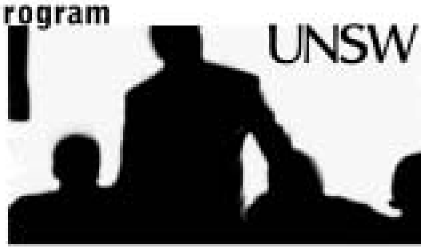
higher education | professional education | research | consultancy services |

Australian Taxation Studies Program



Evaluating the compliance costs and benefits of the Tax Value Method[*]

A report prepared for the Board of Taxation

(6 May 2002)

Associate Professor Chris Evans

and

Dr Binh Tran-Nam

[*] This report was commissioned by the Board of Taxation. The authors gratefully acknowledge the assistance of the Secretariat of the Board of Taxation and the Australian Taxation Office Tax Design Group in facilitating the study. They would also like to acknowledge the contributions of Gayle Balding and Bev Jordan as Research Officers on the project.

Table of Contents

Executive Summary

This report considers the compliance cost implications that are expected to arise from the introduction of the Tax Value Method ("TVM"). It assesses the magnitude and incidence of the transitional costs that businesses and their advisers would face upon implementation of the TVM. It also identifies and evaluates the longer term, recurrent, compliance costs/benefits that would occur, relative to the existing tax system, if the TVM were to be introduced. The report identifies a number of caveats and constraints that qualify its primary findings, not the least of which is the difficulty in evaluating an incomplete hypothetical. The authors, nonetheless, consider that the report constitutes as reliable an evaluation of the transitional and recurrent compliance costs of the TVM as is possible at this stage.

The conclusions of the report are based upon structured interviews conducted with 40 business persons and tax practitioners with knowledge of the TVM. These respondents provided information about their perceptions of the transitional and recurrent compliance cost implications of the TVM for 58 different businesses and three professional associations. The responses have been stratified on the basis of business size (small, medium and large) and business sector (primary, secondary/manufacturing and tertiary/services). Further stratification has also been undertaken to distinguish the responses that relate to tax practitioners (who are likely to have particular transitional compliance cost profiles) and those that relate to other business respondents.

In simple terms, the data collected suggest that there will be significant transitional compliance costs for businesses of all sizes and in all sectors. Virtually every participant (98%) was readily able to identify additional external compliance costs (for example, in seeking expert assistance to deal with implementation), internal labour costs and other (incidental) costs that would be necessarily incurred if the TVM were to be introduced. The data further suggests that practitioners will face a more onerous transitional period as their practices come to terms with a new tax system. Some of the additional costs (and in particular learning costs), it was claimed, could not be passed on to their clients.

In contrast, few businesses or practitioners (16%) were readily able to identify longer term compliance benefits that might emerge from the TVM. Indeed, rather more respondents (34%) failed to identify any significant change to the magnitude of their recurrent compliance costs compared to the current position if TVM were to be introduced. Still more (50%) suggested that their recurrent compliance costs would increase (relative to the current system) rather than decrease.

The report concludes that it would not be possible to recommend the introduction of the TVM if consideration of the compliance cost implications is the sole or primary determinant.

1 INTRODUCTION

1.1 Rationale for the report

The Tax Value Method ("TVM"), known as Option 2, was originally proposed in the Review of Business Taxation[1]. That Review also argued for a more inclusive process for the development of taxation policy in Australia – one which would promote thorough debate and refinement of policy proposals drawing on the experience and skills of both public and private sector practitioners.

The TVM is the first major legislation to be exposed to such significant consultation. As part of this process, in July 2001 the Board of Taxation convened the Tax Value Method Consultative Conference, organised by the Australian Taxation Studies Program at the University of New South Wales ("ATAX"). This report arises directly from discussions prompted by a joint paper by Associate Professor Chris Evans and Dr Binh Tran-Nam at that conference[2].

The paper put it bluntly: "…TVM is only tenable if it reduces the operating costs of the income tax system"[3] and went on to present a preliminary evaluation of the implications as well as proposing a methodology for future testing.

TVM is intended to provide a new structure for the income tax law. Fundamentally it seeks to replace the existing definition of taxable income with a new concept based on changes in the tax values of assets and liabilities (including cash), combined with policy adjustments to taxable income. It is claimed that the TVM will "build a more internally consistent framework for the income tax law, as a means of achieving improved simplicity, durability, transparency and certainty in the law."[4]

The proposed TVM changes the way income tax is calculated but is not intended to change either the income tax liability or the tax timing – so the adoption of TVM is identified as being broadly revenue and efficiency neutral. It is also suggested that the reform should be broadly neutral with respect to equity[5].

Hence the conclusion is drawn that the primary justification for (or against) the TVM is the simplicity gains that may flow from it relative to the existing rules. Arising from this, there is a need to determine whether its introduction will indeed deliver a reduction in the operating costs of the tax system – i.e. a net decrease in either or both compliance and administrative costs. Compliance costs are the costs that taxpayers incur in complying with their tax obligations. Administrative costs are the costs that the revenue authority and other Government agencies incur in administering the tax system.

[1] Review of Business Taxation, *A Tax System Redesigned Report, July 1999 – Overview – Recommendations – Estimated Impacts*, AGPS 1999, section 4 at p155.

[2] Evans, C. & Tran-Nam, B, "The Compliance and Administrative Costs of the TVM: What are the Implications? " in Grbich, Y. & Warren, N (eds), Tax Value Method Consultative Conference, Australian Tax Research Foundation, July 2001.

[3] Ibid at p176.

[4] Explanatory material to Tax Value Method Working Draft (version 2, 6 July 2001) at para 3.3. Accessed at http://www.taxboard.gov.au/taxvaluemethod.htm 14 July 2001.

[5] Ibid. See also the Tax Value Method Information Paper released on 6 March 2002, at pp33-45. It is interesting to note that some of those interviewed offered their view that this was not the case.

Although the original scoping paper proposed measuring compliance **and** administrative costs for both business and non-business taxpayers, time and other constraints have meant that this report deals only with the compliance costs of business taxpayers.

1.2 Compliance costs

The costs that business taxpayers face as a result of complying with their tax obligations can be broken down into three major identifiable and quantifiable components as follows:

- the cost of external expertise or assistance purchased from outside the business;
- the costs of internal labour devoted to tax activities;
- incidental and other monetary expenses incurred by the business on tax activities (for example, the costs of hardware and software necessary to comply with tax obligations).

Compliance costs may also include some recognition of psychological cost – especially during times of change. Such costs have traditionally been very difficult to measure, in contrast to the three elements identified above.

Compliance costs can also be disaggregated into transitional (comprising start-up and temporary) costs and recurrent (or on-going or regular) costs.

Transitional costs

For the purposes of this report, start-up costs and temporary costs are collected together as transitional compliance costs. Start-up costs might include the purchase of software and staff familiarisation with the new tax. Temporary costs might include the extra time taken to comply with tax obligations as staff and tax authorities become familiar with the new rules.

Transitional costs may therefore include:

- the purchase of expert advice, perhaps to decide what the business needs to do to be ready for the introduction of TVM and what systems it needs to put in place to comply with TVM;
- the purchase of temporary expert labour to assist with the implementation of TVM;
- the purchase of training, either in-house or, more typically, attendance at external seminars;
- time lost in learning about TVM, implementing new systems and in lost productivity;
- the purchase of new equipment or the upgrade of existing equipment specifically to deal with the new system, and the acquisition of appropriate software.

Recurrent costs/benefits

In addition to the transitional costs that a business may incur in implementing changes to the tax system, there may also be recurrent compliance costs for the business. To the extent that the introduction of a tax change such as the TVM leads to these recurrent costs being greater than those that would have been borne under the present tax system, it can be stated that there are incremental recurrent costs. On the other hand, if the introduction of the TVM leads to a reduction in compliance costs relative to the existing system, there is an incremental compliance benefit.

1.3 Objectives of the research

The specific objectives of this project are to provide an independent and indicative evaluation of the:

- transitional compliance costs of the TVM for business taxpayers; and

- incremental recurrent compliance costs or benefits of the TVM for business taxpayers.

2 METHODOLOGY

2.1 Outline

The July 2001 paper proposed a two-phase hybrid methodology for determining the transitional and recurrent costs of the TVM. The first phase was to involve up to 80 case studies and structured interviews based upon an extension of the earlier TVM testing. In the second phase the reliability and reasonableness of the outcomes posited from the case study approach was to be subjected to scrutiny by panels drawn from taxpayers, taxpayer representatives, tax practitioners and administrators, business persons and academics.

Constraints of time and resources, as well as a lack of respondents with sufficient knowledge of the TVM to participate in the study, have entailed a significant reduction in the scale and scope of that original proposal. A case study approach still forms the core of the study, but the number of participants has been reduced considerably and non-business taxpayers have been excluded entirely. Nonetheless, an adapted two-phase research has been used, as detailed below.

2.2 Phase one: identifying participants.

The first phase entailed identifying respondents who might be prepared to participate in structured interviews relating to the compliance costs of the TVM. Given that such interviews would only be meaningful if participants had a reasonable base knowledge about TVM, it was not possible to adopt standard or systematic sampling techniques to identify such participants. Participants were therefore identified from three separate sources.

Some of the participants were recruited from the ranks of the members of the TVM Working Group, including members who had been involved in the pilot transaction testing for the TVM. A second cohort was derived from taxpayers and tax practitioners who were undertaking workshops on the TVM being conducted by the ATO's Tax Design Group. Unfortunately the group of volunteers that derived from these two sources was still too small for meaningful study, and so a third source of interview participants was identified. The Institute of Chartered Accountants in Australia ("ICAA") was conducting a separate study, also commissioned by the Board of Taxation, of the views of some of its members on the TVM, and so it was decided to leverage off that group for this study. Each of the practitioners who participated in the ICAA trial was therefore also enlisted to participate in this study.

2.3 Phase two: structured interviews

The second phase consisted of in-depth structured interviews with the business taxpayers and/or their tax practitioners identified in the first phase.

Each interview took between one and one and a half hours and was typically conducted by telephone. Two members of the research team were present at most interviews in order to maximise accuracy and minimise bias in interpretation and recording. It was not uncommon for two or more members of the responding organisation to participate in the interview. A copy of the survey instrument used as the basis for the structured interview was generally provided to participants in advance.

The interview was split into three sections. In the first, information was sought to establish the respondent's knowledge of the TVM and the demographic background of the business taxpayer (e.g. the size and nature of the business). In the second, the respondent was asked to assume that TVM was about to be introduced and to identify and estimate transitional costs of compliance from a variety of perspectives. In the third, the respondent was asked to assume that the transition period was over and to identify and estimate incremental recurrent costs or benefits of compliance.

A copy of the questions used to structure the interview is attached at Appendix A.

2.4 Stratification

It was originally intended that the sample be stratified by size **and** by industry sector (primary, secondary/manufacturing and tertiary/services). Although the sample is presented in this form, the results are analysed **either** by size **or** by sector, not by both. This is because the primary and secondary/manufacturing sectors are under-represented and the sample proved too small to preserve the privacy of the respondents at the greater level of stratification. The limitations of the sample size are discussed further below. There was no attempt to stratify on the basis of the operating vehicle or legal form of the business.

The stratification on the basis of business size is based on turnover (excluding GST). Businesses with a turnover of up to $1m were classified as "small"; those with a turnover of more than $1m and up to $10m were "medium", and those with a turnover in excess of $10m were "large". This classification is consistent with previous research into compliance costs undertaken by the authors. The definition of small business used was also consistent with that used by the Ralph Review in respect to the Simplified Tax System.

2.5 The Sample

From 40 interviews with principals, senior staff or tax practitioners, information was gathered on a total of 58 businesses. In addition the views of three industry association representatives were obtained. Tax practitioners (as well as one of the representatives of industry associations) proved adept at answering on behalf of one or more of their clients. Hence their responses were separately recorded to reflect both their view of the compliance cost implications for their own practice or association, followed by the compliance cost implications from the perspective of a nominated client.

Table 1 Sample distribution by size and business sector

Size of business	**Sector**			
	Primary	**Manufacturing**	**Services**	**Total**
Large	1	1	13	15
Medium	-	1	24	25
Small	4		14	18
Total	**5**	**2**	**51**	**58**

It became apparent during the structured interview phase that practitioners advising small and medium sized business expect to have to shoulder a significant proportion of the burden of the transitional costs of complying with TVM. Currently, most prepare the client's income tax return from data provided by the client – and few expect this practice to change under TVM. The data provided by the client varies – ranging from invoices and Business Activity Statements to profit and loss statements. Arguably, a greater depth of knowledge is required by the practitioner, entailing a greater investment in learning. The practitioners' compliance costs are therefore typically significantly higher than those of clients.

To provide further insight into the impact of introducing TVM, (and to avoid the distortion that would otherwise occur) practitioners' costs are therefore reported separately in Section 3.4 below dealing with transitional compliance cost implications. For the purposes of analysis of transitional compliance costs the sample is therefore further sub-divided as shown in Table 2.

Table 2 Sample distribution of practitioners and other businesses

Size of business	Practitioner	Other businesses	Total
Large	3	12	15
Medium	12	13	25
Small	9	9	18
Total	**24**	**34**	**58**

This subdivision did not prove to be necessary in Section 3.5 dealing with recurrent costs and benefits because there is no significant difference between practitioners' reported recurrent compliance costs/benefits and those reported by the business taxpayer sample.

2.6 Constraints and assumptions

There are a number of constraints and assumptions that need to be made clear. Notwithstanding these constraints, identified below, the authors consider that the report constitutes as reliable an evaluation of the compliance costs of the TVM as is possible at this stage.

Perception not reality

TVM, at the moment, is purely hypothetical, and even then is not a complete or fully developed model. There is therefore no actual experience on which respondents can base their estimates of transitional and recurrent compliance costs. Moreover, the fact that TVM, or something similar, does not exist in any other jurisdiction makes it impossible to provide any meaningful comparative data.

Low knowledge base

The knowledge base for the TVM in the business community is extremely low. Even tax practitioners, who have been coming to terms with a host of other tax changes in the past few years, have a low and variable knowledge of the TVM. Their attitudes thus far have been characterised by "wait and see" and "need to know" approaches. The low levels of knowledge of TVM in the wider business community and in the narrower community of tax practitioners certainly affected the size of the potential sample population and the sampling methodology that could be used. Clearly those with no knowledge of the TVM would find it impossible to identify and evaluate its compliance costs.

Inevitably the low and variable level of knowledge of TVM among business persons and tax practitioners may also have had some negative impact on the quality of the data that they were able to supply. Section 3 below identifies aspects of the observed relationship between the level of knowledge of TVM (as measured by two proxies) and support for the TVM.

Partial methodology

The methodology adopted is partial at best. The sample population is neither randomly drawn nor stratified on any coherent basis. It does not cover non-business taxpayers who will be impacted by the TVM (employees, self funded retirees, other retirees and those with investment income). Nor is it necessarily representative of the business taxpayer population itself. In particular, the sample does not adequately reflect the primary and secondary/manufacturing sectors, and over-represents the service sector.

Further, the methodology does not address the administrative costs and benefits of the TVM – those costs incurred by the ATO and related entities in administering the TVM, and those administrative benefits derived by those organisations as a result of the implementation of the TVM.

Sample size too small to extrapolate

The sample is necessarily limited by the lack of recognition of TVM in the wider business community and the lack of knowledge of its concepts and detail amongst many members of the tax profession. This is marked in the small to medium size businesses.

With such a limited sample size it would be dangerous (if not impossible) to extrapolate the findings to the general economy or to the total population of business taxpayers. At best the methodology can give an indication of the sorts of compliance cost and benefit issues that are likely to emerge, with perhaps some indication of the magnitude of the costs and benefits.

Qualitative rather than quantitative data

Wherever possible, respondents were asked to provide estimates of the magnitude of transitional and recurrent compliance costs. Different techniques were employed to encourage reasonable estimates. These included triangulation (for example, arriving at the same estimates from different angles – by seeking both an aggregate estimate and also building an estimate from its component parts), check questions and the like. Nonetheless, estimation in these circumstances is rudimentary at the best.

Valuation of time

It is well known in the compliance cost literature that the issue of valuing time is critical.[6] The approach adopted in this study was to ask participants to value their working time. Using the imputed wage rate (in the case of businesses) or charge rate (in the case of practitioners), most participants were able to estimate an average value of time lost. Where participants were unable to estimate a value for an hour lost, the value attributed by a similar sized organisation in the same industry was taken as a proxy.

[6] See, for example, Evans, C., Ritchie, K., Tran-Nam, B. and Walpole, M., *A Report into Taxpayer Costs of Compliance*, Australian Government Publishing Service, 1997 at pp9-12.

3 RESEARCH RESULTS

3.1 Overview

Section 3 reports and analyses the data obtained in the survey. In view of the limitations discussed in the previous section, no attempt has been made to extrapolate these results to economy-wide estimates as the research team believes this would be invalid. Nevertheless, observations can be made about the expectations of the participants, the divergences in view and the consensus that emerges. To the extent that the business taxpayers and practitioners interviewed here are not atypical, their expectations may provide useful information to policy decision-makers

As non-tax-advising businesses and those whose business is offering tax and accountancy services differ markedly in their expectations of transitional compliance costs, they are reported separately in Sections 3.3 (Transitional costs for business taxpayers) and 3.4 (Transitional costs for tax practitioners). They are dealt with in an integrated fashion in Section 3.5 dealing with recurrent costs/benefits as there is no apparent difference there.

3.2 Transitional period

Views on the length of the transitional period differ widely from about 6 months to more than 10 years.

Few participants (ten per cent) believe that it will be less than one income tax cycle - the majority of these are advisers answering on behalf of the client. It would seem these answers are influenced by the strong belief that the bulk of the work in complying with the TVM will fall to the independent accountant/tax adviser who prepares the accounts and the tax return. It is worth noting that the other outlying values (more than 5 years) were also obtained from practitioners who answered the question on behalf of their business clients.

The largest group of participants (43 per cent) regards a full income tax cycle of one year as sufficient to overcome any transitional problems associated with the TVM. This is reflected in a median of one year. The mean is 1.7 years. [7]

Five (or almost nine per cent) of the 58 business taxpayers could not provide a meaningful answer to the question dealing with the length of the transition period. These were business respondents as opposed to practitioners.

3.3 Transitional costs for business taxpayers

Size and incidence

As explained in Section 1, transitional costs include external costs (external adviser fees and costs of external training)), costs of internal labour (value of time loss plus costs of hiring temporary labour specifically for TVM related projects[8]) and non-labour costs (hardware, other equipment, software and other incidentals). The survey suggests that the estimated transitional compliance costs of the TVM are substantial and variable.

[7] The mean is the average of the responses while the median is the response in the middle of the range.

[8] Costs of temporary labour to cover time lost are not counted here in order to avoid double-counting and over estimating.

Large business taxpayers' estimates of transitional costs range widely - from $4,340 to $3,416,200, with a mean value of $757,859 and a median value of $458,800. For these businesses, the main component is internal (i.e. the cost of time lost by staff learning about, preparing for, implementing and becoming familiar with the TVM and the cost of temporary staff for TVM implementation projects). The median internal cost is $188,740 - almost three times the median spend on incidentals and more than half as much again as the median spend on external advice and training.

Medium-sized business taxpayers report expected transitional costs in a narrower band from $0 to $13,938 with a mean value of $4,192 and a median value of $2,580. These businesses expected to spend more on external advice than in the other cost categories, which reflects their tendency to rely relatively more on independent tax advisers for assistance with their compliance activities.

Transitional costs expected by small business taxpayers range from $600 to $18,260 with a mean value of $8,467 and a median value of $3,912. Like medium sized businesses, the main component of their transitional compliance costs seems to be external advisers for the same reason.

The fact that the transitional costs of small businesses exceed those of medium businesses is counter-intuitive. This seems to arise because the sample is small and dominated by an extreme response. As there were only two respondents from this type of business (travel) in the entire sample, we are unable to determine whether or not this respondent is typical of their industry.

A clear consensus emerged amongst participants that the transition to TVM was unlikely to require additional investment in computer hardware and other equipment. Very few businesses nominated costs in this area. The same is true of software and other system costs for small and medium sized business but not for large business. This is reflected in median spends for software and other costs of $0 for small and medium-sized business and $65,550 for large business.

Psychological costs

Many business participants identified psychological costs but, as expected, found these impossible to quantify. These costs were variously described as reform fatigue, loss of time with family and stress. Practitioners responding on behalf of their clients predicted that their small business clients would experience psychological costs as they "would struggle to understand the accounting and tax concepts and the difference between profit in hand/bank and taxable income."

3.3 Transitional Costs for tax practitioners

Size and incidence

Practitioners expect to face substantial transitional compliance costs of the TVM. These estimates are both higher than and less variable than those of business taxpayers.

Large tax and accounting practices estimate the transitional costs of TVM will range from $406,250 to $1,082,200 with a mean value of $821,190 and a median value of $975,120. The transitional cost estimates of medium-sized practices fluctuate more widely from $77,500 to $3,994,000 with a mean value of $707,487 and a median value of $184,738. For small practices, transitional costs range from $25,850 to $110,200 with a mean value of $50,333 and a median value of $29,863.

The costs of internal labour are the dominating factor in the case of practitioners, accounting for 96%, 97% and 82% of average transitional compliance costs of large, medium-sized and small practices, respectively. This is mainly the value of time lost acquiring the skills to deal with the TVM and of productivity in the transition period.

It is relevant to consider whether some or all of these transitional costs can be passed on to clients. Many of the practitioner respondents believed that they would be able to recover costs directly associated with a particular client matter (e.g. additional time spent preparing asset registers) but that they would pass on only a portion of their learning costs. A few participants think that the introduction of TVM reform provides increased business opportunities (in the form of more business and seminars, etc).

Psychological costs

Some practitioners cited psychological costs as important. They typically mentioned stresses arising from long working hours and the “re-learning” process (i.e. having to “forget” the principles learned and experience gained with the current system and “learn” the new principles associated with TVM). Although several practitioners mentioned their expectation that the introduction of TVM would prompt a further round of early retirements from the profession (as occurred during the introduction of GST) only one respondent indicated that he/she would consider early retirement or changing industry if the proposed TVM goes ahead.

3.5 Recurrent costs/benefits

After considering transitional compliance cost implications, the study examined the impact of the TVM on business’ longer term (recurrent) compliance costs or benefits. Overall, it was evident that participants found it easier to quantify transitional costs than they did recurrent costs or benefits. Many struggled when it came to providing an estimate of the level of recurrent costs or benefits, and very few felt confident in the accuracy of their estimates in this regard, often choosing not to venture a figure. Nonetheless, participants did feel more comfortable in adopting a less quantitative approach to the evaluation of recurrent compliance costs or benefits.

Under this approach, tax compliance (in its broadest sense) was broken down into 12 component activities (for example, collection of data, liaison with the ATO, tax planning). Participants were asked to identify whether the TVM was likely to decrease, increase or have no impact on the recurrent compliance costs of that activity compared to the existing tax system. The results of this exercise are summarised in Table 3 for all participants.

Table 3 indicates that by far the majority of businesses and practitioners who were surveyed viewed TVM as having no impact on their recurrent compliance costs in the longer term. At the top end of the range, 44 responses out of a total of 58 (approximately 76%) indicated that the TVM would not lead to any change in the compliance costs involved in recording and storing data for tax purposes, compared to the existing system. Towards the other end of the scale, 25 out of 58 responses (43%) indicated that the recurrent compliance costs involved in preparing the income tax return would remain the same under TVM compared to the current system. This was very nearly the same as the number of participants (24, or 41%) who thought their compliance costs related to this activity would increase under TVM.

Table 3 Impact of TVM on recurrent compliance activities: all participants

	Taxpayers who consider recurrent costs will:			Taxpayers unable to answer/not applicable
Compliance activity	**Increase**	**Remain the same**	**Decrease**	
Collection of data	17	35	4	2
Recording & storage of data	12	44	0	2
Processing of data	13	39	4	2
Preparation of tax return	24	25	6	3
Liaison with practitioners	11	21	5	21
Liaison with ATO	6	32	5	15
Fees to practitioners	12	21	5	20
Use of computer equipment	1	54	1	2
Use of software	7	47	1	3
Tax planning	4	43	6	5
Managerial benefits	2	46	8	2
Other	3	51	1	3

Where participants did identify that their recurrent costs would change for an activity, more businesses and practitioners believed there would be increased rather than reduced costs. For example, four times as many responses (24 as against six) indicated that recurrent compliance costs on the preparation of the tax return would increase under TVM. The only exceptions to this were the activities labelled tax planning and managerial benefits. So far as these categories are concerned, more participants regarded the TVM as beneficial rather than costly.

Further insight can be gained by disaggregating the above table on the basis of business size. This is done in Tables 3.a, 3.b and 3.c for large, medium and small business taxpayers surveyed respectively.

Table 3.a Impact of TVM on recurrent compliance activities: large businesses

	Taxpayers who consider recurrent costs will			Taxpayers unable to answer/not applicable
Compliance activity	**Increase**	**Remain the same**	**Decrease**	
Collection of data	3	9	3	0
Recording & storage of data	3	12	0	0
Processing of data	3	10	2	0
Preparation of tax return	4	8	3	0
Liaison with practitioners	3	8	2	2
Liaison with ATO	1	9	2	3
Fees to practitioners	4	7	2	2
Use of computer equipment	0	15	0	0
Use of software	2	13	0	0
Tax planning	1	11	2	1
Managerial benefits	1	9	5	0
Other	1	12	1	1

Table 3.b Impact of TVM on recurrent compliance activities: medium businesses

	Taxpayers who consider recurrent costs will			Taxpayers unable to answer/not applicable
Compliance activity	**Increase**	**Remain the same**	**Decrease**	
Collection of data	6	18	1	0
Recording & storage of data	2	23	0	0
Processing of data	7	18	0	0
Preparation of tax return	13	10	2	0
Liaison with practitioners	3	8	3	11
Liaison with ATO	2	15	2	6
Fees to practitioners	3	9	3	10
Use of computer equipment	1	24	0	0
Use of software	2	22	0	1
Tax planning	1	21	2	1
Managerial benefits	1	22	2	0
Other	0	25	0	0

Table 3.c Impact of TVM on recurrent compliance activities: small businesses

	Taxpayers who consider recurrent costs will			Taxpayers unable to answer/not applicable
Compliance activity	**Increase**	**Remain the same**	**Decrease**	
Collection of data	8	8	0	2
Recording & storage of data	7	9	0	2
Processing of data	3	11	2	2
Preparation of tax return	7	7	1	3
Liaison with practitioners	5	5	0	8
Liaison with ATO	3	8	1	6
Fees to practitioners	5	5	0	8
Use of computer equipment	0	15	1	2
Use of software	3	12	1	2
Tax planning	2	11	2	3
Managerial benefits	0	15	1	2
Other	2	14	0	2

From these tables it is evident that any recurrent benefits were more likely to be perceived by large business participants rather than by those in the small and medium sized business sectors. Incremental benefits for larger business were mainly identified in the areas of collection of data, preparation of tax returns and the activity labelled “managerial benefits”.

This latter category sought to identify efficiency gains that the businesses might have achieved as a result of the switch to TVM. With the introduction of the GST some two years earlier it was hypothesised that businesses would have better management information and systems available to it as a result of the introduction of the GST. The inclusion of the category “managerial benefits” in this study was an attempt to see if such benefits might also arise with the proposed TVM. The fact that only eight (predominantly large) businesses out of 58 were able to identify the possibility of managerial benefits suggests that there is unlikely to be any such efficiency gains for the business sector as a result of the introduction of the TVM.

The incremental costs for medium and smaller business tended to be concentrated in the areas of collection and storage of data and in the preparation of the tax return.

Many practitioners expressed the view that small business would have to collect more information and that the preparation of the return would require a new step added to the process currently used. Whilst this assessment varied dependent on the method deemed most appropriate for the business, the general view appears to be that small and medium sized business will typically require an additional set of reports. For example, few small businesses currently have profit and loss and balance sheet reports prepared, and were not able to see how one or other of these reports would not be necessary in the future if TVM were to be introduced.

Having gone through the various individual categories of compliance activities, the research team then sought business' overall perception on the impact of TVM on their aggregate recurrent compliance costs. The results are summarised in Table 4.

Table 4 Overall impact of TVM on recurrent compliance costs by size

	Taxpayers who consider recurrent costs will			All taxpayers
	Increase	**Remain the same**	**Decrease**	
Large	3 (20%)	8 (53%)	4 (27%)	15 (100%)
Medium	14 (56%)	8 (32%)	3 (16%)	25 (100%)
Small	12 (67%)	4 (22%)	2 (11%)	18 (100%)
All	29 (50%)	20 (34%)	9 (16%)	58 (100%)

Note: the figure in the bracket expresses the number of participants as a percentage of the row total.

Table 4 reinforces the observation made earlier that overall long term benefits are more likely to be perceived by large business, not by small ones. For example, 27% of the large business taxpayers viewed their recurrent compliance costs as likely to be lower under TVM, while 20% of large business taxpayers perceived their recurrent compliance costs as likely to be higher under TVM. By way of contrast, only 11% of small business taxpayers identified a long term compliance benefit, whilst 67% identified the likelihood of increased compliance costs if TVM were to be introduced.

3.6 Further observations

In addition to the primary information relating to the transitional and recurrent costs of the TVM, the study identified a number of other points that will be of relevance. More particularly:

Participants' overall view on TVM

At this stage of development, a clear majority of participants (whether in aggregate or disaggregated by size) oppose the introduction of the TVM. Surprisingly, the proportion of business taxpayers who support the TVM is lowest among large businesses and practitioners, and higher among medium and small business taxpayers. This is illustrated in Table 5.

Table 5 Business' view on the TVM proposal

	Taxpayers who			All taxpayers
	Oppose TVM	**Remain undecided**	**Support TVM**	
Large	12 (80%)	2 (13%)	1 (7%)	15 (100%)
Medium	17 (68%)	3 (12%)	5 (20%)	25 (100%)
Small	13 (72%)	2 (11%)	3 (17%)	18 (100%)
All	**42 (72%)**	**7 (12%)**	**9 (16%)**	**58 (100%)**

Note: the figure in the bracket expresses the number of participants as a percentage of the row total.

Relationship between change in compliance costs and view on TVM

It was hypothesised that since TVM will generally not have any impact on business tax liabilities, a primary determinant of a business' overall view on TVM would be the change in compliance costs that would occur as a result of the introduction of TVM. Further, since transitional compliance costs are substantial, it was considered that a necessary (but not sufficient) condition for a business to support TVM would be that its recurrent compliance costs were lower under TVM relative to the existing system. If this condition were not satisfied (i.e. recurrent compliance costs were higher under TVM) then it was hypothesised that a business would not support TVM.

This hypothesis was confirmed by the study. Six of the nine businesses that supported the TVM proposal (see Table 5) perceived that their recurrent compliance costs would be lower under the TVM compared to the existing system. To put it another way, only three out of 58 participants (approximately 5%) supported the introduction of the TVM without having regard to the compliance cost implications for their business.

Based on this evidence it would appear that compliance costs are a very important determinant of a business' overall view of the TVM.

Relationship between overall level of knowledge and overall view of TVM

A further hypothesis was that a participant's level of knowledge of TVM might impact upon that business taxpayer's support or otherwise for the TVM. More particularly, the study wished to test whether support for the TVM increased as knowledge of the TVM increased.

Two indicators were sought as proxies of participants' knowledge of TVM:

- the amount of time participants had spent learning and talking about and experimenting with the method; and
- participants' own assessment of their knowledge ranking on a scale of 0 (know nothing) to 10 (know everything).

However, when both indicators were tested against the level of support that participants indicated for the TVM, no meaningful relationship was discernible.

There was no clear relationship between time spent learning about the TVM and overall support for, or opposition to, it. Of the four respondents (seven per cent of the total sample) who had invested more than 100 hours in learning about the TVM, three were unanimously opposed and one was undecided. Of the nine per cent who had invested 50 hours, all were opposed, yet the 3 per cent who had invested 80 hours, were all in favour. Fifteen per cent of the sample had invested 25 hours – and none were in favour of the TVM – yet a third of the ten per cent who had invested 15 hours were in favour and two thirds were opposed.

Similarly, tracking the self-assessed knowledge of TVM and overall support for, or opposition to, TVM showed no clearer relationship. A third of the sample rated themselves as having average knowledge (5) and the majority (78%) of them were opposed to TVM. Those who rated themselves "less than average", i.e. between 0 and 4, (43% of the sample) were slightly more disposed to support the method than those who rated themselves "above-average" (between 6 and 10). That is 20 per cent of those with "less than average" knowledge, 10 per cent of those with "average knowledge" and 14 per cent of those with "above average" knowledge supported the TVM.

Comparison with other tax reforms

Participants were asked how they anticipated that the introduction of the TVM might compare to their recent experience with the implementation of the GST. This was done in order to provide a rough guide or benchmark to participants (in terms of degrees of magnitude and significance) of potential compliance cost implications.

A clear difference emerged between practitioners and the businesses they advise. The vast majority of businesses (about 85%) rated the transitional compliance costs associated with TVM as likely to be smaller than those experienced under GST whilst over 40% of practitioners rated it larger than GST. A further 29% of practitioners expect it to be the same as GST.

There was a difference between sectors – with all manufacturers and 92 per cent of the services sector sample expecting to experience lower compliance costs than under GST and primary producers evenly divided (50 per cent expecting higher, 50 per cent lower and one unable to predict).

Loss of intellectual capital

A number of practitioners alluded to the loss of intellectual capital that would occur as one tax system was abandoned in favour of another. The introduction of the TVM would not only necessitate a massive program of up-skilling for the existing tax profession. It would also entail a large element of de-skilling as traditional expertise was lost. It is not entirely clear that this would comprise a compliance cost as that term is traditionally interpreted, but the observation is recorded for the sake of completeness. They also saw the loss of legal precedent and the uncertainty that would exist as the body of precedent was re-built (albeit around different issues) as significant.

4 CONCLUSIONS

The small sample prevents valid extrapolation of the data to arrive at a quantified estimate of the net benefits (or costs) to Australian business taxpayers from moving to the TVM as the prevailing method of calculating business income tax. Given that discussion of the TVM has occurred hot on the heels of a series of business tax reforms including one of Australia's most significant tax reforms for business (GST), the lack of awareness and knowledge of the TVM amongst the wider business community is hardly surprising.

Nevertheless there are a number of conclusions that can be drawn from this project.

Business has little difficulty in identifying and estimating the transitional costs of moving to TVM and concludes that there will be a net cost in the transition which will be high for many of them. They have some difficulty identifying recurrent benefits, less difficulty identifying recurrent costs and greater difficulty quantifying either. The majority sees little change in recurrent costs of complying with TVM compared to the existing system.

We can conclude that independent tax and accounting practitioners expect to spend more time preparing tax returns in the long-term, particularly for their small and medium sized clients. Although some recognise the potential for extra business, few expect to be able to pass on their transitional costs (particularly time lost in learning about the new system and in lost productivity during the transition) and the extra time spent preparing returns in the longer term in higher client fees because "there is no benefit to business."

The latter comment was also echoed by business – reinforcing the conclusion that benefits to business from the TVM are purely indirect. Hence, if the system does not deliver simplicity that results in time savings passed on in lower practitioner fees or more value-adding business advice there is no benefit to business.

Even those that expect TVM to deliver a simpler conceptual framework are not automatically supporters. This appears to be because tax practitioners and business value certainty. They believe that the simpler conceptual framework will allow for more certain assessments of particular transactions or business ventures (resulting in less resources spent researching outcomes or accessing expert opinion). But there is a commonly held view that the introduction of TVM will mean exchanging one set of uncertain outcomes (the grey area of income versus capital) for another (what is an asset/liability and is it being held). They see the loss of legal precedent as a significant cost.

We may also conclude that opposition to TVM is not merely resistance to change. Although some respondents identified reform fatigue as a psychological transitional cost, many also insisted that the existing system is in dire need of reform. It seems clear that few believe that TVM is the appropriate vehicle to deliver the required change. Indeed some of those that identified recurrent benefits from the introduction of the current version of TVM noted that these benefits were policy changes incorporated into the draft TVM legislation, not benefits inherent to the system.

We are able to draw few conclusions about the various methods proposed for complying with the TVM. Most respondents were unable to distinguish between the methods when estimating transitional and recurrent costs – although some practitioners and businesses reported that they expect the Profit and Loss and Direct Preparation methods to be closest to their current systems so that these may entail slightly lower transitional costs. (Others spoke of the need for an additional stage in their preparation of tax returns in order to comply with the TVM – hence their view that recurrent compliance costs would increase.)

The clear message is that three quarters of the business taxpayers interviewed do not support the introduction of TVM when considering the compliance costs – and nearly half the rest are undecided rather than supportive. Most see no clear and certain long-term benefits to outweigh the predictable short-term costs that they are certain they will incur. The scepticism and opposition is surprisingly similar regardless of the size of the business.

There is no evidence from this survey that business taxpayer compliance costs will contribute to a reduction in the operating cost in the long-term. If the measure of TVM is that it "is only tenable if it reduces the operating cost of the tax system", then the conclusion to be drawn is that there will need to be large net savings in tax administrative costs in order to justify the introduction of TVM.

APPENDIX A STRUCTURED INTERVIEW

TAX VALUE METHOD COMPLIANCE COSTS EVALUATION

SECTION 1: This section asks about some background to the business' knowledge of TVM.

1 How would you rate your knowledge of TVM where 0 equals know nothing and 10 equals know everything?

TVM Approach	**Knowledge Rating (0 – 10)**
TVM (version 1)	
TVM (version 2)	
Profit & Loss	
Direct Preparation	
Overall knowledge	

2 Roughly how long do you think you have spent learning about TVM thus far? Include attendance at conferences, workshops, time spent reading, participating in discussions etc.

____

3 On average how many people work in your business?

Owners/partners/directors/trustees	
Full–time employees	
Part–time employees	
Casual/seasonal employees	
Unpaid helpers	
Others	

4 How many of the following internal people are in anyway involved in the tax affairs of your business (for example, two full–time employees, one owner)?

Owners/partners/directors/trustees	
Full–time employees	
Part–time employees	
Casual/seasonal employees	
Unpaid helpers	
Others	

LET'S ASSUME FROM HERE ON THAT TVM IS TO BE INTRODUCED.

SECTION 2: THIS SECTION ASKS ABOUT THE TRANSITIONAL COMPLIANCE COSTS FOR YOUR BUSINESS T0 PREPARE FOR THE TVM.

We are seeking to identify the transitional costs your business may incur in preparing for the implementation of TVM. Transitional costs include both start–up (one–off) costs and temporary costs. These costs include:

- Additional fees paid to external tax advisers to prepare for TVM measures;
- Costs of training owners/partners/directors, staff and other unpaid helpers to prepare for TVM (including both direct training costs, time spent, travelling and accommodation costs, if any);
- The costs of buying or upgrading computers and other equipment;
- The costs of buying new or updated tax and accounting software; and
- The costs of modifying accounting and business system.
- Temporary costs include the additional time required by you/your staff/your helper to comply with the new regulation whilst you are still becoming familiar with the nuances of the tax change.

5 Please estimate the total amount that may be attributable to the seeking of tax advice about TVM. These costs may extend over a long period**.**

	TVM (version 1)	**TVM (version 2)**	**P & L**	**Direct Preparation**
Accountants/Tax Agents	$	$	$	$
Lawyers	$	$	$	$
Financial Consultants	$	$	$	$
TOTAL	$	$	$	$

6 How much money will the business spend on training people in preparation for TVM? . *The costs refer to direct expenses such as training fees, travelling and accommodation costs (not time losses by staff).*

TVM (version 1)	$
TVM (version 2)	$
Profit & Loss	$
Direct Preparation	$

7 Please estimate the training/learning time (in hours) to be spent by different levels of staff in preparation for TVM. These hours include, for example time spent discussing with tax advisers, attending seminars, teaching other in-house staff, and learning new tax software.

	Owner/Partner / Director	**Manager/Accountant/ Programmer**	**Clerk**	**Unpaid Helper**	**Total (Hours)**
TVM (version 1)					
TVM (version 2)					
Profit & Loss					
Direct Preparation					

8 Please estimate the number of extra staff the business will need to hire on a short term basis in order to implement the TVM.

TVM Approach	**Number of staff**	**How long?**
TVM (version 1)		
TVM (version 2)		
Profit & Loss		
Direct Preparation		

9 Please provide an estimate of the cost of buying or hiring computers or special equipment for your business in order to implement TVM. Please estimate the percentage of these costs directly related to the implementation of TVM.

$

10 The equipment in your business may be likewise used for different purposes. Please estimate the costs to your business of equipment to be acquired specifically to deal with TVM. For example, if you plan to spend $500 on a facsimile machine in 2004-2005 and $1000 on a photocopier, and you estimate that 10% is attributable to TVM purposes, write $150 (10% of $1,500) below.

$ ____________

11 If tax or accounting **software** is to be purchased in response to TVM, what is your estimate of the cost?

$ ____________

12 Please list any other transitional costs relating to TVM that have not been covered so far:

Type	Costs
______________	$ ______________
______________	$ ______________
______________	$ ______________

13 In your opinion do you think the implementation costs in relation to TVM for your business would be

__________ smaller than
__________ the same as; or
__________ bigger than

the implementation costs of the GST?

14 Let's assume that it is 2004 and you are preparing your budgets for 2005. How much extra funding will you ask for in order to implement TVM? We are only looking for a ball park figure. You may wish to think back to your preparations for the implementation of the GST to help answer this question.

$ ______________

LET'S NOW ASSUME THAT TVM IS UP AND RUNNING SMOOTHLY.
SECTION 3: THIS SECTION ASKS ABOUT THE RECURRENT COMPLIANCE COSTS OF TVM.

It is costly to your business to comply with the income tax law. The cost components include time expended by internal staff (including directors/partners and so on), fees to tax practitioners, use of computing equipment and software, etc. The use of internal staff includes owners, partners, trustees, directors, managers, lawyers, accountants, computer analysts, clerks and unpaid helpers. The various activities include:

- Collection of relevant accounting and tax data;
- Recording and storage of relevant data;
- Processing of data;
- Preparation & submission of income tax return
- Liaison with external practitioners;
- Liaison with ATO (including tax disputes)
- Fees to practitioners;
- Use of computer equipment;
- Use of software;
- Tax planning;
- Managerial benefits;
- Other categories.

15 Consider a change from the existing income system to TVM. Ignore all the transitional (both start-up and temporary) costs arising from learning the TVM and preparing for it. Suppose now that the TVM system has been implemented and has operated smoothly for some time. Focus now on the plausible incremental (ie, additional) costs or benefits resulting from such a change

Write + if there is incremental benefit, - if there is incremental cost and 0 if neutral.

Activities	**TVM (version 1)**	**TVM (version 2)**	**Profit & Loss**	**Direct Preparation**
Collection of relevant accounting/ tax data				
Record & storage of data				
Processing of data				
Preparation of income tax return				
Liaison with practitioners				
Liaison with ATO (including tax disputes)				
Fees to practitioners				
Use of computer equipment				
Use of software				
Tax planning				
Managerial benefits				
Other categories • • •				

16 If a + or a - has been entered into the above table, try to get more detailed data. That is, for each of the above activity, try to quantify

- How many hours per year?

- Which level of staff is likely to be involved?

17 Having gone through all of these categories, what is your perceived aggregate incremental benefits or costs for your business (assuming that your business remains static, no growth and no decline in terms of turnover).

$ per year

18 If you were starting a business from scratch, do you think your business would be better off or worse off under the TVM relative to the existing income tax system?

19 Will TVM result in higher or lower recurrent compliance costs?
$ per year

20 Having tried to identify and quantify the transitional costs and possible incremental benefits/costs associated with the TVM, does your business support the switch to the TVM?