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# **Compliance and Administrative Costs of Taxation in Canada**

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## Executive summary

Compliance costs refer to the costs incurred by individuals and businesses in complying with tax laws and regulations. Administrative costs include the expenses incurred by governments to manage and maintain the tax system. They are all too often neglected in the discussion of tax policy. They are recognized as important but usually overlooked. The direct costs of taxation coupled with their incentive or behavioural effects normally take centre stage in the discussion and formulation of tax policy.

The main objective of the study, however, is to provide an up-to-date reasonable estimate of the costs of complying with tax laws and regulations and the costs to government in managing and maintaining the tax system. The study also summarizes the limited amount of research completed in Canada and abroad on tax compliance. The results are presented in order to provide some limited points of comparison between the calculations completed for this study and estimates completed previously.

### ***Calculating compliance and administrative costs for Canada***

This study uses two methods, a micro or bottom-up approach and a macro or top-down approach to estimate the cost of tax compliance and administrative costs in Canada for 2005. It relies on a host of different sources and studies to piece together a reasonable range of cost estimates.

### ***Compliance costs***

#### **Personal income taxes**

The estimate for compliance costs for personal income taxes includes the time required to prepare, complete, and remit the tax return (\$2.4 billion), the costs associated with tax preparers (\$400.2 million to \$1.3 billion), and the

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## 2 *Tax Reform in Canada: The Case for a Flat Tax*

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costs of tax preparation software (\$68.2 million to \$163.6 million). In total, the costs for complying with personal income taxes ranged from between \$2.9 billion to \$3.9 billion.

An alternative method employed, which resulted in an estimate of \$5.5 billion, relies on previous research. Specifically, it is derived from an estimate based on research that showed compliance costs for personal income taxes in Canada consumed 3.0% of personal income tax revenue or 0.4% of GDP.

Total compliance costs for personal income taxes ranged between \$2.9 billion and \$5.5 billion depending on the methodology relied upon. They represented between 1.7% and 3.3% of total personal income taxes collected federally and provincially and between 0.2% and 0.4% of GDP in 2005.

### **Business taxes**

The calculation for business-tax compliance costs relied on survey data collected by the Canadian Federation of Independent Business (CFIB), the country's largest representative group for small and medium-sized businesses. Using the data collected by the CFIB as well as independent information from Statistics Canada, an estimate was calculated for total business-tax compliance costs, including direct and indirect costs as well as overhead, which amounted to \$13.0 billion in 2005 or roughly 1.0% of GDP. A second calculation was completed, again based on previous research relying on ratios of business tax compliance costs to the economy. This top-down or macro approach resulted in an estimate of \$19.3 billion for total business tax compliance costs in 2005.

### **Property taxes—personal and business**

The final category of taxes in which an estimate was calculated for compliance costs was property taxes, both for personal and business property. The calculation relied on the number of properties in existence in 2005 coupled with an estimate of the time required to complete property tax remittances. The estimate for compliance costs of personal property taxes ranged between \$124.2 and \$248.4 million while the estimate for business property taxes ranged between \$100.1 million and \$200.1 million.

The overall estimate for compliance costs for property taxes, including both personal and business property taxes for 2005, is between \$224.3 million and \$448.5 million depending on the estimate used for the number of hours required to complete property taxes each year. According to Statistics Canada, total property taxes in 2005 were approximately \$41.1 billion. Thus, property tax compliance costs represent roughly between 0.5% and 1.1% of property taxes collected.

The overall cost of tax compliance in Canada in 2005 ranged between \$16.2 billion and \$25.0 billion. This represents between 3.0% and 4.7% of total federal, provincial, and local total revenues and between 1.2% and 1.8% of GDP in 2005.

### **Administrative costs**

Administrative cost estimates were collected from a variety of sources that undertake and complete tax collection in Canada, including the federal, many provincial, and local governments. The total estimate for administrative costs associated with taxation in Canada for 2005 was \$5.8 billion. There was also an alternative estimate used that was based on a 1995 estimate of administrative expenses of \$2.2 billion, which once adjusted to reflect 2005 costs results in an estimate of \$2.7 billion.

## **Compliance and administrative costs of taxation**

In total, tax compliance costs range from \$16.2 billion to \$25.0 billion depending on the methodology employed. Administrative costs in Canada in 2005 were estimated at between \$2.7 billion and \$5.8 billion. Thus, total compliance and administrative costs in Canada for 2005 range between \$18.9 billion and \$30.8 billion. This represents between 3.5% and 5.8% of total federal, provincial and local revenues and between 1.4% and 2.3% of GDP in 2005. Put differently, each Canadian incurred compliance and administrative costs associated with the country's tax system in 2005 of between \$585 and \$955.

The results throughout this paper show that individuals and businesses incur significant costs to comply with the tax system and that governments expend significant resources administering the tax system. It is, therefore, important that better research be undertaken regarding tax compliance and administrative costs.

Although improving the compliance and administrative costs was not a central goal of this study, a number of specific measures that could be taken to reduce such costs are available. The most obvious and perhaps important of these are any measures that reduce or eliminate tax policies that add complexity to the tax system such as special preferences, multiple tax rates, and the number of taxes collected, to name a few.

Other possible and more specific sources of savings include, but are not limited to, the harmonizing of provincial sales taxes (PST) with the federal sales tax (GST), tax collection agreements (TCA) such as the one now in place between Ontario and the federal government for corporate income taxes, and improved and more advanced technology at the Canada Revenue Agency.



# Compliance and Administrative Costs of Taxation in Canada

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Taxes levied by government to finance public services reduce the resources available to members of society both directly and indirectly. The direct cost is simply the tax itself while the indirect costs include distortions in behaviour<sup>1</sup> (the excess burden of taxation) and the resources consumed in the operation of the tax system. The goal of tax policy should be to raise a sufficient amount of resources for the government to provide services demanded by citizens in the least costly manner possible. That is, governments should minimize the amount of economic distortion caused by the imposition of taxes and be sensitive to the costs imposed on individuals and business when complying with tax laws and regulations (compliance costs) and the costs of managing and maintaining the tax system (administrative costs).

This chapter examines both compliance and administrative costs, which are far too often neglected in tax policy discussions. More specifically, this paper calculates an up-to-date estimate of total compliance and administrative costs for Canada and compares them with those reported in international research.<sup>2</sup> In some countries, recent studies have moved

<sup>1</sup> For a review of evidence on behavioural costs of taxation, see Clemens, Veldhuis, & Palacios, 2007.

<sup>2</sup> The international estimates provided can only be used as rough comparisons since there are often large differences in the design and nature of tax systems in different countries. See Sandford, 1995 for further details on this point.

beyond measurement of compliance costs to focus on how the burden can be reduced, adopting a qualitative rather than quantitative approach. In the case of Canada, the lack of recent work on this issue requires us to focus on total costs.

Unfortunately, relatively little research has been undertaken in this area either in Canada or internationally, with Australia a notable exception. Canada has no consistent time series on compliance and administrative costs, and comparable figures across countries are similarly lacking.<sup>3</sup> The costs of a tax system, which include the indirect costs, are a key component of taxation and require greater and more consistent research.

This study is divided into three sections. The first section outlines the various costs presented above and reviews the international research. The second section provides an estimate of these costs for Canada. Finally, a brief set of conclusions and recommendations are presented.

## 1 Compliance and administrative costs

This section provides a brief definition of compliance and administrative costs. It also provides an overview of the international evidence on these costs.

### **Compliance costs**

Compliance costs are those expenses incurred by individuals, families, and businesses to comply with tax regulations. These include the time and expenses incurred by individuals and businesses to maintain proper records, undertake tax planning, file necessary reports, and calculate required remittances.<sup>4</sup> They include both the costs incurred by individuals and businesses as well as fees paid to tax professionals such as accountants and lawyers. Costs incurred by businesses include collecting, managing, and remitting taxes paid by employees (Employment Insurance, Canada Pension Plan, etc.) to the government, the costs of paying the businesses own taxes, and in providing tax-related information to governments (statement of earned financial income, transactions and so on).

<sup>3</sup> Cordova-Novion and Young, 2001 is an exception.

<sup>4</sup> The research on compliance costs also sometimes refers to psychological costs. These costs relate to that fact that the time spent complying with tax regulations is generally an unpleasant experience and thus imposes costs on taxpayers. These costs have never been measured.



**Administrative costs**

Administrative costs are those incurred by governments to collect taxes and enforce tax regulations. These costs include collecting, administering, and managing the tax-collection system. They include the direct costs of the Canada Revenue Agency (CRA), which is responsible for administering and managing the Canadian tax system and related overhead. They also include indirect costs incurred by judicial and quasi-judicial bodies responsible for settling disputes between taxpayers and the government.

**Review of Canadian and international research**

This section provides an overview of the research completed to date on tax compliance costs both in Canada and abroad. It is designed to provide readers with some context for comparative purposes when studying the compliance cost calculations for Canada provided later in the paper. This overview of the research is organized into two parts: individuals and businesses. The first part summarizes the small amount of research on compliance costs for individuals. The second part focuses on compliance costs for businesses. The discussion differentiates between Canadian research and work completed internationally. The research presented is limited to taxes that are similar to those imposed in Canada. The principal result of reviewing this research is that compliance costs tend to be significant, regressive with respect to the size of business, and increasing with the complexity of the tax environment.

While tax compliance costs are acknowledged as an important aspect of tax policy, there is still not as large or robust a body of scholarly work as is required to improve tax policy. For example, there are a limited number of comprehensive studies of the compliance costs for all taxes using a standardized methodology.<sup>5</sup> The standard practice of research in this field has been to calculate compliance costs for one or a few taxes in a specific region or country. This section summarizes the available research.<sup>6</sup>

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5 Indeed, Evans et al., 1996 and 1997, are two of the very few studies available that examine taxes comprehensively and incorporate a standard methodology.

6 See Appendix 1 (page 28) and Appendix 2 (page 30) for tabular overviews of the research published on this topic. *Nota bene*, however, that the ratios reported in the appendixes are not infallible measures of comparison over time or between countries or taxes. For example, a doubling of the tax rate will have a significant impact on the measures, potentially suggesting that compliance costs compared to revenues have decreased after the rate change when in fact they may still be the same. For that reason, the ratio of compliance costs to GDP is sometimes preferred but that ratio is also subject to the same limitation (GDP can change over time independent of compliance costs).

**Canadian research on compliance costs for individuals**

Very little research has been undertaken on the compliance costs for individuals in Canada. A seminal study by François Vaillancourt (1989) estimated the cost to individuals of complying with personal income tax regulations. Using data collected in 1986 through face-to-face surveys of 2,040 residents over the age of 18 in the 10 Canadian provinces, Vaillancourt concluded that individual compliance costs incurred in preparing (sorting documents and gathering information) and completing personal tax returns represented, on average, 2.5% of taxes paid.<sup>7</sup>

Vaillancourt (1989) also analyzed the relationship between compliance costs and taxpayer characteristics. He concluded that compliance costs were higher for men than for women, for individuals who are self-employed, and for those with higher levels of education. The author highlighted that most of these variations are due to variations in wages and tax complexity faced by the taxpayer.

**International research on compliance costs for individuals**

Unfortunately there is also a limited amount of research available outside of Canada about compliance costs for individuals. Several studies have been completed on compliance costs for individuals in the United States.<sup>8</sup> Moody (2005) is the most recent study to examine individual compliance costs in the United States.<sup>9</sup> The author calculated that individual compliance costs of the federal income-tax system were US\$110.7 billion in 2005.<sup>10</sup> The author also concluded that compliance costs were regressive, hitting lower-income individuals harder than higher-income individuals. Specifically, individuals with adjusted gross income (AGI) of less than \$20,000 incurred compliance costs of 5.9% of their income whereas compliance costs dropped significantly to 0.5% of income for taxpayers earning over \$200,000.

Joel Slemrod of the University of Michigan completed a similar study in 2004.<sup>11</sup> The author estimated that total compliance costs for individuals

7 Since the PIT tax collection system is also used to collect payroll taxes (EI and CPP/QPP premiums) the total revenues used as the denominator in computing this percentage includes PIT, CPP/QPP and EI revenues (Vaillancourt, 1989: 83, note 5).

8 These studies are highlighted and summarized in the recent GAO report on compliance costs (US GAO, 2005).

9 In his analysis, the author excluded costs associated with tax planning, tax audits, and litigations.

10 A previous study by Moody (2002) revealed that compliance costs were \$104 billion in 2002.

11 This study was an update of the research paper completed by Blumenthal and Slemrod in 1992.

amounted to \$85 billion in 2004, which included taxpayer time, preparer fees, and other related expenses, representing 11.1% of personal income-tax revenues.<sup>12</sup> The main reason for the difference in costs expressed in dollars is that Slemrod used a lower value to monetize individual taxpayer time than Moody while the difference in ratios is due to the use of a different denominator: income for Moody and taxes for Slemrod.<sup>13</sup>

Most of the remaining research has relied on survey-based work completed in Australia and Europe. For example, two studies by Jeff Pope (Pope et al., 1990; Pope, 1995) as well as a study by Chris Evans and his colleagues (1997) examined personal income-tax compliance costs in Australia. The studies concluded that compliance costs associated with personal income taxes ranged from 4.3% of tax revenues (Evans et al., 1997) to 10.8% of tax revenues (Pope, 1995). As was the case for Canada, the studies found tax compliance costs were higher for the self-employed.<sup>14</sup>

The estimated costs of compliance with personal income taxes as calculated by Pope and Evans were higher than several studies that examined European countries. For example, Delgado and Diaz (1995) analyzed personal income-tax compliance costs in Spain using face-to-face interviews and found that compliance costs represented 3.3% of tax revenues.

The results from a study in Sweden indicated even lower compliance costs. Malmer (1994) examined the compliance costs of personal income taxes. He determined that compliance costs represented 1.0% of tax revenues.

Allers (1994; 1995) examined the compliance costs of personal income taxes and the wealth tax in the Netherlands using face-to-face interviews and drop-off questionnaires. Allers concluded that compliance costs for personal income taxes represented 1.4% of personal income-tax revenues.

#### **Canadian research on compliance costs for business**

Recall that the costs incurred by business in complying with tax laws and regulations include both the costs of planning, calculating, and remitting taxes for the business itself as well as the collection and remittance of taxes paid by employees (source deductions) to the government and the provision of information to governments.

12 Or 1.25% of AGI (available at <<http://www.taxpolicycenter.org/TaxFacts/Tfdb/TFTemplate.cfm?DocID=344&Topic2id=30&Topic3id=32>>).

13 Slemrod monetized taxpayer time using a \$20 per hour rate while Moody (2005) used a rate of \$39 per hour.

14 Tran-Nam (2001) found that compliance costs for individuals in Australia were highly regressive. In other words, compliance costs as a percentage of income is higher for low-income earners.

More research is available on the compliance costs incurred by businesses both in Canada and internationally than on the compliance costs of individuals. Plamondon (1997) estimated the costs of compliance and administration for Canada's major tax systems for 1996. Using data from Canadian and international research, the author estimated that it cost Canadian businesses between \$2.3 billion and \$4.5 billion each year to comply with federal and provincial tax regulations, with a midpoint of \$3.4 billion. This mid-point represented approximately 0.4% of GDP or 1.5% of tax revenue.

In a study examining both the compliance and administrative costs of payroll and personal income taxes, Vaillancourt (1989) estimated that the compliance costs incurred by employers<sup>15</sup> for personal income taxes and payroll taxes represented 3.5% of taxes collected or 0.5% of GDP.<sup>16</sup>

Vaillancourt (1989) also concluded that these compliance costs, expressed as a percentage of the size of the firm, decreased with firm size. Specifically, an increase in the size of the firm by 1.0% was associated with an increase in compliance costs of between 0.2% to 0.3%, resulting in a decreasing cost-to-size relationship.

Plamondon and Zussman (1998) provide one of the more recent surveys of compliance costs across a number of taxes at both the federal and provincial level.<sup>17</sup> The authors concluded that compliance costs for the GST (federal) were between 3.3% and 6.6% of gross GST revenues. While not as detailed, their cost estimates for provincial sales taxes ranged from relatively low for those jurisdictions that have integrated their provincial sales taxes with the federal GST<sup>18</sup> to relatively high for those provinces that maintain independent sales tax regimes (Veldhuis, 2006). This is an important insight into sources of potential savings, since compliance costs were seen as lower for jurisdictions that had integrated their provincial sales taxes with the federal GST.

Plamondon and Zussman (1998) also provided estimates for compliance costs for corporate income taxes. The authors cite a number of interna-

15 Data was collected through a mail survey of Canadian employers. In total, 4,196 questionnaires were sent out, of which 9.2% were returned.

16 Vaillancourt also examined the total compliance and administrative costs of the personal income tax and payroll taxes in Canada. He concluded that the total compliance and administrative costs for personal income taxes and payroll taxes were 6.9% of taxes collected, which he deemed to be in line with international studies (1989: 83).

17 Interestingly, this study concluded that there were between \$171 and \$285 million in potential savings from moving to a single-tax administration system.

18 The study notes that the "incremental compliance costs associated with the QST are minimal" because it is administratively and policy integrated with the federal GST (1998: 765).

tional studies that indicate an average compliance cost of 1% to 2% of taxes remitted for corporate income tax. However, the authors' calculations indicated that the Canadian compliance costs are roughly double those estimates, ranging from roughly 2% to 4% of taxes remitted. The finding that Canadian corporate income taxes impose a high compliance cost on businesses when compared to other jurisdictions may signal the need for reform to preserve competitiveness.

Erard's (1997a) report for the Technical Committee on Business Taxation estimated that the compliance burden for income and capital taxes for large companies in Canada in 1995 was an average of \$10.3 to \$11.0 million, implying a compliance burden of 4.6% to 4.9% of taxes paid.<sup>19</sup> Plamondon (1997) also completed a survey of compliance costs for small and medium-sized firms. Respondents estimated that they spent \$3,829 in compliance costs over a 12-month period, representing an average of 2.6% of sales volume.<sup>20</sup>

Finally, a recent study by the Canadian Federation of Independent Business (CFIB, 2005a) concluded that the average total tax compliance cost for small and medium sized corporations<sup>21</sup> amounted to \$18,417. The study also calculated and reported the average annual tax-compliance costs on a per-employee basis, ranging from \$3,313 for firms with fewer than five employees to \$423 for firms with five to 499 employees. In other words, the smaller the business, the higher the tax compliance cost impact per employee.<sup>22, 23</sup>

### ***International research on compliance costs for business***

International research supports the Canadian findings. Most of the research on business tax-compliance costs has been undertaken in the United States, Australia, and Europe, especially in the United Kingdom, the Netherlands,

19 The study further noted that the cost of complying with federal and provincial corporate income and capital taxes were substantially higher for firms in the mining, oil, and gas sectors as well as those with foreign operations.

20 Plamondon's results show that tax compliance costs ranged between 0.2% and 5.7% of sales volume. According to his results, businesses with higher sales volume have decreased compliance costs as a share of sales volume.

21 Large companies are those with more than 500 employees whereas small and medium-sized firms are defined as those with fewer than 500 employees.

22 Data were reported by firm size using the number of employees to break down the results into four groups. The use of employees as opposed to turnover or sales reflects the information collected in the questionnaire.

23 The study (CFIB, 2005a) also concluded that differences in rules among provinces increased compliance costs.

and Sweden. As noted earlier, the United States Government Accountability Office (US GAO, 2005) recently concluded a major review of compliance cost studies in the United States.<sup>24</sup> The study reviewed compliance-cost research in the United States for personal income taxes, corporate income taxes, payroll taxes, estate and gift taxes, and excise taxes; and concluded that the lowest compliance-cost estimates for personal and corporate income taxes resulted in costs of \$107 billion or roughly 1% of GDP. However, it noted that other studies suggested a higher cost of roughly 1.5% of GDP.

The GAO report includes a number of studies examining business tax compliance costs in the United States. Slemrod (2004) estimated the costs to business of collecting and remitting income and payroll taxes for their employees in 2004 to be approximately \$40 billion, which includes corporations and partnerships and covers all costs associated with completing and filing a tax return except post-filing costs such as appeals.

Slemrod and Venkatesh (2002) completed a somewhat narrower examination of business-tax compliance costs for the 2001 tax year using a comprehensive survey.<sup>25</sup> The study excluded the 1,350 largest corporations in the United States, all businesses with less than \$5 million in assets, and all partnerships with less than a requisite number of members. Like Slemrod's 2004 study, this study covered income and payroll taxes, and included all direct and indirect expenses associated with preparing and completing a tax return except for post-filing costs. Not surprisingly given the narrower scope, the overall cost of compliance for businesses was estimated at \$22 billion.

Recently, Scott Moody of the US Tax Foundation completed a broad review of tax compliance costs in the United States in 2005 using IRS data. The study included taxpayer and preparer time but excluded other out-of-pocket expenses and post-filing costs. Moody (2005) estimated the cost to businesses in complying with the federal income-tax system in \$147.7 billion for fiscal year 2002.<sup>26</sup>

Evans et al. (1996, 1997) have published two of the few studies that attempt to evaluate and calculate compliance costs for all business-related federal taxes. Both studies examined Australia in the 1994/95 period. They

24 The full study is available at <<http://www.gao.gov/new.items/do5878.pdf>>.

25 Unfortunately, the response rate was rather low (10.25%) and large discrepancies were noted between the results of the survey and actual data. For example, there were large discrepancies between the assets noted by the IRS and what was indicated in the survey responses.

26 As noted earlier, much of the difference between Moody (2005) and Slemrod (2004) relates to differences in the value used to monetize taxpayer time. Specifically, Moody uses a rate of \$47.96 per hour while Slemrod uses a rate of \$25 per hour.



estimated that the compliance cost to business, including the self-employed, was about 9.4% of taxes collected or 1.02% of GDP.

Most studies examine specific taxes in order to quantify their compliance costs for business. One can regroup the studies under three headings: corporate income tax, payroll type taxes, and VAT taxes. With respect to the corporate income tax, in a seminal study, Slemrod and Blumenthal (1996) estimated the compliance costs of corporate income taxes for both federal and sub-federal returns. Using a sample of 1,329 large corporations, the authors calculated the compliance costs at 3.2% of revenues collected.

Pope (1995) estimated the social compliance burden for corporate income taxes for companies in Australia using data for 1990/91 at approximately 22.9% of revenue collected. Ariff, Ismail, and Loh (1997) provided estimates for compliance costs of corporate income tax in Singapore for 1994/95. The authors' calculations indicated that larger companies (with higher sales) reduced their overall compliance costs as a percentage of sales, which ranged from 0.042% to 0.03%, depending on the size of the firm. A similar study by Chan et al. (1999) for Hong Kong for fiscal 1995 found the usual regressive relationship between company size and compliance costs. They estimated that the compliance cost of corporate income taxes for businesses is about 0.126% of sales turnover.

There have been several studies undertaken on the compliance costs of sales taxes and payroll taxes. For example, Allers (1994, 1995) estimated the costs of compliance and administration for the major tax systems in the Netherlands for 1990. Specifically, he studied the cost for businesses of retaining and remitting payroll taxes, value-added taxes (VAT), and corporate income tax. The author concluded that the average compliance cost represented 4% of taxes collected or 1.5% of GDP. According to the author, the regressivity<sup>27</sup> of compliance costs is confirmed, and the self-employed also typically incurred higher compliance costs.

Similarly, Sandford and Hasseldine (1992) evaluated the compliance costs of employers and business for income tax and the GST in New Zealand for 1989 and 1990. The authors concluded that compliance costs of business taxes were large and cumulative in impact (2.5% of GDP). As in other studies, compliance costs were found to be regressive, falling with disproportionate severity on smaller businesses.

The VAT and source-deducted taxes by businesses in Sweden were studied by Malmer (1995). Using a mail survey, the author estimated the compliance cost of these taxes in 1993 at 1.2% of tax revenues, or equivalent to 0.3%

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27 Compliance costs as percentage of business income are smaller for larger firms.

of GDP. Like Allers (1994, 1995), Malmer concluded that compliance costs are regressive. Pope et al. (1993a) studied the burden of employer-collected taxes such as pay-as-you-earn (PAYE), fringe-benefits tax (FBT), prescribed payment system (PPS), and payroll taxes in Australia for the year 1989/90. They estimated the compliance costs of employers' PAYE and payroll tax at 1.4% of revenue yield, while the FBT compliance costs were estimated at 10.9% of revenue yield.

Sandford et al. (1989) evaluated the compliance costs of the value-added tax (VAT) and corporate income tax for 1986 in the United Kingdom. Using a sample of 3,000 businesses, the authors concluded that the average annual compliance costs were 3.7% of VAT revenues collected or the equivalent of 0.7% of taxable sales,<sup>28</sup> implying a compliance burden of 0.24% of GDP.

Collard and Goodwin (1999) studied the compliance costs for employers of pay-as-you-earn (PAYE) and national insurance contributions in the UK in 1995/96. These compliance costs were estimated at 1.3% of tax revenue. Their estimates revealed that compliance costs were highly regressive (bottom 30% pay 75% of compliance costs), and labour costs account for almost half of the compliance costs.

## Conclusions

First, more research is needed on the issue of compliance costs, both in Canada and internationally. Second, more standardization is required in the research in order to allow for more accurate inter-tax comparisons to increase understanding of the compliance-cost implications of relying on different taxes. The research reviewed indicates that significant compliance costs are incurred by individuals, families, and businesses in addition to the direct costs of taxation. These costs must be taken into consideration when assessing tax policy and the design of specific taxes. Importantly, a number of scholars and reports have generally concluded that business taxes impose higher compliance costs than individual taxes, and this too should be taken into consideration (US GAO, 2005: 8).

28 Compliance costs as a percentage of business income range from 1.94% for firms with less than £20,500 of business income, to 0.03% for those with more than £10,000,000 of business income. In other words, compliance costs as a percentage of business income are smaller for larger firms.



## 2 Estimates of compliance and administration costs

This section of the study provides estimates of the compliance and administrative costs of the Canadian tax system. Compliance costs are calculated by type of tax while administrative costs are organized by level of government. An overall estimate of the total compliance and administrative costs in Canada for 2005 is provided at the end of the section.

### Compliance costs

As noted earlier, compliance costs are those expenses incurred by individuals and businesses to comply with tax regulations. This section presents estimates for compliance costs for personal income taxes, business taxes, and property taxes.

#### Personal income taxes (PIT)

This section provides estimates of compliance costs for personal income taxes<sup>29</sup> based on two approaches. The first approach uses micro data from various sources (bottom-up approach), while the second uses an aggregate ratio (top-down approach) to calculate the compliance costs of personal income taxes.

Vaillancourt (1989) estimated that the average time to complete a 1985 Canadian (federal and provincial) personal income-tax return was 5.35 hours for all types of returns, regardless of the mode of preparation.<sup>30</sup> This estimate of the total average amount of time required to complete a personal income tax return includes the time spent preparing and sorting documents (2.25 hours), gathering required information (1.01 hours), completing the return (either by self or by an unpaid preparer), and the time spent interacting with paid preparers (if applicable).<sup>31</sup> The average hourly wage for 2005 was

29 Although personal income tax is largely based on wages and salaries, it also includes income derived from dividends, interest, capital gains, and self-employment.

30 Note that the estimate does not include the time spent on tax planning or tax appeals. The inclusion of these activities would increase the estimate to 5.55 hours. See Vaillancourt, 1989: table 2.1 (page 26) and table 2.4 (page 36), for more information.

31 Vaillancourt and Blais (1995) attempted to measure changes in the compliance time associated with personal income taxes over the period from 1971 to 1993. They found a small decrease in the average number of hours required to prepare a personal income tax-form for a typical taxpayer from 1.93 hours in 1985 to 1.76 hours in 1993. However, other data indicates that there may be very little change. For example, table 2.1 on page 28 in Vaillancourt (1989) indicates 0.75 of an hour for preparation of tax documents for all taxpayers. This figure is

\$19.09.<sup>32, 33</sup> This provides a per-tax-filer estimate of the time cost required to complete a personal income tax return of \$102.13 (5.35 hours multiplied by the average hourly wage of \$19.09).

According to the Canada Revenue Agency (CRA), there were 23,528,860 tax-filers in 2004 (table 1). This number has been adjusted by 1.6%, which is the average annual growth rate in tax-filers over the last 10 years (1995-2004) to reflect the expected number of tax-filers for 2005: 23,905,322 (table 3). The forecast amount of time-based compliance costs for personal income taxes for 2005 is \$2.4 billion (table 2).

There are additional costs to consider when developing a micro or bottom-up approach. An estimated \$400.2 million to \$1.3 billion was paid in 2005 in tax preparer fees (table 2).<sup>34</sup> This includes both electronic and standard paper return filing by tax preparers. In addition, a little over 4.5 million Canadian

for all tax-filers compared to 2.28 hours for those preparing reports themselves. This group represented 33.3% of tax-filers (Vaillancourt, 1989: table B-1). A confidential data report from Intuit Canada, a leading tax-preparation group indicated tax-preparation time in 2005 varied from 30 to 60 minutes for the users of its software. Recomputing the 5.35 estimate while assuming that the 2.28 is replaced by 0.75 and taking into account that, according to the data contained in table 3, only one-half of all tax-filers do so electronically with the remaining tax-filers using the standard method yields a time of 5.10 hours. Given the small difference between the two estimates (5.35 versus 5.10), the authors selected the figure based on the larger sample of taxpayers. Note that, while the proliferation of tax software and related technology has certainly increased the accurateness of tax returns, it is unclear whether it has decreased the overall time required to complete returns. For example, such software prompts users to consider deductions and credits that they may not have otherwise considered. In addition, the tax code itself has certainly become more complex since the reforms of the late 1980s, which adds time to completing returns.

- 32 According to Statistics Canada's *Canadian Labour Market at a Glance 2005* (Catalogue no. 71-222-XIE), the average hourly wage in Canada was \$19.09 before taxes and other deductions.
- 33 Pope in C. Sandford (1995) identifies at least six methods by which to value labour time, including self valuation, a reasonable compensation valuation, before-tax wage rate, and after-tax wage rate. For the purposes of our calculation (social costs), before-tax wages were used.
- 34 This number is calculated based on 2004 data from the Canada Revenue Agency, which has been adjusted to reflect expected numbers for 2005. The forecast for 2005 indicates a total of 10,005,416 tax returns completed by tax preparers. See tables 1 and 2 for more information. Two estimates were used to calculate a range of potential costs for tax preparation and completion. The first was based on the average revenues per client served by H&R Block (Canada), one of the country's largest tax-preparer firms. The 2006 annual report of H&R Block indicates a per-client revenue of \$39.76 (H&R Block, 2006). The second estimate was based on a confidential report from a professional accounting organization. It indicates the average revenue per client for these services was between \$100 and \$150 (mid-point of \$125 was used).

**Table 1: Tax returns by filing method and agent/author, 2004**

	Number of returns (2004)	Percentage	Projections for 2005 <sup>1</sup>
<b>Total Returns</b>	23,528,860	1.6%	23,905,322
<b>Taxpayer Filed and Prepared</b>			
<i>Electronic</i>	620,420	2.6%	630,347
<i>Paper (Standard)</i>	8,411,810	35.8%	8,546,399
<b>Tax Preparer Filed</b>			
<i>Electronic</i>	6,639,040	28.2%	6,745,265
<i>Paper (Standard)</i>	3,208,810	13.6%	3,260,151
<b>Tax Preparer Filed, Tax Payer Prepared</b>			
<i>Electronic</i>	3,851,900	16.4%	3,913,530
<i>Paper (Standard)</i>	—	0.0%	—
<b>Filed by Discounter</b>			
<i>Electronic</i>	796,890	3.4%	809,640
<i>Paper (Standard)</i>	—	0.0%	—
<b>Total Electronic</b>	11,908,250	50.6%	12,098,782
<b>Total Paper (Standard)</b>	11,620,620	49.4%	11,806,550

Note 1: The average growth rate over the last 10 years (1995–2004) of 1.6% was used to calculate the expected total number of returns for 2005. The 2004 percentage composition was then applied to the total expected number of returns for 2005.

Sources: Canada Revenue Agency, 2006, Special request (2006-171): Number of Tax Returns by Filing Method and Agent/Author; calculations by the authors.

tax-filers completed their personal income tax returns using computer-software. The estimated cost for tax software for 2005 was between \$68.2 million and \$163.6 million based on average prices ranging from \$15 to \$36 (table 2).<sup>35</sup> Finally, the forecast for 2005 indicates that 809,640 returns were filed by a discounter, with an estimated total cost of \$12.1 million (table 2).<sup>36</sup>

The total estimated compliance costs for personal income taxes, which includes the time associated with completing the tax return, fees paid to

35 This figure was calculated based on 2004 data from the Canada Revenue Agency adjusted to reflect expected numbers for 2005. The forecast indicated that 4,543,877 tax returns were completed electronically in 2005. See tables 1 and 2 for more information.

36 The compliance-cost estimate assumed the lowest cost possible in estimating the fees charged for discounting.

**Table 2: Compliance costs for personal income taxes, 2005**

	Lower bound estimate	Upper bound estimate
<b>Time Costs, All Returns</b>		
<i>Time required to complete return (hours)</i>	5.35	
<i>Average hourly wage</i>	\$19.09	
<i>Number of tax-filers</i>	23,905,322	
<i>Total time cost</i>	<b>\$2,441,486,369</b>	
<b>Tax Preparer Filed Returns</b>		
<i>Number of returns completed by tax preparers</i>	10,005,416	
<i>Average cost (fee) for preparation</i>	\$40	\$125
<i>Total preparer costs (fees) paid</i>	<b>\$400,216,624</b>	<b>\$1,250,676,950</b>
<b>Electronically filed by taxpayer</b>		
<i>Number of returns filed electronically</i>	4,543,877	
<i>Average cost (fee) for preparation</i>	\$15	\$36
<i>Total preparer costs (fees) paid</i>	<b>\$68,158,157</b>	<b>\$163,579,576</b>
<b>Filed by a Discounter<sup>1,2</sup></b>		
<i>Number of returns filed</i>	809,640	
<i>Average cost (fee) for preparation</i>	\$15	
<i>Total preparer costs (fees) paid</i>	<b>\$12,144,604</b>	
<b>Total</b>	<b>\$2,922,005,754</b>	<b>\$3,867,887,499</b>

Note 1: Users of tax discounters are assumed to have the same costs as all users.

Note 2: The lowest cost estimate was used to proxy the cost for Discounters.

Sources: Canada Revenue Agency, 2007, Special request (2006-171): Number of Tax Returns by Filing Method and Agent/Author; H&R Block, 2006; calculations by the authors.

preparers, and costs associated with computer software packages is between \$2.9 billion and \$3.9 billion (table 2).

The second approach is to use established macro or top-down estimates of the compliance costs associated with personal income taxes. Vailancourt (1989) estimated that compliance costs for personal income taxes represented 3.0%<sup>37</sup> of personal income tax revenue or 0.4% of GDP.<sup>38</sup> Using

37 Appendix 1 indicates an estimate of 2.5% but includes not only personal income taxes but also Unemployment Insurance and Canada and Quebec Pension Plan revenues.

38 The compliance cost estimate based on GDP is quite similar to the finding for Australia of 0.34% of GDP (Evans, Ritchie, Tran-Nam and Walpole, 1997).

these ratios yields a compliance-cost estimate for personal income taxes of between \$5.0 billion and \$5.5 billion.

The total compliance costs for personal income taxes range from between \$2.9 billion (bottom-up approach) to \$5.5 billion (top-down approach) depending on the method selected. Total compliance costs for personal income taxes represented between 1.7% and 3.3% of total personal income taxes collected federally and provincially and between 0.2% and 0.4% of GDP in 2005.

### **Business taxes<sup>39</sup>**

This section groups most business taxes together and, like the methodology employed for compliance costs of personal income taxes, relies on two approaches, micro and macro. The micro approach is based on survey work completed by the Canadian Federation of Independent Business (CFIB, 2005a) and research completed by Brian Erard of Carleton University for the Technical Committee on Business Taxation.<sup>40</sup> The CFIB surveyed its members about the total amount of money spent complying with both federal and provincial tax regulations.<sup>41</sup> It specifically differentiated between “outside tax assistance” such as accountants and lawyers and “in-house expenses” such as staff salaries and software. The phrasing of the question was such that overhead costs are more than likely not included. Specifically, no mention was made of overhead either as a generic term or through a list of indirect expenses such as rent and utilities. The omission, which is a common problem in this kind of study was corrected by adding a standard overhead charge. Research completed by Erard (1997a) provides an estimate for overhead charges (36%)<sup>42</sup> that can be applied to the survey-based results of the CFIB.<sup>43</sup>

39 The World Bank carries out international comparisons on the cost of doing business, including the cost of paying and collecting taxes. The study and corresponding data are available at <<http://www.doingbusiness.org>>.

40 The studies for the Commission are available at <<http://www.fin.gc.ca/taxstudy/wpliste.html>>.

41 The survey did not attempt to measure the costs of municipal tax administration, in particular those of property taxes.

42 A study of tax compliance costs in the United States by Hall (1993) arrived at a similar overhead charge estimate of 34.0%. See Hall, 1993: table 2, at <<http://www.taxfoundation.org/files/6de470dbbb6286da788e6b6f2cc1643a.pdf>>.

43 Erard (1997a) calculated overhead ratios for large corporations, both general and financial, for the Technical Committee on Business Taxation. His conclusion was that overhead expenses (in-house non-personnel) were 36% for large non-financial (general) corporations and 44%

Business-tax compliance costs for provincial and federal tax regulations were calculated by applying the compliance costs per employee estimated by the CFIB survey (2005a) by the number of employees in each of the categories (table 3). For example, the CFIB calculated that the compliance cost per employee for firms with five to 19 employees totalled \$1,898.<sup>44</sup> That figure was then multiplied by the total number of employees in Canada in firms of that size to arrive at a cost estimate of \$3.4 billion for firms with five to 19 employees. This figure was then adjusted to include overhead costs to arrive at a total business tax compliance cost estimate for firms with five to 19 employees of \$4.7 billion (table 3).

This calculation was replicated for the four firm sizes covered by the CFIB survey and reported on by Statistics Canada. The authors completed a similar calculation for the final category of employees (500+), which was not covered by the CFIB survey, to arrive at a total estimate of business tax compliance costs for 2005. The total estimated cost of business tax compliance including direct costs, indirect costs, and overheads was \$13.0 billion (table 3). This represents 1.0% of GDP in 2005.

The second approach, which uses a macro method to calculate business-tax compliance costs, also relies on research completed by the Canadian Federation of Independent Business (2005b). This study examined the overall burden of regulations on business in Canada using survey responses of the CFIB's members.<sup>45</sup> The study estimated the total cost of regulations on business at \$33 billion in 2005. Applying the ratio of 43% for tax compliance costs compared to total regulatory costs from Cordova-Novion and De Young (2001) results in an estimate of tax compliance costs for business of \$14.2 billion in 2005. The 43% ratio is applicable in the Canadian context given the importance of taxes as a source of regulatory burden in Canada. According to the survey respondents, the three most burdensome federal regulations were related to the GST, payroll taxes, and income taxes (CFIB 2005b: 13). In addition, sales taxes were deemed to be the second most burdensome of provincial regulations and property taxes and property assessment regulations were the first and third most costly municipal regulations (CFIB 2005b: 14). Adjusting this macro-based estimate of \$14.2 billion to include overhead costs results in a revised compliance cost estimate of \$19.3 billion (table 4).

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for financial corporations. The calculation used in this study has assumed the lower of the two estimates (36%).

44 This figure has been adjusted to reflect costs in 2005. Specifically, the figure calculated from CFIB in 2004 (\$1,857) was adjusted to reflect inflation for 2005.

45 A total of 5,896 responses were used in calculating the costs of regulations.

**Table 3: Compliance costs for business, 2005**

Number of persons employed by enterprise <sup>1</sup>					
0–4	5–19	20–49	50–499	500+	Total
Number of employees (2005)					
889,148	1,805,841	1,347,166	2,675,322	3,739,536	10,457,013
Compliance costs per employee <sup>2</sup> (CDN\$)					
3,386	1,898	912	432	204	
Total compliance costs before overheads (CDN\$)					
3,010,655,128	3,427,486,218	1,228,615,392	1,155,739,104	762,865,344	9,585,361,186
Imputed overhead (36%) (CDN\$)					
1,083,835,846	1,233,895,038	442,301,541	416,066,077	274,631,524	3,450,730,027
Total compliance costs (CDN\$)					
4,094,490,974	4,661,381,256	1,670,916,933	1,571,805,181	1,037,496,868	13,036,091,213

Note 1: Employment by enterprise size of employment (SEPH) for all employees, unadjusted for seasonal variation, for selected industries classified using the North American Industry Classification System (NAICS), annual persons.

Note 2: CFIB compliance costs data are for 2004 and have been adjusted by the Canadian inflation rate for 2005. Compliance costs per employee for firms with more than 500 employees were assumed by authors given pattern of costs observed for other business size in the CFIB survey (CFIB, 2005a).

Sources: Statistics Canada, 2007, Employment by size, CANSIM Table 281-0042; Statistics Canada, 2006c, Survey of Employment, Payrolls and Hours (SEPH); CFIB (2005a); Erard, 1997a; calculations by the authors.

## Property taxes

### *Residential property taxes*

According to Statistics Canada (2006b), the number of households in 2005 was 13,014,400 units.<sup>46</sup> We have assumed that, on average, most taxpayers do not appeal their assessment and that a fair and reasonable estimate of the amount of time required to calculate (if applicable), file, and pay personal property taxes ranges between 0.5 hours (low) and 1.0 hour (high) per

<sup>46</sup> According to Statistics Canada's SPSPD/M, from which the number of households was extracted, the definition of a household is: "The household (e.g. single family dwelling, townhouse, apartment unit, etc.) is the basic unit of the Survey of Labour and Income Dynamics, the unit on which the SPSPD is essentially based. The definition of household is keyed to dwelling location, and does not consider the interrelationships of its members beyond the fact that they live in the same unit."



household.<sup>47</sup> This assumption leads to an estimate of between \$124.2 and \$248.4 million for the cost of compliance with personal property taxes (table 4).<sup>48</sup> Both the lower-and upper-bound estimates are included in the overall calculation of compliance costs (table 4).

#### *Business property taxes*

According to Statistics Canada's Small Business Research and Policy group (Statistics Canada, 2006c) there were 1,048,286 business establishments in Canada in 2005.<sup>49</sup> This figure includes only those establishments defined as Employer Businesses, which means that they have employees. It purposely excludes individuals and family members since these types of establishments are unlikely to pay business property taxes.

If we assume a range of five hours (low) to 10 hours (high) for compliance time<sup>50</sup> for business property taxes and use the national hourly wage rate (\$19.09), we arrive at an estimate of between \$100.1 million and \$200.1 million for compliance costs for business property taxes (table 4). This is higher than the typical costs but takes into account implicitly the fact that some businesses appeal their tax bills. The lower-bound estimate is included in the calculation (table 4) for total compliance costs while the upper-bound estimate is excluded since it is included in the overall upper-bound business-tax compliance cost estimate.<sup>51</sup>

The overall estimate for compliance costs for property taxes, using explicit costs for both personal and business property taxes for 2005 is between \$224.3 and \$448.5 million depending on the estimate used for the number of

47 The authors readily acknowledge that many property owners spend little or no time on personal property taxes as it is automated with financial institutions. However, some property owners receive more than one bill per year (3 in Montreal for example). In addition, some personal property owners appeal their assessments, which means additional time and expenses. Finally, some individuals may be operating businesses out of their homes and thus may incur higher compliance costs.

48 This estimate uses the average national hourly wage of \$19.09 per hour.

49 The data is available from Statistics Canada's Strategis Group, which includes the Small Business Research and Policy Group: <<http://strategis.ic.gc.ca/epic/site/sbrp-rppe.nsf/en/rdo1832e.html>>.

50 This estimate is based on the authors' experience and interpretation of past research. It includes all aspects of tax compliance including planning, preparing, organizing, and remitting tax payments.

51 The CFIB (2005b) report included property taxes in the calculation of the overall burden of regulations on business in Canada.



**Table 4: Total compliance costs, 2005 (CDN\$)**

	Lower-bound estimate	Upper-bound estimate
Personal income taxes	2,922,005,754	5,474,904,000
Business taxes	13,036,091,213	19,300,000,000
Property taxes, personal	124,222,448	248,444,896
Property taxes, business <sup>1</sup>	100,058,899	—
<b>Total compliance costs</b>	<b>16,182,378,313</b>	<b>25,023,348,896</b>

Note 1: Business property taxes are removed from the aggregate macro-estimate because they are included in the estimate of business tax compliance costs.

Sources: see tables 1, 2, and 3; calculations by the authors.

hours required to complete property taxes each year.<sup>52</sup> According to Statistics Canada, total property taxes in 2005 were approximately \$41.1 billion.<sup>53</sup> Thus, property-tax compliance costs represent roughly between 0.5% and 1.1% of property taxes collected. This is a reasonable estimate given the evidence available on compliance costs of other taxes in Canada and abroad.<sup>54</sup>

### **Total compliance costs**

The data and calculations contained in tables 1, 2, and 3 are combined to determine an overall cost of tax compliance in Canada in 2005 of between \$16.2 billion and \$25.0 billion (table 4). This represents between 3.0% and 4.7% of total federal, provincial and local total revenues and between 1.2% and 1.8% of GDP in 2005.

### **Administrative Costs**

As defined previously, administrative costs are incurred by governments in order to collect taxes and enforce tax regulations. These costs include collecting, administering, and managing the tax collection system itself.

The administrative costs incurred by governments in Canada to maintain and administer the tax collection system were documented by examining government financial statements (Public Accounts) as well as departmental

52 Please note that the upper bound estimate for business property taxes of \$200.1 million is excluded from the overall calculation and tables 4 and 6 because business property taxes are included in the upper-bound estimate of overall business tax compliance costs.

53 CANSIM table 385-0001, all governments.

54 Note that we have been unable to find any other evidence on the compliance costs of property taxes in Canada. In addition, none of the four external referees were aware of any additional research or evidence.

reports. In addition, the authors examined reports by municipalities and tax assessment agencies in order to collect a broad spectrum of potential and actual administrative costs.<sup>55</sup>

Administrative costs incurred by the Canada Revenue Agency, which are readily available in the federal Public Accounts, including the costs of collecting federal personal income taxes, corporate income taxes, the goods and services tax (GST), the harmonized provincial GST, payroll taxes such as employment insurance, excise duties, provincial personal income taxes (except Quebec) and provincial corporate income taxes (except for Alberta, Ontario, and Quebec). The administrative costs for these taxes amounted to \$3.7 billion in 2005 (table 5).

Administrative costs for a host of taxes collected provincially, which include British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec and the Atlantic provinces, were all found in provincial sources, including both provincial Public Accounts and provincial treasury reports.

Finally, the administrative costs for property taxes were set at 2% of taxes based on a review of the cost of collecting property taxes in Montreal and British Columbia.<sup>56</sup> The total estimate for administrative costs associated with taxation in Canada for 2005 is \$5.8 billion (table 5).<sup>57</sup>

Plamondon et al. (1997) offer an alternative estimate for administration costs.<sup>58</sup> They calculated administrative costs to be \$2.2 billion in 1995, which adjusted for inflation, results in an estimate for 2005 of \$2.7 billion. Please note that this estimate implicitly assumes no changes upwards or downwards in the complexity or costs associated with tax collection and management of tax regulations on the part of government. It represents our lower-bound estimate of potential administrative costs in Canada for 2005.

55 Vaillancourt reports that the costs of central agencies and courts are negligible with respect to the PIT system: “less than 1%” (1989: 74).

56 Specifically, an author discussed this issue with an official in the Finance Department of Montreal, reviewed their budgets and assessed the costs of operation of the property tax assessment agency in British Columbia.

57 Two biases in the calculations should be noted. First, the calculations do not include the costs of the justice system and of central services. Vaillancourt (1989) found these costs to amount to roughly 2% of the direct costs of collecting federal personal income and payroll taxes. Second, the calculations may inadvertently include some spending by provincial finance departments that is not directly linked to collecting and managing the tax system. It seems reasonable to expect these two biases, one positive and one negative, and neither substantial, to cancel one another out.

58 CFIB estimated that the Canada Revenue Agency’s operating costs amounted to 2.06% of tax revenues collected in 2003/04 (2005a: 10).

**Table 5: Administrative costs, 2005 (CDN\$ millions)**

Government	Amount	Taxes covered
<b>Federal: Canada Revenue Agency<sup>1</sup></b>	3,700	Federal PIT, CIT, GHST/HST, payroll taxes, excises taxes & duties federally collected provincial PIT and CIT
<b>Alberta</b>	55	Provincial CIT, some excises
<b>British Columbia</b>	41	Sales tax, excises
<b>Ontario</b>	460	CIT, sales tax, excises, payroll tax
<b>Québec</b>	870	PIT, CIT, QST/GST, excises, payroll tax
<b>Manitoba</b>	16	Sales tax, excises
<b>Saskatchewan</b>	11	Sales tax, excises
<b>Atlantic provinces(estimated)</b>	40	Excises and sales in PEI
<b>Municipalities and school boards<sup>1</sup></b>	600	Property taxes
<b>Total</b>	5,793	

Note 1: includes payment to Revenu Québec for GST collection; said amount not included in Revenu Québec costs

Note 2: For municipal costs we use information for Montréal and British Columbia as follows.

**Montréal:** Property tax revenues 2007: \$1,379,257,000 (Ville de Montreal, 2007, p. 258, table 70); Budget of the valuation unit for 2007: \$21,437,000 (Ville de Montreal, 2007, p. 271, table 78); ratio is 1.5%;

**British Columbia:** Amount spent 2005: \$70,682,000 (British Columbia Assessment Authority, 2005, p. 71); Revenue 2005: \$2,700,000,000 municipal property tax (p. 15), or ratio of 2.5%, or \$5,000,000,000 total; 1.4% ratio.

These are large organizations; we assumed higher costs overall to take into account the size of various municipalities in Canada.

**Sources:** Public Accounts of the federal and provincial governments;

**Sources: Provincial Administrative Costs**

**Québec:** Revenu Québec, 2005, *Comptes publics du Québec 2005-2006*, p. 2-172, <<http://www.finances.gouv.qc.ca/documents/Comptespublics/fr/vol2-2005-2006.pdf>>; **Ontario:** Ministry of Finance, 2006, *The Estimates 2006-2007*, Tax revenue (Vote 743 Main estimates), <[http://www.fin.gov.on.ca/english/budget/estimates/2006-07/volume1/mof\\_743.html](http://www.fin.gov.on.ca/english/budget/estimates/2006-07/volume1/mof_743.html)>; **Alberta:** Alberta Finance, 2005, *Alberta Finance Annual Report 2005-2006*, Consolidated Statements of Operations, p. 51 <[http://www.finance.gov.ab.ca/publications/annual\\_repts/finance/annrep06/far002.pdf](http://www.finance.gov.ab.ca/publications/annual_repts/finance/annrep06/far002.pdf)>; **British Columbia:** Ministry of Small Business and Revenue, 2005, *Annual Service Plan Reports 2005/06*, Revenue Programs, <[http://www.bcbudget.gov.bc.ca/Annual\\_Reports/2005\\_2006/sbr/Service\\_Delivery\\_and\\_Core\\_Business\\_Areas.htm](http://www.bcbudget.gov.bc.ca/Annual_Reports/2005_2006/sbr/Service_Delivery_and_Core_Business_Areas.htm)>; **Manitoba:** Manitoba Finance, 2005, *Annual report 2005-2006*, Taxation Division, p.37-45, <[http://www.gov.mb.ca/finance/annualrep/2005\\_06/finance.pdf](http://www.gov.mb.ca/finance/annualrep/2005_06/finance.pdf)>; **Saskatchewan:** Saskatchewan Finance, 2005, *2005-2006 Annual Report*, p.25, <<http://www.gov.sk.ca/finance/annreport/annualreport20052006.pdf>>.

**Sources: Municipal Administrative Costs**

**Montréal:** Ville de Montreal, 2007, *Budget du conseil d'agglomération 2007*, <[http://ville.montreal.qc.ca/pls/portal/docs/page/service\\_fin\\_fr/media/documents/budget-2007-14-cag-activites.pdf](http://ville.montreal.qc.ca/pls/portal/docs/page/service_fin_fr/media/documents/budget-2007-14-cag-activites.pdf)>;

**British Columbia:** British Columbia Assessment Authority, 2005, *2005 Annual Report*, <[http://www.bcassessment.bc.ca/pdf/publications/reports/2005\\_annual\\_report.pdf](http://www.bcassessment.bc.ca/pdf/publications/reports/2005_annual_report.pdf)>.

## Conclusion and recommendations

Table 6 summarizes the total compliance and administrative costs estimated for Canada for 2005. In total, tax compliance costs range from \$16.2 billion to \$25.0 billion depending on the methodology employed. Administrative costs in Canada in 2005 were estimated at between \$2.7 billion and \$5.8 billion. Thus, total compliance and administrative costs in Canada for 2005 range between \$18.9 billion and \$30.8 billion (table 6). This represents between 3.5% and 5.8% of total federal, provincial and local revenues and between 1.4% and 2.3% of GDP in 2005.

To place the aggregate figures in context for readers, per-capita and tax-filer estimates were also calculated (table 6). Each Canadian incurred compliance and administrative costs associated with the country's tax system in 2005 of between \$585 and \$955.

The results presented above and throughout this paper show that individuals and businesses incur significant costs to comply with the tax system and that governments expend significant resources administering the tax system. It is, therefore, important that better research be undertaken regarding tax compliance and administrative costs.

### Recommendations

Although improving the compliance and administrative costs was not a central goal of this study, a number of specific measures that could be taken to reduce such costs is presented below for interest. The following is not by any means an exhaustive list and in fact only includes some of the more simple and straightforward reforms available.

- 1 Harmonizing provincial sales taxes with the federal sales tax (GST) is one method that reduces compliance costs for business and administrative costs for government (Plamondon and Zussman, 1998). Harmonizing the five provincial sales taxes that are currently independent from the federal GST (British Columbia, Saskatchewan, Manitoba, Ontario, and Prince Edward Island) would result in reduced paper work and administration for businesses and lower collection costs for governments.
- 2 Exploring the possibility of tax collection agreements (TCA), such as the one now in place between Ontario and the federal government for corporate income taxes, could result in additional savings in administrative costs. These costs have already been lowered by the existence of various tax collection agreements with respect to the provincial personal income tax (9 provinces) and corporate income tax (7 provinces).

**Table 6: Total compliance and administrative costs, 2005 (CDN\$)**

	Lower bound estimate	Upper bound estimate <sup>1</sup>
<i>Personal income taxes, individual</i>	2,922,005,754	5,474,904,000
<i>Business taxes</i>	13,036,091,213	19,300,000,000
<i>Property taxes<sup>2</sup></i>	224,281,347	248,444,896
<b>Total compliance costs</b>	16,182,378,313	25,023,348,896
<b>Administrative costs<sup>3</sup></b>	2,690,000,000	5,793,300,000
<b>Total compliance and administrative costs</b>	18,872,378,313	30,816,648,896
<b>Per capita (32,271,000)</b>	\$585	\$955

Note 1: Most of the upper bound estimates were derived from macro estimates.

Note 2: The difference in compliance costs for property taxes is due to the inclusion of business property taxes in the macro method in business taxes generally and in the use of different estimates for residential property taxes.

Note 3: Lower bound estimate is derived from an inflation-adjusted estimate based on Plumondon's work (1997).

Sources: Tables 1, 4, and 5; calculations by the authors; Statistics Canada, Income and Expenditure Accounts Division, 2006.

- 3 Improved and more advanced technology at the Canada Revenue Agency might also bring about improved private-sector and public-sector systems that reduce compliance and administrative costs. Specifically, improving technology at CRA could allow more efficient private-sector technologies to emerge while improving efficiency at CRA itself.
- 4 Potentially modifying (increasing) the GST threshold, which has not been adjusted since implementation may alleviate some of the recognized problems regarding compliance costs for VAT-type taxes relative to firm size.<sup>59</sup>
- 5 More generally, reducing or eliminating tax policies that add complexity to the tax system such as special preferences, multiple tax rates, and the number of taxes collected, to name a few would also reduce the complexity and thus the compliance and administrative costs of the tax system.

<sup>59</sup> We must note, however, that many businesses with sales below the threshold already voluntarily register for the GST because it entitles them to claim GST input credits on their capital purchases. See Keen and Mintz, 2004 for an interesting discussion of the optimal GST threshold.

**Appendix 1: Studies of the compliance costs for individuals, 1985–2006**

[Appendix 1 spans two pages; to view, use “facing pages” in Adobe Acrobat® or Reader®.]

<b>Tax; survey type (year of data)</b>	<b>Size of sample; type of respondents</b>	<b>Response rate</b>
<b>Vaillancourt, 1989; Canada</b>		
PIT; face to face interviews (1986)	2,040 individuals	100%
<b>Moody, 2005; United States</b>		
Data from the Internal Revenue Agency (IRS)	—	—
<b>Slemrod, 2004; United States</b>		
Update of Blumenthal and Slemrod, 1992	—	—
<b>Pope, Fayle and Duncanson, 1990; Pope, 1995; Australia</b>		
PIT postal survey (1988)	6,737 individuals	16.3%
<b>Evans, Ritchie, Tran-Nam and Walpole, 1997; Australia</b>		
PIT postal survey (1995)	1,996 taxpayers	50%
<b>Blumenthal and Slemrod, 1992; Minnesota, United States</b>		
PIT postal survey (1989-1990)	2,000 individuals	43.2%
<b>Delgado and Diaz, 1992; Spain</b>		
PIT face to face interviews (1989)	2,355 individuals out of 2,500 agreeing to be interviewed	100%
<b>Malmer, 1994; Sweden</b>		
PIT postal survey (1992)	12,000 individuals	67%
<b>Allers, 1994, 1995; Netherlands</b>		
PIT and wealth tax	24,920 individuals contacted	44%

Sources: Vaillancourt, 1999; compiled by authors.

Average compliance costs	Conclusions
2.5 % of tax revenue	Costs increase, then decrease, with age; increase with schooling.
Ranges from 0.45% to 5.87% of adjusted gross income (AGI)	Compliance costs for individuals amounted to \$110.7 billion; are highly regressive, hitting lower-income individuals harder than higher-income individuals.
11.1% of personal income tax revenue	Compliance costs for individuals rose from 8.5% in 1995 to 11.1% of personal income tax revenue in 2004.
4.3 to 10.8 % of tax revenue	Costs increase with tax complexity and are higher for the self employed
4.0 % of tax revenue; 0.34% of GDP	Self-employed individuals face higher compliance costs
\$353.7 per respondent in 1989	Low- and high-income households have higher compliance costs; costs increase with schooling and are higher for the self employed.
3.3 % of tax revenue	Most taxpayers use outside help with better educated ones using it less; monetary cost is regressive (fixed amount/income)
1.0 % of tax revenue	Self-employed individuals or those selling assets face higher compliance costs
1.4 % of PIT revenue	Income tax + compliance time increases with age, education and income

**Appendix 2: Studies of the compliance costs for businesses, 1985–2006**

[Appendix 2 spans two pages; to view, use “facing pages” in Adobe Acrobat® or Reader®.]

Tax; survey type (year of data)	Size of sample; type of respondents	Response rate	Average compliance costs as % of selected indicator
<b>Brown and Vaillancourt, 1986; Canada</b>			
Federal sales tax; face-to-face for large firms (1985); postal survey (1985)	36 large manufacturing firms; 1600 small manufacturing firms; sample from revenue Canada list	60% 11%	0.67% of revenue of federal sales tax for large firms; 2,775% for small firms
<b>Vaillancourt, 1989; Canada</b>			
Personal income tax and payroll taxes; postal survey (1986)	4,196 employers; sample from Dunn and Bradstreet list	9%	0.1% of before-tax entreprise income; 3.5% of taxes
<b>Erard, 1997a; Canada</b>			
CIT and capital taxes; postal survey (1996)	250 firms members of Tax Executive Institute	24%	0.03% gross receipts; CDN\$97 per employee
<b>Plamondon, 1997; Canada</b>			
All taxes; phone survey (1997)	3,082 small entreprises; sales <5 millions	41%	2.55% of sales
<b>CFIB, 2005a; Canada</b>			
All taxes web survey (2004)	Small and medium businesses (less than 500 employees)	1,935 respondents	18,417 per small and medium enterprise
<b>Sandford, Godwin and Hardwick, 1989: United Kingdom</b>			
Value added tax(VAT); corporate income tax (CIT); postal survey (1987)	3,000 businesses; sample from inland Revenue	23%	3.69% of VAT collected; 0.69% of taxable sales
<b>Sandford and Hasseldine, 1992; Hasseldine, 1995; New Zealand</b>			
Pay as you earn (P.A.Y.E.); fringe benefits tax (FBT); Goods and Services tax (GST- VAT), CIT; Postal surveys of independent samples(1991)	4,743 employers; 9,541 businesses; sample from Inland Revenue	40%; 31%	1.92% of P.A.Y.E.revenue; 1.73% of FBT revenue; 7.3% of GST revenue
<b>The Fraser Institute</b>			



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Costs as % of country output	Compliance costs by size of business, smallest and largest size category	Conclusions
0.16% of GNP	Costs over taxable sales: smallest 1/3: 0.12; largest 1/3: 0.055	Compliance costs as % of business income are smaller for larger firms and higher with the degree of complexity (number of rates, exemptions, ...)
0.54% of GDP	Cost over gross income; smallest 1/3: 3.36; largest 1/3: 0.64	Compliance costs as % of business income are smaller for larger firms. Using alternative measures of size (number of employees or tax documents does not change this finding)
n/a	—	Natural resources sector incurs higher costs; costs increase with the number of provinces where CIT is paid
n/a	Cost/business income: less than \$50,000: 5.7; \$2–5 million: 0.2	Sales taxes generate more compliance costs issues than others
n/a	\$ per employee: 0–4 employees: \$3,313; 50–499 employees: \$423	Differences in rules between provinces increases compliance costs
0.24% of GDP	Cost/taxable sales: less than 20,500: 1.94; above 10,000,000: 0.03	Compliance costs as % of business income are smaller for larger firms; large firms gain from improved cash flow
2.5% of GDP for taxes studied	Cost/business income; less than \$30,000: 13.4; more than \$50 million: 0.03	Compliance costs as % of business income are smaller for larger firms; simpler tax procedures are associated with lower compliance costs

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**Appendix 2 (continued): Studies of the compliance costs for businesses, 1985–2006**

<b>Tax; survey type (year of data)</b>	<b>Size of sample; type of respondents</b>	<b>Response rate</b>	<b>Average compliance costs as % of selected indicator</b>
<b>Pope, Fayle, and Chen, 1993a, 1993b, 1994; Pope, 1995; Australia</b>			
P.A.Y.E., FBT, PPS (Prescribed Payment System); postal survey (1989/1990);	2,739 enterprises;	27%;	13.8% of PIT and CIT
wholesales tax (WST); postal survey (1990/1991);	2,467 enterprises;	24%;	revenues;
CIT postal survey (1990/1991)	2,531 enterprises;	34%	1.9% of WST revenue
	sample from phone book		
<b>Allers, 1994, 1995; Netherlands</b>			
Taxes collected or paid by businesses (payroll taxes, VAT, CIT, PAYE); postal survey (1990)	5,393 enterprises; stratified sample from chamber of commerce list	20%	4% of tax revenue
<b>Malmer, 1994; Sweden</b>			
VAT and source deducted taxes by businesses; postal survey (1993)	9,361; phone filtered sample based on official lists (50,499 employees)	64%	1.2% of tax revenue
<b>Blumenthal and Slemrod, 1996; United States</b>			
CIT federal and state; postal survey (1992)	1,672 large enterprises in Coordinated Examination Program of the IRS; 1329 active	28%	3.2% of total CIT; 2.6% of federal CIT; 5.6% of state CIT
<b>Ariff, Zubaidah, and Loh, 1997; Singapore</b>			
CIT postal survey (1995)	234 firms on Singapore stock exchange	26%	0.042–0.03% of turnover (1994/1995)
<b>Evans, Ritchie, Tran Nam, and Walpole, 1997: Australia</b>			
All federal taxes; postal survey (1995)	8,039 sole traders (self-employed) and enterprises	31%	9.8% of tax revenues
<b>Chan et al., 1999; Hong Kong</b>			
CIT; postal survey (1995/1996)	58/75/496 firms on Hong Kong stock exchange	15.10%	0.126% of sales

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Costs as % of country output	Compliance costs by size of business, smallest and largest size category	Conclusions
2.1% of GDP for taxes studied	Cost/business income (PAYE): less than \$500,000: 4.0; \$5–10 million: 0.2 :0.4	Compliance costs as % of business income are smaller for larger firms; CIT is an important source of compliance costs
1.5% of GDP	—	Compliance costs as % of business income are smaller for larger firms; variations in compliance costs by sector are explained mainly by differences in firm size but the retail sector exhibits higher costs for all sizes of firms
0.3% of GDP	—	Small enterprises (measured by number of employees) have substantially higher compliance costs than large ones; VAT compliance costs are double those of other taxes
n/a	Costs/sales: less than 250,000: 0.46; more than 5,000,000: 0.05	Compliance costs as % of business income are smaller for larger firms; primary sector firms incur higher compliance costs
n/a	Costs /turnover: smallest: 0.4; largest: 0.08	Lower reliance on external assistance reduced costs as evidenced in large firms
1.94% of GDP	Cost/business income: smallest : 3.4; largest: 0.18	P.A.Y.E. et WST have lower costs than PPS or FBT
n/a	Cost /sales: less than 100,000: 5.41; more than 5,500,000: 0.21	Higher compliance costs in Hong Kong relative to Singapore may be related to lower administrative costs in Hong Kong; more reliance on external advisers than in other countries is observed

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**Appendix 2 (continued): Studies of the compliance costs for businesses, 1985–2006**

<b>Tax; survey type (year of data)</b>	<b>Size of sample; type of respondents</b>	<b>Response rate</b>	<b>Average compliance costs as % of selected indicator</b>
<b>Collard and Goodwin, 1999; United Kingdom</b>			
PAYE national insurance, (1995/1996); postal survey	5,195 employers, provided by Inland Revenue	29.20%	1.3% of revenue
<b>Hasseldine and Hansford, 2002; United Kingdom</b>			
VAT; postal survey (2000)	6,232 business taxpayers	23%	
<b>Selmrod and Venkatesh, 2002; United States</b>			
Business tax compliance costs; survey	Excludes the largest 1,350 corporations, all businesses with less than \$5 million in assets, and all partnerships with less than a certain number of partners.	10.25%	Compliance burden was estimated in \$22 billions
<b>Slemrod, 2004; United States</b>			
Update of Slemrod and Blumental, 1996	Covers all corporations and partnerships	—	Compliance costs were estimated in \$40 billions, which represents 23.7% of corporate tax collected.
<b>Moody, 2005; United States</b>			
Data from the Internal Revenue Agency (IRS)	—	—	Compliance costs for businesses were estimated at \$148 billion (including sole proprietors). Businesses bear 56% of total compliance costs.

Sources: Vaillancourt, 1999; compiled by authors.



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