

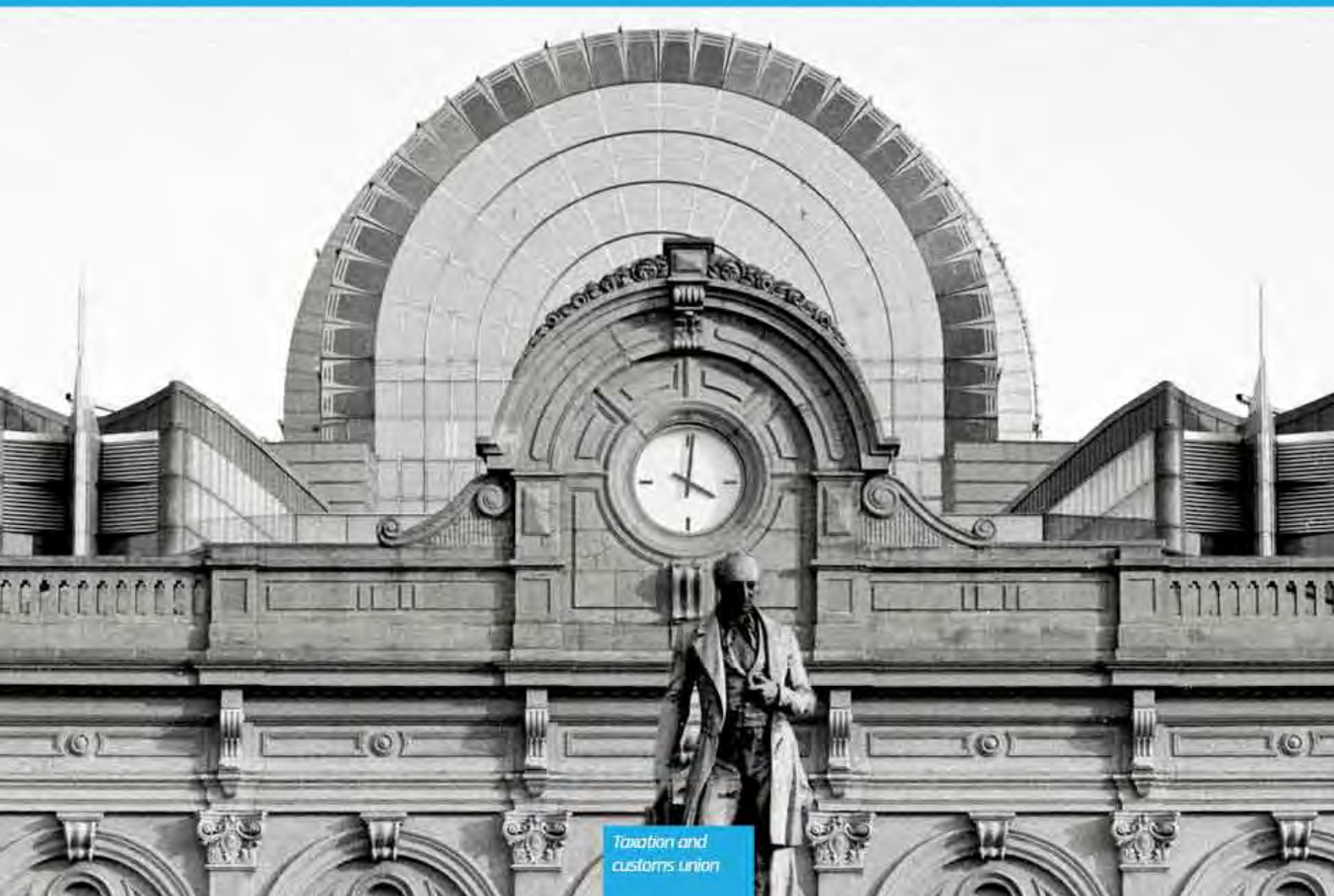


TAXATION PAPERS

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The Consortium consisting of
Ramboll Management Consulting,
The Evaluation Partnership and
Europe Economic Research

A review and Evaluation of Methodologies to calculate tax compliance costs



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A REVIEW AND EVALUATION OF METHODOLOGIES TO CALCULATE TAX COMPLIANCE COSTS

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the evaluation partnership 

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List of Acronyms

Abs	Administrative Burdens
ACTAL	The Dutch Advisory Board on Administrative Burden
AMVAB	Aktivitetsbaseret Måling af Virksomhedernes Administrative Byrder (Danish SCM)
ATO	Australian Tax Office
BAU costs	Business-As-Usual costs
BKI	Bürokratiekostenindex (Bureaucracy Cost Index/ Germany)
BTBM	Business Taxpayer Burden Model (US)
CAR	Cost-driven Approach to Regulatory Burdens (The Netherlands)
CC	Compliance Costs
CIT	Corporate Income Tax
Destatis	Federal Statistical Office (Germany)
DKK	Danish Krone
DRs	Data Requirements
EBIT	Earnings Before Interest and Taxes
EU	European Union
EUR	Euro
EUROSTAT	Statistical Office of the European Union
EU SCM	European Union Standard Cost Model
FSH	Food Safety and Hygiene Regulations
GDP	Gross Domestic Product
HMRC	HM Revenue & Customs (UK)
IA	Impact Assessment
IBFD	International Bureau of Fiscal Documentation
IFC	The International Finance Corporation
IN	Inspection Costs (CAR-methodology)
IOs	Information Obligations
IRS	Internal Revenue Service (US)
ITBM	Individual Taxpayer Burden Model (US)
NKR	National Regulatory Reform Council (Germany)
NNR	Board of Swedish Industry and Commerce for Better Regulation
OECD	Organisation for Economic Cooperation and Development
OHS	Occupational Health and Safety
OTS	Office of Tax Simplification (UK)
PIT	Personal Income Tax
PwC	PricewaterhouseCoopers
R&D	Research & Development
RCM	Regulatory Cost Model
SBBM	Small Business Burden Model (US)
SCM	Standard Cost Model
SECO	Swiss State Secretariat for Economic Affairs
SIROCCO	Scanning Instrument Regulations of other compliance costs
SKM	Standardkosten-Modell (German SCM)
SMEs	Small and Medium-sized Enterprises
SSC	Social Security Contribution



TCC	Tax Compliance Costs
TCR	Total Costs of Regulations (Sweden)
TCS	Total Cost to Serve (UK)
TER	Team Effektiv Regulering (Team for Effective Regulation, Denmark)
TIINs	Tax Information and Impact Notes (UK)
TY	Tax Year
VAT	Value-Added Tax



Executive Summary

This study reviews, assesses and compares twelve methodologies which can be used for measuring compliance costs of taxation. These methodologies are: the Standard Cost Model (SCM), Paying Taxes, the Taxpayer/Business Burden Model, the Total Cost of Regulation to Business (TCR), the Scanning Instrument Regulations of Other Compliance Costs (SIROCCO), the Regulatory Check-up Model (RCM), Guidelines on the Identification and Presentation of Compliance Costs in Legislative Proposals by the Federal Government (GIPCC), the Cost-Driven Approach to Regulatory Burden (CAR), the Complexity Index of the UK Office of Tax Simplification, the Total Cost to Serve (TCS), the Tax Information and Impact Note (TIIN), and the Bureaucracy Cost Index (BKI).

Tax compliance costs are defined as the costs borne by businesses and individuals for complying with tax regulation, excluding the costs of the taxes themselves.

The study first describes the methodologies, then it assesses whether they can be useful to support the preparation of impact assessments,¹ to measure the tax compliance costs of cross-border transactions and for both small and large businesses; whether they can be used to compare countries' tax compliance costs on a regular basis; and whether they are flexible enough as to be useful to measure the compliance costs of various taxes.

On the basis of a comparison of the various methodologies, the result is that SCM is the methodology which best fits the criteria outlined above. SCM can be used to assess a total figure for administrative costs for businesses and for identifying the most burdensome pieces of legislation. It has already been applied as part of impact assessments and it is the most widely applied methodology to assess compliance costs in the Member States today. Paying Taxes is on the other hand particularly strong when it comes to comparing countries' compliance costs and doing so on a regular basis.

The study ultimately advances also a few suggestions to fine-tune SCM and Paying Taxes to the EU-context. In particular, the (EU) SCM could potentially benefit from a more standardised definition of main concepts (e.g. the interpretation of information obligations, the kind of costs to include in the measurements, etc.). In practice, this could mean developing process maps for each of taxes analysed to give users a clear indication about what costs to include and how to interpret obligations. This would increase even further the transparency and comparability of the EU SCM measurements.

Paying Taxes could also be adapted to the EU context by reviewing the underlying concept of model company, and by taking cross-border transactions into account. The approach could be expanded to include additional model companies, accounting for different procedures for small and large companies, different business entities, whether they outsource tax-related compliance activities or keep them in-house.

The study also finds that CAR, despite being relatively new, offers promising features to accommodate the requirements. CAR takes as a starting point the business perspective (actual costs – looking into the representative business' accounting books), and it attempts to shift the task of breaking down costs and separating them from businesses to experts. However, the CAR-methodology relies on the same core equation as the SCM

¹ http://ec.europa.eu/governance/impact/index_en.htm



and the two methodologies share many of the same methodological challenges; disentangling costs, the selection of a representative business and the same issues regarding comparability.



1. Introduction

The Consortium consisting of Ramboll Management Consulting, The Evaluation Partnership and Europe Economic Research has been assigned by DG Taxation and Customs Union of the European Commission (DG TAXUD) to undertake a study on methodologies for measuring tax compliance costs. The study has been carried out by Ramboll Management Consulting in cooperation with Beierholm, State Authorised Public Accountants, and IBFD (International Bureau of Fiscal Documentation) as subcontractors.

1.1 Study objectives

Tax compliance costs can be defined as all the costs borne by businesses and individuals for complying with tax regulation, excluding the costs of the taxes themselves. As tax system implementation is largely concerned with information processing, the bulk of costs of tax compliance are caused by information obligations, for instance, record keeping, filing in tax returns with data etc.²

To comply with tax provisions, both businesses and individuals bear **tax substantive costs** (e.g. they might need to purchase a specific software to fill in tax returns) and **tax administrative costs**. The latter refer to the costs of providing information, understood in a broad sense as for example:

- The costs borne by VAT liable persons for keeping accounts in sufficient details for VAT to be applied and its application checked by tax authorities;³ other compliance costs of VAT are those related to submitting periodic VAT returns, issuing invoices, and recapitulative statements;
- Costs borne by authorised warehouse keepers under the meaning of Directive 2008/118/EC for keeping account of stocks and movements of excise goods;⁴
- Costs for providing information needed for a single taxpayer tax return according to article 110 of the proposed Council Directive on the Common Consolidated Corporate Tax Base (CCCTB).⁵

Tax administrative costs can be further qualified as **tax administrative burdens**, in case of information that, in the absence of legal provisions, would not be collected and kept by taxpayers.⁶

Tax compliance costs are a growing concern among taxpayers which have to bear them and tax administrations that wish to increase the efficiency of tax systems. The issue is particularly relevant for businesses that must allocate resources which could be spent on

² OECD (2004): Guidance note. Compliance Risk Management, p.7.

³ See Directive 2006/112/EC on the common system of value added tax, article 242.

⁴ See Directive 2008/118/EC concerning the general arrangements for excise duty and repealing Directive 92/12/EC.

⁵ See Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) COM (2011) 121/4.

⁶ The definitions above are based on the concepts and definitions of the Action Programme for Reducing Administrative Burdens in the EU; http://ec.europa.eu/dgs/secretariat_general/admin_burden/



core business activity to address tax compliance costs. Intuitively, the more time and resources are spent on compliance, the less remain available for core business activity.

- Tax compliance costs are regressive, i.e. small businesses tend to bear a higher burden, and tend to grow for businesses active across borders. For instance, there is evidence that VAT compliance costs are higher for business selling goods and services within the internal market (compared with compliance costs of domestic transactions). Taking into account for the destination country's VAT rules has a cost.⁷
- Compliance costs are lower for simpler taxes – that is, taxes with less rate differentiation, exemptions etc.
- Tax compliance costs have an influence on tax compliance: the simpler the tax systems, the lower the costs and the higher the expected degree of voluntary compliance.
- A key cost item is information: understanding applicable tax rules and how to deal with taxes takes time and money. Fourth, tax compliance costs have distributional effects, with a similar logic than the one applying to taxes per se.⁸

1.2 Measuring tax compliance costs: the EU Standard Cost Model

Reducing tax compliance costs begins with measuring them. The methodology currently used by the Commission services to measure tax compliance costs is the EU Standard Cost Model (EU SCM).⁹ The EU SCM has been used in particular to measure the tax compliance costs of VAT (of VAT compliance costs).¹⁰

The EU SCM is used in the study as benchmark against which to evaluate other methodologies for measuring tax compliance costs.¹¹

In addition, the Commission services rely on data from *Paying Taxes* – among other indicators - to assess challenges related to tax compliance and tax administration in the Member States.¹² As such, the total time to comply indicator part of *Paying Taxes* is quoted in the joint DG ECFIN/ DG TAXUD Tax Reforms in EU Member States report since its 2011 edition.¹³

⁷ European Commission (2012a): Tax reforms in EU Member States. Tax policy challenges for economic growth and fiscal sustainability.

⁸ Shaw, Slemrod, & Whiting, 2010

⁹ "Whenever a measure is likely to impose significant administrative costs on business, the voluntary sector or public authorities, the EU Standard Cost Model presented below must be applied." Quoted from the Impact Assessment guidelines annex:

http://ec.europa.eu/governance/impact/commission_guidelines/docs/ia_guidelines_annexes_en.pdf

¹⁰ http://ec.europa.eu/dgs/secretariat_general/admin_burden/docs/enterprise/files/abst09_taxlaw_en.pdf

¹¹ The EU SCM is presented in more details at the beginning of section 4.

¹² *Paying Taxes* is also further presented in section 4.

¹³ The Tax Reforms Report provides an overview of recent tax reforms carried out in MS and identifies trends across countries. In addition, the report compares the administrative burden of tax systems for SMEs in using the *Paying Taxes* indicator;

http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee5_en.pdf



1.3 Study objective and scope

The objective of this study is to review methodologies which can be used to measure tax compliance costs, compare them with the EU SCM, and see whether any of them could be recommended as useful to complement or even replace the methodology currently in use.

The study moreover investigates whether any of the methodologies reviewed could be useful to complement *Paying Taxes* in screening the tax compliance costs of Member States' tax systems.

The focus of the study is on tax compliance costs borne by businesses. It should also be stressed that this study is about tax compliance costs methodologies: it is a "study of studies", which does not present new empirical findings.

The costs of administering the tax systems borne by public authorities are beyond the scope of this study.

1.4 Sources of information

Information on methodologies for measuring tax compliance costs have been collected via secondary sources (desk research and workshop with the International Bureau of Fiscal Documentation IBFD)¹⁴, a survey addressed to national authorities and a set of in-depth interviews and a workshop with experts in the field.

1.5 Structure

The document is structured as follows:

- In Section 2, a review of approximately 180 studies on tax compliance costs published between the 1980s and 2013 is presented;¹⁵
- In section 3 the results of the survey, the in-depth interviews and workshop with experts are presented;
- Section 4 describes and assesses a set of methodologies for measuring TCC;
- Section 5 compares the methodologies and recommends a suitable methodology to support the work of DG TAXUD. This part includes suggestions for improving / fine-tuning the existing methodologies.

¹⁴ The IBFD (International Bureau of Fiscal Documentation) is an Amsterdam-based organisation, active worldwide in the areas of research, information and education on taxation and the modernisation of tax administrations.

¹⁵ An evaluation matrix has been used for the mapping of the studies. This matrix is submitted to DG TAXUD as a separate document with the report.



2. Tax compliance costs research: A review

The first step of the study consisted in a review of the literature on tax compliance costs. We looked into 180 papers, articles and other material on the subject. We complemented the review of the literature with research over the Internet aimed at identifying the most common methodologies used to measure tax compliance costs.

Since the mid-1980s, a substantial body of research has attempted to identify and measure tax compliance costs. Over the course of approximately 20 years, several contributions have been published specifically on tax compliance costs.¹⁶

This section presents the results of the literature review and the methodologies identified. The chapter is structured along the following three points:

1. **Taxes covered in the TCC literature**
The first point to be clarified is which type of compliance costs the literature has looked into. Important variables here are the type of tax whose TCC are measured and the jurisdiction in which the tax is levied.
2. **Bearer of tax compliance costs**
It is important to understand who is actually bearing the costs of tax compliance. The focus of the study is on TCCs borne by businesses and individuals.
3. **Methodologies and methodological issues**
Which methodologies do researchers generally use to measure TCC? This is a crucial question in the context of this study. A particularly salient issue in this respect are data collection techniques employed by researchers.

2.1 Taxes covered in the literature: the importance of VAT compliance costs¹⁷

Generally, the TCC literature is divided into two main groups, depending on the focus of the studies:

- Firstly, there are studies that measure the compliance costs of a specific tax such as VAT (number of studies reviewed: 16, GST: 5), Corporate Income Tax (7) or Personal Income Tax (13).
- Secondly, there are several studies with a wider scope, which cover the TCC of a variety of taxes or of a whole tax system (63). A few examples include: a study by KPMG looking at the TCC of the UK tax system (KPMG 2006); a paper looking at the TCC of all business taxes in Croatia – except customs (Blažić 2004), or all taxes and contributions that are government-mandated, at the national, regional and local level (IFC/World Bank 2012).

Only a few (4) studies cover Social Security Contributions (SSC) compliance costs. No studies have been found dealing exclusively with SSCs, although some studies are taking them into account as part of the overall tax system (e.g. IFC/World Bank 2012, Blažić

¹⁶ Bibliography by James and Edwards (2010).

¹⁷ In (parenthesis) readers will find the number of studies referred to.



2004, Reekmans/Simoens 2010, World Bank Group 2009). Excise duties compliance costs are covered by 9 studies, either exclusively or in combination with other taxes.

There is a considerable body of literature focussing on the **compliance costs of VAT**. In this field, there are a few studies (25) looking at the question of how do VAT TCC vary depending on the type of transactions for which costs are measured.¹⁸

Taxation is largely a national matter and therefore a crucial variable for any study aiming at measuring tax compliance costs is the jurisdiction studied, or to put it differently the geographical scope of studies.

In the 1980s, studies focussed on tax compliance costs in the UK (3), Canada (3), the US (2) and Ireland (1). The 1990s witnessed a rise in studies covering tax compliance costs in European countries other than the UK and Ireland, such as the Netherlands (Allers 1995), Sweden (Malmer 1995), and Spain (Díaz/Delgado 1995). TCC in Canada (8), the UK (4), the US (3), Australia (Pope et al. 1990) and New Zealand (Sandford/Hasseldine 1992; Hasseldine 1995) continued to be covered also in the 1990s.

During the late 1990s and the beginning of the 2000s, authors started looking into tax compliance costs in Africa, Asia and South America: researchers studied tax compliance costs in Tanzania (Shekidele 1999), Malaysia (Loh et al. 1997), Hong Kong (Chan et al. 1999), Brazil (Bertolucci 2002), and India (Chattopadhyay/Das-Gupta 2002). There are also more recent studies focussing on TCC in those areas for instance: South Africa (FIAS 2007; Hasseldine et al. 2012), Ethiopia (Yesegat 2009), and Indonesia (Susila/Pope 2012).

Below we present a few findings from the literature review:

- Verwaal and Cnossen (2002) examine the VAT-related compliance costs of intra-Community transactions and find that compliance costs account for 5% of the value of businesses' intra-Community trade and that these costs may reduce trade intensity between Member States. However, Barbone, Bird and Vázquez-Caro (2012) maintain that due to the absence of follow-up studies succeeding the Verwaal and Cnossen study, it is difficult to evaluate the extent to which VAT compliance costs are still burdensome to companies engaged in intra-Community trade ten years later.
- The European Commission's Tax Survey (2004) also shows that cross-border activity leads to higher VAT-related compliance costs. Compliance costs increase with the number of subsidiaries abroad. Econometric investigation, based on the data provided by the 700 EU companies participating in the European Tax Survey, provided quantitative evidence that there is an additional cost for companies that are active cross border.
- The 2011 "retrospective evaluation of elements of the EU VAT system"¹⁹ includes a chapter (pp. 95-154) dedicated to a review of the literature on the costs of VAT,

¹⁸ See Article 2 of Directive 2006/112/EC for the definition of taxable transactions under the Union's common system of VAT.

¹⁹ http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/report_evaluation_vat.pdf.



including compliance costs. The key findings of the study show that within the last decade, the SCM has been used for assessing compliance cost and for policy purposes. The review further find that:

- Compliance costs are high and significant for individual businesses.
 - EU-based taxpayers face additional burdens when they engage in cross-border trade, although little empirical evidence on the actual costs borne by firms in EU countries attributable to cross-border trade within the EU or with non-EU countries exists.
 - Compliance costs are regressive; small businesses suffer a proportionally greater burden by compliance requirement relative to large businesses
 - Compliance costs are not falling over time in the absence of policy action.
-
- An empirical study of tax compliance costs in Portugal, conducted by Lopes, Basto & Martins (2012), shows that compliance costs of personal income tax in the country are related to the number of dependents; the level of taxpayers' education, the economic activity (wage earners or self-employed) and income levels. Taxpayers without professional assistance spent on average 3.79 hours filling in the tax return. In addition, evidence show that the higher the age of taxpayers, the more stressful they felt in the completion of the tax return.

2.2 Who pays the costs of tax compliance? A focus on businesses

The literature focuses on the TCC borne by businesses rather than TCC for individuals. When measuring TCC for businesses, most studies cover the costs for companies of various sizes. There are, however, studies explicitly covering the tax compliance costs for a certain company size, usually SMEs and smaller companies. Large companies are represented by 5 studies, small and medium-sized companies by 35 studies. A few examples are highlighted below:

- Sandford and Hasseldine (1992) look at the compliances cost for businesses in New Zealand. They reach two main conclusions: 1) tax compliance costs are very large and cumulative in their impacts; they are several times the administrative costs of the Internal Revenue Department and, in total, equivalent to about 2.5 % of GDP, 2) They are regressive, individually and collectively, falling with disproportionate severity on smaller businesses, which are therefore put at a disadvantage compared to larger firms.
- A study conducted in Germany by Blaufus, Eichfelder, Hundsdoerfer (2011), investigates the (personal) income tax compliance costs. Their results show evidence for a considerably higher cost burden of self-employed taxpayers. The aggregated cost burden of German income taxpayers amounts to EUR 6.1-7.2 billion, respectively 3.2-3.7% of the income tax revenue in 2007.

As with company size, most studies do not distinguish between specific business sectors in their analyses. An example of a study focussing on a specific sector is a research by Tran-Nam and Glover (2002), who look at the GST compliance costs of small businesses in the agriculture in Australia. The data collection method chosen in the study is a mix of questionnaires, log-books and follow-up interviews of 25 businesses. The findings showed that the mean gross GST transitional costs amount to Australian dollars (AUD) 5.442 per small business, with a net value (subtracted tax deductibility benefits and direct subsidy) of AUD 3.815 per business.



2.3 How to measure tax compliance costs: Results of the review of literature and desk research

The majority of the reviewed studies do not seem to adopt a specific and formalised methodology. Rather, researchers use ad hoc methods for measuring tax compliance costs: customised to the tax whose tax compliance costs they assess, the jurisdiction under investigation and the bearers of the costs. Since the mid-2000s, more and more authors started using the Standard Cost Model (SCM) as methodology. SCM and methodologies which build on it seem to be currently the most common and widely applied tools to measure tax compliance costs, at least in Europe.

In addition to the SCM – and *Paying Taxes*, we discovered the following methodologies through the literature review and desk research:

- Methodologies used by the US Internal Revenue Service (IRS): Individual Taxpayer Burden Model (ITBM), the Small Business Burden Model (SBBM) and the Business Taxpayer Burden Model (BTBM);
- The Total Costs of Regulations to Businesses (TCR), which has been used by the Board of Swedish Industry and Commerce for Better Regulation;
- The Scanning Instrument Regulations of Other Compliance Costs (SIROCCO);
- The Regulatory Check-up model (RCM), used in Switzerland;
- The Guidelines on the Identification and Presentation of Compliance Costs (GIPCC), used by public authorities in Germany;
- The Cost driven Approach to Regulatory burden (CAR), a Dutch methodology developed by SIRA Consulting;
- The Complexity Index (CI) used by the UK Office of Tax Simplification (OTS).

Each of these methodologies is presented in more details in chapter 4. Below we present a few key methodological issues which we consider important to set the scene for the analysis.

A key methodological issue is related to data collection techniques. The literature comprises both research based on secondary and primary sources. Examples of studies based on **secondary sources** include:

- Studies grounded on documentary analyses (c.f. Arthur Andersen & Co. 1984; Allers 1990; Yesegat 2009). This method was applied by Yesegat (2009) in the study about operating and compliance costs of VAT in Ethiopia. Documentary analysis was conducted using public documents, archival records, personal and administrative documents, as well as study reports. By applying documentary analysis, Yesegat analysed various documents relevant for the study, in order to find the trends and characteristics of the Ethiopian VAT system.²⁰

²⁰ Yesegat (2009): Value-added tax in Ethiopia, pp. 105.



The bulk of the literature relies on primary sources of information, using mostly surveys and interviews as data collection techniques.

The majority of the reviewed studies use large-scale surveys as their source of data - a representative sample of businesses answers a questionnaire on their compliance costs and other issues related to tax regulation.²¹

The response rate of the surveys varies considerably across the studies applying this method, ranging from a mere one per cent in an Indian study (Chattopadhyay/Das-Gupta 2002) to 67% in a large-scale survey among Swedish SMEs conducted by the Swedish National Tax Board (Malmer 1995). However, the high rate in the latter seems to be an exception, since response rates in these kinds of surveys are quite low in general. As Sandford finds, the average response-rate for large-scale mail surveys of tax compliance costs is around 30%.²² The studies using this kind of survey show that there are several reasons for the differences in response rates. Firstly, they may depend on cultural factors. In countries where there is a lower tendency to participate in surveys, the response rate is expected to be lower. Secondly, response rates also depend on company size. Most studies using large-scale surveys as their primary source of data find that the response rate of SMEs is considerably lower than the one of larger businesses (Contos et al. 2012). Thirdly, support by national authorities and key professional associations are also seen as a crucial factor in reaching a higher response rate.

Interviews are another important data source. Roughly a third of the studies represented in the matrix rely on personal or telephone interviews also as part of a follow-up approach following a survey. A more recent example for this practice is a study conducted by Klun (2003). Following a survey among Slovenian enterprises about time spent on VAT compliance tasks, 21 follow-up interviews were conducted with some of the respondents in order to assess which costs they had included in their assessment of costs related to the fulfilment of tax compliance requirements. The following open questions have been asked in a study using interviews as the main source of data (Alexander/Bell/Knowles 2004): When you hear people talk about compliance costs, what do you understand them to mean? To what extent are compliance costs an issue for you and your business? How do these compliance costs impact on you and your business?

In addition, expert interviews and expert assessments constitute another important means of acquiring information about tax compliance costs borne by companies. The study published by Plamondon (1997) is an example of a study based on expert assessments in panels of business accountants and chief financial officers, as a supplement to a large-scale telephone survey.

Other sources of information are provided for by the analysis of diaries/records:

- The study design applied by Bell et al. (2004) is about tax compliance costs for small businesses in New Zealand. They relied on diaries and follow-up interviews as their data source. The authors of this study surveyed 25 small businesses. The first stage of the survey involved a face-to-face interview with these 25 businesses. Firms were then asked to keep a diary of money and time spent on compliance-related activities and to send it back to the researchers on a weekly

²¹ The literature provides some examples of questionnaires actually sent to businesses. An example for a large-scale survey questionnaire can be found in the study conducted on behalf of the Swedish Tax Board about VAT compliance costs in Sweden (Skatteverket (2006): Compliance Costs of Value-Added Tax in Sweden, pp.106).

²² Sandford (1995): Improving the Methodologies, pp. 378.



basis over the course of 13 months. For that purpose, a form for weekly completion (the “diary”) had to be designed and customised for each of the participating firms first. In the end, only 18 businesses provided the researchers with data for the whole period. The third stage consisted of follow-up interviews.²³

Apart from various challenges related to the different data collection methods, another relevant methodological issue concerns the research design. A major issue that causes confusion in the TCC literature is the fact that studies use cost terms differently and have a different understanding of what costs to include in the measurements (Barbone et al. 2012).

Most of the literature reviewed regards case-studies focusing on TCC in a specific jurisdiction (c.f. Tran-Nam/Glover 2002; Evans/Tran-Nam/Jordan 2002). Yet, a minority of the reviewed studies (28) adopt a comparative research design. These studies cover a wide range of countries ranging from EU Member States (European Commission 2004; European Commission 2007; European Commission 2012) to a variety of advanced economies in general (SCM Network 2005; GAO 2008; Cordova-Novion/De Young 2001; Bertelsmann Foundation 2006; Chittenden et al. 2003; Torriti 2012).

Paying Taxes by PwC (IFC/World Bank 2012) is probably the most comprehensive comparative study which includes an assessment of tax compliance costs (measured at time to comply).

Most studies containing a comparative element cover VAT (13 of the studies), either exclusively or in combination with other taxes. 4 studies cover PIT, 3 cover CIT, either exclusively or together with other taxes. SSCs in a comparative perspective are only covered by two studies, in combination with other taxes.

2.4 Conclusion

Two main conclusions derive from the literature review: a) those concerning the literature *per se*; b) conclusions on methodological issues.

a) The extended literature review has shown that a majority of studies deals with VAT compliance costs.

Compliance costs are often found to be regressive in relation to business size. Most studies focus on private businesses and do not differentiate between sectors.

The majority of studies use large-scale surveys and expert assessments as methods for data collection. A common drawback from the large-scale surveys is the relatively low response rates. Few studies adopt a comparative research design.

b) Based on the literature review, four key methodological challenges have been identified which researches interested in measuring TCC have to face:

- Lack of standardised concept definitions: in the Introduction, the definition of TCC for this study is modelled on the basis of the Action Plan for Reducing Administrative Burdens in the EU. Yet, the literature does not use consistently one single definition of TCC. All the elements which form the “tax compliance cost” concept present in fact a certain degree of ambiguity: taxes and tax systems vary

²³ Bell et al. (2004): Quantifying Compliance costs for small businesses in New Zealand, pp. 8.



greatly depending on the countries studied; there is no common definition of “tax compliance” or “compliance”; “costs” imply monetisation of measurements, yet what is accounted as being part of “costs” varies.

- Data collection: large-scale surveys, interviews and expert assessments have been identified as being the most common technique for data collection. These different methods are very often used in combination. The low response rate typical of large-scale surveys may be a relevant challenge to take into account.
- Comparability: diversity in tax systems represents a challenge to the comparative study of TCC across tax jurisdictions. The literature review shows that there are relatively few attempts at measuring TCC using a comparative research design.
- Frequency of alteration of tax codes:²⁴ a further challenge is the frequency of change of the tax code in several tax systems. Even relatively small changes to the tax code might lead to significant variations in TCC. Studies which are not updated on a yearly or even more frequent basis may soon become obsolete.

²⁴ Assessing or measuring the rate of change of tax systems is out of the scope of this paper.



3. Findings from survey, interviews and workshops

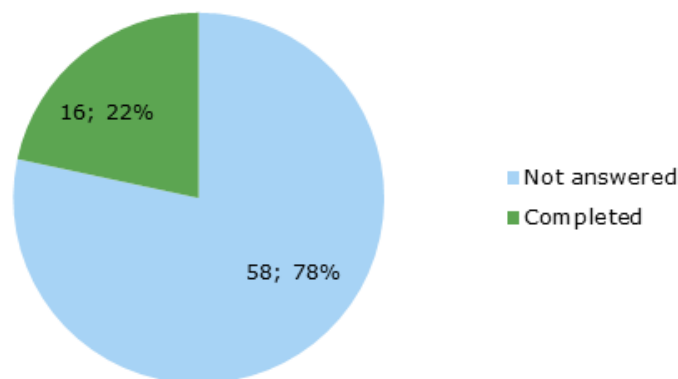
As a second step in the study, we conducted a survey and run a round of in-depth interviews with experts on tax compliance costs. The aim was to make sure that the list of methodologies we had prepared on the basis of desk research and literature review was as complete as possible. We also wished to learn more about how methodologies are actually used by practitioners. To gain even more insights on tax systems and tax compliance costs, we organised a workshop with IBFD and a second one with tax compliance costs experts.

3.1 Key findings from survey with national administrations in Member States

The aim of the survey with public authorities in the Member States was to check that the list of methodologies we had identified via the literature review and desk research was as complete as possible.²⁵ We also wished to get an insight into how Member States' national authorities measure tax compliance costs (assuming they do so in the first place).

Eventually, 13 national authorities filled-in the surveys; Austria (2 respondents), Belgium (2 completed), Bulgaria, Cyprus, Czech Republic, Denmark, Germany, Ireland, Latvia, Lithuania, Malta, Romania and Sweden (2 respondents).

Chart 1: Survey response rate



Out of the respondents, half (8 respondents from 7 countries: Belgium, Denmark, Germany, Ireland, Lithuania, Malta and Sweden (2 respondents)) do measure tax compliance costs and the other half do not (8 respondents from 7 countries: Austria (2

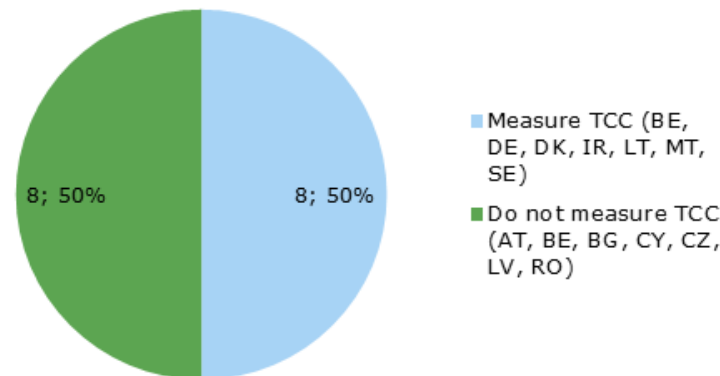
²⁵ The email survey was distributed to 86 respondents from all Member States (at least one per Member State). The list of respondents was primarily derived from the official SCM Network (www.administrative-burdens.com), with the exception of a few pointed out by the DG TAXUD. With a few emails bouncing back, the survey reached 74 respondents.

The survey was distributed on June 19 and the initial deadline was set to July 3, 2013. As a consequence of respondents being out of office due to the holidays and at the request of a few respondents, the deadline was extended until August 6. The final response rate reached approximately 22%, with 16 completed surveys.



respondents), Bulgaria, Cyprus, Czech Republic, Latvia and Romania; one respondent from Belgium also indicated they do not measure tax compliance costs).

Chart 2: National authorities measuring TCC (N=16)



Focusing on respondents who actually do measure tax compliance costs, we discovered that all respondents use the same methodology, the SCM; and that a majority of them consider this the best possible way to measure TCC.²⁶ All respondents measure TCC for small businesses (as well); they typically receive good support from the business community (6). Measurements of TCC are done either using internal resources of national authorities (2), or they are outsourced to external experts such as consultancies (2), or both (3).²⁷ Data to feed in measurements are gathered via interview with businesses (7), expert assessments (6), surveys (4) or by using (secondary) statistical data (1).

Measuring TCC in practice can be difficult. Two respondents pointed out that a key challenge is how to isolate within the SCM “administrative burdens”, that is the costs for complying with obligations with which businesses would not have complied in the absence of legislation forcing them to do so. One respondent stressed the complexity of tax measures as a key difficulty. Another surveyed person expressed that it is often not easy to collect information from businesses, which are usually not conversant with SCM concepts on the basis of which surveys or questionnaires addressed to them are based.

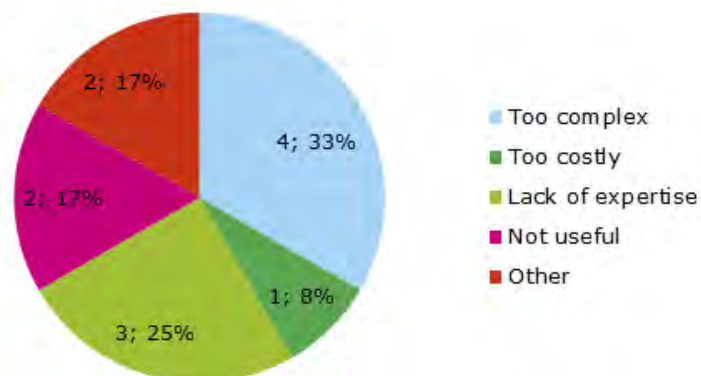
Out of the countries not measuring TCC, reasons for not doing seem to vary: some respondents consider it not useful; in some cases, national authorities may lack expertise, find the task too complex or too costly.

²⁶ One respondent pointed out that the ideal methodology would be a mix of several existing ones.

²⁷ One missing value



Chart 3: Reasons for not measuring TCC (N=8, multiple answers possible)



3.2 In-depth interviews with experts

We interviewed 14 experts on tax compliance costs measurement from different countries and organisations, both public and private:

- SIRA Consulting, the Netherlands
- HM Revenue & Customs, UK
- Internal Revenue Service, US
- PwC, UK
- Board of Swedish Industry and Commerce for Better Regulation
- Regulatory reform expert, the Netherlands
- Ministry of Finance, the Netherlands
- Federal Statistical Office, Destatis, Germany
- Office of Tax Simplification, UK
- Danish Business Authority, Denmark
- State Secretariat for Economic Affairs, Switzerland

The following issues were most often raised by the interviewees when it comes to methodology-related points:



1. Difficulty of separating business-as-usual costs and tax compliance costs

The interviews confirmed the finding from the literature review related to the challenge of disentangling business-as-usual (BAU) costs from compliance costs. Some of the interviewees named a few suggestions on how to overcome this challenge. Some interviewees, for example, mentioned that they use experts' and tax practitioners' knowledge to remove business-as-usual costs from compliance costs in the measurements. Within RCM, the business-as-usual costs are also estimated by experts. However, it has been confirmed in the interview that it will never be possible to perfectly separate between "ordinary" accounting business-as-usual costs and compliance costs. One interviewee stressed the importance of transparency about the approach and consistency in the types of costs which are included.

2. Corporate Income Tax is the most complicated

Another SCM-related issue raised by one interviewee is the measurement of corporate income tax compliance costs. The measurement of these costs is considered to be more complicated than the costs related to other kinds of taxes. The reason for this complexity lies in the different compliance procedures between small and large companies, which vary to a great extent. Whereas small businesses, if not incorporated, are not liable to corporate income tax, large companies usually have to deal with compliance costs related to transfer pricing. According to the respondent, it is difficult to account for these differences and the SCM cannot sufficiently capture them in one overall measurement.

3. Shift from ex-post to ex-ante measurements

This issue was raised by almost all interviewees. The main reason for this is the relative ease of conducting ex-ante assessments, which are not as costly and time-consuming as ex-post measurements.

Budgetary constraints obviously play an important role: most interviewees mentioned them in some way or another. It seems like there is a trend towards less costly and less time-consuming ways of acquiring data and conducting measurements, through estimates as part of ex-ante Impact Assessments.

Ex-post measurements are in some cases hardly ever conducted anymore, except in some exceptional cases (e.g. complex measurements like digital solutions).

GIPCC incorporate an ex-post as well as an ex-ante approach. The Federal Ministries estimate ex-ante the costs of change in compliance costs of new legislative proposals, while Destatis validates the compliance costs of existing legislation after two years. Moreover, the so-called "ex-post projects", which are decided upon by the Federal Government, were mentioned in the interview. These projects include areas such as home care and income tax statements.

4. Challenge of multiple data sources

The fourth issue concerns the *data sources* that methodologies are based on in the different countries. It is important to note that many interviewees mentioned the challenges of retrieving data from different data sources and the advantages of having data from a more consolidated source.

Some interviewees explicitly mentioned the challenge of not having a consolidated database for all the required data, as merging data from different sources may be problematic.

It emerged from the interviews that one of the strengths of *Paying Taxes* is that robust results can be produced due to consistency in the methodology applied, and the data collection exercise which is organised by the World Bank and which uses a number of expert contributors in each economy who are supplied with guidance notes.



Furthermore, in certain cases experience shows that it may, at times, be challenging to secure participation of small businesses in workshops and interviews, which may lead to these businesses being underrepresented in the measurements.

5. Rely on expert assessments but ensure acceptance and participation from stakeholders

It was moreover mentioned several times during the various interviews that it is important to secure *acceptance and participation from stakeholders* (e.g. small business associations, businesses themselves) in the process in order to increase trust in the results received by experts.

6. Focus on key taxes

Several interviewees stated that VAT and CIT are the most important taxes to look at when assessing business-related tax compliance costs. In some measurements for example, VAT and CIT are considered at a detailed level since they are the most important ones for businesses. The same reasoning applies to the *Paying Taxes* time indicator, which looks at VAT (and other consumption taxes), CIT and labour taxes, which according to research by the PwC are the most time-consuming taxes for businesses across the world. Questions asked in relation to the compliance burden of other taxes in the context of the *Paying Taxes* case study company suggested that this burden was not significant. One interviewee also mentioned that around 95% of all tax-related compliance costs can be covered by only focusing on CIT, Wage tax, VAT, and PIT, as these are the most burdensome taxes to comply with.

7. Focus on the administrative burden part of compliance costs

Interestingly, several interviewees mentioned that in the tax area, the *administrative burden part of compliance costs* (i.e. those costs resulting from information obligations only) may be sufficient to look at. While in many other areas (such as environmental law) the substantive part of compliance costs may be bigger than the administrative burden related to fulfilling information obligations, this is not the case in the tax area.

8. Trend towards combining quantitative measurements with business perception

In Denmark the Danish Business Authority has developed a business forum (www.enklerleger.dk), where the businesses can point at areas which they perceive as being burdensome and at the same time suggest possible solutions. This concept requires the government to act on every issue brought up by the businesses, as the initiative follows the principle of "comply or explain" each area suggested by the business forum. A similar approach has been adopted in the US, where the IRS has developed a business forum on their website, in which businesses can submit ideas for reducing taxpayer burden.²⁸

This new trend appears to be a result of the limitations of the SCM. One interviewee mentioned that the SCM is not yet capable of measuring for example the time it takes for businesses to e.g. wait for a business permit, which could be reduced through improved processes and guidance notes, etc. Also in the UK, where a model has been developed, which actively addresses the additional costs involved with a customer experience of dealing with HMRC – an aspect which is not part of the SCM measurements. These

²⁸ <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Help-the-IRS-Identify-Meaningful-Taxpayer-Burden-Reduction-Opportunities>



additional costs include telephone costs for calls to HMRC (financial costs) and the time spent dealing with HMRC (opportunity costs). The stress and hassle of having to deal with HMRC (psychological costs) are also considered during the process of mapping the customer's interaction. To summarise, including qualitative assessments of business perception has become a more important element in the various countries. However, quantitative measurements are still important as they are needed to justify actions and to follow the cost development.

Another example of a more qualitative approach of consulting taxpayers worth highlighting in this context is the Australian Tax Office's Simulation Centre. This approach aims at accounting for the taxpayers' views and suggestions for improvement. This is further outlined in the following box.²⁹

Box 1: The simulation centre (usability lab)

The Australian Tax Office's Simulation Centre (usability lab)

The Australian Tax Office (ATO) uses a state-of-the-art simulation centre in order to assist the ATO in trying, testing and co-designing their business processes. The centre is part of the broader "Listening to the Community" programme which was announced in 2002 and it serves as a usability lab allowing the designers (ATO staff) and end-users (taxpayers) of the tax system to share their experiences.

Transactions between ATO staff and taxpayers (such as paper products and phone scripts to ATO's electronic interfaces) are tested by taxpayers who will use these services and products before they are introduced. The centre has been especially used for testing training materials and online systems used by citizens and for testing usability issues. The Simulation Centre aims to apply a user-centred, co-design approach which invites citizens, i.e. ordinary taxpayers, members of tax professions and industry bodies, to help the ATO to create processes which better fit the end-users' needs and reduce bureaucracy. It includes two simulation rooms, an observation room, a discussion room and a design space. The centre allows ATO staff to observe citizens and their reactions while they are interacting with ATO products (e.g. tax forms). The overall aim is to include the community in the design and operation of administrative systems.

Sources: Gibson (2005), Australian Tax Office (2010)

3.3 Workshops

3.3.1 Workshop held in Amsterdam by IBFD

As part of the study, a **Workshop of tax systems in the Member States** was held in Amsterdam in April 2013 together with IBFD.³⁰

The workshop served to gain a better understanding of EU Member States' tax systems and of the challenges that differences in tax rules across Europe might represent when measuring tax compliance costs.

²⁹ An initiative similar to the Australian one can be found in Denmark. MindLab is a part of three Danish ministries (Ministry of Employment, Ministry for Education and Ministry of Business and Growth). Its aim is to involve citizens and businesses in creating new and improved solutions for the public sector (<http://www.mind-lab.dk/om>, retrieved 2013-09-18).

³⁰ The IBFD (International Bureau of Fiscal Documentation) is an Amsterdam-based organisation, active worldwide in the areas of research, information and education on taxation and the modernisation of tax administrations



In addition, initiatives and good practice examples were discussed in order to supplement the literature review. The workshop discussions helped give an initial idea of important features that a good methodology should be able to take into account.

3.3.2 Workshop with tax practitioners in Copenhagen

The second workshop held in Copenhagen included a variety of Member States, ensuring a good representation of the main drivers behind different tax systems in Europe.³¹

The focus of this workshop related more directly to the features of a good methodology for calculating TCC. Tax practitioners were asked to share their view on the characteristics of the tax systems in their respective countries with regard to CIT, VAT and PIT/SSCs, taking into account the requirements agreed upon with the European Commission (sensitivity to SMEs, comparability, recurrence, etc.).

Experts agreed that there are certain issues regarding the characteristics of the various tax systems that need to be taken into account by a suitable methodology. The most important points are summarised in the following:

- It is very important to sufficiently consider that there are *different processes to comply* with tax regulations in the various countries and the different taxes. There are for example considerable differences in the compliance processes applicable to small and big companies, or whether businesses can file their tax returns electronically.
- It is essential to account for *outsourcing of tax-related compliance procedures*, which has an impact on compliance cost as well. SMEs across Europe (with the exception of e.g. Poland and the Czech Republic) are generally outsourcing tax-related compliance activities to external tax consultants.
- When it comes to *VAT* and *CIT*, the experts remarked that *CIT* is the most diversified tax, while *VAT* is less diversified than any other tax and therefore easier to handle.
- According to the accountants, there is a *need for clear definitions and a precise manual*, which helps keeping inconsistencies caused by different understandings of cost types and what kinds of costs to include at an absolute minimum.
- The accountants saw a challenge in how business-as-usual costs resulting from “ordinary” accounting can be disentangled from actual compliance costs. It is therefore essential, as already outlined above, to be very clear about the definition of costs, in order to avoid mistakes and confusion.
- According to the experts, the best data source for measuring compliance costs are expert assessments and expert panels. They found surveys to be less suited, as respondents tend to misunderstand questions. In addition, it is also considered more difficult to receive comparable results through surveys.

³¹ The session was arranged as a part of HLBI's International Tax and Audit conference and conducted in cooperation with IBFD. It took place in Copenhagen on July 3, 2013 and hosted a number of tax accountants from a variety of Member States; Czech Republic, Denmark, Finland, France, Germany, Greece, Latvia, Poland and UK.



- When it comes to the most appropriate methodology for calculating tax compliance costs, the experts thought that an adapted version of PwC's *Paying Taxes* would be most suited for this purpose. As *Paying Taxes* only takes one model company into consideration, it would however be necessary to broaden its scope to include more case-study companies of different business sizes and entities.
- Moreover, the workshop participants agreed on that there definitely is a certain trade-off between the pace of receiving results and the detail/accuracy of a methodology. Considering that decision-makers need results quickly to make informed decisions on tax-related policies, a most suited methodology should account for this fact.

3.4 Conclusion

The survey, the interviews and the workshops were a necessary exercise in order to get an overview of tax systems and the current state-of-play of measuring compliance costs in the Member States, to ensure a better understanding of existing methodologies, to find out about potential new methodologies and to get the experts' and national administrations' inputs on suggestions on what a suitable methodology should be able to account for.

Through the workshops, we gained a better overview of EU Member States' tax systems and more insights on what a good methodology for TCC measurement has to take into account. We learned that corporate income tax is perceived to be the most complex tax, whereas VAT is considered less diversified – although VAT may be complicated when dealing with cross-border transactions costs. Experts also pointed out the typical challenge of disentangling costs and the shortcomings of survey approaches compared with expert assessments. The essential point emphasised was that tax systems are different and that tax compliance procedures differ (small vs. large company, outsourcing, electronic filing, etc.).

From the survey we found that most national administrations, participating in the survey, assess compliance costs by relying on the SCM. Securing stakeholder participation and separating business-as-usual costs from compliance costs are two key difficulties encountered by national authorities.

Through the interviews, we collected more information about tax compliance costs methodologies. We also discovered three additional methodologies: the Total Costs to Serve model (TCS/UK), the Tax Information and Impact Notes (TIINs/UK) and the Bureaucracy Cost Index (BKI/Germany). In addition, we learned more about the challenges experts face when trying to measure tax compliance costs.

To sum up, we highlight the key lessons learned: first, it is evident that there is a trend to measure tax compliance costs before new tax rules are implemented rather than ex-post. Experts believe this is not only more effective (prevention is better than cure), but also cheaper and faster. Second, separating business-as-usual costs and administrative burdens emerges as the biggest difficulty when measuring TCC. To tackle this problem, experts recommend being very clear in defining and categorising the cost items to be covered by the measurement. Finally, we found confirmation that, when it comes to



complying with taxes, the bulk of the costs result from information obligations rather than from substantive costs.

In the next section, we move on describing the tax compliance cost methodologies identified through our research.



4. Tax compliance costs methodologies: Description and assessment

This chapter is the backbone of the study. We describe the methodologies we have identified through our research (including surveys and interviews) looking at to what extent they match the requirements for a "suitable" methodology to be used by DG TAXUD (presented below). For each methodology, we try to summarise its main characteristics, how and why it is used in practice, pros and cons. We also complement as much as possible the descriptions with concrete examples of how methodologies have been applied. To ease readability, each paragraph starts with a small table showing in a snapshot how the methodology discussed matches the requirements. Also, in the text we have put in bold the "keywords" which relate to the requirements.

4.1 Introduction

In this chapter we will start by describing the methodology the Commission services currently use for measuring tax compliance costs, the EU SCM, and the Paying Taxes methodology, whose results are used in the Tax Reforms Report.

In addition to the EU SCM and Paying Taxes, through our research and literature review we identified seven additional methodologies for measuring tax compliance costs:³²

1. Methodologies used by the US Internal Revenue Service (IRS): Individual Taxpayer Burden Model (ITBM), the Small Business Burden Model (SBBM) and the Business Taxpayer Burden Model (BTBM)
2. The Total Costs of Regulations to Businesses (TCR), which has been used by the Board of Swedish Industry and Commerce for Better Regulation;
3. The Scanning Instrument Regulations of Other Compliance Costs (SIROCCO), a Dutch methodology;
4. The Regulatory Check-up Model (RCM), used in Switzerland;
5. The Guidelines on the Identification and Presentation of Compliance Costs (GIPCC), used by public authorities in Germany;
6. The Cost driven Approach to Regulatory burden (CAR), a Dutch methodology developed by SIRA Consulting;
7. The Complexity Index (CI) used by the UK Office of Tax Simplification (OTS).

³² For clarification purposes it needs to be stressed that the methodologies under scrutiny cannot all be defined as methodologies as such. A methodology is a system of broad principles or rules from which specific methods or procedures may be derived to interpret or solve different problems within the scope of a particular discipline. A methodology is therefore not a formula but a set of practices, whereas a method is the way (or tool) used to complete the discipline (businessdictionary.com). Methodology is the study of a method or methods. Subsequently, some of the "methodologies" outlined are not methodologies but methods (a technique or a process). In addition, these techniques do not offer a consolidated methodology which offers a manual, guidelines or handbook.



Moreover, as a result of the in-depth interviews, we discovered three additional methodologies:

- 8. Total Cost to Serve (TCS);
- 9. Tax Information and Impact Note (TIINs);
- 10. Bureaucracy Cost Index (BKI).

For each methodology, we present the main characteristics (why the methodology was developed and how it is used), focusing on the requirements DG TAXUD considers useful for a tax compliance costs methodology, namely:

- It must be capable of supporting impact assessments;
- It must be able to capture the tax compliance costs borne by businesses operating across borders;
- It must allow for segmentation, that is differentiating between the compliance costs of large and small(er) businesses;
- It should be flexible enough as to be useful to measure the compliance costs of, ideally, any kind of tax and should take into account the tax compliance costs which might be due to EU rules
- It should be possible to use it to assess and compare tax compliance costs of entire tax systems and to do so periodically (recurrence)

The sections in this chapter concerning the aforementioned requirements are in **bold**.

In addition to key characteristics, we present for each methodology a few practical examples to show how it is applied and we give a short overview of methodological issues such as data collection methods generally used, possible issues with results' accuracy and challenges of using the methodology in practice.

4.2 The EU Standard Cost Model (EU SCM)

Table 1: Requirements fulfilled by the EU SCM

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
1. EU SCM	✓	✓	✓	✓	✓	(✓)	✓

4.2.1 Methodological characteristics

The EU SCM methodology (2009) concerns the Administrative Burdens (ABs) imposed on private businesses by legislation, and focuses on information obligations (IOs). The EU SCM tool is intended for microeconomic analysis and **used in Impact Assessments of proposed measures (ex-ante) and the simplification of existing measures (ex-post)**. The EU SCM methodology provides a very detailed and transparent measurement, which does not only produce a total figure of the administrative costs on businesses (and potentially citizens), but also identifies the burdensome IOs and the cost factors of every piece of legislation at a disaggregated level. This enables policy makers to discuss reduction possibilities, assess ex-ante the effects on business costs and on the total



administrative burden.³³ The measurement is broken down to activity level and the EU SCM consists of 14 standard administrative activities.³⁴

The EU SCM defines compliance costs as all the costs of complying with regulation, with the exception of direct financial costs and long term structural consequences. The EU SCM addresses a subset of compliance costs by focusing on the administrative costs of businesses. This term both includes administrative burdens and business-as-usual costs.

Box 2: Cost types as defined by the EU SCM

Compliance costs are all the costs of complying with regulation, with the exception of direct financial costs and long term structural consequences. In the EU SCM these can be divided into *substantive compliance costs* and *administrative costs*. The EU SCM only looks at *administrative costs*.

Administrative costs are the costs incurred by businesses in meeting legal obligations to provide information. The administrative costs consist of *Business-as-usual costs* and *Administrative burdens*.

Business-as-usual costs are the costs which would be endured even in the absence of the legislation.

Administrative burdens are the costs stemming from the part of the process which is done solely because of a legal obligation.

Source: European Commission (2009a): pp.46.

The major costs measured in the EU SCM are labour costs (internal and/or external) and the cost of potential purchases. The internal costs consist of the hourly pay of the group(s) performing the administrative activity, including an overhead percentage. The external labour costs are relevant for businesses who have decided to outsource some of their activities, i.e. use external tax service providers. As with the internal costs, the hourly rate of the external service providers is used to quantify them. However, no overhead percentage is added to the external labour costs. Acquisitions are defined as the expenditure on necessary acquisitions to comply with specific IOs and/or data requirements (DRs).³⁵

The EU SCM methodology can be applied anywhere irrespective of business size and sector, and the methodology is **able to take into account cross-border transactions** in its current setting. With the starting point of the methodology being legislation, the EU SCM is not limited to a certain area of taxes and is **applicable potentially to all types of taxes and legislation**. In addition, the measurement approach also **allows for segmentation**, e.g. if unit costs are expected to vary significantly between different segments or if there is a need to allow specific areas of interest, like for example a focus on SMEs. Typical distinction between groups derives from their size, type or location.

It is possible, yet complicated, **to do cross-country comparisons** using SCM, as small differences in the practical application of the EU SCM are present and ad hoc decisions are part of the measurements across Member States. An example of an attempt to compare the administrative burdens related to VAT in the Netherlands, Denmark, Norway and Sweden was carried out in 2005.³⁶ Comparing the measurements proved to be complicated although, initially, it had been decided upon which information obligations to compare across countries. Measurements were carried out by the same consultancy firm

³³ Regulatory Reform Group (2008a): Cutting red tape the Dutch way, p.5.

³⁴ European Commission (2009a): Part III: Annexes to Impact Assessment Guidelines, p.51.

³⁵ Ibid.: p.47.

³⁶ SCM Network (2005).



in order to overcome differences in the application of the methodology in the various countries. This made the measurements relatively comparable.

4.2.2 Application of the methodology

The SCM methodology is the “EU common methodology” for measuring administrative burdens.³⁷

It has been adopted across the EU and been used to measure the tax compliance costs of all kinds of taxes. It has been broadly applied to measure VAT in EU Member States.³⁸ Moreover, it has been employed for measuring CIT, PIT and SSC.³⁹

Measurements are carried out with different intervals in Member States, varying from measurements every five years⁴⁰ to updated annual measurements in e.g. Denmark and Sweden.⁴¹ The frequency of measurement recurrence is therefore up to each Member State, but the methodology **allows countries to conduct measurements annually** if required.

A few concrete examples of SCM measurements conducted in Denmark are outlined below, including results.

- The Danish SCM is used to conduct updated measurements every year for IOs that have changed as a result of new or amended laws and regulations⁴² (shift in focus after 2010)⁴³
- The Danish Ministry of Taxation based its updates in 2005 on 75 acts and 99 executive orders, divided in income taxation, earnings- and A-tax (withholding tax), indirect taxes and other information obligations
- Results:⁴⁴
2005:
 - Business related legislation imposes costs that sum up to a total of approximately 8 billion DKK
 - Income tax, which e.g. includes the obligation to complete and file tax-reports, represents approx. 56% of the total administrative costs under the Ministry of Taxation
 - Indirect taxes, which among others include the VAT Act and the Act concerning excise tax, represents approx. 26% of the total administrative costs under the Ministry of Taxation
 - Approx. 50% of the total administrative cost under The Danish Ministry of Taxation can be allocated to three acts:
 - 1. The requirements of the Announcement on minimum standards (for accounts and bookkeeping)

³⁷ COM(2005) 518 final

³⁸ Better Regulation Executive (2005a): Measuring Administrative Costs, p.58; SCM Network (2013).

³⁹ SCM Network (2013), Erhvervs- og Selskabsstyrelsen, Denmark (2005), Erhvervs- og Selskabsstyrelsen (2011), KPMG LLP (2006).

⁴⁰ Input from interview with the Ministry of Finance, the Netherlands

⁴¹ Input from interview with the Danish Business Authority; Swedish Agency for Growth Policy Analysis (2010): p.22.

⁴² Erhvervs- og Selskabsstyrelsen (2010).

⁴³ After 2010 the Danish Business Authority went from 100-150 ex-post measurements annually to an ex-ante focus of the most burdensome areas, involving only 10-20 measurements annually (Interview with the Danish Business Authority).

⁴⁴ Erhvervs- og Selskabsstyrelsen (2005): AMVAB – Skatteministeriet, pp.2-3.



- 2. The Danish Tax Control Act
 - 3. The Danish Value Added Tax Act
 - 83.8% of the burdensome legislation relates to legislation of Danish origin (C-regulation), followed by A (10.4%) and B (5.8%) regulation.
- 2009:
- Administrative cost reduction achieved till 30 June 2009: from a zero-base measurement estimate in 2001 of 10.452 million DKK to 7.462 million DKK in June 2009 – a reduction in total administrative costs of 28.6%.

4.2.3 Methodological issues

The EU SCM manual provides a detailed description of how to construct the measurement and what costs to include in the application across Member States.

Data can be collected through expert assessments, consultation of stakeholders and so forth. It is typically considered sufficient to produce overall estimates, using standard ratios for e.g. overheads, overall hourly labour tariffs, etc.⁴⁵ Furthermore there are no recommendations as to how many interviews should be conducted.

The basic formula for calculating the costs is simple; Price x Quantity. Price represents the costs incurred by businesses and is constructed on the basis of labour costs (internal and/or external) and acquisitions, and the time required for carrying out the administrative activity, measured in hours.

Businesses are, therefore, asked to specify how much time and money they spend on performing each administrative activity that is required when fulfilling a given IO. In addition, it should be noted that the internal costs correspond to the wage costs plus an overhead for administrative activities, as stated in the earlier section. In the EU framework, a default mark-up of 25% is recommended for overheads.⁴⁶

The Quantity variable adds to the equation the frequency of activities each year multiplied by the size of the population of businesses affected.

Based on the gathered data, a subsequent standardisation of the time and money spent on performing each administrative activity is carried out. The standardisation intends to give a representative figure of the costs incurred by a *normally efficient* business within each segment. The *normally efficient* business is one of the two standard working assumptions of the EU SCM.⁴⁷ Although this main assumption provides a detailed approach with a single standardised estimate for each potential segment, it also has its limitations and challenges. The *normally efficient* business assumption may, on one hand, simplify the measurement, but on the other hand remove it further from reality. Furthermore, the assumption does not ensure a uniform, consistent or accurate data collection.

The other working assumption of the EU SCM is the *full compliance* principle, which aims to capture how businesses are supposed to follow the rule and what costs these

⁴⁵ European Commission (2009a): Part III. Annexes to Impact Assessment Guidelines, p.54.

⁴⁶ Ibid.: p.53.

⁴⁷ A typical firm is usually identified by calculating the median performance, thereby leaving exceptional and non-representative businesses out of the estimates. In this way a single estimate for the *normally efficient* business that would need to complete each administrative activity simplifies the calculations and generates an easy measurement.



businesses would bear by following all the rules that they are subject to.⁴⁸ However, the level of compliance is usually not 100%. Legislation may be misunderstood by the businesses, or actual compliance may be lower by choice. In these cases the costs of complying with a regulation may be different from the costs that the businesses actually incur.⁴⁹

4.3 The *Paying Taxes* methodology

Table 2: Requirements fulfilled by *Paying Taxes*

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
2. <i>Paying Taxes</i>	-	-	-	-	-	✓	✓

Paying Taxes is part of the *Doing Business* study conducted annually by IFC and the World Bank. *Doing Business* was first conducted in 2003 and its purpose is to assess the business environment in 189 countries and to rank these countries according to how they score on different dimensions deemed important for a favourable business environment.⁵⁰ *Doing Business* measures the business environment by using the case of a standardised, mid-sized firm. By focusing on this standardised firm, it aims at achieving consistency of the measurements and comparability across the 189 countries under scrutiny.⁵¹

The Standard Cost Model is at the root of this approach, which however focuses more on the standardised case-study company than on specific pieces of legislation, which are the starting point for the SCM.

4.3.1 Methodological characteristics

Paying Taxes is a methodology which assesses the ease of paying taxes across 189 economies, by taking the total tax rate and the administrative burden into account. It is **an ex-post tax burden assessment**, i.e. it assesses the impact of existing legislation (however **not specific to EU legislation**) on the tax burden.

Box 3: Cost types as defined by *Paying Taxes*

Administrative Burdens:

- Time it takes to prepare, file and pay taxes in hours per year (Time indicator)
- The number of tax payments per year (Tax Payments indicator)

Source: IFC/World Bank (2012): pp.140-142.

Administrative burden consists of the *time* needed to fulfil the activities connected to preparation, filing and payment of the taxes, as well as the *number of taxes and contributions paid*.⁵²

⁴⁸ Ibid.: p.55.

⁴⁹ Torriti (2012): Standard Cost Model: Three Different Paths and Their Common Problems, p.105.

⁵⁰ The dimensions covered are *regulations for starting a business, dealing with construction permits, registering property, getting electricity, getting credit, protecting investors, trading across borders, enforcing contracts, resolving insolvency and Paying Taxes* (IFC/World Bank 2012: *Doing Business* 2013, pp.15).

⁵¹ The number of economies included in the *Paying Taxes* study was originally 174 and this has been added to over the 9 years since it was first undertaken. The following countries have been added in the most recent year: Libya, Myanmar, San Marino and South Sudan (Interview with PwC).

⁵² IFC/World Bank (2012): *Paying Taxes* 2013, pp. 140.



- Time indicator⁵³
The time indicator assesses the time taken to *prepare, file and pay* the three main types of taxes and contributions: corporate income tax, labour taxes and social security contributions, as well as value added or sales taxes. It is recorded in hours per year.

Preparation time is the time needed to collect all necessary information, to compute the payable tax and to calculate the payable amount. It also includes the time associated with making separate calculations or keeping separate accounting books for tax purposes, if the business is required to do so.

Preparation consists of the following standard activities:

- Data gathering from internal sources;
- Additional analysis of accounting information to highlight tax sensitive items;
- Actual calculation of tax liability including data inputting into software/spread sheets or hard copy records;
- Time spent maintaining/updating accounting systems for changes in tax rates and rules;
- Preparation and maintenance of mandatory tax records if required.

Filing time is the time necessary to complete the tax return forms and file the relevant returns at the tax authority.

Filing consists of the following activities:

- Completion of tax return forms;
- Time spent submitting forms to tax authority, which may include time for electronic filing, waiting time at tax authority office, etc.

Payment time measures the hours required to make the payment online or directly at the office of the tax authority (including waiting time if the taxpayer has to queue there).

The act of paying of the taxes includes all the time spent on any tax payments required and actually making the payments:

- Calculations of tax payments required including, if necessary, extraction of data from accounting records;
- Analysis of forecast data and associated calculations if advance payments are required;
- Time to make the necessary tax payments, either online or at the tax authority office (including time for waiting in line and travel if necessary).

The factors outlined above are disclosed separately in the *Paying Taxes* report.⁵⁴

⁵³ Ibid.: p.141.

⁵⁴ Ibid.



- Tax payments indicator⁵⁵
This indicator includes the total number of taxes paid, the method of payment, the frequency of payment, the frequency of filing and the number of agencies involved. This indicator also includes taxes withheld by the company (such as VAT and employee-borne labour taxes). These taxes do not have a negative impact on the income statement of a company, but they do add to administrative burden and are hence included in the tax payments indicator.

Apart from the administrative burden, *Paying Taxes* also accounts for the Total Tax Rate indicator, which measures the cost of all the taxes a business bears.⁵⁶

The case study company forming the basis of all measurements conducted by the *Paying Taxes* study performs general industrial or commercial activities. More specifically, it produces and sells flower pots. It does not do business in areas which are subject to specific tax regimes, such as selling tobacco or liquor. Excise duties on these products are hence not included in the assessment, while excise duties on fuel are.⁵⁷ The main assumptions of the unit of measurement/standardised business are outlined below.

Box 4: Assumptions about the standardised company

The business:

- is a limited liability, taxable company
- started operations on 1 January 2010 (at that time, it purchased all its assets and hired all its workers)
- operates in the economy's largest business city
- is 100% domestically owned and has 5 owners (natural persons)
- performs general industrial or commercial activities (produces ceramic flowerpots and sells them at retail)
- does not participate in foreign trade
- has 60 employees (4 managers, 8 assistants, 48 workers)

Source: IFC/World Bank (2012): p.139.

As the unit of measurement in *Paying Taxes* is the above mentioned standardised business, the methodology cannot distinguish between different business sizes and sectors. Hence **segmentation is not possible**.

Paying Taxes **measures all taxes and contributions which are government-mandated at federal, state and local level**, and which have to be paid by the standardised company.⁵⁸ Excise duties on liquor and tobacco, as well as **cross-border transactions, are excluded** from the measurement.⁵⁹ In addition, for the *time* indicator,

⁵⁵ Ibid.: p.140.

⁵⁶ Ibid.: p.142. The Total Tax Rate indicator measures the amount of taxes and mandatory contributions borne by the case-study company. This indicator is expressed as a share of the company's commercial profit and it is part of the ranking (p.142). However, since the cost of the taxes themselves are not the focus of the study at hand, this indicator will not be further elaborated upon.

⁵⁷ IFC/World Bank (2012): *Paying Taxes 2013. Methodology and example calculations for each Paying Taxes sub-indicator*, p.140.

⁵⁸ Ibid.: p.138.

⁵⁹ Ibid.: p.139.



only VAT, CIT and labour taxes are taken into account, for which Paying Taxes is **to a minor degree considered tax restricted**.

Paying Taxes offers the possibility of ranking the different economies with regard to the ease of paying taxes. It is therefore **possible to use it to compare countries** with each other and to benchmark their performance.

4.3.2 Application of the methodology

Since 2003 *Paying Taxes* have been part of the Doing Business report, which is **updated and published every year**.

Examples of results and developments of the *Paying Taxes* ranking include the following for selected countries:

- Denmark: compared to its overall ranking in the 2011 report (rank 13), Denmark kept its position at this rank in the 2013 report. In Denmark, the case-study company would have spent around 135 hours to pay its taxes and it would have made around 9 tax payments. The corresponding numbers in the 2013 report are 130 hours and 10 tax payments.
- Spain: Spain was ranked 71st on the overall ease of paying taxes in 2011, but it considerably improved to rank 34th in the 2013 report. While the numbers of tax payments stayed the same in both years (total number: 8), the total tax time decreased from 197 in the 2011 report to 167 hours in 2013.⁶⁰

4.3.3 Methodological issues

There is no overall manual as such for the *Paying Taxes* methodology, but there are data notes in the World Bank Doing Business guide and instruction to contributors for completion. PwC also provides guidance notes each year for its staff that contributes to the study. Moreover, PwC provides internal training courses and global conference calls with the members of its staff that complete the World Bank questionnaire regarding the methodology and its application.⁶¹

The calculation consists of the design of the ranking. The ranking of the ease of paying taxes is the average of the percentile rankings of its component indicators (total tax rate, time, and frequency). The various indicators are computed by tax experts from a number of different firms (including PwC) in the national states according to national tax legislation, based on the case-study company.

The *Paying Taxes* methodology offers strong consistency. It uses the same guidance notes which are sent out every year, the same requirements for the case-study company

⁶⁰ Ibid.: pp.146; IFC/The World Bank (2010): *Paying Taxes 2011*, pp.88.

⁶¹ Interview with PwC.



and the same survey instrument across all 189 countries.⁶² In addition, the contributors made by PwC benefit from the internal training provided for its staff, their expertise in dealing with tax issues, and global conference calls which it holds with its contributors regarding the methodology and final results. More importantly, results are considered robust and reliable as consensus is needed among all contributors in a territory, otherwise data is not used or amended year on year.

Although a number of measures are taken to ensure a standardised and consistent measurement approach, potential misunderstandings among the experts as regards cost concepts and questions asked in the survey instrument can occur.

Consistency in the measurement approach is at the same time one of the main challenges faced by *Paying Taxes*, since the requirements connected to computing compliance costs may limit its flexibility. As *Paying Taxes* only considers administrative burdens and the total tax rate for a mid-sized standardised company located in the biggest city of a certain country, it is not able to capture differences between business regulations in various regions within the country, which may differ.

As in the case with SCM, *Paying Taxes* assume full compliance with tax rules.⁶³

4.4 Methodologies used by the US Internal Revenue Service (IRS)

Table 3: Requirements fulfilled by the IRS methodologies

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
3. IRS	✓	-	✓	-	-	-	(✓)

4.4.1 Methodological characteristics

The US Internal Revenue Service (IRS) has developed three compliance burden assessment methodologies which address tax compliance costs from different perspectives:

1. The Individual Taxpayer Burden Model (ITBM)
2. The Small Business Burden Model (SBBM)
3. The Business Taxpayer Burden Model (BTBM)

IBM developed the US Individual Taxpayer Burden Model (ITBM) in 1998 on behalf of the IRS. The model simulates the burden (time and out-of-pocket costs) experienced by individual taxpayers (Wage and Investment and Self-Employed) during the pre-filing and filing time periods (such as tax-related recordkeeping and planning).

⁶² The survey instrument for the *Paying Taxes* methodology is available at: http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Methodology/Survey-Instruments/DB2013/Paying_taxes_survey_en.xls, retrieved 2013-06-07.

⁶³ IFC/World Bank (2012): *Doing Business 2013. About Doing Business: measuring for impact*, pp.17.



The US Small Business Burden Model (SBBM) was developed to complement the ITBM; the IRS first deployed the SBBM in 2006. This methodology is used to estimate the compliance costs for businesses with end-of-year assets of less than \$ 10 million⁶⁴ and to test the hypothesis that business compliance costs are regressive.⁶⁵

The IRS continues to develop and improve its compliance burden estimation methodologies.⁶⁶ The most recent development in this area is the Business Taxpayer Burden Model (BTBM), which builds on the SBBM. The new methodology reflects a more comprehensive measure of compliance costs and differentiates the costs based on the character and size of the business.

The IRS methodologies are able to carry out "what-if" simulations of policy changes and **predict (ex-ante) the burden** effect based on a number of business characteristics. By deconstructing measurements to activity level (e.g. recordkeeping, tax planning, form completion, form submission, working with paid professionals, etc.), these methodologies allow the IRS and policy-makers to understand which aspects of the tax compliance process impose the largest compliance costs for different groups of businesses and evaluating options for burden reductions.⁶⁷ The mission of IRS' Taxpayer Burden Reduction (TBR) is to achieve a significant reduction in unnecessary burdens for all taxpayers through e.g. standardisation, guidelines, etc. This is partly done by burden estimations using the three methodologies or through the business forum available on the IRS web, where businesses can submit suggestions for reducing taxpayer burden.⁶⁸

The IRS literature employs the terms *taxpayer burden*, *compliance burden* and *compliance costs* interchangeably, but they have one common definition, as outlined in the box below.

Box 5: Cost types as defined by the IRS models

Taxpayer burden, compliance burden and compliance costs common definition;

The time and out-of-pocket costs incurred by taxpayers in response to the Federal tax system information reporting and payment requirements, above and beyond the tax liability remitted to the federal government

Source: Input from the US IRS

This concept does not include psychological costs and deadweight losses from economic behaviour changes.⁶⁹ An example could be the average time and expense required to complete and file a tax form.

The most recent methodology developed by the IRS is able to cover compliance costs for all businesses. The model (BTBM) **allows for differentiation between business size**

⁶⁴ Contos et al. (2012): Taxpayer Compliance Costs for Corporations and Partnerships, p.3.

⁶⁵ Ibid.: p.4.

⁶⁶ The development of an information-reporting burden survey is currently under way. This work is part of a long-term effort to develop and link econometric models for income, excise, employment, and transfer taxes. This effort is being used to allow the IRS to better link the costs and benefits of information collected from the public (Input from the US IRS).

⁶⁷ It appears as if the activity (category) level for the ITBM (Guyton et al. 2006, p.119) is slightly different from the SBBM (DeLuca et al. 2007, p.164).

⁶⁸ IRS (2013): Taxpayer Burden Reduction: <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/About-Taxpayer-Burden-Reduction>, retrieved 2013-09-26.

⁶⁹ Contos et al. (2012): Taxpayer Compliance Costs for Corporations and Partnerships, p.2.



(by assets or receipts). Key business characteristics affecting compliance costs include entity type, total assets, total receipts and return complexity (the Individual Taxpayer Burden Model is similar with income, return complexity, and compliance methods as the key characteristics).⁷⁰ The BTBM takes as the point of departure (the dependent variable) the burden and it can control for key firm characteristics as outlined above. The model aims to calculate the total monetised burden, stemming from the US **federal tax system** (States' specific taxes are not included⁷¹), which is equal to the sum of monetised time spent on pre-filing and filing activities and out-of-pocket costs. The methodology (-ies) does not appear tax specific as such nor capable of identifying the origin of legislation. In the current setting, **EU legislation is (obviously) not taken into account**, although the IRS methodologies could potentially be transposed to the EU context.

The IRS methodologies are **currently not suited for cross-country comparison**. However, according to the interviewee from the IRS, cross-country comparisons could potentially be achieved by mapping the country specific tax requirements into consideration in the complexity variables (which could be quite challenging) and then adjusting the model coefficients for inflation and exchange rates. That being said, the BTBM has been adapted for use with survey data from Sweden and the UK in support of work by the US Treasury Office of the Tax Analysis with the assistance of the revenue agencies of these countries.⁷² Somewhat similar econometric models of SME compliance costs have been developed by academic researchers for comparison between Germany and Belgium, using survey data from the respective countries.⁷³

The IRS models are, moreover, **not able to measure cross-border transactions** yet, as this firm characteristic is not accounted for in the burden categories (activity level) or in the set of attribute indexes used as drivers of compliance burden today (e.g. preparation methods).⁷⁴ It should be possible to include this feature, however, through elaboration of the current methodology.

4.4.2 Application of the IRS methodologies

The results of the IRS methodologies are used to support or achieve several important goals. They are used by the IRS to respond to inquiries and provide planning analysis to support policy makers. The IRS compliance cost estimates from the models are included in annual US Office of Management and Budget reports to Congress and the President. In addition, the IRS model results provide policy analysis support to staff of the U.S. Treasury Office of Tax Analysis and the U.S. Office of Management and Budget.⁷⁵ Furthermore, the methodologies have assisted the IRS in providing taxpayers with top

⁷⁰ Input from the US IRS.

⁷¹ The US IRS is aware of no comprehensive comparative estimates of state income tax compliance costs have been performed in the US. However, a national study on state retail sales tax compliance costs was conducted in 2006 by PwC: Retail Sales Tax Compliance Costs: A National Estimate: http://www.streamlinedsalestax.org/uploads/downloads/JCCS_Part_I_Final_Report_Vol_I_20060407.pdf. The IRS burden models can, however, provide estimates of federal income tax burden by state.

⁷² This study was undertaken solely for research purposes of the US Treasury to see if the BTBM could be adapted to use information collected by a different agency to produce useful estimates. It is clearly better to have country specific survey data to calibrate the coefficients than to use coefficients estimated from one country's data to estimate compliance costs for another country; Input from interview with IRS.

⁷³ See Eichfelder et al. (2010): Tax Compliance Costs: the Effect of Authority Behavior and Taxpayer Services, in the linked issue of the IRS Research Bulletin: <http://www.irs.gov/pub/irs-soi/10rescon.pdf> (pp.37-68).

⁷⁴ Guyton et al. (2006): The effects of tax software and paid preparers on compliance costs, p.118.

⁷⁵ IBM (2013): Taxpayer Burden, <http://www.304.ibm.com/easyaccess3/tipss3/contenttemplate/#!/xmlid=187119>.



quality service and of helping them understand and meet their tax responsibilities. **The Individual Taxpayer Burden Survey is conducted annually** whereas **the Business Taxpayer Burden Survey is conducted once every three years**. Both a 2012 Individual and 2012 Business survey are currently underway.⁷⁶

A few concrete examples of the IRS measurements conducted have been outlined below, including results.

Individual Taxpayer Burden Model

- Survey 2003, results:⁷⁷
 - Average burden of 25.5 hours and \$149 per taxpayer (in TY2000)
 - Money spent is higher for taxpayers using paid professional than do software users and self-preparers

Small Business Burden Model

- Survey 2005, results:⁷⁸
 - Preliminary estimates of 1.7-1.8 billion hours and 15-16 billion dollars in small business income tax compliance burden for calendar year 2004
 - An overwhelming majority of time burden stems from recordkeeping activities
 - Firm structure influence the level of tax burden (e.g. different recordkeeping requirements, files different primary tax forms, deals with different section of the Tax Code, etc.)
 - 86% of small businesses use a paid professional for tax preparation
 - Total time and money burden are highly correlated with the size of a business⁷⁹

Business Taxpayer Burden Model

- Survey 2010, results: (based on TY2009)
 - Smaller businesses incur higher burden (measured by total assets and number of receipts)
 - The total compliance costs, for corporations and partnerships with less than \$10 million in assets (defined as small businesses), was \$93 billion⁸⁰

4.4.3 Methodological issues

The IRS methodologies rely on survey data (and tax return data) and cover only those activities which would not have occurred without the Federal tax system. The last BTBM survey was conducted in 2010 and covered tax year 2009. The sample size of this survey was 22,000 business entities and the response rate was 31.5%.⁸¹ The survey data consists of a mixed-mode telephone and mail protocol and the data collection protocol in 2010 included four successive contacts (reminders, follow-up telephone calls to non-respondents. etc.), and all contacts included instructions on how to take the survey on

⁷⁶ Input from the US IRS.

⁷⁷ Guyton et al. (2003): Estimating the Compliance Cost of the U.S. Individual Income Tax, p.18.

⁷⁸ DeLuca et al. (2007): The IRS Research Bulletin; Aggregate Estimates of Small Business Taxpayer Compliance Burden, p.148.

⁷⁹ Ibid.: pp.165-171.

⁸⁰ Contos et al. (2012): Taxpayer Compliance Costs for Corporations and Partnerships: A new Look, p.12.

⁸¹ Ibid.: pp.4-5.



the web. The data collection ran over the course of approximately 21 months, from July 2010 to April 2012.⁸²

The models establish econometric relationships between tax return characteristics and reported monetised compliance costs.⁸³ The cost types measured in the methodologies consist of out-of-pocket costs and a monetised value of taxpayer time. Hence external costs and internal labour costs, including overheads.⁸⁴ Taxpayer surveys collect the time expended and the out-of-pocket costs for taxpayers. In the models, time expended is monetised to control for the substitution of time and money. Results can be reported as total monetised costs or broken out into total time and total out-of-pocket costs.

The models explain roughly half of the variation in reported compliance costs and they are calibrated to both the mean and distribution of survey responses, controlling for outliers.⁸⁵ Some of the modelling trade-offs with the IRS approach concerns survey respondents allocation of costs. Ideally, respondents should only report the time and out-of-pocket costs associated with their federal income tax return, it is unlikely that most taxpayers differentiate the time they spend on federal and state income tax planning.

In addition, SBBM seems to face the challenge of joint costs. It has proven difficult for businesses to separate the activities they engage in due to normal business processes and those they engage in for tax purposes.⁸⁶ Moreover, the usual drawbacks of surveys apply: methodologies risk facing nonresponse bias and low response rates, particularly for SMEs.⁸⁷ Measures taken to improve the representativeness and accuracy of results include using stratified random sampling, streamlining questionnaires, providing more than one response mode (paper, web, phone), and limiting recall bias. In regards to the latter, the IRS conducts the surveys in up to five waves, selecting the sample population from tax returns that were posted within the wave period. In this way the IRS contacts taxpayers close to the time they filed their returns.

4.5 Total Costs of Regulations (TCR) to Businesses

Table 4: Requirements fulfilled by the TCR

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
4. Swedish TCR	-	✓	✓	✓	✓	-	-

⁸² Ibid.: pp.4-5.

⁸³ Input from the US IRS.

⁸⁴ Contos et al. (2009): Taxpayer Compliance Costs for Small Businesses, p.2904.

⁸⁵ Input from the US IRS.

⁸⁶ The IRS confronted this challenge by instructing taxpayers on e.g. the SBBM survey questionnaire to consider which activities are constitute the IRS' definition of Federal tax compliance costs and which activities are beyond the scope of compliance; DeLuca et al. (2007): The IRS Research Bulletin; Aggregate Estimates of Small Business Taxpayer Compliance Burden, p.150.

⁸⁷ The IRS has addressed the SME concern by developing a simpler data collection instrument for small businesses to help counter the typical low response rate among these entities.



4.5.1 Methodological characteristics

The Board of Swedish Industry and Commerce for Better Regulation (NNR) developed an alternative approach to demonstrate that there are other dimensions to government regulations that are of importance for companies in addition to administrative burdens, a concept which was considered somehow restrictive. NNR therefore developed the Total Costs of Regulations (TCR) survey approach in 2005, which was followed up by a survey in 2008. The purpose of this survey approach was to highlight businesses' total regulatory costs and identify the legislative origin of the costs.

The TCR approach is only intended to measure the regulatory costs for businesses of existing (ex-post) legislation and regulations; **it cannot assess proposed legislation (ex-ante)**. It produces a total figure of the regulatory costs on businesses, and is able to identify the legislative origin of the costs, which enables policy makers to discuss reduction possibilities.

The total regulatory costs are defined as the total costs incurred by companies in complying with all requirements that have encountered as a result of laws and regulations in the course of one year. These costs consist of three cost type as show in the box below.

Box 6: Cost types as defined by the TCR

Administrative costs resulting from requirements to draw up, compile, store and/or submit information to public agencies or third parties

Material costs resulting from requirements that necessitate investments in facilities or staff; adaptation of products; of implementation of measures, such as rehabilitation or actions associated with the work environment

Financial costs resulting from requirements to pay taxes and charges

Indirect effects are not included in the TCR approach as it was considered to be practical impossible, although important.⁸⁸

The starting point of the survey approach is legislation within four regulatory areas: labour market, environment, tax, and sector specific legislation. Legislation is then broken down into various measures or steps that companies must take to fulfil the legislative requirements (e.g. book keeping, documentation, investments, auditing, compilation of annual accounts, payment of taxes, drawing-up of applications, etc.). The model is constructed using six real cases of companies of different sizes and sectors, and it **allows differentiating for SMEs**. However, it should be noted that no large business is represented in the survey (businesses between 7 and 32 employees only). The TCR approach has included six different sectors (technology, the environment, the hospitality industry, bus transport, agriculture and district heating) and is **restricted to these sectors**. The model **takes into account all relevant tax issues**, indirect and direct taxes, and **cross-border transaction have also been accounted for** with import/export of some of the companies. In addition, the methodology was intended to identify the origin of costs, for which it is also **capable of tracing back legislation to the origin**.

⁸⁸ Interview with NNR (Swedish Better Regulation Council).



The model, however, does **not seem suitable for cross-country comparison**.⁸⁹ As the model's unit of measurement is six real companies, it complicates the comparability of measurements across Member States. To ensure consistency in measurements, it would require finding businesses having the same organisational structure in terms of e.g. business size, sector and products.

4.5.2 Application of the methodology

NNR received detailed information on the costs imposed on the companies by various requirements in the regulations. The TCR approach has been applied twice; first in 2005, and then a follow up in 2008.⁹⁰ The TCR methodology is **not intended for annual measurements** in its current setting.

The model has only been applied in Sweden, and a few concrete examples of the results are outlined below.

- Results: 2005 (and 2008)
 - The majority of the regulatory costs to the case study companies originate in national regulation (82%).
 - Both the original and follow-up survey showed that there were strong reasons to widen the political perspective to include more aspects than administrative obligations.
 - Regulatory costs were generally quite stable between 2005 and 2008

Considering the TCR results, it is interesting to highlight that the observed level of regulatory costs were stable between 2005 and 2008. Financial and material costs of regulations were found to be considerably higher than the administrative costs that the government is measuring and aiming to reduce. Administrative costs constituted on average approximately 15% of total regulatory costs for the businesses studied.

4.5.3 Methodological issues

The TCR approach appears to be a relatively straightforward method for measuring the regulatory costs of businesses. The sample consists of six case study companies, representing micro and small businesses in six different sectors. The data collection relies on in-depth interviews (3-4 hours) carried out for each of the six case study companies in 2005 and 2008.⁹¹ Although the approach takes various measures to improve accuracy and consistency (same team of two persons doing all the interviews, interviewing the same person in each case study company both times, providing individual questionnaires two weeks in advance), the description of how to construct the measurements is not publically available. The model may also face a number of methodological issues related to e.g. the selection of case companies and the challenge in bookkeeping (separating costs).⁹²

⁸⁹ NNR (Swedish Better Regulation Council) (2010): The Total Cost of Regulations to Businesses in Sweden – 2008 compared with 2005, pp.3-8.

⁹⁰ NNR (Swedish Better Regulation Council) (2006): The Total Cost of Regulations to Businesses in Sweden: NNR Regulatory Cost Project: Final Report.

⁹¹ However in 2008 five businesses out of six participated

⁹² Interview with NNR (Swedish Better Regulation Council).



4.6 Scanning Instrument Regulations of Other Compliance Costs (SIROCCO)

Table 5: Requirements fulfilled by SIROCCO

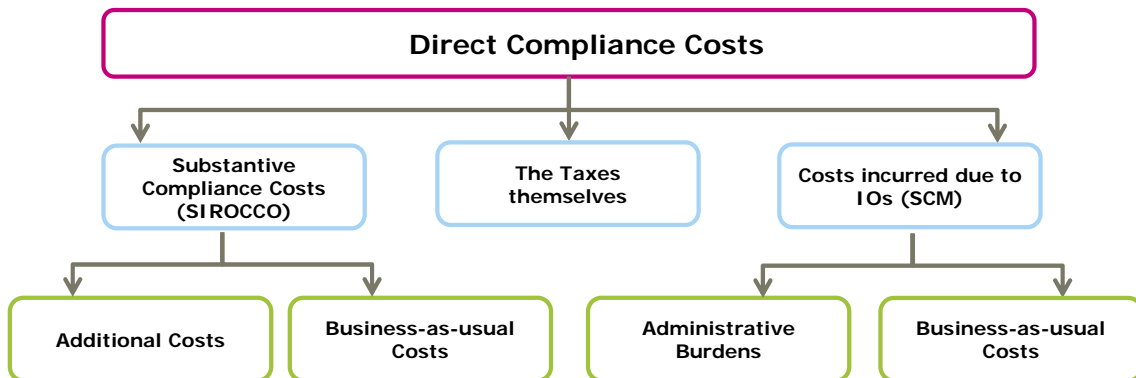
	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
5. SIROCCO	✓	✓	✓	✓	✓	(✓)	✓

The Dutch Cabinet broadened its administrative burden reduction policy program of 2007-2011 to address additional regulatory burdens as it was recognised that businesses were not only confronted with and hindered by administrative burdens.⁹³

Substantive regulatory obligations should therefore be addressed as businesses, according to Actal,⁹⁴ are not readily distinguishing between administrative burdens and other compliance costs. A broader approach with emphasis on the reduction of substantive compliance costs was therefore on the agenda in the Dutch Regulatory Reform Group from 2007. The new approach was named SIROCCO, which is short for Scanning Instrument Regulations of Other Compliance Costs.⁹⁵

The new instrument is an SCM module in the field of substantive compliance costs and thus builds on the fundamentals of the SCM.⁹⁶ SIROCCO is intended as an aid to be used when measuring substantive compliance costs, and is therefore only meant to determine the magnitude of costs entailed in compliance with substantive obligations and possibilities for their reduction.⁹⁷ The SCM and SIROCCO appear to be complementary tools for the measurement of direct compliance costs, which is illustrated in Figure 1 below.⁹⁸

Figure 1: Direct compliance costs: SCM and SIROCCO



⁹³ Regulatory Reform Group (2008a): Cutting red tape the Dutch way, p.10.

⁹⁴ Actal = The Dutch Advisory Board on Administrative Burden

⁹⁵ Nijssen, A. (2012): Business Regulation and Compliance Costs, p.37.

⁹⁶ The following section on SIROCCO is based on Nijssen et al. (2008) and Nijssen (2012) if not otherwise indicated.

⁹⁷ Nijssen et al. (2008): Measurement of substantive compliance costs for existing regulations, p.7.

⁹⁸ Ibid.



4.6.1 Methodological characteristics

SIROCCO looks at the substantive obligations and the resulting additional costs imposed on private businesses, cf. Box 7 below.⁹⁹

Box 7: Cost types as defined by SIROCCO

Compliance costs are all the costs of complying with regulation, with the exception of direct financial costs and long term structural consequences. These can be divided into *substantive compliance costs* and *administrative costs*. SIROCCO is only looking at *substantive compliance costs*.

Substantive costs for businesses are the direct compliance costs with substantive obligations arising from legislation and regulations. The substantive costs consist of Business-as-usual costs and Additional/Marginal costs.

Business-as-usual costs are all the costs incurred by businesses on the basis of statutory substantive obligations that are inherent to the business.

Additional costs (Marginal costs) are all costs incurred by businesses on the basis of statutory substantive obligations that are extraneous to the business.

Source: Nijssen et al. (2008): pp.6-8.

Substantive obligations are defined as "all statutory obligations of businesses to directly comply with norms, standards, codes of conduct and all other requirements aimed at safeguarding public causes in a direct way".¹⁰⁰ In other words, these are obligations to implement behavioural changes or make adjustments to the production process, production methods or products, which could be e.g. putting tags on consumer products.¹⁰¹

The baseline of this methodology is the imaginary demarcation line that can be drawn by separating the total substantive compliance costs into Business-as-usual (BAU) costs and additional costs. The starting point for determining the additional costs is the existing legal standard (the lower limit) from where the potential additional costs from a proposed legal standard are to be measured.¹⁰² As businesses are generally concerned with delivering e.g. safe products to their consumers and providing safe working conditions for their employees, a large part of the substantive compliance costs are considered to be BAU costs.

SIROCCO is therefore used to make proposals about how and to what extent the additional costs for businesses can be reduced. The purpose of the measurement instrument is to determine which activities (and investments) the businesses will need to carry out in order to comply with substantive obligations, and how much money this involves on an annual basis. The instrument does not only produce a total figure of the substantive compliance costs on businesses, but also identifies the burdensome substantive obligations and the cost factors of every piece of legislation at a disaggregated level. It therefore provides a great level of detail and transparency and

⁹⁹ Although SIROCCO is only concerned with the substantive obligations and excludes information obligations, as they are to be measured using the classic SCM, one exemption should be pointed out. Information obligations to third parties, e.g. consumers, clients and employees, belong to the substantive obligations and the costs they entail are considered substantive compliance costs (Nijssen et al. 2008: p.8.)

¹⁰⁰ Nijssen et al. (2008): Measurement of substantive compliance costs for existing regulations, p.8.

¹⁰¹ Ibid.: p.6.

¹⁰² With a draft regulation that focuses on situations in the business sector that have not been previously regulated, the lower limit used is the average sector practice. If, however, a proposed regulation focuses on an economic activity that does not exist in the Netherlands, then the integral costs that new entrants incur to meet its requirements are considered as the additional costs; Nijssen et al. (2008): p.7.



enables policy makers to discuss reduction possibilities, **assess ex-ante and ex-post the effects on business costs** and on the total additional burden. Measuring substantive compliance costs, however, only makes sense to the extent that the government can influence these costs by amending legislation or by making changes to compliance in practice.

SIROCCO is not restricted to a selection of business sectors or sizes and the measurement instrument is developed to **accommodate differentiations in a target group**. Hence segmentation is built in to the instrument. In addition, the tool is in theory **applicable to all types of taxes** and is in principle able to measure any type of transactions (**including cross-border transactions**), and **measure any type of legislation or regulation**.

With SIROCCO being a SCM module with an open structure, it may **complicate cross-country comparison**. The instrument provides methodological guidelines which need to be unified to be able to ensure a robust comparison. It appears from desk research that no cross-country studies using this particular methodology currently exist. However, the instrument can accommodate cross-country comparisons by using its standard application across countries.

4.6.2 Application of the methodology

The measurement instrument **allows countries to conduct measurements as often as required**. However, in the tax area in the Netherlands, SIROCCO has not been applied, as this certain field of regulation is only considered to include information obligations.¹⁰³

4.6.3 Methodological issues

The substantive compliance cost handbook provides a detailed description of how an additional cost measurement could be carried out in practice across Member States.

The typical data collection method is to conduct approximately five individual face-to-face interviews which are standardised per category of typical firms to arrive at a single figure for the amount of time required for an activity or the amount of an investment.

As a substantive obligation may differentiate companies by characteristics such as legal sector, number of personnel etc., or there are several types of *solutions*¹⁰⁴ with which businesses have a substantive obligation to comply, more categories of typical firms exist. Different *solutions* exist as regulations typically do not prescribe how to comply with a substantive obligation. However, in most cases there will only be one commonly applied *solution* per unique substantive obligation.¹⁰⁵

Based on the data collected, a subsequent standardisation of the time and money spent on performing each activity and/or investment is carried out for the typical firm(s). The basic formula is similar to the classical SCM: Price x Quality.

As SIROCCO builds on the same main working assumption as the classical SCM (primarily the *typical firm* assumption), it also reflects some of the similar challenges – which is to be expected as it is a module of the latter methodology. SIROCCO does not produce

¹⁰³ Interview with the Ministry of Finance, the Netherlands.

¹⁰⁴ Definition of solution: "the chosen manner of compliance", Nijssen et al. (2008): p.12.

¹⁰⁵ Ibid.: p.29.



actual costs to businesses but an approximation due to the *typical firm* assumption, among other factors. One distinct difference between the SCM and SIROCCO approach is the *full compliance principle*. The magnitude of the substantive compliance costs is based on either actual or full compliance. As a default the measurement should be carried out on the basis of actual compliance. However, if no information on actual compliance is available, expert estimates or full compliance can be assumed.¹⁰⁶

While actual compliance brings the measurement closer to the real costs, the assumption of the typical firm is pulling in the other direction. On one hand, this assumption simplifies the measurement, but on the other hand, it may bring the measurement further from reality. Apart from the assumption as such, the instrument also imposes some challenges in the initial selection of typical firms, as there is no clear standard procedure for selecting the interviewees and the initial selection of typical businesses for interviews is subjective and based on few interviews.

In addition, it has proven difficult to identify potential cost reductions for the substantive obligations that are not part of the normal operating procedures (BAU costs), i.e. additional (marginal) costs. Some costs may occur even in the absence of a substantive obligation, for which it is important to separate BAU costs from additional costs. Otherwise, a reduction measure may only lead to a reduction on paper, and not in practice. This procedure is not easy and overlaps may occur.

It should be emphasised that the instrument provides some accuracy and stability. Repeated measurements could yield more or less the same results and the rates used are based on existing statistics on wages and wage costs.

4.7 The Regulatory Check-up Model

Table 6: Requirements fulfilled by the Regulatory Check-up Model

	Support IA	Cross-border transactions	Segment a-tion (SMEs)	Include all taxes	EU Legi-slation	Cross-country comparability (Consistency)	Recur-rence
6. Regulatory Check-up	✓	*	✓	✓	✓	-	✓

The Handbook on the Swiss Regulatory Check-up Model was developed by the Swiss State Secretariat for Economic Affairs (SECO) and published in 2011. It is based on the Regulatory Cost Model (RCM) developed on behalf of the German Bertelsmann Foundation, which largely builds on the SCM.¹⁰⁷

In Switzerland, like in many other European countries, the Standard Cost Model (SCM) initially developed in the Netherlands, was used to measure administrative costs in some regulatory areas. However, as the SCM is restricted to administrative costs (defined as costs endured by private businesses due to information obligations to public authorities), it was considered insufficient in measuring the broader concept of regulatory costs, which result from all different kinds of obligations to act.

¹⁰⁶ Ibid.: p.18.

¹⁰⁷ Staatssekretariat für Wirtschaft SECO [ed.] (2011): Regulierungs-Checkup. Handbuch zur Schätzung der Kosten von Regulierungen sowie für die Identifizierung von Potenzialen für die Vereinfachung und Kostenreduktion: p.7.



4.7.1 Methodological characteristics

The Regulatory Check-up Model serves the purpose of estimating the costs endured by the private economy due to state regulations.¹⁰⁸ Although the model focuses on federal and national law, it is also capable of **including EU legislation**.¹⁰⁹

It **assesses ex-ante the impacts of every new piece of legislation** which concerns more than 10.000 businesses. The Handbook outlines the most important steps and responsible actors in an assessment of regulatory costs.

The Regulatory Check-up Model aims to assess the direct regulatory costs endured by companies resulting from obligations to act, including information obligations, cf. definition in box 8 below. Obligations to tolerate and obligations to abstain from something (prohibitions) are not included in the measurement.¹¹⁰

Box 8: Cost types as defined by the Regulatory Check-up Model

Regulatory costs: the costs incurred by norm addressees in their compliance with regulatory obligations to act.

Source: Staatssekretariat für Wirtschaft SECO [ed.] (2011): p.44.

There are basically four categories of *direct costs for businesses (regulatory costs)*, resulting from information obligations and other obligations to act. These direct costs are assessed qualitatively and quantitatively. *Indirect costs* like opportunity costs are also included in the measurement. However, contrary to the direct costs, they are exclusively assessed qualitatively.¹¹¹ For a complete overview of the costs, see illustration below in Figure 2.

¹⁰⁸ Ibid.: p.5.

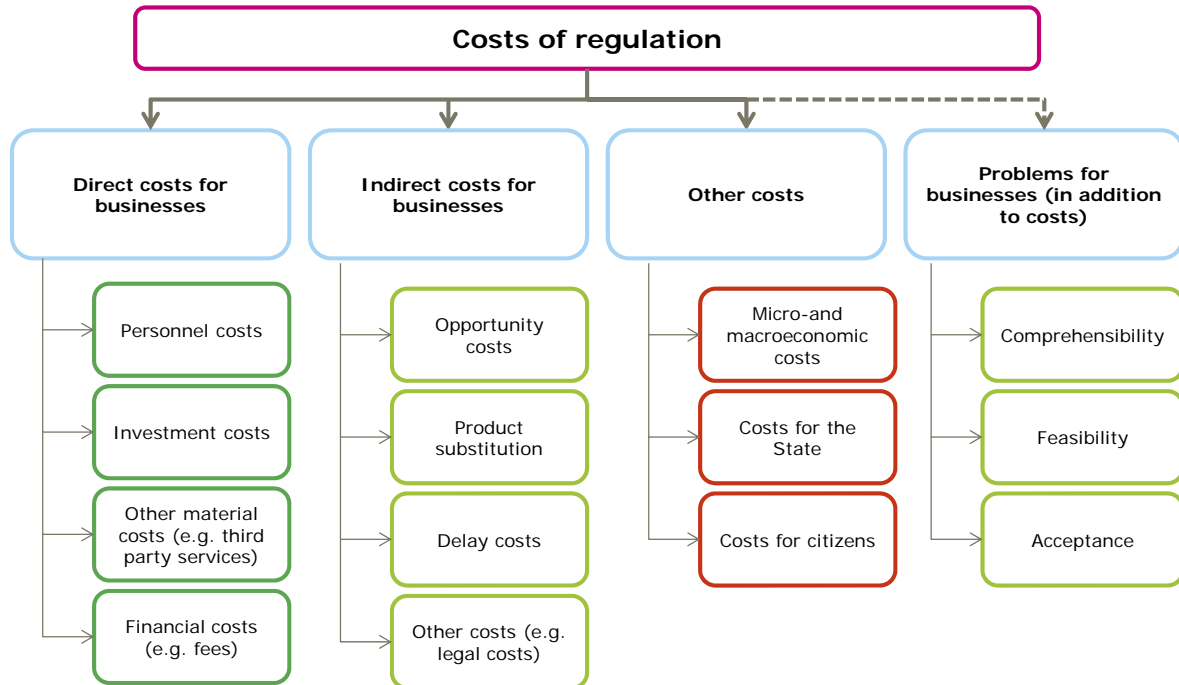
¹⁰⁹ The RCM by Bertelsmann accounts for EU Regulations (Schatz et al. – Bertelsmann Foundation 2009: p.21), As the Swiss Model is largely based on the RCM, it is assumed that it is able to capture this aspect as well.

¹¹⁰ Ibid.: p.9.

¹¹¹ Contrary to the RCM presented by the Bertelsmann Foundation, which quantitatively estimates opportunity costs, the Swiss Model assesses these costs only qualitatively (SECO 2011: p.11).



Figure 2: Costs of regulation as defined by the Regulatory Check-up Model



- assessed quantitatively and qualitatively
- assessed qualitatively
- not assessed

Source: adapted from Wallart (2012), p.4.

In order to derive the regulatory costs, business-as-usual costs, i.e. the costs which would be endured by the business even without a regulation, are subtracted from the sum of personnel costs, investment costs, financial costs, and other material costs.

The Swiss model is **able to account for segmentation**, which is considered an important element in the assessment of regulatory costs.¹¹² Different business sizes and sectors can hence be taken into account.¹¹³ However, (tax) compliance costs for individuals are not taken into consideration by the model. The methodology is in theory able to **account for a variety of different taxes**, although current measurements specifically take CIT and VAT into account and assess the costs related to these taxes at a rather detailed level.¹¹⁴ Other, smaller taxes are also evaluated in the Swiss case. Whether the Swiss model is also able to **capture cross-border VAT transactions remains uncertain**.¹¹⁵

The handbook for the Swiss Regulatory Checkup Model has been designed for measuring compliance costs in Switzerland. Hence, in its current setting the methodology is **not**

¹¹² SECO (2011): Regulierungs-Checkup, p.21.

¹¹³ Ibid.: p.21.

¹¹⁴ Interview with SECO (State Secretariat for Economic Affairs).

¹¹⁵ Interview with SECO.



suited for cross country comparison. However, it might be possible to conduct measurements in other countries based on an adapted manual.

4.7.2 Application of the methodology

The measurements, which are expected to finish in 2013, are conducted in fifteen regulatory areas especially relevant to Swiss businesses, one of them being the tax area.¹¹⁶

In terms of **recurrence of the measurements**, a shift from an ex-post to an ex-ante assessment can be observed in Switzerland as a consequence of the new Guidelines for Impact Assessments of new legislative proposals.¹¹⁷ As outlined in the Guidelines, ex-ante assessment of the estimated impacts of a piece of regulatory legislation has to be conducted when more than 10.000 businesses are affected.

4.7.3 Methodological issues

The Swiss Regulatory Checkup Model is described at a rather detailed level in a handbook, as well as in a manual for conducting Impact Assessments.¹¹⁸ In order to ensure comparability across the different Swiss cantons, Federal Authorities and contractors conducting these measurements follow the handbook to the extent possible.

As far as data sources are concerned, the Swiss Regulatory Checkup Model is largely based on expert assessments. The Handbook suggests that at least six experts from different educational and occupational backgrounds should take part in the assessments.

The following backgrounds should be considered when selecting experts:

- Public authorities: enforcement authorities, the Federal level, the Cantons;
- Businesses and interest organisations;
- Experts who are familiar with working practice in many different businesses (e.g. consulting agencies).

In the first phase of the assessment, these experts are asked to estimate the costs based on a questionnaire and to justify their estimates. In the second phase, a workshop with all experts should take place, in order to discuss the different estimates and agree on a figure for each cost category.¹¹⁹

The cost estimates received through experts' assessments and business interviews are extrapolated with the help of the total number of cases, to receive the total costs of regulations for all businesses. The total number of cases is computed by multiplying the total number of norm addressees with the annual frequency of an activity related to compliance with a legislative act. Statistical data, secondary statistical data (data which was originally not intended for statistical purposes) or expert estimations should be used in order to assess the total number of norm addressees. The frequency of activities is

¹¹⁶ SECO (2011): Regulierungs-Checkup, p.8.

¹¹⁷ Eidgenössisches Departement für Wirtschaft, Bildung und Forschung (2013): Regulierungsfolgenabschätzung. Handbuch, März 2013.

¹¹⁸ The Handbook for conducting impact assessments is available here: http://www.seco.admin.ch/themen/00374/00459/00465/index.html?lang=de&download=NHZLpZeg7t,Inp6lONTU042l2Z6ln1acy4Zn4Z2qZpnO2Yuq2Z6gpJCDdn9_gmym162epYbg2c_JJkbnokSn6A--, retrieved 2013-08-15.

¹¹⁹ Ibid.: pp.27.



assessed on the basis of expert assessments, assessments by the companies themselves, or through assessments from the Federal Authorities.¹²⁰

As the model shares some of the same assumptions as the SCM, it also faces similar challenges and advantages as those approaches. Specifically, the most important challenges are:

- The assumption of the *normally efficient* business, which the model is based on and which may not reflect the “real” (tax-related) compliance costs;
- Consistency issues: despite the fact that there is a common handbook which has to be consulted by all involved parties, there may still remain certain challenges in ensuring consistency throughout the measurements;

4.8 Guidelines on the identification and presentation of compliance costs in legislative proposals by the Federal Government

Table 7: Requirements fulfilled by the German Guidelines

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
7. German Guidelines	✓	*	✓	✓	✓	-	✓

As a result of an amendment to the Act on the establishment of the National Regulatory Reform Council in 2006, which entered into force on 22 March 2011, the National Regulatory Control Council (NKR)¹²¹ received the mandate to examine the comprehensibility and correct the methodology for estimating the compliance costs of new federal regulations. Before this amendment, only the costs resulting from information obligations (a subset of compliance costs) were assessed based on the German version of a (partly modified) Standard Cost Model.¹²² Hence, the scope of the measurements was extended from administrative costs (the costs resulting from compliance with information obligations) to substantive compliance costs (the costs resulting from compliance with different obligations stemming from federal legislation, i.e. including more than costs related to information obligations).

All German Federal Ministries have to assess the anticipated change in compliance costs for each of their legislative proposals, in order to enable the responsible decision-makers to decide on the least burdensome regulatory option.¹²³

4.8.1 Methodological characteristics

The Guidelines assesses **new legislative proposals (ex-ante)**.¹²⁴

As outlined in the Act on the Establishment of the National Regulatory Control Council, compliance costs are defined as including the total measurable time expenditure and the

¹²⁰ Ibid.: p.23.

¹²¹ The National Regulatory Control Council (Nationaler Normenkontrollrat) is responsible for supporting the German Federal Government in supporting its measures to reduce bureaucracy. It was founded in 2006 and its competencies were increased in 2011 (Nationaler Normenkontrollrat 2012a).

¹²² Federal Statistical Office (2006): Introduction of the Standard Cost Model.

¹²³ Federal Statistical Office (2011): Guidelines, pp.4.

¹²⁴ Ibid.: p.19.



costs incurred by citizens, businesses and public authorities in order to comply with federal legislation, cf. Box 9 below.¹²⁵ Administrative costs stemming from information obligations are displayed separately for businesses.¹²⁶

Box 9: Cost types as defined by the German Guidelines

Compliance costs are costs resulting from compliance with different obligations stemming from federal legislation

Administrative costs are the costs resulting from compliance with information obligations

Source: Federal Statistical Office (2011): p.5.

Obligations are defined as "individual provisions inducing direct changes in costs, time expenditure or both for its addressees". These obligations stem from federal regulations and oblige the norm addressees to comply with them. Information obligations are a sub-category of these obligations. "Direct changes" refers to a change of cost and time expenditure which is directly attributable to compliance with a particular provision.¹²⁷

The Guidelines on the Identification and Presentation of Compliance Costs lay down the kinds of costs to be included for individuals, businesses and the public authorities. For businesses, the following costs shall be taken into account in the measurements:

- *Personnel costs* consist of the time spent on complying with a certain procedure multiplied by the corresponding wage rate.
- *Material and purchase costs* (referred to simply as "material costs") are directly endured by businesses due to compliance with obligations stemming from federal laws. Expenses for external services (e.g. training costs and costs of audits) are also considered. One-time material costs are displayed separately. They are also referred to as adjustment costs and they occur due to a change to a new procedure, e.g. the exchange of software due to a change in legislation.¹²⁸

Business-as-usual costs, the taxes themselves and social security contributions, as well as indirect effects such as imputed costs (lost hypothetical profit and other charges such as countervailing charges) are not part of compliance costs in these guidelines.¹²⁹

The Guidelines outline how to assess compliance costs for public authorities, individual citizens and businesses. As far as the latter are concerned, the methodology is **sensitive to company size**, as particular attention should be paid to the extent to which SMEs are affected by new legislation.¹³⁰ In addition, the Guidelines are able to account for costs stemming from all different kinds of obligations, including tax legislation. They are hence **not restricted to certain types of taxes**, but rather able to take different ones into account. Whether the German Guidelines **include cross-border VAT transactions remains uncertain as this is not addressed in the Guidelines**. The methodology can, to a certain degree, take **EU law into account** in the measurement. Directives are

¹²⁵ Ibid.: p.5.

¹²⁶ Ibid.: p.19.

¹²⁷ Ibid.: p.8.

¹²⁸ Ibid.: pp.20-26.

¹²⁹ Ibid.: p.12.

¹³⁰ Ibid.: p.19.



accounted for when they have been transposed into national legislation. Regulations are usually not measured, unless a ministry wishes to do so.¹³¹

The Guidelines were elaborated in order to assess changes in compliance costs due to legislative proposals stemming from federal legislative acts.¹³² They are designed exclusively for the assessment of compliance costs in Germany, and only at the federal level, as legislation from the Länder level is not accounted for in the measurements. Hence the German Guidelines in its current form do **not seem suited for conducting cross-country comparisons**.

4.8.2 Application of the methodology

All German Federal Ministries have to assess the anticipated change in compliance costs for each of their legislative proposals, in order to enable the responsible decision-makers to decide on the least burdensome regulatory option.¹³³

The approach outlined in the Guidelines is both an ex-ante and an ex-post one. Each ministry is supposed to ex-ante identify the anticipated change of compliance costs of **every new legislative proposal** before it is brought forward.¹³⁴ The ex-post approach consists of validations of compliance costs estimates of existing measures conducted by the German Statistical Office (Destatis) **every two years**.

One concrete example of an (ex-post) compliance cost measurement in the tax area, applying this methodology, was mentioned at an interview with the Federal Statistical Office conducted on August 13, 2013. This study was published in 2011 and is about the "Compliance costs in the area of harmonization and reduction of storage and harmonization periods of trade, fiscal and social law".¹³⁵ It aimed to assess the compliance costs associated with the storage of documents related to *inter alia* tax law, to assess the impact of a reduction of storage periods in the three abovementioned regulatory areas, as well as to gather suggestions for improvement from the business' perspective. The study found that the annual compliance costs in Germany resulting from storage of documents related to the three areas (trade, fiscal and social law) is around € 30 billion, with administrative costs resulting from information obligations account for around 20% of the total compliance costs (EUR 6 billion) and compliance costs stemming from other kinds of obligations account for the remaining 80% (EUR 24 billion).¹³⁶

4.8.3 Methodological issues

The manual used for assessing compliance costs are the "Guidelines on the Identification and Presentation of Compliance Costs in Legislative Proposals by the Federal Government". Training courses on the methodology are available for staff conducting the measurements.¹³⁷

¹³¹ Interview with Destatis (German Statistical Office).

¹³² Federal Statistical Office (2011): Guidelines, p.11.

¹³³ Federal Statistical Office (2011): Guidelines, pp.4.

¹³⁴ Ibid.: p.5.

¹³⁵ Die Bundesregierung (2011): Erfüllungsaufwand im Bereich Harmonisierung und Verkürzung der Aufbewahrungs- und Prüfungsfristen nach Handels-, Steuer- und Sozialrecht.

¹³⁶ Ibid.: p.5.

¹³⁷ Interview with Destatis.



As far as data sources are concerned, the respective ministries are in principle free to select the data sources they would like to use for their assessments.¹³⁸ The following sources are proposed by the Guidelines:

- Information from earlier assessments of compliance costs or administrative costs can be taken from databases¹³⁹ or publications;
- Consulting with governments of the different "Länder";
- Consulting with relevant associations;
- External experts' assessments.¹⁴⁰

The annual compliance costs of an obligation are calculated by multiplying the annual frequency of an action per affected party by the total number of affected parties, i.e. by multiplying the costs per case with the number of cases.¹⁴¹ The costs per case are calculated by multiplying the time spent on an activity by the corresponding wage rate, and consequently adding the material costs per case to this amount.¹⁴² The annual number of cases is determined by multiplying the annual frequency of compliance with a provision or a process per affected party by the total number of affected parties.¹⁴³

Legislative proposals by all German Federal Ministries are to be assessed in accordance with the Guidelines. The fact that several ministries have to conduct the assessment might be a challenge for consistency. Moreover, not all details are outlined in the Guidelines, which may lead to different understandings of the cost concepts and therefore also to comparability problems of the results. The free choice of data sources may furthermore be problematic with regard to the comparability and consistency of the data.

4.9 The Cost Driven Approach to Regulatory burden (CAR)

Table 8: Requirements fulfilled by the CAR

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
8. CAR	✓	✓	✓	✓	✓	(✓)	(✓)

4.9.1 Methodological characteristics

The Cost Driven Approach to Regulatory burden (CAR) was developed in 2012 by the Dutch Consultancy firm SIRA Consulting and was finalised earlier this year (although no manual has been published yet). It aims to overcome certain limitations of the Standard Cost Model (SCM) and to broaden its focus from administrative burden to regulatory burden. While the SCM takes as a starting point the total burden of a regulation, CAR examines the impact of regulations from the business' perspective, taking into account the total burden for businesses in complying with legislation and regulations. The CAR model therefore takes the real costs, by looking into the business' accounting books, incurred in complying with regulation, irrespective of which legislation is at the origin of the cost, as its point of departure.

¹³⁸ Federal Statistical Office (2011): p.5.

¹³⁹ An example given is the WebSKM-Website: www.destatis.de/webskm.

¹⁴⁰ Federal Statistical Office (2011): p.5.

¹⁴¹ Ibid.: p.19.

¹⁴² Ibid.: p.7.

¹⁴³ Ibid.: p.19.



The objective of the CAR-methodology is not to contribute to the realisation of reduction targets as such but to identify priorities and reduction measures that make a real contribution to a company's bottom line, instead of assessing the impact of a regulation from a legislative point of view.¹⁴⁴

The model allows for measuring impacts of a current policy (ex-post), **predicting (ex-ante) impacts** of policy changes and for counterfactuals (what if a policy is not implemented?). On that note it should be stressed that the objective of the CAR-methodology is never to change or delete certain policy goals, but rather to make sure that these policy goals are reached at lower costs. Hence, it focuses on growth and innovation rather than changing regulation.

The term Regulatory burden includes three elements; Administrative Burdens (ABs), Compliance Costs and Inspection Costs, cf. Box 10 below.

Box 10: Cost types as defined by the CAR-methodology

Regulation burdens consist of Administrative Burdens, Compliance Costs and Inspection Costs

Administrative Burdens are the costs that have to be made for personnel or other expenditures in order for businesses to comply with Information Obligations resulting from government legislation and regulations.

Compliance Cost are the costs that have to be made for personnel or other expenditures in order for businesses to comply with Legal Obligations resulting from government legislation and regulations, including investments like safety materials, soil protection systems, air filters, etc.

Inspection Costs are the costs that have to be made by businesses for making (production) locations accessible, accompanying government inspectors and providing necessary compliance evidence and/or information (e.g. tax office, environment agency, fire authority, etc.)

Source: Bex et al. (2013): p.2 and p.19

Every CAR assessment consists of the following four main phases as illustrated in Figure 3 below.¹⁴⁵

¹⁴⁴ Bex et al. (2013): The CAR-Methodology applied to SME bakeries, p.10.

¹⁴⁵ For elaboration on the CAR application see Annexes A and C.



Figure 3: Four main phases in a CAR assessment



Source: Bex, P./SIRA Consulting (2012): DEBR Workshop 7: How to measure the overall burden of regulation? A Cost Driven Approach to Regulatory Burdens.

The CAR-methodology is **not restricted to a selection of business sectors or business sizes** and can be applied widely. In addition, the representative company selected could **potentially be a business engaged in cross-border transactions**. It **allows tracing legal obligations to their origin (national or EU)** and measuring the costs of legal obligations per cost centre. In addition, the model **allows for a comparison over multiple years** and is able to **take into account all types of burdens stemming from various taxes**, among other regulatory burdens.¹⁴⁶

4.9.2 Application of the methodology

The CAR-methodology is able to measure the regulatory burden for businesses on a **regular basis and compare results at different points in time**. However, as the CAR-methodology is new, practical recurrence of measurements remain to be seen, as only pilot studies have been carried out at this point in time. The model has been applied and tested in 6 different business sectors (Chemistry I – blenders of chemical products, SME bakeries in four EU Member States, Chemistry II – producers of performance and refinery catalysts, Hairdressers and beauticians, Chemistry III – producers of plastic, Iron and steel sector).

Some of the results and findings of the CAR-methodology are outlined below.

1. Main findings of the pilot study of four SME bakeries in the EU:¹⁴⁷
 - The regulatory burden of the four investigated bakeries varies between 10% and 12.5% with values for the earnings before interest and taxes (EBIT)'s between 0.1% and 2.8%
 - The distribution of the Regulatory Burden (12.5%) is as follows: AB 1.0%, CC 10.9% and IN 0.6%¹⁴⁸

¹⁴⁶ Bex, P. (2013a): The Cost driven Approach to Regulatory burdens (CAR).

¹⁴⁷ Ibid.

¹⁴⁸ Bex et al. (2013): The CAR-Methodology applied to SME bakeries, p.19.



- Food and Safety and Hygiene Regulations account for 70% of all Regulatory Burdens of SME bakeries (the highest of any category), of the regulation itself, approx. 70% comes from requirements for food premises¹⁴⁹
- Low EBIT in this sector, so the reduction of regulatory burden will have tangible impact on profitability of the company
- Legislation on FSH, Food Labelling, and OHS is essentially the same (EU-Regulations are uniformly implemented, transposition of EU-Directives is comparable, comparable systems for inspections by government authorities)
- Employment laws significantly impact the cost structures of SME bakeries
- Measures to reduce the regulatory burden of SME bakeries include e.g. exempt SMEs from new and existing EU legislation, introduce lighter EU-regimes for SMEs, reduce the burden proof placed on SMEs in dismissal procedures

2. Main findings of pilot study of chemical industry:¹⁵⁰

- Regulatory burdens are between 7% and 14% of the production costs.
- A 20% reduction of the regulatory burdens can increase EBIT from 5% to 6%.
- Regulatory burdens are often obstacle to necessary innovation.
- Regulatory burdens can be further reduced through focus on more cost-efficient implementation.

In addition, using CAR, SIRA has identified over EUR 5 billion extra regulatory burdens for businesses in the Netherlands (e.g. Employment rights and labelling).¹⁵¹

4.9.3 Methodological issues

Earlier this year (2013) the CAR-methodology was finalised.¹⁵² However, with no manual published at this point in time, a few elements of the model still remain uncertain due to limited available material.

What is clear is that data is collected through interviews with the financial management of the selected company and through business administration (accounting books). The CAR-methodology is based on real costs and all data are stored in an extended Standard Cost Model that is specifically tailored for the CAR-methodology.¹⁵³ The value added from the CAR is its starting point which is the real costs of a representative business. Although the CAR-methodology offers some very promising features, the measurement approach also appears to face very similar challenges as the SCM in regard to e.g. disentangling costs – due to the application of the same core equation as the SCM.¹⁵⁴ As the CAR model does not directly ask businesses to separate regular business expenses from regulatory burdens, this exercise is primarily done by experts, for whom the task remains a challenging issue. When the allocation of costs is complex the CAR model does not

¹⁴⁹ Ibid.: p.21.

¹⁵⁰ Bex, P./SIRA Consulting (2012): DERB Workshop 7: How to measure the overall burden of regulation? A Cost Driven Approach to Regulatory Burdens.

¹⁵¹ Ibid.

¹⁵² Interview with SIRA Consulting.

¹⁵³ Bex et al. (2013): The CAR-Methodology applied to SME bakeries, p.8.

¹⁵⁴ See comparison of the CAR-methodology and SCM application in Annex B.



consider a cost a burden unless completely certain, for which the regulatory burden may be underestimated to some extent.¹⁵⁵

With the CAR taking the business perspective as its point of departure, and not legislative perspective as the SCM, this requires the CAR to first scan and list all relevant legislation. This exercise, along with going through a business' accounting books, requires the body carrying out measurements to be experts with an accounting background.

The assumptions observed in the SCM seem to apply also to how CAR is used to select a representative business. Where the SCM assumes a typical business and full compliance, CAR speaks of a representative business in the sense of being financial healthy and compliant.

The set of criteria for selecting a business in the CAR consists of a number of qualitative criteria, e.g. a business having no compliance cases again them, with a track record in the industry (not a new company), with no venture capitalists involved (no current takeover), with new technology, and with broad public familiarity, etc. As these criteria are not clearly defined, this may complicate the comparability of representative businesses across Member States. In fact, the CAR pilot study on SME bakeries in four Member States eventually compared the compliance costs of businesses of different sizes, with e.g. Ireland selecting a large business as its representative business.¹⁵⁶

4.10 The Complexity Index (CI) of the Office of Tax Simplification (OTS)

Table 9: Requirements fulfilled by the Complexity Index

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
9. Complexity index	-	*	-	✓	*	-	(✓)

4.10.1 Methodological characteristics

The Complexity Index was published in December 2012 and the aim of the index is to provide an indication of which areas of tax legislation are considered to be particularly complex compared to others and to develop a tool that can help prioritise the future work of the UK Office of Tax Simplification (OTS). In other words, the methodology is intended to help tax policy makers in the UK avoid unnecessary complexity and to help prioritise areas for future tax simplification.¹⁵⁷ The Index is therefore intended to be **applied to the whole of the tax system** (including transposed EU legislation) and the outcome is meant to inform proposals for new OTS projects to the Ministers.

This is accomplished by ranking all of the **existing tax legislation** by degree of complexity, following seven criteria that the OTS has determined as sources of complexity for users of tax legislation. The seven criteria of complexity are:¹⁵⁸

1. Legislative complexity;

¹⁵⁵ Interview with SIRA Consulting.

¹⁵⁶ Bex et al. (2013): The CAR-Methodology applied to SME bakeries, p.25.

¹⁵⁷ Office of Tax Simplification (2012): The Office of Tax Simplification Complexity Index, p.4.

¹⁵⁸ Ibid.: p.5.



- The number of sections and paragraphs
 - The number of pages of legislation in Tolley's 2011-12¹⁵⁹
 - The number of reliefs from OTS review
 - The number of Finance acts (since 2000)
 - The Gunning-Fog readability index score¹⁶⁰
2. HMRC guidance complexity;
 3. Number of taxpayers;
 4. Average ability of taxpayers;
 5. Avoidance risk;
 6. Cost of compliance for taxpayers;
 7. HMRC operating costs.

The seven criteria are subsets of the three categories of legislative complexity (1), effectiveness (2-5) and resource efficiency (6-7). The three categories are based on the conceptual approach of the usability model, which is further based on the International Standard Organisation's definition of usability.

The seven criteria are a mix of subjective judgement and objective measurements of complexity in the index. The objective criteria are criterion 1, 3, and 4, whereas criterion 2, 5, 6, and 7 are collectively subjective criteria.

The CI provides a pragmatic approach which serves as a tool for stimulating debate and confirming or dissuading impressions on how complex tax rules are. With this purpose in mind, the methodology is relatively different from the previous ones outlined in this chapter, as they all generally focus on the compliance costs of businesses. This index is not considered to produce cost estimates only, although it addresses the compliance costs of taxpayers, cf. definition in box below.

Box 11: Cost types as defined by the Complexity Index

Cost of compliance for taxpayers is not defined in the published paper. However, HMRC define compliance costs as "the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities, over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax; costs which would disappear if the tax was abolished. Compliance costs can be broken down to three categories: 1) time costs, 2) direct costs, 3) psychological costs. Administrative burdens are only a proportion of compliance costs and do not account for one-off costs, such as, familiarisation with a policy change or costs incurred from HMRC or customer error"

Source: Hill/Noti, HMRC (2009): Costing Customer Time: pp.3-5.

The index focuses on legislative complexity and takes the tax legislation as its point of departure.¹⁶¹ In the current setting it does not seem capable **to differentiate between business size and sector**. It is **uncertain whether cross-border transactions could potentially be taken into account** and whether it could **be used to compare tax compliance costs in different Member States**.

4.10.2 Application of the methodology

The first version of the methodology application has been tested on some parts of the UK tax system, including the last three rewrite acts as well as aggregates levy, IR35, share

¹⁵⁹ Tolley® Guidance provides comprehensive information in different areas of taxation: Personal Tax, Owner-Managed Businesses, Corporate Tax, IHT Trusts & Estates, VAT and Employment Taxes.

¹⁶⁰ The Gunning-Fog is a weighted average of the number of words per sentence, and the number of long words per sentence.

¹⁶¹ Ibid.: p.8.



schemes, and bank payroll tax.¹⁶² When the methodology will be approved and refined in the second version, it is intended to be applied across the rest of the direct and indirect tax legislation in the UK.¹⁶³

4.10.3 Methodological issues

The Complexity Index version 1 was published by the OTS in December 2012. However, the paper presenting this version should not be taken as a detailed manual, but rather a paper outlining the broad characteristics and overall calculation method. Weightings are for instance not elaborated upon and the weighting range is not clearly outlined and therefore considered arbitrary.

The overall calculation method is described as a combination of scoring and weighting of the seven criteria. The complexity index ranks each area of tax legislation depending on its relative complexity (constructed by the above mentioned seven criteria) from 0 to 10, with 0 being the least complex and 10 the most complex. Each criterion is further scored on a scale from 1 to 5 and assigned a certain weight.

Each of the three usability categories are given equal weights at an aggregated level (summing to 150), whereas the sub-categories within each of the three categories are assigned an individual weight to indicate their relative importance in the overall measure.¹⁶⁴ The relative complexity index rating of the separate criteria is calculated by multiplying the score with the assigned weights of each criterion. This calculation method is however constructed slightly differently for one of the seven criteria, namely the legislative complexity criteria. This criterion is still scored out of 5, but to get to this score, the five sub-categories, e.g. the number of pages of legislation, are divided by 100 to get a score out of 10. These scores are then ranked across all of the tax legislation and each quintile given a number from 1 to 5 depending on their legislative complexity. The legislative complexity score then becomes relative across tax legislation.

To reach an overall complexity index score for the particular piece of tax legislation, the seven individual index scores are summed and then divided by 150.¹⁶⁵

The index has a number of limitations and is therefore continuously refined. One of the limitations of the Complexity Index is the inclusion of subjective criteria in the index. By not having specific and measurable thresholds for various criteria, but only a scale of low/medium/high and straightforward/medium/complex, among others, the overall index becomes somewhat arbitrary and subject to comparability problems.

It is also a matter of debate whether all the criteria currently included in the index are necessary. If the goal is to measure the order of priority tasks by the OTS, then the seven

¹⁶² Ibid.: p.4.

¹⁶³ The second version of the Complexity Index was published in September 2013. The second version addresses some of the deficiencies of the first version outlined in the report. The index is now split up into intrinsic complexity and impacts, thereby reducing double counting, which has been criticised in the first version. The second version of the complexity index still remains work in progress and is expected to be further refined. For a complete overview of the second complexity index go to: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/250995/ots_complexity_index_version2.pdf

¹⁶⁴ The initial weightings were tested and refined by two tax experts scoring different areas of the UK tax system and the final scores discussed with tax authority staff and tax advisors. They were found to confirm people's instincts for which parts of the tax system were more complex than others (Input from JS, the UK Office of Tax Simplification).

¹⁶⁵ Office of Tax Simplification (2012): pp.6-7.



criteria could be justified. If, however, complexity of legislation is what is to be measured, then criteria such as number of taxpayers, ability of taxpayers, avoidance risk, and cost of compliance and operating costs) could be discarded from the index.¹⁶⁶ In addition, as some of the criteria might be overlapping, this may lead to potential double counting/correlation (e.g. number of pages, number of reliefs, etc.). Another point made is that it is necessary to separate the complexity per se from the costs/consequences of complexity.¹⁶⁷

4.11 Total Cost to Serve (TCS)

Table 10: Requirements fulfilled by the TCS

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
10. TCS	-	*	-	✓	*	-	-

4.11.1 Methodological characteristics

The UK remains one of the most advanced countries within the area of tax compliance costs assessments. The legislative complexity of the UK system has been acknowledged and there have been several attempts to improve measurements and simplify legislation in recent years. One such attempt is the introduction of the Total Cost to Serve (TCS) model in 2008.¹⁶⁸ This measurement tool involves a systematic examination of all facets of a particular customer experience of dealing with HMRC, taking full account of what actually happens in practise (**ex-post focus**), so as to capture the full costs to a customer (businesses or individuals) and to HMRC. The model focuses on costs that actually arise when a customer experience is not 'ideal'. That being said, it remains **unclear what legislative processes are included**. This model was developed to better understand customers, in order for HMRC to target their communications and resources more effectively. Subsequently, the TCS helps HMRC to identify where processes commonly fail, how changes in customer behaviour and needs impact costs, what the critical cost-sensitive issues for customers and HMRC are, and find out how representative cost elements are within their customer population. Finally, the TCS helps identify areas for internal efficiencies and continuous improvement.

While the TCS was developed for determining the costs to individuals, it has been aligned to the SCM and is used to understand the cost of error, contact, etc. for business customers. Whereas the SCM assumes a *normally efficient*, compliant business, TCS helps HMRC to quantify costs that actually arise when the customer's experience with HMRC is not 'ideal'. Hence, the TCS model aims to capture the additional costs that the SCM might not include.

The additional costs to consumers (businesses or individuals) are financial costs and opportunity costs (psychological costs are also considered but not quantified in financial terms), which are not included in the SCM estimates.

¹⁶⁶ Office of Tax Simplification - Comment on the Complexity Index from Richard Baron, Institute of Directors, December 2012.

¹⁶⁷ Office of Tax Simplification - Comment on the Complexity Index from David Ulph, January 2013.

¹⁶⁸ HMRC (2013): Total Cost to Serve.

**Box 12: Cost types as defined by the TCS approach**

Financial costs - include telephone costs for calls to HMRC, etc.

Opportunity costs - time spent in dealing with HMRC that could have been spent doing other things.

Psychological costs – the stress and hassle of having to deal with HMRC

Source: HMRC (2013): Total Cost to Serve

The additional costs are quite significant according to HMRC.¹⁶⁹ Moreover, the SCM-based estimates have been challenged by businesses and tax professionals as they aren't considered to be 'realistic'. The TCS therefore allows HMRC to take a more inclusive view of the overall costs of a particular activity, and HMRC has started to use this approach to inform changes they are making (to compare 'as is' with 'to be'). The model is **able to measure all kind of taxes**. However, it looks at the experience of businesses or individuals in a broad sense; it is therefore **not able to differentiate between e.g. business size and sector**. As the TCS is applied on a case-by-case basis and no specific manual exists, it is **not suited for cross-country comparison**. In connection with the unconsolidated nature of the TCS, no information about the TCS and the potential inclusion of **cross-border transactions** could be found. It therefore remains unclear whether businesses engaged in cross-border trade are accounted for in the methodology.

4.11.2 Application of the methodology

The TCS aims to provide a broader view of costs to both customers and to HMRC, with the goal of reducing them by simplifying the process itself (e.g. amend a form, improve the guidance, make the digital service more intuitive, etc.). Due to the methodology's case-by-case approach and its purpose in mind, the **frequency of recurrence** of TCS measurements is assumed to be rather irregular.

HMRC has given an example of the use of TCS, which is briefly outlined below.

- Total Cost to Serve,¹⁷⁰
Example: VAT Registration Customer Journey Facts:
 - 265.000 register for VAT each year
 - 30% - the minimum error rate for the manual VAT1 (VAT registration form)
 - 66% - the critical error rate during 'learning from mistakes' (150 people)
- Results:
 - Costs if all customers were correct: £2.3m to HMRC and £6.9m to customers
 - Costs with 30% of registrations having errors: £3.1m to HMRC and £8.1m to customers
 - Costs with 66% errors: £4.1m to HMRC and £9.6m to customers

The TCS results are used by HMRC to identify the potential cost savings if "errors"/processes (e.g. telephone waiting line) were improved/did not incur when customers deal with HMRC. Hence the TCS model helps identifying and reducing the compliance costs.

¹⁶⁹ Interview with HMRC.

¹⁷⁰ HMRC (2013): Total Cost to Serve.



4.11.3 Methodological issues

The TCS is used on a case-by-case basis and no manual as such exists. It has no overall baseline as the SCM and the two approaches are therefore aligned and used to complement one another at this point in time.¹⁷¹ Due to limited information available on the TCS, it is not fully clear where potential challenges in the model lie, apart from the ones related to its case-by-case approach.

4.12 Tax Information and Impact Note (TIINs)

Table 11: Requirements fulfilled by the TIINs

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
11. TIINs	✓	*	✓	✓	*	-	-

4.12.1 Methodological characteristics

Another initiative introduced by the HMRC and HM Treasury is the Tax Information and Impact Notes (TIINs). This new approach was published in December 2010 and has been in use since 2011.¹⁷² It is a new internal process for **undertaking Impact Assessment of tax policy changes**. It is **able to measure all types of taxes**. The Tax Impact Assessment process has been designed to be part of the policy making process from the outset, and not simply the completion of a template at the very end. The TIINs summarise the impacts of a policy change, consider a wider range of impacts and covers a broader range of policy changes than the former Impact Assessment regime for taxes. **Whether this includes EU legislation as well remains unclear**. These notes provide a clear statement of the policy objective, impact on the budget, the economy, individuals, businesses and civil society organisations, as well as any other specific impact.¹⁷³ They are **not suited for cross-country comparisons**, as the new Tax Impact Assessment process does not offer a consolidated approach. Rather, it is a collection of supporting documents that describes the policy changes. Since very limited information about the TIINs is available, **no information about cross-border transactions exists**, for which it is not possible to assess whether the TIINs take this aspect into account. In contrast, the model **allows differentiating for specific impacts on SMEs**.

4.12.2 Application of the methodology

The TIINs are produced for all substantive changes in tax and national insurance contributions policy by primary and secondary legislation. The approach **does not appear to be intended for providing updated figures on a frequent basis**, as it addresses costs on a case by case approach only. All recently issued TIINs can be accessed on HMRC's website. An example of the use of the TIINs is outlined below.

TIIN, 16 July 2013 – Employee shareholder status: Capital gains tax exemption and income tax/NICs treatment.

¹⁷¹ Interview with HMRC.

¹⁷² HM Treasury (2011): Tax Policy Making, Tax Impact Assessments and Tax Information and Impact Notes.

¹⁷³ Ibid.



Policy objective: to reduce the regulatory burdens on business, promote business and employment growth and increase the choices available to businesses and employees

Impacts:

- Exchequer (£m): 2013-2016: nil, 2016-17: -10, 2017-18: -45
- Economic impact: no significant macroeconomic impacts
- Individuals and households: expected that 50,000 to 80,000 individuals a year may benefit from the income tax and NICs changes, of which 20,000 to 40,000 may benefit from the CGT exemption on disposal of the shares
- Business including civil society organisations: negligible impact on businesses and civil society organisations
- Operational impacts (HMRC or other): the on-going costs of operating 'employee shareholder' employment status are estimated to be between £500,000 and £1.25 million
- Small firm impacts: these measures are beneficial and excluding companies with fewer than 20 employees would not achieve the stated policy objective.

The TIINs require policy makers to answer seven basic questions to support the policy change, these are:¹⁷⁴

- What are you doing? *The policy objective.*
- Why are you doing it? *Which of the Government's priorities for the tax system does it support?*
- Why are you doing it this way? *Options appraisal.*
- What will it raise? *The exchequer and any wider economic effect.*
- What will it cost customers? *Not just business and charities but also individuals and households.*
- What will it cost the Public Sector? *Costs/benefits to HMRC or other delivery department.*
- What are the other impacts? *Equalities, small firms, competition, carbon emissions etc.*

4.12.3 Methodological issues

This new Tax Impact Assessment process does not offer a consolidated approach or guidelines as such. Rather, it is a collection of supporting documents that describes the policy change.¹⁷⁵ The data collection method is a mix of consultation and stakeholder engagement to inform and test their understanding of the impacts of a proposed change in policy. This process provides indications of expected impacts and overall estimates given by expert assessments. The model can therefore be a useful summary of the overall impacts.

4.13 Bureaucracy Cost Index (Bürokratiekostenindex /BKI)

Table 12: Requirements fulfilled by the BKI

	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence
12. BKI	-	(✓)	-	✓	(✓)	(✓)	✓

¹⁷⁴ Interview with HMRC.

¹⁷⁵ Interview with HMRC.



4.13.1 Methodological characteristics

The Bureaucracy Cost Index was introduced by the German Federal Government in the beginning of 2012 and it takes the bureaucracy costs on January 1, 2012 as a starting point. It has been decided to do so in order to maintain the comparatively low level of administrative burdens reached by the end of 2011 and to measure future developments against this benchmark. The BKI aims to assess the actual costs (ex-post) relative to a baseline measurement of administrative burdens in 2012, and hence **no estimation of costs related to proposed legislation (ex-ante)**. The index constitutes an important element of the Federal Government's "Programme for bureaucracy reduction and better legislation" in Germany and it builds on the German SCM.¹⁷⁶

The Bureaucracy Cost Index shows the development of bureaucracy costs endured by businesses in Germany. Bureaucracy costs are defined as burdens sustained by businesses when complying with legislative requirements of acquiring, transmitting or keeping data or other information. Examples for these legislative requirements include documentary and reporting requirements.

This definition of bureaucracy costs matches the definition of administrative costs outlined in the German Guidelines on the Identification and Presentation of Compliance Costs.¹⁷⁷ It is therefore assumed that the terms "bureaucracy costs" and "administrative costs" can be used interchangeably.

Box 13: Cost types as defined by the BKI

Bureaucracy costs are the costs resulting from compliance with information obligations

As the index builds on the SCM, it is **possible to apply the index across countries** as long as it is kept in mind that definitions need to be adapted and the application of the SCM is unified across countries. However, as the BKI is recently developed, it has not been adopted in any other Member State yet. The index also **includes all types of taxes and potentially legislation** and is not restricted to a subset of business sizes or sectors. It should be emphasised that the index only produces one overall figure for all kinds of businesses. Subsequently, the index does **not allow differentiating for SMEs**, specific business sectors or other segmentation groups. **Cross-border transaction could potentially be taken into account** and depends entirely on the SCM baseline.

The bureaucracy cost index shows a decrease or increase of bureaucracy costs endured by businesses, depending on whether the Federal Government decides on policies to relieve businesses from bureaucracy costs or on policies which further increase these costs.¹⁷⁸

4.13.2 Application of the methodology

The Bureaucracy Cost Index is **assessed on a monthly basis** by the German Statistical Office and the results are published on its homepage.¹⁷⁹ There has been a slight increase

¹⁷⁶ Standardkosten-Modell (SKM)

¹⁷⁷ Refer to definition of "administrative costs" in: Federal Statistical Office, Destatis (2011): Guidelines, p.10.

¹⁷⁸ Destatis (2013): Bürokratiekostenindex, <https://www.destatis.de/DE/ZahlenFakten/Indikatoren/Buerokratiekosten/Ergebnisse/Buerokratiekostenindex/Buerokratiekostenindex.html>, retrieved 2013-09-02.

¹⁷⁹ Die Bundesregierung (2012): Bürokratiekosten eingeführt, <http://www.bundesregierung.de/Content/DE/Artikel/2012/12/2012-12-11-bki.html>, retrieved 2013-09-02.



of bureaucracy costs during 2013 compared to the beginning of January 2012. The latest value from July 2013 for example is 100.32, which means that bureaucracy costs have increased by 0.32% compared to the beginning of 2012. Subsequently, the baseline administrative burden from 1 January 2012, which was 40.343.579 EUR, currently amounts to 40.472.680 EUR for businesses.¹⁸⁰

4.13.3 Methodological issues

The index is based on data retrieved from the WebSKM Database¹⁸¹ administered by the German Federal Statistical Office and works as follows. The bureaucracy costs endured by businesses as of 1 January, 2012 are taken as a starting point and they are assigned the value of 100. In order to assess whether decisions taken by the Federal Government have increased or decreased the bureaucracy costs, the Actual Administrative Burden at one point in time is divided by the Administrative Burden on 1 January, 2012. The resulting number is then multiplied by 100. A resulting value of 102 at one point in time for example means that the bureaucratic costs have increased by 2% compared to January 1, 2012. A value of 99 expresses a decrease by 1% since the beginning of 2012.

The index itself is simple. However, SCM-based administrative burden measurements have to be updated and carried out every month to feed the model, which involves time and efforts. The challenges are not related to the simple index; rather the underlying measurements calculated using the SCM. As these challenges have already been outlined in section 4.2.3 they are not further addressed in this section.

¹⁸⁰ The results can be retrieved from this homepage: Destatis (2013): <https://www.destatis.de/DE/ZahlenFakten/Indikatoren/Buerokratiekosten/Ergebnisse/Buerokratiekostenindex/Tabellen.html>, retrieved 2013-09-02.

¹⁸¹ WebSKM, <https://www-skm.destatis.de/webskm/online>, retrieved 2013-09-02.



5. Comparison of methodologies and suggestions for improvement

In this chapter we build on the description made in the previous one to compare the various methodologies, trying to identify which one could be used as a possible complement or even alternative to EU SCM for impact assessment and to the PwC/Paying Taxes for use in the Tax Reforms Report. We also advance some suggestions on how methodologies can be improved to better fit the requirements of DG TAXUD.

5.1 Assessment of the suitability of the methodologies

1. Supporting Impact Assessments

A suitable methodology at the EU level should be able to measure the impacts and consequences of proposed initiatives, and it is therefore relevant to discuss which methodologies are able to accommodate this key requirement.

The IRS methodologies are able to carry out "what-if" simulations of policy changes and predict the burden effect based on a number of business characteristics. However, we consider that these methodologies are not the most appropriate for supporting IAs, as these models are not able to isolate specific legislative articles. Contrary, SIROCCO, the Regulatory Check-up, the German Guidelines and the CAR-methodology are all able to support IAs as they can be used to measure ex-ante tax compliance costs for new proposals, down to specific legislation.

The Tax Information and Impact Notes (TIINs) are developed specifically for supporting IAs. Moreover, this methodology looks at impacts of policy change of various stakeholders (the economy, individual, businesses, etc.) and addresses the costs of specific legislative changes. Taking into account how different stakeholders will be affected by new proposals is an important aspect of the IA process.

The remaining methodologies are used for ex-post measurements. This is the case with the Swedish TCR approach and the UK TCS model. The BKI aims to assess the actual costs relative to a baseline measurement of administrative burdens in 2012, and hence does not estimate the costs related to proposed legislation. Finally, the UK Complexity Index ranks all of the existing tax legislation by degree of complexity. It gives an indication of the level of complexity of a particular legislation yet in our understanding it cannot in its current form be used to produce cost estimates for either proposed or existing legislation.

Summing up

In addition to the EU SCM, the methodologies that are able to support IAs and measure proposed legislation are: SIROCCO, the Regulatory Check-up, German Guidelines, the CAR-methodology and the TIINs.

2. Cross-country comparison of tax systems' compliance costs

Paying Taxes is used by PwC/World Bank to assess the compliance costs (expressed in time, as clarified in chapter 4) of 189 economies worldwide, including all EU Member States. The total time to comply indicator has been included in the publication "Tax



Reforms in EU Member States” since its 2011 edition. DG ECFIN and DG TAXUD have used it, together with other indicators, to examine whether Member States face challenges regarding tax compliance and tax administration.

In principle, all methodologies could be used – if duly fine-tuned - to measure the costs of entire tax systems: after all, tax systems are collection of pieces of tax rules and legislations, the basis unit of analysis of most methodologies. Yet, many seem too fine-grained to allow for a “macro” level estimate of tax systems’ compliance costs.

Using the EU SCM to measure the costs of VAT “only” for 6 Member States resulted in 2009 in a very extensive study: we assume that adopting the same methodology for entire tax systems with tens if not more pieces of legislation would be very time consuming and costly.

The same can be said of other methodologies, with the partial exemption of the BKI which, resulting in a simple index, could potentially be used for getting a snapshot of tax systems’ compliance costs assuming that baseline measurements are available.

Summing up

Most of the methodologies under scrutiny are in principle capable of carrying out cross-country comparisons; however, all the methodologies would need to be modified and adapted to accommodate cross-country comparison. The complexity and costs of using fine-grained methodologies to estimate entire tax systems’ compliance costs should not be underestimated. The only methodology that is suited in the current setting is *Paying Taxes* due to various measures taken to ensure consistency and comparability (one body approach, internal training, etc.)

3. Cross-border transactions

Anecdotes and evidence show that doing business across borders is particularly “costly” – quite obviously: businesses have to deal with more than one jurisdiction’s tax rules in the absence of harmonisation.

The IRS methodologies can control for key firm characteristics (e.g. business size, organisation type, industrial sector, etc.). However, cross-border transactions are not one of the current control variables included today, although this could be incorporated in the methodologies’ specifications. SIROCCO is able to take into account cross-border transactions in its current setting. In the Guidelines cross-border transactions are not mentioned, however, as this methodology builds on the SCM, it is expected that it is possible to do so. For the Regulatory Check-up model, it remains unclear whether the model accounts for cross-border transactions.

Paying Taxes excludes the cross-border aspect in its model company. The CAR-methodology could potentially account for it by choosing a representative business which is engaged in cross-border transactions. The TCR has also taken cross-border transaction into consideration in their approach, by including real businesses involved in import/export.



The Complexity Index may take cross-border transactions into account. However, it is sound to assume that this index is not the most suited for this, as it does not estimate TCC. Due to limited information available for the TCS and the TIINs, no information on cross-border transactions is available. As a consequence, it is unclear whether these two models fulfil this requirement. Finally, the BKI relies on SCM measurements, which are able to take cross-border transactions into account. Nevertheless, as it remains uncertain what is actually included in the baseline of the German index (SCM January 2012); it is not clear whether cross-border transactions are included in the current setting.

Summing up

In the current setting, it appears that the most suited methodologies for taking cross-border transactions into account are – in addition to the EU SCM – SIROCCO, CAR as well as the TCR.

4. Measurement of tax compliance costs originating from EU legislation

DG TAXUD is interested in a methodology which can be used to estimate the impact of tax-related proposals at the EU level on tax compliance costs in order to assess whether a new proposal leads to more or less compliance costs compared with the current situation.

In principle, the compliance costs of EU-level proposals can be measured as that of any other piece of regulation. So, for instance, we assume that the IRS methodologies, which are used currently to measure the compliance costs of the US federal tax system, could be applied in an EU context, with some adaptations.

In addition, we do not see any issue with using SIROCCO, the Regulatory Check-up, the German Guidelines (although focusing on federal legislation), the CAR-methodology and the Swedish TCR for measuring the effect of EU rules on tax compliance costs.

For approaches which are not yet fully consolidated, it is not as obvious whether EU legislation could be taken into account. Likely, the UK Complexity Index could be used to tank the complexity of EU rules. The TCS model focuses on quantifying costs that actually arise when the customer experience (for businesses or individuals) is probably not 'ideal', hence it is assumed this could be related to any legislative process, national or EU-related. The TIINs look at impacts of tax policy changes. This is also considered to apply to any legislation, regardless of the origin. Ultimately, the BKI is able to take EU legislation into account. However, it is unclear whether this aspect is included in the baseline. Finally, *Paying Taxes* looks at national legislation and EU legislation to the extent that it has been transposed in national rules.

Summing up

Several of the methodologies are able to accommodate this requirement, although it remains uncertain for a few, due to limited information and work in progress. What is certain, though, is that the EU SCM, SIROCCO, the Regulatory Check-up, the Guidelines, the TCR and the CAR-methodology have incorporated this feature.



5. Segmentation

Evidence shows that tax compliance costs are proportionally higher for SMEs, and that, in general, different processes to comply (e.g. small vs. large business, outsourcing vs. in-house, electronic filing vs. manual filing) affect the level of compliance costs. In order to account for these differences, a suitable methodology therefore needs to be able to differentiate between these processes.

Many of the methodologies under scrutiny are not restricted to a certain business size or sector and are applicable to all of them. However, some of the methodologies are not able to differentiate between them (e.g. focus on SMEs).

The first IRS methodology (ITBM) was only able to account for individuals. Later, the methodology was extended to address small businesses (SBBM), and today the BTBM is able to take all businesses into account. In addition, the methodology is able to control for business characteristics like size, sector, etc., which renders this methodology suitable for segmentation. The same applies to the SCM-based methodologies such as SIROCCO, the Regulatory Check-up model, the German Guidelines and the CAR-methodology. Also the TCR is accommodating this requirement and has, for instance, been used to carry out measurements of real companies of different sizes and sectors. The TIINs are also capable of focusing on impacts of SMEs.¹⁸²

Paying Taxes, on the other hand, provides a very specific framework using a model company. Hence, it is not possible to distinguish between different business sizes and sectors. The UK Complexity Index is also not suited for this purpose, as it cannot measure tax compliance costs of any business or individual in its current setting. Finally, the TCS and the BKI are both able to take all types of businesses, sizes and sectors into account. However, they are not suited to differentiate the results depending on the business size. The TCS looks at the experience of businesses or individuals in a broad sense; it is therefore not able to differentiate either business size or sector. Finally, the BKI with its SCM fundament can take all business sizes and sectors into account. However, the index is only carried out on an overall basis (producing only one overall figure); it can therefore not differentiate between different types of businesses (sizes and sectors).

Summing up

The methodologies which fulfil this requirement are the IRS BTBM methodology, SIROCCO, the Regulatory Check-up model, the Guidelines, the CAR-methodology, the TCR and the TIINs.

6. Operational flexibility

Ideally, a methodology for measuring tax compliance costs should be flexible enough to accommodate the compliance costs of several different taxes and be as comprehensive as possible.

The vast majority of the methodologies are not "tax specific" and can cover the tax compliance costs of different categories of taxes. As an example, the CAR-methodology examines the impact of regulations, irrespective of area of legislation, and the Complexity

¹⁸² cf. TIIN, 16 July 2013 – Employee shareholder status: Capital gains tax exemption and income tax/NICs treatment, outlined in section 4.12.2



Index provides an indication of which areas of tax legislation are considered particularly complex compared to others, hence all taxes are taken into account.

Paying Taxes, however, focuses on VAT, CIT and labour taxes.

Summing up

This requirement is almost satisfied by all the methodologies in the current setting, apart from *Paying Taxes*, which addresses VAT, CIT and SSC. The restrictions of *Paying Taxes* in this respect are, however, considered to be relatively easy to overcome if adapted accordingly.

7. Recurrence

Tax rules change frequently. An important requirement for assessing tax compliance costs methodologies is that they can be used frequently (annually) to see the impact of changes on tax compliance burden.

In practice, we see that not all methodologies are used regularly. Whereas the majority of methodologies are able to be applied on a regular basis, this rarely occurs in practice.

In the US, the Individual Taxpayer Burden Survey is conducted annually whereas the Business Taxpayer Burden Survey is conducted once every three years.

The EU SCM is widely applied in Member States today but recurrence of measurements is highly dependent on the individual Member States. Whereas Denmark and Sweden have been very active in using the SCM on an annual basis; other Member States have applied the SCM less frequently.

The Swedish TCR approach has only been applied in Sweden in 2005 and 2008 and no further measurements using this approach are intended.

The German ex-ante assessments are carried out for every new legislative proposal. Ex-post validations are conducted by the Federal Statistical Office every two years.

In Switzerland, the first round of ex-post measurements is on-going. Similar to the German case, ex-ante assessments on the impacts of a new piece of legislation have to be conducted when more than 10.000 businesses are affected by the policy change.

The CAR-methodology has only been applied to a few pilot studies, but findings from the interview show that measurements are not time-consuming. However, it remains to be seen whether measurements will be conducted on a recurrent basis in the future.

The frequency of recurrence of the UK Complexity Index remains unclear, though a new version of the Index is currently underway.

Paying Taxes and the new BKI both provide updated figures on an annual and monthly basis, respectively. *Paying Taxes* is the only methodology which has consistently been providing updated figures for various economies (since 2003). The BKI is relatively new and has been providing monthly updates in Germany since January 2012.



Finally, the TCS and TIINs are not as suited for providing figures on a regular basis, as the TCS model addresses specific customer experience on a case-by-case basis, and the TIINs summarise the impacts of a policy change at a certain point in time.

Summing up

Paying Taxes is used in a yearly survey. Also the BKI is used to deliver frequent updates. That being said, most of the methodologies are in principle able to provide updated figures on a regular basis.



Table 13: Suitability of methodologies

Methodology	Requirement I (Supporting IA) Methodology used today: EU SCM					Requirement II (Comparability) Methodology used today: Paying Taxes		Type of costs
	Support IA	Cross-border transactions	Segmentation (SMEs)	Include all taxes	EU Legislation	Cross-country comparability (Consistency)	Recurrence	
1. IRS	✓	-	✓	-	-	-	(✓)	Admin burden + substantive costs
1. Swedish TCR	-	✓	✓	✓	✓	-	-	Admin burden + substantive costs
3. SIROCCO	✓	✓	✓	✓	✓	(✓)	✓	Substantive costs
4. Regulatory Check-up	✓	*	✓	✓	✓	-	✓	Admin burden + substantive costs
5. German Guidelines	✓	*	✓	✓	✓	-	✓	Admin burden + substantive costs
6. CAR	✓	✓	✓	✓	✓	(✓)	(✓)	Admin burden + substantive costs
7. Complexity index	-	*	-	✓	*	-	(✓)	Admin burden + substantive costs
8. TCS	-	*	-	✓	*	-	-	Admin burden +
9. TIINs	✓	*	✓	✓	*	-	-	Admin burden +
10. BKI	-	(✓)	-	✓	(✓)	(✓)	✓	Admin burden

*Indicates no information.

Yes suitable: ✓, Not suitable: -, Partly suitable, but issues:(✓)



5.2 Assessment of the accuracy of the methodological measurements

The suitability and quality of the results also depend on accuracy – i.e. how well the methodology provides results that reflect the real costs for businesses to comply with tax regulations.

The IRS methodologies explain roughly half of the variation in reported compliance. Another challenge regarding accuracy concerns the separation of costs. Respondents should only report the time and out-of-pocket costs associated with their federal income tax return. However, this has proven difficult for businesses. The IRS confronted the challenge by instructing taxpayers on the questionnaire to consider which activities are parts of the IRS' definition of Federal tax compliance. In addition, the representativeness of the surveys remains an issue as the response rate, particularly for SMEs, is lower than for other business sizes.

The Regulatory Check-up, the Guidelines and the BKI are simplified measurement approaches. Due to their general working assumptions (similar to the EU SCM) of a *normally efficient* business and the *full compliance principle*, they are based on a standardisation of the time and money spent performing each activity. SIROCCO aims to reflect actual compliance costs more accurately by not assuming full compliance by default.

The TCR reflects relatively accurately the real costs of the six case study businesses due to various measures to improve accuracy. Although the TCR is promising in terms of accuracy, its objective is to give a picture of the regulatory costs faced by real businesses in Sweden. In addition, the survey approach may also face some issues related to the representativeness of the selected companies, as companies were required to show sensitive information such as tax numbers.

The CAR-methodology also aims to reflect the actual costs of an existing business. Contrary to the SCM, it does not rely on assumptions and no extrapolation is carried out. In addition, it is mainly experts who separate regular business expenses and burdens by consulting the accounting books of the representative business. This is considered to be more accurate than relying on business interviews only. However, the fact that only one business is chosen and the selection criteria are not clearly may reduce accuracy.

The *Paying Taxes* methodology bases its measurements on a standardised business. As *Paying Taxes* estimates the costs of a fictive company, and assumes norm adherence (in other words full compliance of businesses), the methodology skews somewhat the results from the real costs.

The accuracy of the Complexity Index is expected to be rather low as it relies on a number of subjective criteria which do not produce accurate estimates. Estimates of tax compliance costs might end up being appropriate and only give an indication of the cost level, scaled from low/medium/high cost to taxpayers.

The accuracy of the TCS and the TIINs might be limited due to their case-by-case approach. No manual exists and it remains unknown how measurements are exactly conducted in the TCS model. The TIINs rely on consultations and stakeholder engagement to inform and test their understanding of the impacts of a proposed change



in policy. Measurements are not considered to reflect the actual costs, as only indications of the expected impacts are given.

Summing up

The two methodologies which appear to provide the most accurate measurements are the TCR approach and the CAR-methodology which both rely on actual costs of existing businesses.

5.3 Assessment of the costs of the methodologies

In general, tax compliance costs studies do not explicitly state the costs involved in carrying out the measurements. However, through in-depth interviews and input from experts, it has been possible to either give an estimate of the cost level or an indication of the costs or time involved with measurements. Below a few numbers and indications of the main cost elements related to the various methodologies are given:

- The US IRS methodologies rely on surveys conducted among a large population, typically a sample of 20.000. Survey costs include survey contractor support (such as creating or modifying the survey instrument, data collection, and data analysis), printing and mailing the survey packets, and follow-up contacts. According to the US IRS, annual costs of these cross-sectional studies tend to decrease once the materials have been developed and fielded successfully. This is due to the IRS having built controlled experiments into their survey protocols allowing them to improve the efficiency of data collection while maintaining comparability across surveys.¹⁸³
- Denmark: TER (Team Effective Regulation) conducts 10-20 ex-ante SCM measurements today. TER consists of sixteen employees of whom approximately half are involved in measurements, among other related things in the team. An ex-ante SCM measurement costs approximately 100.000 – 200.000 DKK.¹⁸⁴
- Sweden: The case-based survey approach named *Total Cost of Regulations to Businesses in Sweden* involved six real case companies who were interviewed for three to four hours in 2005 and again in the follow up survey in 2008. A team of two internal experts from NNR did the subsequent interviews both years. The costs per case company in 2005 were approximately 15.000 EUR. The second survey in 2008 was 5.000 – 6.000 EUR per case company. These cost figures did not include the costs of the internal experts of NNR, as they were unpaid.¹⁸⁵
- UK: In the UK, HMRC is the governmental body in charge of measurements. HMRC has around 2.5 employees dedicated full-time to calculating administrative burdens and coordinating work on impact assessments, and about the same number (annually) working up estimates of administrative burden changes relating to policy and/or operational initiatives. In addition, the department spends

¹⁸³ Input from the US IRS.

¹⁸⁴ Interview with the Danish Business Authority.

¹⁸⁵ Interview with NNR (Swedish Better Regulation Council).



£100.000 – 200.000 annually, working on estimates and keeping the SCM model up-to-date.¹⁸⁶

- The Netherlands: The cost of carrying out a zero base SCM measurement of tax compliance costs is considered to amount to 500.000 EUR (possibly higher). This includes 15-16 taxes, calling and consulting businesses, and it takes approximately half a year (depending on the complexity).¹⁸⁷
- Switzerland: For Switzerland, cost estimates are not available
- Germany: The costs are not assessed. However, in the interview it was indicated that ex-ante measurements are considered considerably less expensive than ex-post, mostly due to the fact that they are less time-consuming.
- Paying Taxes: Information about the costs of applying *Paying Taxes* is not disclosed by the IFC and the World Bank in the annual reports. The data collection technique relies on experts of the 189 different jurisdictions for which data are computed. The cost number of this enormous exercise across 189 economies is not measured as a whole. However, the staff effort is considerable and requires the input of the World Bank, PwC and the other contributors. Three people from the World Bank are occupied full time with *Paying Taxes* throughout the year (one assistant and two experts). Above that, an overall manager is spending some time on all the Doing Business Indicators, of which *Paying Taxes* is one among ten others. Within PwC a team of five is working for six months of the year on the basic output and on the analysis of the *Paying Taxes* publication which is produced jointly with the World Bank. In addition, PwC has offices in over 160 economies in which internal experts in each location take part in completing the questionnaire. PwC also provides internal training of their local experts and every year a guidance note is sent out to everyone taking part in the measurements. Furthermore, PwC do global conference calls with contributors regarding the methodology and final results.¹⁸⁸
- CAR-methodology: The cost of conducting measurements using this new methodology remains uncertain. However, according to SIRA Consulting, the pilot study on SME bakeries in four Member States was not considered a time-consuming or costly exercise. In total, SIRA spent 5 days per bakery to carry out measurements. However, concern has been expressed by delegates at a workshop in 2012, questioning that this new methodology may be expensive and/or difficult to implement.¹⁸⁹

¹⁸⁶ Interview with HMRC.

¹⁸⁷ Interview with the Ministry of Finance, the Netherlands.

¹⁸⁸ Interview with PwC.

¹⁸⁹ New Dutch methodology to reduce regulatory costs, 23 November 2012; <http://regplus.blogspot.dk/2012/11/new-dutch-methodology-to-reduce.html>.



Summing up

Large scale surveys tend to be time-consuming, but not necessarily costly. Applying a real business approach like the Swedish TCR and the CAR-methodology is less time-consuming but may be expensive. According to the experts behind the TCR, the approach was costly. However, this perception is quite different from the one for the CAR, which was not considered to be expensive nor time-consuming. In addition, ex-ante measurements are found to be less time-consuming and costly than ex-post.

5.4 Assessment of the impacts of the methodologies

The implications of applying the different methodologies are difficult to assess. Usability is a proxy for the ability of the methodologies to provide input to decision-makers that can be used (and has been used) to improve legislation, costs and/or administration thereof.

In general, the impacts of the various methodologies appear to be increased awareness and discussion at the political level. The impacts of the results of e.g. the Swedish Total Costs of Regulations survey was a discussion at the general political level in 2005. The purpose of the survey approach was to highlight the need for a more inclusive view of tax compliance costs, taking into account more aspects than administrative burden only. This was achieved and a movement towards a broader cost scope was observed, not only in Sweden.

The results of the IRS methodologies serve several important goals, as outlined in section 4.4.2, and provide policy makers with important feedback. The models, for instance, provide data for micro-simulation models that estimate the impact of proposed legislation (ex-ante IA) in taxpayer burden before the legislation's authorisation. In addition, for fiscal year 2013 the models were used to identify 30 million hours in burden reduction initiatives. The opportunities identified have now all either been implemented or are in process of being implemented.¹⁹⁰

A methodology which offers one of the most consolidated approaches is the World Bank's *Paying Taxes*. The results of *Paying Taxes* are widely used, especially by national governments. A few examples are outlined below:¹⁹¹

- *Paying Taxes* have been used by DG ECFIN / DG TAXUD in their annual Tax Reforms in EU Member States report in 2011, 2012 and 2013;
- The Netherlands:
Various reforms have been introduced to improve the ranking of the country in *Paying Taxes*;
- Malaysia:
The Malaysian government created a department specifically monitoring the *Doing Business* indicators, which include the *Paying Taxes* indicators, in order to improve the tax system;

¹⁹⁰ Input from the US IRS.

¹⁹¹ Examples given by interview with PwC



- The US:
Some researchers in the US studied the impact of CIT on entrepreneurs by taking the basic results of *Paying Taxes* and correlating them with other economic indicators.

Summing up

The methodologies have all served public authorities which use the results to identify and reduce tax compliance costs. Particularly results of *Paying Taxes* are widely used across countries for benchmarking business environments and monitor progress. In addition, SCM measurements have been widely used (domestically) to meet reduction targets.

5.5 Conclusion

There are several methodologies for calculating tax compliance costs, each with respective advantages and disadvantages. The methodologies are different in what costs they include and how measurements are carried out. Several methodologies employ a common baseline while trying to address the deficiencies of previous iterations. Accordingly they share common features.

In addition, a shift of the purpose of the methodologies measuring tax compliance costs has also been observed over time. The initial purpose and focus was the measurement of existing tax compliance costs (ex-post). Contemporary focuses have shifted to the prevention of new burdens, by assessing the effects of new proposed legislation (ex-ante) on the compliance costs endured by businesses.

In order to decide on the most suited methodology it is therefore crucial to keep in mind the purpose it is supposed to fulfil.

Based on the assessment of the methodologies, it was found that the IRS methodologies, SIROCCO, the Regulatory Check-up, the Guidelines, the CAR-methodology and the TIINs could potentially serve in an Impact Assessment (they are all suited for ex-ante assessments in their current contexts), and be used as an alternative to the EU SCM. However, if we take into account other requirements, the conclusion can be further narrowed. Two methodologies fulfil the same number of requirements (cf. **Error! Reference source not found.**); SIROCCO and CAR (and EU SCM as “baseline” methodology).

However, SIROCCO is considered less suited as it focuses on substantive compliance costs, which have been found to be less significant in the tax area. Several experts consider it sufficient to look at information obligations as the vast majority of all tax compliance costs will be covered by these obligations. Additionally, it has proven difficult to identify potential cost reductions, as many substantive obligations (e.g. investments) are often considered business-as-usual costs. SIROCCO looks at more than administrative burdens (information obligations), which faces the challenge of including business-as-usual costs.

CAR offers a promising new approach. However, it has only been tested in a few pilot studies, nor is there a published manual yet.



Overall, we therefore conclude that the EU SCM remains the best suited methodology for IAs.

Concerning comparison of tax systems' compliance costs we confirm that *Paying Taxes* offers the best suited methodology in light of its consistency, simplicity and frequency of updates. This methodology is the only one providing updates annually for various countries.

We consider, however, that both the EU SCM and *Paying Taxes* could potentially benefit from being adapted to fit the other requirements considered important by DG TAXUD. In the following section we recommend how to do it.

5.6 How to improve EU SCM and Paying Taxes: some suggestions

Based on our assessment, we have identified some potential areas for improvements of the EU SCM and *Paying Taxes*, in addition to some general features considered important for a "suitable" methodology for calculating tax compliance costs.

A good methodology should be flexible enough as to be useful to measure the compliance costs of any tax. However, evidence shows that also when it comes to measuring tax compliance costs the 80/20 principle seems to apply: it is sufficient to focus on key taxes (VAT, CIT and labour taxes) to cover the greatest part of compliance costs for businesses.

Another finding is related to the data sources used for a good methodology. Typically, measurements are carried out using surveys, business interviews or expert assessments as sources. Tax practitioners consider surveys less suitable for a number of reasons e.g. typically low response rate and response biases (SMEs tend to be underrepresented). Moreover, small businesses in Europe tend to outsource tax compliance procedures. This implies that accountants are more knowledgeable than small businesses themselves when it comes to tax compliance costs. Another argument is the fact that they are typically very time-consuming, which has been observed for e.g. the US IRS methodologies. Moreover, considering that SMEs are especially important for the European economy, it has to be borne in mind that experience has shown that it is difficult to ensure participation of small businesses in interviews. In order to account for their perspective as well, **a good methodology may therefore primarily rely on expert assessments.**

As briefly mentioned in the conclusion, a shift in measurements from ex-post to ex-ante has been observed. Today, tax policy makers are concerned about preventing new burdens and interested in receiving results on expected burdens before they introduce new legislation in order to make informed decisions. Experts have indicated that ex-post measurements and the original SCM baseline measurements are very costly and time-consuming. It has for instance taken approximately two years to carry out measurements in 15 legislative areas in Switzerland, which is a cost-intensive exercise. HMRC support this argument and express the need for austerity in times of economic hardship. As a consequence, governments cannot spend, or are not willing to spend, the same amount of money on measurements again. There is therefore a need for cheaper and less time-consuming measurements.

Finally, the most important aspect is the purpose of the methodology and the level of detail required. Considering that there is a need for a methodology that is suited for



Impact Assessments and one that is capable of providing comparable indicators across EU Member States on an annual basis, the EU SCM and *Paying Taxes* remain the most suitable ones. However, by further developing both methodologies, they could potentially fulfil a larger number of the DG TAXUD requirements and become even more suited for use in the EU context.

5.6.1 EU SCM

We think that there is scope to improve the flexibility of the EU SCM. We learned from our interviews, survey and review of the literature that it has proven difficult to assess what (precisely) countries measure, as they are not consistent in their definitions of e.g. the population, what kind of costs to include, what overheads to include, how to carry out measurements and so forth. One common source of confusion is the interpretation of an information obligation. Although the definition of the term is unified, it is not clear whether countries include both producing, documenting and reporting that you comply with the obligation. In addition, the challenge of disentangling business-as-usual costs from administrative burdens remains.

Process maps could be a potential remedy to overcome the abovementioned flexibility issues. A process map for each of the important taxes (e.g. VAT, CIT, and labour taxes) could be developed. In order to give the Member States a clear indication of the boundaries of what to include in the measurements, the process maps should address two key elements.

First, it is important to clearly outline what to include in the **tax obligations**. The idea is to find a common ground across EU 28 and to ensure that the countries, as a minimum, include the obligations outlined in the process maps. This will help overcome the potential challenge of demarcation, e.g. towards bookkeeping and company law.

Second, the **process maps** should include a clear description of the typical activities undertaken for the tax obligation. The present activity level offered in the EU Impact Assessment Guidelines include 14 standard activities/actions, of which the main required activities are familiarising with the information obligation, retrieving relevant information from existing data, designing information material, copying, filing and submitting the information.¹⁹² We suggest adding an additional level in the process maps, which more specifically describes and clarifies how to interpret the activities, thus what to include and what not to include.

In addition, the process maps should clearly state how the obligations and activities should be interpreted. By being very clear about what elements to include in the standard application process, overlapping and double counting should be kept at a minimum and measurements are expected to become more transparent and comparable.

The suggestion of process maps corresponds to *Paying Taxes*' guidance notes, which are distributed (internally), to all the contributors, in order to increase consistency and minimise misunderstandings.

In addition to process maps, the EU SCM may have to become more standardised in other areas in order to reduce country differences to the largest extent possible. Today users in several Member States differentiate between business size, sector, outsourcing, etc. The

¹⁹² European Commission (2009a): Part III: Annexes to Impact Assessment Guidelines: p.51 and p.60.



SCM must ensure that the categorisations of groups are unified across the EU e.g. definition of business sizes (applying standardised definitions, if any).

Further research related to the adaptations of the EU SCM could consist of gathering the information needed for the process maps. In order to produce one for each main tax, research about common denominators (and main differences) for each Member States' tax area would have to be carried out.

5.6.2 Paying Taxes

The strength of *Paying Taxes* lies in its simplicity, its one-body approach and its proactive measures taken to ensure consistency (guidance notes, internal training, expertise, etc.). The central coordination is a key strength of the methodology, which at the same time has gained wide acceptance, trust and participation due to the inclusion of national experts.

Paying Taxes could potentially benefit from broadening the concept of the model company, in order to better suit the European context. In its current setting the model company is not engaged in cross-border transactions. However, this is a key aspect within the EU, as the methodology should be able to capture the costs of complying with different tax laws in particular when doing business in the Internal Market.

The model company could benefit from an inclusion of cross-border transactions costs, VAT in particular, which has been identified as a major source of compliance costs.

Moreover, the current model company is a fictive company which might not be entirely representative for businesses in Europe. As a consequence, the revision and adaptation of the **model company to characteristics of European companies** would be an improvement. Either it could be suggested that the methodology sticks to one model company (e.g. one that engages in cross-border transactions) and uses a typical small business in the EU (in order to keep a focus on SMEs) or the methodology could be further expanded to include more than one model company. As tax systems in the EU are different and processes vary, tax compliance costs imposed on different kinds of businesses differ as well. In order to account for this, more case studies could be included. Suggestions for some of the different aspects that could be captured include: different procedures for small and big companies, different business entities, whether businesses file online or manually, whether they outsource tax-related compliance activities to external consultants or keep them in-house, and whether there is only one applicable VAT rate or different ones.

To sum up, there is potential to replicate the advantages of *Paying Taxes* (strength of comparison and consistency), and adapting the model company (potentially including a number of different model companies), which more accurately reflect typical businesses in the context of the Internal Market.

Further research related to the adaptations of *Paying Taxes* would consist of analysing the European businesses and the Member States' tax systems; to find out about typical characteristics of both businesses and tax procedures and to decide on how many and which types of model companies should be included in the methodology.



5.6.3 Further outlook: CAR as a promising new approach

The Cost Driven Approach to Regulatory Burden (CAR) offers promising features to accommodate the IA requirement and appears to provide a suitable complement or even alternative to the EU SCM. The value added of this new methodology is its starting point, the business perspective (actual costs – consulting the representative business' accounting books), and its attempt to shift the task of breaking down costs and separating them from the businesses themselves to experts. However, the CAR-methodology relies on the same core equation as the SCM (apart from the CAR model including more than information obligations) and the two methodologies are assumed to share many of the same methodological challenges of for example disentangling costs, the selection of a representative business and the same issues regarding comparability. In addition, the CAR-methodology does not provide an aggregated number of total regulatory burdens, as extrapolation to the national level is not carried out. Keeping these challenges in mind, the CAR-methodology is considered worthwhile to further look into once a manual has been published and once it has been more widely applied.

In annex A we make a first attempt at giving a closer look at CAR, with a step by step guide to its use modelled on the basis of the SCM step by step guide included in the EC Impact Assessment guidelines annexes.¹⁹³

¹⁹³ http://ec.europa.eu/governance/impact/commission_guidelines/docs/ia_guidelines_annexes_en.pdf



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Annex I: CAR-methodology: Step by step guide

The CAR-methodology focuses on the *Regulatory Burden* (defined by three compliance modes: administrative burdens, compliance costs and inspection costs¹⁹⁴) on businesses resulting from legislation and takes a *Top Sector Approach*. The Dutch government has identified ten business sectors in which the Dutch Economy is most competitive internationally. The Top Ten Sectors are:

- Chemical industry;
- Horticulture;
- Water;
- Agriculture & Food;
- GMO;
- Life sciences & health;
- High tech;
- Energy;
- Logistics;
- Creative industry (design, media & entertainment, fashion, etc.).

The intention of the *Top Sector Approach* is to strengthen the international presence of Dutch companies by, among others, reducing their regulatory burdens and coordinating investment in R&D and innovation. The assessment of the positive or negative effects of regulatory burden on businesses should therefore begin with a sector analysis, followed by the actual business analyses where burdens are quantified. Finally, the CAR-methodology identifies reduction measures which should be implemented in National Better Regulation programmes.

An application of the CAR-methodology can be divided in a number of steps. The entire workflow is summarised in Table 14 below, followed by a description of each step, to the extent possible.

Table 14: Step by step application of the CAR-methodology

	Phase 1: Sector Analysis
Step 1:	Get an overview of all regulations
Step 2:	Identify subsectors
Step 3:	Select a representative company
	Phase 2: Business Analysis
Step 4:	Analyse the selected company and identify the Cost Centres
Step 5:	Analyse the financial and business administration
Step 6:	Quantify Regulatory Burden
Step 7:	Trace Origin of the Regulatory Burden

¹⁹⁴ Administrative burdens are the costs of complying with information obligations; Compliance costs are the costs of complying with legal obligations; Inspection costs are the costs of accommodating government inspections and providing the necessary compliance evidence and/or information: Bex et al. (2013)



Step 8:	Analysis and consolidation of the findings for reporting
Phase 3: Sector Reduction Plan	
Step 9:	Verify quantitative findings
Step 10:	Evaluate the influence of government on the cost structure of businesses in the sector
Step 11:	Tailor reduction measures to the requirements of each (sub)sector
Step 12:	Prioritise reduction measures that directly increase competitiveness, innovation and employment opportunities
Phase 4: Better Regulation Programme	
Step 13:	Evaluate the value of the identified reduction measures for other sectors
Step 14:	Integrate reduction measures in a National Better Regulation programme
Step 15:	Broaden the scope so that other sectors benefit as well

Phase 1: Sector Analysis

Step 1: Get an overview of all regulations

The CAR-methodology starts by choosing a sector to focus on out of the aforementioned Top Ten Sectors. Following this, an inventory of the relevant legislation is made. In order to gather and build this list of relevant legislation, it is necessary to have experts with an accounting background. That being said, it remains unclear how this legislative review process is actually carried out. This list of legislation is important in order to know what to look for when starting the actual business analysis in phase 2.

Example: In the SME bakery pilot study it was estimated that it took two consulting days to list and scan all relevant legislation by the experts.

Source: Interview with SIRA Consulting

Step 2: Identify subsectors

After producing the list of legislation, the structure and the characteristics of the sector are analysed. This includes identifying similarities and differences in potential subsectors. The latter step identifies whether the sector is to be subdivided in subsectors or not (segmentation), depending on whether differences in processes exist within each sector.

Step 3: Select a representative company in a sector or a subsector

A representative business is not identified statistically; rather, a representative business should resemble e.g. 80% of companies in its sector. Selecting one representative business consists of a certain set of qualitative criteria. The Commission's services are asked to use the following two main criteria in the course of selection:

1. A Financially healthy company
2. A company in compliance



In other words, it should be a company of sound behaviour, with no pending compliance-related legal actions or issues, with a track record in the industry (not a new company), and without venture capitalist involvement (no current potential takeover). In addition, it should be a company with broad public familiarity and a respectable technological profile; it should be, in summation, a company to be proud of.¹⁹⁵

Phase 2: Business Analysis

Step 4: Analyse the selected company and identify the Cost Centres

The actual business analysis starts with an analysis of the situation of the selected company as a business case. The aim is to get an understanding of the main characteristics of the business and its structure. This includes describing the Cost Centres which are relevant for identifying the Regulatory Burdens.

Amongst relevant examinations of Cost Centres are: the business' form of ownership, its products and services, its employees, its location, its market penetration and competitive environment, its capital structure, etc.

Although identified Cost Centres depend on the business under review, the same Cost Centres tend to be identified due to a general way of doing bookkeeping across businesses. Cost Centres are, to a large extent, similar due to the use of somewhat standardised accounting systems. Business administrations prepare their accounting books based on "accounting guidance books" for which the same overall type of Cost Centres are commonly employed.

Example: The company costs of the SME bakery pilot study conducted by SIRA consulting consisted of four Cost Centres. These Cost Centres were selected after an analysis of the business structure:

1. Management and Bookkeeping (indirect costs)
2. Maintenance and Repair (indirect costs)
3. Production (direct costs)
4. Sales (direct costs)

The cost of *Production* is directly related to the production of goods and is therefore classified as direct costs. *Sales* are costs related to the bakery shops where the product is delivered to the customers and where approximately 90% of company turnover is generated.

Source: Bex et al. (2013): p.12

Main activities in each Cost Centre as well as the type of costs associated with those activities (direct costs and indirect costs) should be outlined in a schematic overview.

Step 5: Analyse the financial and business administration

By examining the annual accounts and using a step-down allocation of costs, an analysis develops from a clear understanding and visibility of the business' turnover, its profitability, its material costs, and its production costs. On the basis of production costs, material costs and turnover, Earnings Before Interest and Taxes (EBIT) is calculated. Finally, all numbers are converted to percentages.

¹⁹⁵ Interview with SIRA Consulting.



Example: The data provided by the SME bakeries in the pilot study conducted by SIRA Consulting was Turnover, Material Costs, Production Costs and EBIT. The Cost structure of the SME bakeries consisted of a simplified framework:

1. Turnover minus Company Costs is the EBIT
2. The Company Costs are subdivided in:
 - a. Material costs (e.g. flour, butter, eggs and other ingredients)
 - b. Production costs
3. Production costs are subdivided in two different types of costs:
 - a. Other costs (e.g. personnel costs, rent, energy, waste, water, amortisation, equipment)
 - b. Regulatory Burden (i.e. Administrative Burdens, Compliance Costs and Inspection Costs)

Material costs are never considered a Regulatory Burden, but instead a Regular Business Expense. *Other costs* denote a combination of Regulatory Burdens and Regular Business Expenses.

Source: Bex et al. (2013): p.13 and input from interview

Step 6: Quantify Regulatory Burden

This step involves measuring the costs of legal obligations in each of the Cost Centres and expressing these costs as percentage of non-personnel and personnel costs. Moreover, this step involves an assessment of whether these costs are seen as a regulatory burden or a regular business expense:

1. Non-personnel costs that are regular Business Expenses
2. Non-personnel costs that are Regulatory Burdens
3. Personnel costs that are Regulatory Burdens
4. Personnel costs that are regular Business Expenses

The task of separating regular business expenses from regulatory burdens should be performed by an expert with insight and expertise in the accounting area, as this may be rather complex.

Example: The strategy used by SIRA Consulting in the SME bakery pilot study to disentangle Regular business expenses from Regulatory Burdens was to go through the accounting books and decide whether costs were identified as burdens or not. This task was performed by jointly asking businesses where a certain bill was stemming from. If the business responded that it was from e.g. investigations every year, then SIRA Consulting identified this cost as a Regulatory Burden for the business. In more complex situations, where this estimation was not straightforward and the allocation between legal obligation and business expense was not clear, SIRA Consulting was careful with overestimating Regulatory Burdens. If any doubt as to the allocation of these costs, then they were not taken into consideration, as the CAR-methodology aims at including and discussing only the Regulatory Burdens that they are certain about.

Source: Interview with SIRA Consulting

This step gives a micro understanding of the costs of all Regulatory Burden, i.e. Administrative Burdens, Compliance Costs and Inspections. In addition, it also provides information about whether costs are one-off, periodical, or annual.

The core formula for quantifying the Regulatory Burden is similar to the SCM formula (apart from the CAR-methodology including other legal obligations like investments as well). Hence external costs, internal costs and out of pocket costs need to be identified, in addition to the time spent by personnel.

In order to quantify the external costs of goods and services, company invoices are used. The cost of legal obligations is also defined as time spent, which is identified through



company interviews. Both time spent on different compliance activities and the frequency of these activities are established in interviews. The non-personnel costs for compliance activities are calculated by multiplying expenses incurred with their frequency of occurrence.¹⁹⁶ The expenditure is derived by using the SCM for the calculation of Administrative Burdens and Compliance Costs (Time in hours x Tariff).¹⁹⁷ A distinct difference between the CAR and the SCM calculations is the fact that the CAR does not extrapolate to a national level. Hence without aggregated measurements, CAR does not provide a number for total regulatory burdens at a national level, but rather for the representative business.

After having identified and quantified all legal obligations, the list is then used in the next step to trace back legal obligations to their origin.

Step 7: Trace origin of the Regulatory Burden

In order to enhance transparency on who is responsible for what, the regulatory origin of burdens needs to be identified. This task is relatively straightforward at this point since an overview of all regulations and legal obligations that pertain to the sector was made in the sector analysis in phase 1. The articles and origins of the burden can be ascertained by consulting this list of legal obligations.

Three levels of regulatory frameworks exist:

1. EU Regulations; burdens arising entirely from the EU Council and European Parliament and by the Commission alone that specifically states the way in which the obligation must be met.
2. EU Directives; burdens set by the EU Council and European Parliament and by the Commission that requires transposition of Directives into national Member States' laws, where the Member States are free to decide how to meet the goals. Each EU Directive specifies the date by which the national laws must be adapted – giving national authorities the room for manoeuvre within the deadlines necessary to take account of differing national situations.
In this respect it should be mentioned that gold plating may occur in Member States, which is indirectly addressed in the CAR-methodology when comparing the transposition of EU Directives in Member States.
3. National laws and regulations; burdens arising entirely from national obligations.

When relevant, International Treaties, Charters and Agreements are also included.

Step 8: Analysis and consolidation of the findings for reporting

In this step findings are consolidated in order to make recommendations for reduction measures. Graphs, figures and tables illustrate findings and show the percentage of Company Costs that are due to Regulatory Burden, the Regulatory Burden per Cost Centre, the total Regulatory Burden subdivided in Administrative Burdens, Compliance Costs and Inspection Costs, etc. These estimates should be reported in a standardised manner (to the extent possible) to allow for their comparison. No common reporting sheet exists as of today, it seems, however; this is a useful reporting tool and an example

¹⁹⁶ Bex et al. (2013): The CAR methodology applied to SME bakeries, p.17.

¹⁹⁷ Ibid.: p.9.



derived from the SME bakery pilot study has been drafted (see draft example of reporting template in attachment).

Phase 3: Sector Reduction Plan

Step 9: Verify quantitative findings

The purpose of this step is to reach consensus about the quantitative findings. The Commission's services should therefore consult the (financial) managers of other businesses in the sector to verify quantitative findings. Typically this includes a workshop with 8-12 businesses per (sub) sector. A discussion about the numbers is initiated in order to ensure that the right company has been selected. In the verification process it is advisable only to involve people with appropriate knowledge about the representative company.

Step 10: Evaluate the influence of government on the cost structure of businesses in the sector

The Regulatory Burden is a proxy of the influence of governments. If Regulatory Burdens are quantified as being 10% of Turnover, then governments can influence 10% of this business, at least for the part of the burden which stems from national legislation.

Step 11: Tailor reduction measures to the requirements of each (sub) sector

Based on the business analysis in phase 2, an indication of ways to reduce the burden may already be identified. Apart from ideas stemming from phase 2, the workshop in step 9 contributes with a set of measures to increase competitiveness, innovation and employment opportunities.

Step 12: Prioritise reduction measures that directly influence competitiveness, innovation and employment opportunities

Phase 4: Better Regulation Programme

Step 13: Evaluate the value of the identified reduction measures for other sectors

Step 14: Integrate reduction measures in National Better Regulation Programme

Step 15: Broaden the scope so that other sectors benefit as well

The last step focuses on the spill-over of benefits between sectors. A (cost-benefit) focus on key sectors allows for a significant reduction of Regulatory Burdens across sectors. One such example is e.g. that VAT procedures are identified as being complex in one sector. Addressing this issue in one sector may very well affect other subsectors that may subsequently also benefit.



Annex II: Comparison of the CAR and SCM: Step by step application

When comparing the step by step application of the two approaches it becomes evident that the actual cost calculations appear very similar (comparing the standard reporting sheets, which outlines the actual business analysis). The difference lies in the point of departure of the two methodologies. Where the SCM methodology takes legislation as its starting point and asks businesses to break down costs to activity level, the CAR-methodology takes the business perspective instead and looks into the business' accounting books and asks the representative business about its real costs.

One can argue that the CAR-methodology reflects somewhat closely the SCM assumptions of a normally efficient business (CAR: financially healthy) and full compliance principle (CAR: a compliant business).

Subsequently, the CAR-methodology starts by looking in the accounting books of the representative business and then traces back costs to the same level of detail as offered by the SCM. The difference is that the baseline of the CAR is *real* costs, whereas the SCM baseline is a cost estimate simulating a real business. In addition, a distinct feature, is that businesses are not asked to break down the costs themselves, which in theory is the value added from the CAR. Instead, this task is left for experts and/or governments to do, as they more accurately know where costs stem from. However, in reality the actual reporting sheets of the two approaches appear to be quite similar. In theory, the SCM asks businesses to disentangle their costs down to activity level and separate business as usual (BAU) costs from administrative burdens, however; in reality, experts typically perform these classifications as businesses are normally not capable of carrying out this exercise. Hence the actual process is not that different from the CAR, as both methodologies partly rely on business interviews and partly on expert assessments. In addition, the CAR-methodology also asks the business where costs stem from. Although CAR does not ask businesses (alone) to break down costs and separate BAU from burdens, it appears as if this methodology still faces the challenge of disentangling regular business expenses from regulatory burdens.

By comparing the two step by step approaches of the CAR and SCM it becomes apparent that they seem to share more or less the same main steps. They both trace back burdens/cost estimates to their origin (national or EU) and they are both based on the same core equation (apart from the CAR including more than IOs). Consequently, they both report on the internal and external costs (and time spent), and out-of-pocket costs. Furthermore, they both share the issues of e.g. separating costs, selecting a representative business and defining the population.

A few differences in the two applications, though, are that CAR includes other legal obligations (more than IOs), and that it starts by scanning and listing all relevant legislation and looking at the business' accounting books. In addition, the CAR-methodology does not provide an aggregated number of total regulatory burdens, as extrapolation to the national level is not carried out.

To sum up, the order of the SCM step by step application is different from the CAR-methodology. However, they both trace back costs down to activity level, for which the



same steps are needed, regardless of who actually performs this task (businesses or experts). Overall the eleven steps in the SCM application (cf. Table 15 below) correspond roughly to the first nine steps of the CAR-methodology. The CAR then goes a step further (steps 10-15) than the SCM by looking at reduction measures and how to integrate these measures in National programmes.

Table 15: Step by step application of the SCM¹⁹⁸

Phase 1: Preparatory analysis	
Step 1:	Identification and classification of IOs (e.g. certification of products) & data requirements (e.g. the certificate must provide the date of production and composition of the product)
Step 2:	Identification of required actions (e.g. training members and employees about the IOs, filling forms)
Step 3:	Classification by regulatory origin (e.g. EU rule on certification in the transposition of an agreement of the WTO)
Step 4:	Identification of target group(s), also called segmentation (e.g. large enterprises that have to fulfil obligation 'A' and small enterprises that have to fulfil obligation 'B', the size of the enterprise being defined by its turnover)
Step 5:	Identification of the frequency of required actions (e.g. small enterprises have to fill a form once a year)
Step 6:	Identification of relevant cost parameters (e.g. particular relevance of external costs – using accounting firms – and equipment) Qualitative assessment of significant burdens (i.e. applying de minimise threshold test to determine which IOs need to be quantified)
Step 7:	Choice of data sources (Eurostat and e.g. the number of hours each need to perform required actions will be based on the results of interviews of enterprises, etc.)
Phase 2: Data capture and standardisation	
Step 8:	Assessment of the number of entities concerned
Step 9:	Assessment of the performance of a 'normally efficient entity' in each target group, taking into account cost parameters identified in step 6
Phase 3: Calculation and reporting	
Step 10:	Extrapolation of validated data to EU level
Step 11:	Final reporting and transfer to the database

¹⁹⁸ European Commission (2009a): Part III: Annexes to EU Impact Assessment Guidelines, p.48.



Annex III: Reporting sheet for the CAR Business Analysis (SME Bakery)

The reporting sheet for the CAR business analysis is divided into different parts to cover the following steps: a) identifying cost centers: costs taken into account are those for management and bookkeeping, maintenance and repair, production and sales; b) analysing the financial and business administration. Figures to be reported cover material costs, the turnover (EBIT), productions costs and company costs; c) quantifying burdens: this step covers quantification of both business and regulatory personnel and non-personnel related costs.

On the basis of these steps, the analyst is able to compute the total regulatory burden (RB), and to assess its percentage in terms of business turnover.

The RB can be further divided into three elements, administrative burdens, compliance costs and inspections costs. Finally, the CAR reporting sheet allows specifying the origin of the RB assessed: EU rules and/or national laws and regulations.

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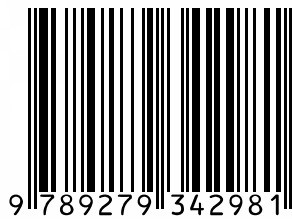
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