THE COMPLIANCE COSTS OF PERSONAL INCOME TAXATION
- A REVIEW OF THE LESSONS

by

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INTRODUCTION

The costs of operating an income tax system are widely recognised as comprising the collection costs to the public sector (administrative costs) and the costs imposed upon the private sector (compliance costs). Compliance costs have been referred to in other terms, such as ‘the hidden costs of taxation’ by Sandford and the ‘disguised tax burden’ by Strumpel.

The main objective of this paper is to discuss the importance of compliance costs specifically in the context of personal income taxation, and how best these costs may be estimated empirically. Further, the paper places this topic in the context of Australian income tax legislation, although all previous research studies have been undertaken overseas. It should be emphasised that only the compliance costs

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2B. Strumpel, ‘The disguised tax burden compliance costs of German businessmen and professionals’, (1966) XIX National Tax Journal (1) 70. It should be noted that the term ‘compliance costs’ as used by Martin in 1944 is stated by Strumpel to be too narrow a term for his research. Nonetheless, Strumpel’s research would seem to fit within the term ‘compliance costs’ as used by current leading researchers in the U.K. and U.S.A. (See J.M. Martin: ‘Costs of Tax Administration: Examples of Compliance Expenses’ (1944) 29 Bulletin of the National Tax Association (April) 194, as cited by Strumpel.)
to individual taxpayers are being considered, and not the costs to employers of
collecting PAYE, or items such as financial institutions withholding tax from
interest payments, all of which would be part of a full analysis of the compliance
costs of personal income taxation.

Compliance costs arise as part of the process of collecting and handing over data
and information to the Australian Tax Office (ATO), dealing with any queries or
enquiries from the ATO contesting assessments and then finally handing over the
relevant sum of money to the ATO. Compliance costs have three major components:
- the money costs spent on professional fees of tax agents, accountants,
  investment advisors, lawyers, as well as expenditure on taxation guides,
  books, travel, communications and stationery;
- time costs i.e. the time spent by taxpayers on completing the tax forms
  themselves or in preparing information for the tax agent/accountant;
- psychic\textsuperscript{3} or mental\textsuperscript{4} costs to taxpayers of being involved in the income tax
  system. For example, the anxiety, particularly among the elderly, of having
to deal with complex and incomprehensible tax forms and information.

James and Nobes\textsuperscript{5} recognise another cost, to third parties such as friends and
relatives who may be asked to assist taxpayers with their returns. However, this

\textsuperscript{3}The term used by Sandford, \textit{supra} note 1, at 108.
\textsuperscript{4}The term used by S. James and C. Nobes, \textit{The Economics of Taxation}, 2nd ed.
\textsuperscript{5}\textit{Ibid.}
cost element raises the question of the incidence of the above money, time and psychic costs, which may include all members of the family structure (spouse, parents, children, other relatives and friends, as well as the individual taxpayer) depending upon the circumstances.

Taxation maxims were discussed as early as the late 18th Century by Adam Smith, who identified equality (meaning proportional taxation); certainty; convenience of payment; and economy in collection. Sandford⁶ points out that the last three of these maxims 'were concerned wholly or partly with compliance costs'. Thus, for example, on the second maxim of certainty Smith stated that 'the time of payment, the manner of payment, the quantity to be paid, ought to be clear and plain to the contributor, and to every other person', so that the taxpayer should not be put 'in the power of the tax-gatherer'. Moreover, in discussing the last maxim of economy in collection, Smith clearly recognised the importance of the psychic costs of taxation: 'by subjecting the people to the frequent visits and odious examination of the tax-gatherers, it may expose them to much unnecessary trouble, vexation and oppression; and though vexation is not, strictly speaking, an expense, it is certainly the equivalent to the expense at which every man would be willing to redeem himself from it'⁷. The Asprey Report, commissioned to review the Australian taxation system, recognised Smith’s maxims by saying that 'there should be a fair distribution of the burden of taxation and that revenue raising be by means that are not unduly complex and do not involve the public or the

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⁶Sandford, supra note 1, at 108.
⁷Ibid.
administration in undue difficulty, inconvenience or expense. For brevity these aims are referred to as efficiency, fairness and simplicity.\textsuperscript{8}

A NEGLECTED SUBJECT

There is an irony here which readers familiar with taxation literature will no doubt appreciate. The term compliance costs, often linked with its counterpart administrative costs, is widely mentioned in textbooks, articles, ATO and government reports. However, these terms almost always command only a few sentences and, at best, a few paragraphs. In the case of ATO\textsuperscript{9} and government\textsuperscript{10} reports one has the impression of 'lip service' (acknowledgement only) being paid to a concept which is useful when discussing the need to simplify the taxation system. Yet it seems that the concept of minimizing compliance costs is regarded as idealistic and, it is implied, compliance costs are difficult if not impossible to quantify.

The history of attempts to measure the compliance costs of any taxation, not just personal income taxation, is limited. One of the first studies was in 1935 by

\textsuperscript{8}Aust., Taxation Review Committee Full Report (Asprey Report) (Canberra: AGPS, 1975) at 12, Para. 3.6.

\textsuperscript{9}See, for example, the Australian Tax Office, 'Corporate Plan 1987-88' and 'Future directions for the Taxation Office', 1987.

\textsuperscript{10}See, for example, Reform of the Australian Tax System, Draft White Paper (Canberra: AGPS, 1985).
Haig\textsuperscript{11}, who investigated the compliance costs of corporation tax in North America. A series of similar small-scale studies followed. In the 1960s there was renewed interest with more ambitious studies, including a large study of the disguised tax burden of German businessmen and professionals by Strumpel\textsuperscript{12}. The present decade has seen much more interest internationally, with greater funding permitting larger-scale, comprehensive and more representative compliance cost studies e.g. various studies by Sandford, UK and Slemrod, USA\textsuperscript{13}. The first study specifically on the compliance costs of personal income taxation was in 1944. A chronological summary of studies on the compliance costs of personal income taxation is shown in Table 1.

In Australia, there has been no published research on compliance costs as far as this author is aware. Indeed, the subject has only been recognised as one worthy of policy debate as recently as 1985\textsuperscript{14}. By comparison, it was recognised in the UK at a senior policy level in 1978\textsuperscript{15}. Why then is the subject of compliance costs of taxation such a relatively neglected subject?

There would appear to be two key reasons for this lack of interest. Firstly, the estimation of income tax compliance costs usually involve surveys of individual taxpayers to be comprehensive (the same is true of business taxpayers, although that does not concern us in this paper). Questionnaire design, pilot studies, and

\textsuperscript{11}Haig, as cited by Sandford, \textit{supra} note 1, at 108.
\textsuperscript{12}\textit{Supra} note 2.
\textsuperscript{13}See Table 1, \textit{infra}.
a main survey of thousands of individual taxpayers - in order to achieve as representative a sample as possible - is a considerable and costly exercise. Nearly all personal income tax compliance cost studies to date have used a survey technique, separately and distinct from the tax assessment exercise itself. Indeed, this seems to be the most appropriate method.

A second reason, and probably the more important, is what may be termed the absence of the political will arising from the lack of pressure from taxpayers. It may be argued, of course, that taxpayers are very conscious and aware of the reality of compliance costs (although probably the vast majority would be unfamiliar with the term), but that they accept them as inevitable (which at some level they must be given that the income tax system exists) or as too small to warrant expending yet more time complaining about. A more important reason for the lack of fuss and complaint may be that individual taxpayers are unorganised.

Thus it seems reasonable to presume that if more political pressure in its widest sense had been brought to bear, appropriate resources would have found their way into government research agencies in order to estimate compliance costs. Indeed, in the UK, after initial research by Sandford in the 1970s pioneered the way, the UK government has given explicit recognition to the need to reduce compliance costs for one group, namely small businesses18. The Inland Revenue and Customs and Excise in the United Kingdom have produced (and published in their annual reports and elsewhere) a Taxpayer’s Charter, which specifically says: ‘In particular it (the government) recognises the need to minimize costs incurred by taxpayers in complying with the law’. Moreover, the Inland Revenue and Customs

and Excise fully co-operate with compliance cost studies, and these organisations, together with the Treasury and the Economic and Social Research Council, have in recent years funded further research\textsuperscript{17}.

An indication of how low the subject rates in public debate in Australia is that the ATO makes no mention of it in its 1986/87 Annual Report. Nonetheless, the following relevant comments have been included in targets which the ATO is working towards between 1987 and 1992 as specified in the 1987 ATO document 'Future Directions for the Taxation Office' (page 5):

\textit{VISION FOR 1992}

\textit{Tax laws will be fair, easy to read and understand, and simple to administer.}

To achieve this vision we will have:

- A program for the ongoing review of the tax laws.
- A commitment to simplifying the tax laws.
- Efficient practices for the timely release of explanatory material and tax rulings; and for the briefing of Tax Office staff, taxpayers and their advisers.

More specific comments include: 'There will be an ongoing review of the effectiveness of tax laws, with emphasis on administrative and compliance costs.' This 'ongoing review' is confirmed in the 1987/88 ATO Corporate Plan. This states that the key objective of the Policy and Legislation Group is 'to improve the effectiveness of the tax system and its administration ...'. In order to achieve this four 'action strategies' are defined, the first of which is to 'provide

\textsuperscript{17}Sandford, supra note 1, at 108.
timely, relevant and clear advice on taxation proposals to meet Government and ATO objectives with particular emphasis on comparative administration and compliance costs of options.'

A very useful critique of the ATO's Statement on future directions has been given by Speed. He makes the key point that, in striving for laws which are simple to administer, the ATO should not achieve this 'by transferring the administration of the tax laws from the Taxation Office to the private sector.'

Thus in the past the subject of compliance costs has been almost totally ignored in Australia. We are now at the stage where the subject is being tentatively recognised, but with no real evidence available of compliance costs in Australia to be able to further the public debate.

REASONS FOR ITS GREATER RECOGNITION

A number of possible reasons may explain the greater interest now being given to the subject of compliance costs by the tax authorities and academic researchers, particularly in Australia. These would comprise the greater complexity of income tax legislation, the increased perception of complexity by both professional tax advisors and the public, the effects of the increasing real tax burden over time and the greater number of taxpayers, and the application of questionnaire survey and psychological techniques to the area.

18 Australian Tax Office Corporate Plan, supra note 9, at 12.
20 Ibid, at 598.
The quantity of income tax legislation has been increasing since the original *Income Tax Assessment Act 1996-97* was introduced by the Commonwealth Government. Although 'there is no clear or unique understanding of what complexity is and how it can be defined and measured' amendment complexity has been represented by the 'fraction of the existing statute amended by a particular amending Act'. This measure shows that the average complexity of the amendment task has remained relatively constant over time, with approximately 15 per cent of the Act being modified by any Amending Act, even although the Act has more than trebled in size.

This is contrary to many tax professionals’ and lay persons’ beliefs. For example, Speed states that 'It is now accepted that no one person understands or can understand the tax laws', and that 'It is impossible to draft simple to read and understand laws on complex subjects'.

Given the difficulty and lack of research into objectively measuring income tax legislation complexity, it is not possible to comment further on this aspect. However, it does seem clear that, even if it could be shown that over a wide range of measures income tax complexity has not increased over time, it is the professional and public perception of complexity that is the more important indicator. This will be influenced, and in many cases determined, by the design of the tax forms, tax guides and pamphlets. Some taxpayers may be confused as to

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22 Id. See the discussion on the difficulty of defining and measuring the complexity of legislation, at 530-531, and also Figures 7-10, at 542-545.

23 Supra note 19, at 598.
which form they should complete. Even assuming that the correct form is obtained, the layout, size of print, type of questions asked, the length of words and sentences, space between words and boxes, and so on, are all factors which will determine whether the information required by the ATO is easily understood or not.

Research by Lewis found that the Australian tax guides were more difficult, in terms of the average number of syllables and the average number of sentences per 100 words, than those used in many other countries\textsuperscript{24}. Thus the tax guide used by most taxpayers, Form S, had a Fry\textsuperscript{25} readability score of 17, representing a reading age beyond that of a 'quality' newspaper, whereas other countries tax guides were typically rated at around 13, equivalent to the reading level of popular newspapers. The ATO's own research\textsuperscript{26} found that more than 30 per cent of taxpayers who used the (old) S Form had some difficulty in completing the form and in understanding the guide. The Australian S Tax Form and Guide has since been re-designed and a new form was introduced in 1986/87, at the same time as the introduction of self-assessment. Plans are in hand by the ATO to re-design other tax forms, including reducing the choice of forms by combining the A and B tax

\textsuperscript{24}A. Lewis, The Psychology of Taxation (New York: St. Martin's Press, 1982), Chapter 11, Simplicity and Comprehensibility, at 191-197.

\textsuperscript{25}E.A. Fry, 'A readability formula that saves time', (1968) 2 Journal of Reading, at 513-516, 575-578, cited by Lewis.

\textsuperscript{26}S. Levy, Deputy Commissioner of Taxation for Western Australia, in 'What the Commissioner Said: the New S Form Tax Return', (1985) XX Taxation in Australia (July) 54.
forms into one\textsuperscript{27}. Other research\textsuperscript{28} found that the majority of Australian guides were more difficult than those used in Britain.

This whole issue of the psychology of completing income tax returns and its relationship with compliance costs is one worthy of further work. As a 'fiscal psychologist'\textsuperscript{29} argues, 'calls for simplified forms and a reduction in personal compliance costs are more likely to be heeded if psychologists and others spent more time than they do at present investigating the errors and costs of the processing of forms once completed. Recommendations must be made with reference to the system as a whole'.

Considering the issue of 'taxpayer education', the ATO has been paying increasing attention in recent years to this. For example, the ATO formed a new taxpayer service group in early 1987, and have considered ideas for voluntary tax helpers, an approach that has been adopted by both Canada and the USA. Taxpayer education is likely to have an impact on the level of compliance costs, as well as, of course, the amount of tax revenue.

A major reason for the increasing awareness and importance of compliance costs is the way in which the real tax burden has increased, both in terms of real effective rates of taxation and the number of taxpayers, because of high inflation and minimal and erratic increases in tax threshold levels. Thus, over the period

\textsuperscript{27}T. Boucher, 'Tax Reform and Tax Administration - Where Do We Go From Here?', (1987/88) 22 Taxation in Australia (6) 366, at 368. It is noted that combining the A and B Forms has been achieved for the 1987/88 tax year.


\textsuperscript{29}Lewis, supra note 24, at 194.
1976/77 to 1983/84, the excess of the Consumer Price Index (CPI) growth over tax bracket indexation was an average of 5.13 per cent p.a.\textsuperscript{30}. This whole issue of indexation of tax thresholds and allowances has also been fully discussed elsewhere\textsuperscript{31}. Suffice it to say that 408,800 (6.7 per cent) additional taxpayers were brought into the tax net over the two-year period from 1982/83 to 1984/85, and that 242,420 (3.7 per cent) taxpayers in 1984/85 were in receipt of pensioner rebate/unemployment and sickness benefit rebate\textsuperscript{32}. This situation was partly rectified in the May 1988 Economic Statement, when the Government announced the raising of the pensioner rebate (from $250 to $430) and the taxable income level (from $6,142 to $6,892) in 1988/89. The effect will be to take 255,000 pensioners out of the 'tax net'\textsuperscript{33}.

Over the period 1954/55 to 1984/85 the effect of inflation and non-indexation of taxation thresholds is clearly illustrated by the level at which the top rate of income tax is incurred. In 1954/55 it cut in at income levels 18 times average yearly earnings, whereas in 1984/85 it cut in at only 1.6 times average yearly earnings\textsuperscript{34}. Personal income tax has also assumed a much greater importance, rising from around 35 per cent of Commonwealth budget revenue in the mid 1950s to some 52 per cent in the 1980s\textsuperscript{35}.

\textsuperscript{30}N.R. Norman, \textit{The Economics of Personal Tax Escalation in Australia}, (Sydney: Committee for Economic Development of Australia, George Allen and Unwin, 1985), at 82-91.

\textsuperscript{31}See, for example, C. Terry, \textit{Personal income tax indexation}, (Sydney: Australian Tax Research Foundation, 1983) and J. R. Harrowell, \textit{Understanding Tax Reform}, (The Institute of Public Affairs, N.S.W., 1985).

\textsuperscript{32}ATY Taxation Statistics, 1982-83 and 1984-85, Volume 1. See Table 1.1 and Table 1.15-(a).

\textsuperscript{33}The Australian Financial Review, May 26, 1988, at 10.

\textsuperscript{34}Draft White Paper, supra note 10, at 19, para. 2.9.

\textsuperscript{35}Id., at 18, para. 2.5.
Thus lower income earners and even non-earners, as well as the elderly, are finding themselves (from time to time) being required to complete tax forms. For many, particularly those whose educational qualifications are limited, this may be a difficult and time-consuming task.

THE RELATIONSHIP BETWEEN ADMINISTRATIVE COSTS AND COMPLIANCE COSTS

A key question, particularly to policy makers, is the relationship, if any, between the level of administrative costs (public collection costs) of income tax and compliance costs. As the quantity of income tax legislation - but not necessarily its complexity, as discussed earlier - increases over time, it may be hypothesized that compliance costs would rise together with administrative costs. In Australia, using the usual measure of administrative costs, namely expressed as a percentage of tax revenue, there has been little change over the last 30 years in the collection costs of the Commonwealth Tax Office, at just over 1 per cent. However, this measure can be disputed as accurately reflecting the amount of administrative work involved. It does not reveal, of course, changes in the absolute level of taxation revenue and expenditure on collection, or tell us anything of the level of efficiency of ATO revenue collection.

A second hypothesis - possibly a cynical one - is that the tax collection authorities could lower the level of their administrative costs by shifting some

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36 The costs of collecting income tax only in 1986/87 were 1.127 per cent of tax revenue, compared with 1.14 per cent in 1955/56 (source: ATO Annual Reports).

37 There is unlikely to be one single measure which reveals changes in the efficiency of income tax administration and collection. An obvious measure is tax revenue raised per $ expenditure on staff and changes to this measure over time. As far as I am aware, this information is not publicly available.
of the administrative burden onto the taxpayer. Such a policy - whether deliberate or accidental - is most unlikely to occur in a single year, but rather occur steadily and unobserved by the vast majority of taxpayers over a longer period of time. A system of self-assessment would tend to have this effect of lowering the level of administrative costs and raising those of compliance costs. Whilst there is no evidence from any country to support this hypothesis, the very limited cross-sectional data that does exist tends to support the hypothesis that the lower the level of administrative costs the higher is the level of compliance costs. Thus the compliance costs of US income tax have been estimated at five per cent to seven per cent of the federal and state income tax yields\(^3\), whilst administrative costs of federal income tax were 0.48 per cent in 1984 according to the Internal Revenue Service Annual Report. In the UK compliance costs have been estimated at 3.6 per cent of income tax revenue yields\(^3\), compared with administrative costs of 1.49 per cent.

THE ECONOMIC MEASUREMENT OF COMPLIANCE COSTS

As discussed earlier, the usual method of estimating compliance costs is by means of a postal questionnaire survey. Such a survey must elicit as accurate responses as possible as to the amount of time and money spent completing the appropriate tax return. The main components are the amount of time spent on tax affairs, by both the respondent and spouse/de facto, the amount of incidental expenses in connection with the person's tax affairs e.g. travel, phone calls, postage and,


for persons who pay for professional assistance, the amount paid in fees for work in regard to income tax return preparation, processing and (possibly) planning.

One particular aspect upon which there is no clear cut answer is the valuation of the time spent on tax affairs, in order to convert this into a monetary figure. There are a number of alternative valuations. Firstly, ask respondents to value their own time spent on their income tax affairs. This approach is fraught with difficulties - some may not understand the concept and thus not answer, whilst others, particularly highly paid businessmen and professionals, may value their time at thousands of dollars per hour. Others may misread the question and put in their total value of time rather than the value of their time on an hourly basis. Although such misinterpretations can be corrected prior to computer analysis, this approach overall may lead to a high compliance monetary cost on this item.

However, Sandford\textsuperscript{40}, in his Personal Income Tax survey of 1983-84, compared the value set on time by respondents and the value estimated from the earned income of the individual respondent contained in the Survey of Personal Income for those respondents in full-time employment. Overall, the comparison bears out the general validity of respondents' own valuation of their time. The ratios of own valuation of time compared to estimated valuation were: 0.93 (basic rate taxpayers, income over 9,500 pounds p.a.); 0.99 (basic rate taxpayers, income under 9,500 pounds p.a.); 1.27 (higher rate taxpayers). Sandford's results thus give greater confidence to the approach of respondents valuing their own time spent on their income tax affairs.

\textsuperscript{40}\textit{Ibid.}
A second approach would be to include respondents' monetary valuation of their time subject to a maximum value. Such a value would be arbitrary and reflect the researchers' view of what a realistic opportunity cost\(^{41}\) of time may be. This approach would yield a lower total overall compliance cost estimate than the first method.

A third approach is to apply an average value of time for all respondents, irrespective of their income and thus their individual opportunity cost. This approach uses what may be termed an 'equity rate', and would be derived from national earnings in Australia for the relevant year, expressed as an hourly rate. This approach will almost certainly give the lowest estimate of the three methods but, on balance, this is likely to be the most realistic estimate of compliance costs. In support of this view, analogies may be made with other sectors of the economy where the value of time methodology is important, such as the transport sector e.g. valuing the benefits of road improvements, in which an average value of time is widely used to quantify benefits of time savings\(^{42}\).

A fourth approach would be to have a specific question on income in the survey questionnaire, and to value an individual taxpayer's time directly from that response. However, there may be a reluctance from some taxpayers to respond to this question, and researchers have to handle this question carefully in order to avoid a low overall response rate.

\(^{41}\)Opportunity cost is a well-used economic term meaning the 'foregone alternative'. In this case it means the amount of money a person may have earnt, or the value of doing other business/work activities, had the person not been dealing with tax affairs.

There are further alternative, although less likely, valuations. If it could be reasonably hypothesized that the vast majority of respondents are likely not to be working instead of dealing with their income tax affairs but enjoying leisure activities, such as sports, watching TV, then such time could be valued at a fraction of the hourly wage rate, or even zero. A precedent exists in the transport sector where travelling time rated as non-working time in the UK is valued at 25 per cent of the hourly wage rate by the Government for investment appraisal purposes. In some developing countries such time may even be valued at zero i.e. there is no community or social benefit to saving such time.

Thus there needs to be further research and a policy debate into the opportunity cost of time spent dealing with income tax affairs. Indeed, it may be found that a single overall value of time figure for all taxpayers is too simplistic and that different values for different socio-economic groups may be more appropriate e.g. the self-employed may value their time at their hourly earnings rate whereas salaried employees may value their time at a lower hourly rate. Researchers in the field of compliance costs have to date concentrated on obtaining overall estimates of compliance costs rather than investigating such specialist aspects. Further work by the author will obtain two main compliance cost estimates, using the average hourly earnings for adults and individuals own time valuation (subject to realistic, or maximum, values), in order to convert time spent on tax affairs into a monetary figure.

Regarding fees paid for professional assistance (to an accountant, tax agent, lawyer/solicitor, investment advisor etc.), it is usual to theoretically distinguish between unavoidable (mandatory) and avoidable (voluntary or
Unavoidable costs are those which a taxpayer has to incur in order to comply with the law; avoidable costs are those which a taxpayer chooses to incur in order to minimize his tax liability. The view could be taken that it is only the former that should be included in compliance costs as they are the only necessary costs. However, without income tax (as does occur in some countries) avoidable costs would not have been incurred. Sandford discusses the problems with this distinction, and proposes a concept such as that of the lawyer: 'the costs which a reasonable man would incur' to replace the term 'unavoidable costs'. Whilst it is important to distinguish between these two types of cost, estimates of compliance costs by this author will include both unavoidable and avoidable costs in the estimation. Nonetheless, a distinction between the two types of costs should be made.

Sandford distinguishes between three types of compliance costs over time: start-up or commencement costs; temporary costs; and regular costs. Briefly considering this in the context of Australia, it should be noted that income tax was first introduced in South Australia in 1884, and by the Commonwealth Government in 1915. Although uniform legislation by State and Commonwealth Governments was introduced in 1936, subsequent amendments introduced differences which remained until the income tax system was unified during the Second World War. From time to time there are significant amendments which introduce temporary costs over and above the usual level. Such temporary costs arise from taxpayers

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43 Sandford, supra note 39.
44 Ibid.
45 Id., supra note 39.
unfamiliarity with the tax, and will remain until taxpayers fully understand and can cope with the change in the income tax legislation. At that point a new regular cost level is introduced, which may be higher than, the same as or less than the previous regular costs level, depending on whether the change brought in complication or simplification.

MEASUREMENT OF ATTITUDES

Current research into compliance costs is unlikely to be undertaken in only economic terms, but incorporate some assessment - however simplistic - of taxpayers attitudes and reasons for their behaviour in dealing with their tax affairs.

A fundamental question is whether or not taxpayers have difficulty in completing their tax form. If so, for what reasons? Difficulty in understanding the form and accompanying instructions, collecting the information, knowing how to fill in the form and the complexity of the tax laws are probably the most obvious reasons.

Another key question is whether a taxpayer chooses to complete his tax return on his own or pay for professional assistance. The study currently being undertaken by the author into the compliance costs of personal income taxation at The University of Western Australia included fourteen reasons why taxpayers may seek professional assistance and twelve reasons why they may not, with the usual opportunity to give further reasons and comment in more detail. The responses should also give an indication of taxpayers attitudes towards both professional advisors and the ATO.
Compliance costs usually generate resentment. If compliance costs are exceptionally high, and resentment grows, then, it may be argued, some taxpayers may feel justified in reducing the burden by means of tax evasion. Such a view is plausible, but extremely difficult to confirm one way or the other. (This situation could in theory be investigated if there were relatively low rates of taxation which involved high compliance costs, because of poor legislation, poor tax form design etc.. Would tax evasion be any higher - ceteris paribus - than in a low tax/low compliance cost situation?)

Compliance costs are likely to affect various socio-economic groups of taxpayers differently, so that attitudes between groups will vary significantly. Compliance costs tend to be regressive in their distributional effects, unlike administrative costs which, being incorporated into the tax system, can be assumed to be in line with the government’s taxation policy. Thus it can be argued that the government, when examining the cost-effectiveness of its income tax policy, should consider both administrative and compliance costs and not just administrative costs. Sandford argues that there is a strong case for tilting the balance in favour of administrative costs in order to reduce the burden of compliance costs.

**PROBLEMS OF ESTIMATION ARISING FROM THE SURVEY TECHNIQUE**

Having obtained information from a large random sample of taxpayers in order to compute compliance costs as discussed above, certain statistical problems common to all survey techniques need to be considered. It is likely that certain

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47Sandford, supra note 1, at 111.
48Ibid.
socio-economic groups e.g. those on low incomes, may have a much lower than average response rate, whereas other groups e.g. the retired, may have a higher response rate. Response rates of different socio-economic and income groups need to be compared with the corresponding proportion in the taxpaying population as a whole throughout Australia. The compliance costs of each of these sub-groups is then calculated and weighted in proportion to the taxpaying population as a whole. Any failure to do this would seriously undermine the validity of the results. Indeed, it could still be argued that certain sub-groups may not contain sufficient responses to be statistically significant. Other than the costly exercise of resurveying such a group, possibly by phone or personal interview, there is no obvious or easy solution to this. The figures are then grossed-up in order to give an aggregate figure for the country as a whole.

It is important, therefore, to view the final compliance cost figure as an estimate, an order of magnitude of a hitherto ignored, hidden cost of the taxation system.

The other problem facing researchers is the quality of the source of the names and addresses of taxpayers. Sandford in his 1983/84 UK survey was most fortunate in gaining the co-operation of the Inland Revenue, who provided him with a random sample of 4,241 taxpayers as well as providing additional data about the income of these taxpayers. A system was devised to ensure complete anonymity and confidentiality. Slemrod, in his 1983 Minnesota, USA survey of 2,000 residents obtained his sample from a professional name-service that maintained a continually updated file of names and addresses from telephone lists, voting records and other

49 Such information can only be obtained from ATO statistics, of course.
sources. Although it may be expected that Slemrod's sample was not as accurate in targeting taxpayers as Sandford's, the response rates of both were high (Sandford: 43 per cent; Slemrod: 33 per cent) for this type of survey.

Nonetheless, there were two major problems with the responses in Slemrod's survey. Firstly, low income households were understated - only 8.3 per cent of the sample reported income of less than $10,000 while 35.4 per cent of taxpayers in 1982 throughout the USA had adjusted gross income in this range. Moreover, the sample was biased towards taxpayers with relatively complicated tax returns, even for given income classes. Slemrod's sample was thus reweighted in terms of income and itemisation class to allow for these two factors.

Strumpel, in his 1963 German study of businessmen and professionals, obtained a random sample of 1,009 self-employed, provided by EMNID, the German Gallup Institute, and used a weighting system to offset differences in sampling and response rates.

**EMPIRICAL RESULTS TO DATE**

A summary of the results of previous studies into the compliance costs of personal income tax are presented in Table 1. In view of the limited number and their different approaches, it is not realistic to attempt to determine any trend over time. Vaillancourt, in a review of the evidence of the compliance costs of business and personal taxation, concludes that personal income tax compliance

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50 Compliance cost studies of other taxes, e.g. Value Added Tax, Wealth Tax, are not included here.

<table>
<thead>
<tr>
<th>AUTHOR/YEAR</th>
<th>COUNTRY</th>
<th>METHOD</th>
<th>COMPLIANCE COST ESTIMATE</th>
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</thead>
<tbody>
<tr>
<td>Martin,a,b,c 1944</td>
<td>USA</td>
<td>Face to face interviews</td>
<td>1.2% of federal tax revenues</td>
</tr>
<tr>
<td>Vicks,d 1965</td>
<td>USA</td>
<td>Survey (of parents of economic undergraduates)</td>
<td>32% of State tax revenues</td>
</tr>
<tr>
<td></td>
<td>(Montana)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strumpel,f 1966</td>
<td>West Germany</td>
<td>Survey</td>
<td>29% of tax yield (1,692 DM per taxpayer in 1963; self-employed only)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wicks,h 1966</td>
<td>USA</td>
<td>Survey (of parents of college students)</td>
<td>11.5% of federal tax revenues (888 per taxpayer)</td>
</tr>
<tr>
<td></td>
<td>(Montana)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wicks and Killworth,c,i 1967</td>
<td>USA</td>
<td>Postal Survey</td>
<td>20.7% of State and local tax liability.</td>
</tr>
<tr>
<td></td>
<td>(Montana)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Willis,a 1969</td>
<td>USA</td>
<td>Estimate</td>
<td>2.4% of federal tax revenues</td>
</tr>
<tr>
<td>Sandford,a 1973</td>
<td>UK</td>
<td>Survey</td>
<td>1.9% - 3.4% of tax revenue</td>
</tr>
<tr>
<td>Commission on Federal Paperwork,a, 1977</td>
<td>USA</td>
<td></td>
<td>3% of federal tax revenues (aggregate $4.6 billion in 1977)</td>
</tr>
<tr>
<td>Slemrod &amp; Sorum, 1984</td>
<td>USA</td>
<td>Postal Survey</td>
<td>5% - 7% of federal and state income tax revenues ($275 per household, reweighted; aggregate $17-27 billion in 1982)</td>
</tr>
<tr>
<td></td>
<td>(Minnesota)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Slemrod, 1988</td>
<td>USA</td>
<td>Re-estimate of 1982 study</td>
<td>Aggregate $30 billion in 1988</td>
</tr>
<tr>
<td>Author(s)</td>
<td>Country</td>
<td>Method</td>
<td>Results</td>
</tr>
<tr>
<td>-----------------------</td>
<td>---------------</td>
<td>-----------------</td>
<td>-----------------------------------------------------------</td>
</tr>
<tr>
<td>Sandford, forthcoming</td>
<td>UK</td>
<td>Postal Survey</td>
<td>3.6% of tax revenue (aggregate £1,149 million in 1983/84)</td>
</tr>
<tr>
<td>Vaillancourt</td>
<td>Canada</td>
<td>Face to face</td>
<td>Results not published yet; expected 1989</td>
</tr>
<tr>
<td>Pope, Fayle &amp; Clements</td>
<td>Australia</td>
<td>Postal Survey</td>
<td>Results not published yet; expected 1989</td>
</tr>
</tbody>
</table>

**NOTES:**

a: As cited by Slemrod, *supra* note 38.

b: As cited by Vaillancourt *supra* note 51.

c: The studies by Martin (1944) and Wicks and Killworth (1967) also considered other taxes.


e: The figures quoted are mean values. The median values are much lower: 7% (1965 study) and 3% (1966 study).

f: *Supra* note 2.

g: For professionals the compliance cost estimate ranged from 9% to 46% of tax yield, and for businessmen from 20% to 84%.


j: *Supra* note 38.


l: *Supra* note 39.

m: *Supra* note 51.

costs fall in the three percent to seven per cent (of tax revenue) range, and that
self-employment increases compliance costs significantly\(^2\). The leading
researchers in the field, Sandford and Slemrod, accept that the compliance costs
of income tax are likely to be higher if the system is one of self-assessment. As
their studies suggest, USA compliance costs are approximately double those of the
UK.

Regarding Australia, if compliance costs were to emerge significantly higher than
those of the USA i.e. above seven per cent of tax yield, then this could be
regarded as high by (limited) international comparison and thus a cause for
concern. Alternatively, a figure around the three to four per cent level may be
regarded as satisfactory by comparison to studies in other countries, but still,
when expressed in absolute dollar terms, representing a high cost imposed on
taxpayers. It should be noted that, whilst Australia now has a system of
self-assessment for most taxpayers, the system is different from that of the USA,
which requires that taxpayers compute their own tax liability and pay it at the
time of lodging their returns. The Australian self-assessment system does not
require payment at the time of lodging.

\(^{2}\) Vaillancourt (1987) undertook a review of twenty compliance cost of taxation
studies, of which four were categorised as personal income tax studies and sixteen
as business taxation studies. This paper cites ten compliance costs of personal
income taxation studies (see Table 1). The difference of six is explained as
follows. Pope includes Martin, 1944; Strumpel, 1966; Wicks and Killworth, 1967;
Willis, 1969; Commission on Federal Paperwork, 1977; and Sandford, forthcoming,
1989. Note that Vaillancourt includes Wicks' 1965 and 1966 studies whereas Pope
includes all three of Wicks' studies: 1965, 1966 and 1967, as does C.T. Sandford,
174-175. It should also be noted that Vaillancourt classifies Strumpel (1966)
under business (Table 2) rather than personal (Table 4), yet Table 1 (studies in
chronological order) recognises his study as 'Personal Income Tax'. The range of
three to seven per cent of tax revenue quoted by Vaillancourt refers, in this
author's view, to the studies of Sandford and Slemrod; earlier studies mostly lie
outside this range.
The University of Western Australia is currently undertaking a study, sponsored by the Australian Tax Research Foundation, into the compliance costs of personal taxpayers, involving a postal questionnaire survey of 7,000 taxpayers throughout Australia. Results are expected to be available in 1989.

CONCLUSIONS

The compliance costs of income tax have been all but ignored by government and tax authorities until very recently. The topic of compliance costs has been characterised by a lack of research funding and thus empirical results which would provide a sound foundation for policy debate. Since the 1960s there have been only nine significant published research studies worldwide into the compliance costs of personal income tax, and only two, by Sandford of the UK and Slemrod of the USA, this decade. Results from current studies in Canada and Australia are expected to be published in 1989.

It is important that the Australian government and the ATO, as well as, of course, taxpayers themselves, be fully aware of both the total compliance costs of income taxation policies and the distributional effects that these have.

This paper has presented the theoretical foundation from an inter-disciplinary viewpoint, a review of the practical problems of estimation, and a summary of studies into the estimation of compliance costs of personal income taxation overseas. This is a necessary starting point and prelude to the publication of empirical results for Australia. Hopefully, an informed policy debate will ensue.

53 Pope, Payle and Clements, supra Table 1, Note n.