately clear if these are valid indications that the helper's time really has no value, or a misunderstanding of the point of the question. Our decision to use group averages means their time is given a value.

Accounting/taxation overlap

The accounting/taxation overlap issue is a long-standing problem with no immediate solution. To gather some data on this issue, without attempting to oblige respondents to make precise splits between accounting and taxation for particular activities or tax types, we created some questions beginning with “imagine for a moment that New Zealand was tax-free.” We see these as promising, delivering qualitative but useful data while being easy to answer (in particular, not so off-putting as to reduce response rate). For example:

Imagine for a moment that New Zealand was tax-free: do you think that you would still use computerized accounting software? Assume that the costs of buying and updating the software remain as they are now.

Respondents who answer “definitely yes” provide us with indicative information that these external costs are not primarily considered additional tax costs. Pretesting showed that respondents could answer these rating questions quickly and easily.

The same rationale was applied to questions about external payroll services and about using an external accounting/adviser to do the annual accounts. The latter provides indicative information on the overlap issue where obtaining precise cost splits is fraught. In particular, by asking the same question of their tax advisors, we tested whether major differences in points of view exist on this question. There was 60-percent congruence. The lack of agreement went in both directions: businesses thinking they would continue to use an advisor when their advisors thought they would not, and vice versa.

Trimmed means

Given the importance to this project of detecting changes over time, e.g., before and after the implementation of a tax simplification initiative, we excluded extreme values and used trimmed means in our calculations of compliance costs. Even a small number of extreme values can have a devastating effect on the probability of detecting a significant difference that really exists in comparisons between types of businesses or over time. This approach is unlike traditional compliance costs research which has focused on estimating total compliance costs nationwide and so has been obliged to include extreme values simply because they are real.

Effect on the definition of compliance costs

The changes described above mean that our measures are no longer attempting to measure compliance costs as measured previously. This requires special care with phrases such as “total compliance costs.” Thus:

- people may total up compliance costs or hours for all tax types in the core questions about time spent on tax activities, but these are not total compliance costs because of the exclusions, e.g., audit costs;
- where we use a trimmed mean to describe average costs for a group of businesses (e.g., employers with fewer than five staff), we cannot simply multiply that result by the number of businesses to get aggregate “total” compliance costs nationwide which should include the extreme values as representing part of the total picture (whereas we could do so if we used the normal mean);
- however, the trimmed means do provide an aggregate “benchmark” compliance cost which is not influenced by the presence of a very few high values, and, hence, it is more useful for detecting change.

Improving the Response Rate

“There is a tenacious myth, widespread not only in compliance cost research circles, that mail surveys almost inevitably deliver low response rates.”⁹ Our consultant was determined to undermine this myth on our behalf, referring to current good practice as described by Dillman (2000). And we were determined to achieve as much as was feasible given the cost and time, and we have been successful to a degree.

Response rates for large-scale mail surveys of business compliance costs have typically been low (e.g., 30 percent-40 percent). The recent IRS project on taxpayer burden provides an instructive exception with response rates of 56 percent and 60 percent, albeit concerning individuals (including the self-employed) rather than businesses.¹⁰ Another exception is Evan’s Australian survey of individuals at 50 percent.¹¹

Our efforts

We attacked this on a number of fronts; some of the more effective or unusual ones are noted here.

Respondent-friendly questionnaire

One distinctive aspect of compliance cost questionnaires is their unusual level of difficulty. The sheer difficulty of understanding some questions, the need to recall over the previous 12 months, and the common need in businesses for more than one person to be involved in answering questions (e.g., different people may handle PAYE and income tax) can all reasonably be expected to reduce response rates. These difficulties mean that it is more important than usual to ensure that the questionnaire is as user-friendly as possible.

The foundation for user-friendly questionnaire design is very thorough pretesting by highly experienced survey professionals alert to the possibilities for improvement suggested by the comments and behaviors of respondents. Content-area experts (economics, tax policy, accounting) rather than survey specialists led the design of the early draft questionnaires. Once the conceptual issues and pitfalls were documented, survey specialists had a substantial role to play in overcoming the response difficulties encountered by businesses. This project included 24 pretest interviews by survey specialists in addition to several by a content-area specialist with extensive previous experience of compliance cost surveys. Ongoing involvement of content-area experts remains essential as it is easy for well-intentioned suggestions for “simplification” to result in a conceptually flawed question.

We also suggest that the formatting of our questionnaire provides useful examples of good practice to others planning compliance cost surveys. Sound design features that might be overlooked by others include:

- The prominent “start here” arrow to increase the number who actually read the initial instructions.
- Careful attention to the role of tax advisers (e.g., the supplementary instruction in certain questions to include taxes where their accountant/tax advisers completed the returns).
- Ensuring that the later general instructions (defining what are not compliance costs) are more likely to be read, by formatting them like a question.
- Reverse shading subtly highlighting the places where a response is required.
- Exceptional care over design details, layout, and order in the central question on internal time.

Income tax only questionnaire variant

We designed an entirely separate and much shorter questionnaire for the common cases where income tax was the only relevant tax. This shorter questionnaire had a higher response rate of 52 percent compared with 47 percent for the main questionnaire. This confirms the value of providing questionnaire variants tailored to the needs of important subgroups rather than expecting them to navigate their way through a distinctly longer and more complex questionnaire (much of which is irrelevant to them).

A number of personalized contacts and reminders

The survey process included a presurvey consent letter, the questionnaire mailout with a token incentive, a postcard reminder or thank you, a reminder questionnaire to those still not responding, and a final telephone contact. Points of particular interest are picked up in sections below.

Telephone reminder

The telephone contact was a somewhat experimental element which was added to the process when we realized the budget allowed for it.

Telephone contact to nonrespondents was the last of our reminders and was limited for reasons of budget to 300 respondents. Initial response to the telephone reminders was fairly positive: 75 percent agreed to return the questionnaire, requested another copy or said they had already sent it in (60 percent of whom had not in fact). In the end, only 18 percent had returned the questionnaire. This compares with 12 percent from those not phoned. In the absence of good evidence about the beneficial impact of such telephone contact with business compliance cost surveys internationally, the experience gained here is important to guide such decisions in New Zealand in the future, and may also be useful to compliance cost researchers overseas.

We note that including some contact by telephone is a common option to be considered, particularly with business surveys (e.g., Dillman, 2000). For example, an initial telephone contact might be useful to help ensure that the questionnaire was sent to the right person in the business (and ideally, personalized). Alternatively, telephone can be used for reminders (as we did), or to gather compliance cost responses in a “mixed-mode” design with data coming both from written questionnaires and from telephone interviewing (e.g., IBM, 2003).

Media promotion

We also used the media of relevant business associations,¹² Inland Revenue's targeted newsletters, and local newspapers to encourage businesses to respond, appealing to the benefits that might accrue for them in the future.

Summary of results to respondents

Survey respondents were asked at the time of the survey if they wished to be sent a summary of findings. The research company will attend to this to protect anonymity.

Our dilemma—the consent letter

When engaging the services of a contracted research company, it is normal practice in Inland Revenue to send a letter to the selected sample taxpayers encouraging them participate and giving them the opportunity to opt out, i.e., their names and information will not be passed to the contracted research company.

A consent letter was sent out 3 weeks before the initial questionnaire mailout, and 546 businesses opted out of the survey. This results in a 5-percent reduction in response rate before a single questionnaire is delivered. This stands in sharp contrast to the known beneficial effects of a prenotice letter sent a few days before the questionnaire (Dillman, 2000, p.156, cites improvements of 4 percent-6 percent). It is probably the case that this process presents an easy opt-out for those who might be wavering. It is the recommendation of our research survey consultant that we should reconsider the consent letter process.

We have a dilemma. The consent letter process serves many purposes. Firstly, in terms of integrity and customer relations. It does conjure up a number of phone calls from people seeking reassurance, and, so, we know that it gives confidence to many taxpayers about the relevance and genuineness of the survey. We also receive calls from people irate that we should even contemplate sending on their names, and, so, we have the opportunity of explaining and mollifying this response. Secondly, it usefully brings to light a number of corrections about contact details, ensuring a better chance of response in these cases. Thirdly, in the interests of survey efficiency and a higher response, consent allows us to directly link some administrative information to the survey response for research purposes, thus reducing the length of the questionnaire and thus providing exact information rather than

respondent's estimated recall. A question remains whether such additions to questionnaire length might reduce response rate by less than the 5 percent resulting from the consent process.

We have no answer to this yet, but will be seriously considering the advantages and disadvantages of the options for our next survey.

Our results

Some 2353 questionnaires of the 4848 sent out were completed and returned—a 49-percent response rate. If the opt-outs prior to the questionnaire are included as nonresponses, the response rate reduces to 44 percent.

Our successes

The techniques that helped:

- questionnaire design and pretesting, using both experts in the area of compliance costs and survey expertise
- separate questionnaire for subgroups
- reminder postcard
- telephone reminder.

Achievements and Lessons

For many tax administrations and business environments, a survey which asks businesses to recall time spent on specific tax-related activities remains the feasible approach to quantifying compliance costs. We recognize, however, that such surveys rest on a number of inherent approximations and uncertainties, such as recall of time spent in the past, imputations, and difficult lines of questioning. We put considerable expertise and time into refining the art of tax compliance cost questioning, and, through a number of small steps, we think we have advanced the cause.

First, we have been clear about the practical policy purpose of the work which resulted in a focus and definition of compliance costs slightly different from other exercises. The consequent adjustments means we are not measuring “total compliance costs.” We do, however, have a robust benchmark with the necessary detail to assist future policy development and evaluation.

Secondly, we are relieved to have achieved an almost 50-percent response rate, considerably better than the less than 40-percent often reported for business compliance cost surveys, especially those relying on postal techniques. We referred to, tested, and used some of the lessons from the exten-

sive literature on achieving good response rates. It did not come cheaply: recurring use of experts in compliance costs and in survey design and methodology; much pretesting for our local conditions; and the cost of applying the techniques. And it all takes a long time.

Thirdly, we are confident about the time recalled by businesses as spent on tax activities. Pretesting the question in annual and monthly forms and asking for times broken down into categories, in two questions which were then crossed-checked has worked well.

Fourthly, apportioning the cost of using external advisors to different tax types remains important as external costs are a large proportion of compliance costs. We made some gains. The approach to the external advisor in relation to a specific client worked, it being quick and easy for the advisor to complete. The poor consent rate from the businesses attenuates the reliability of the results. This area needs further work in the future.

Finally, the strength and balance of advice from the various areas of expertise must not be underestimated. Our subject matter experts—in compliance costs, in business, in tax policy and administration—worked alongside the research experts—in survey design and methodology, in statistical planning, and in analysis—giving us final confidence in our results.

Appendix 1

Strengthening the recall and recording of time spent on tax activities

Note: References to Q13a and Q13b are to the two main questions asking for time spent on tax activities. These questions are reproduced below.

Further to the discussion in the section ‘Recalling time spent,’ other ways of strengthening the critical question were:

- Order. Should the split by person or the split by tax activity be presented first? Initial pretest reactions differed quite sharply on this issue. Depending on the number of people involved with tax matters and the allocation of tax activities, some found one split much easier to deal with first, and some found the other much easier.
- Overlap and double-counting between activities in Q13a. It was important that the list of tax activities be both exhaustive and mutually exclusive. For example, we combined two activities originally recorded separately (learning about new tax laws versus learning

about existing tax laws) because pretesting exposed a risk that respondents would simply record the time they spent learning about tax in general in both places. “Implementing tax law changes” was also deleted as inviting double-counting of hours recorded beside other activity types.

- **Overlap between tax types.** In principle, it can be difficult to split some activities such as recording financial information between GST or income tax. We encouraged businesses not to think about this potential problem by placing the GST column before the income tax column. This reinforced the common tendency to assign all the initial work to GST and consider only end of the year issues for income tax (as reported by Ritchie, 2001, p. 310).
- **Length.** It was important to keep the list of tax activities in Q13 as short as possible so that respondents could take reasonable care to avoid
- **Double-counting** (not to mention making the question look less intimidating). For this reason, some questions were removed from their draft positions as activities within Q13a and asked more briefly later in the questionnaire.
- **Year versus month.** Initially we favored asking respondents to record times for a year rather than expecting them to estimate on a monthly basis (which can be awkward for small businesses, because some taxes are only dealt with once or twice a year). However, initial pretest results where respondents obviously estimated the annual figures required by musing aloud about monthly figures (and even writing monthly figures down sometimes) convinced us to return to the ATAX approach of requesting monthly figures (Sandford and Hasseldine, 1992, requested annual figures).
- **Minutes.** Particularly with monthly recording, fractions of an hour (as used in the ATAX questionnaire) were an issue. We replaced the original request to write fractions of an hour by a separate box for recording minutes.
- **0’s versus missing values versus not applicable.** Rather than suggesting that people might leave lines blank if no time were spent on particular tax, we suggested that they make things clearer by crossing out the relevant column. Furthermore, if no time were spent on particular activity, we instructed that respondents write in 0 or a dash (-).

- “Positive” versus “negative” definition of compliance costs. One question which is really a general instruction provides a list of activities that are not compliance costs. We considered the alternative of trying to list activities that were compliance costs but found it less satisfactory.

Figure 1: Questions 13a, 13B, and 14

Internal Time/Costs

13a In answering this question:

- Please estimate the average hours **per month within this business** spent on tax activities during the last 12 months. Some taxes are dealt with only once or twice a year; please include this time on a monthly basis (e.g. if you spent **12 hours** on end-of-year income tax count this as **1 hour** per month).
- Include time spent by owners/partners/directors/trustees, paid employees, and unpaid friends or relatives.
- Only count hours **once** (e.g. if you count some hours beside the heading “Recording information needed for tax”, do not count the same hours beside “Calculating tax, completing tax forms, paying tax”).
- If no time was spent on a particular activity, please write in 0 or a dash (-). If the tax type does not apply to your business, you can cross out the column.

	GST	Income Tax, including provisional tax	PAYE, including child support, student loans, ACC levy	Fringe Benefit Tax
Recording information needed for tax (e.g. GST amounts, employee tax codes). <i>To work this out, imagine New Zealand became tax free. Consider what you would stop recording and write down how much time you would save.</i>	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Calculating tax, completing and filing returns, paying tax	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Dealing with IRD (e.g. letters, phone calls, visits, email)	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Tax planning (e.g. for losses)	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Dealing with tax advisors (including providing information to them)	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Learning about tax laws (new or existing) e.g. from newsletters, Tax Information Bulletin, the Internet	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Other tax activities (please describe)	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Total hours per month , (on average)	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min

Internal Time/Costs

13b Now, please tell us how the time you recorded in Q13a was divided across different people. In answering this question:

- Please estimate how many **hours per month** the following **people** within this business spent on the taxes below during the last 12 months. **The total for each tax should be about the same as for question 13a.**
- For taxes which are dealt with only once or twice a year; please include this time on a monthly basis (e.g. if you spend 12 hours on end-of-year income tax count this as 1 hour per month).
- If there is more than one person in a category, provide the total number of hours for all the people in that category.
- If no time was spent on a particular activity, please write in 0 or a dash (-). If the tax type does not apply to your business, you can cross out the column.

	GST	Income Tax, including provisional tax	PAYE, including child support, student loans, ACC levy	Fringe Benefit Tax
Owners/Partners/Directors/Trustees	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Paid employees (e.g. clerks, managers, internal accountants, IT staff)	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Unpaid friends or relatives	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min
Total hours per month (on average)	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min	<input type="text"/> hr <input type="text"/> min

Please Check: Are the totals immediately above similar to the totals for question 13a? Yes No → If not, please check and adjust

14 Time spent on the above activities is valuable. What was the approximate value of this time for each group of people?

Owners/partners/directors/trustees	\$ <input type="text"/>	per hour
Paid employees	\$ <input type="text"/>	per hour
Unpaid friends or relatives	\$ <input type="text"/>	per hour

Endnotes

- ¹ Ministry of Economic Development, *SME's in New Zealand: structure and dynamics*, Wellington, September 2004.
- ² A number of discussion documents outlining initiatives to reduce tax compliance costs for small businesses have been released, including the *Simplifying Taxpayer Requirements (1997)* discussion document and, more recently, the *Less Taxing Tax (1999)*, *More Time For Business (2001)*, and *Making Tax Easier for Small Businesses (2003)* discussion documents.
- ³ Inland Revenue appreciates and acknowledges the assistance from Dr. Chris Evans and Dr. Binh Tran-Nam of Atax at the University of New South Wales, Katherine Ritchie of Manukau Institute of Technology, Dr. Charles Sullivan of Capital Research, Business New Zealand, the Institute of Chartered Accountants of New Zealand, and Colmar Brunton.
- ⁴ C. Evans and B. Tran-Nam, *The tax compliance costs of small and medium-sized business*, Atax, University of New South Wales, January 2004, page 12. A research report commissioned by the New Zealand Inland Revenue Department.
- ⁵ PAYE = Pay As You Earn, the withholding tax on wages; GST = Goods and Services Tax.
- ⁶ Best fit was for businesses with 1-5 employees with $R=0.64$; all business $R=0.56$.
- ⁷ Australian Taxation Studies programme, University of New South Wales.
- ⁸ Statistics New Zealand, *Quarterly Employment Survey*, September 2004: average total hourly earnings.
- ⁹ Sullivan, 2005, page 12.
- ¹⁰ IBM, pages 20-21.
- ¹¹ Evans and Tran Nam, page 50.
- ¹² For example, *Chartered Accountants Journal*, volume 83, number 9, page 42, October 2004.

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