

# Tax policy report

## Preliminary evaluative assessment of the direct effects of compliance activities

<b>Date</b>	27 February 2026	<b>Priority</b>	Low
<b>Security level</b>	In Confidence	<b>Report number</b>	IR2026/056

<b>Action sought</b>		<b>Deadline</b>
Minister of Finance	<b>Note</b> that compliance activities continue to generate returns of comparable size to those observed in recent years, suggesting that substantial tax gaps persist.	none
Minister of Revenue	<b>Note</b> that compliance activities continue to generate returns of comparable size to those observed in recent years, suggesting that substantial tax gaps persist.	none

<b>Purpose</b>
This report briefs Ministers on Inland Revenue's preliminary assessment of the direct effects of compliance activities. The report is a condition of Budget 2025 funding for developing Inland Revenue's internal capability to assess, based on international best practice, the direct and indirect effects of compliance activity going forward.

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## Preliminary evaluative assessment of the direct effects of compliance activities

### Executive Summary

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- 1 This note provides a preliminary assessment of the direct effects of compliance activities. The assessment provides insight into the extent and nature of tax gaps, and thereby supports policy advice about the likely returns to additional compliance funding and internal priorities for compliance resource deployment as compliance risks shift.
- 2 New Zealand's tax system performs well in terms of the overall cost to collect tax, and filing and payment timeliness. But the continued high ratio of annual compliance dollar returns to the cost of compliance activities suggests the persistence of material tax gaps. The sharp increase in audit activity following the Budget 2024 increase in compliance funding was accompanied by a correspondingly large jump in audit discrepancies identified, indicating substantial direct effects from audit. Compliance data by segment suggests continued relatively large tax gaps in Micro-business, Small-medium Business and Significant Enterprises, consistent with overseas experience.
- 3 The future focus of our compliance evaluation work is the achievable level of total returns to specific compliance activities, counting all direct and indirect effects, and considering upstream measures to promote voluntary and automatic compliance as well as enforcement. Compliance activities interact and reinforce each other to reduce tax gaps, requiring an integrated assessment of a wide range of indicators.

### Background

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#### Relation to previous and existing reporting

- 4 This note responds to Ministers' direction to Inland Revenue to report on our preliminary investigation of the direct effects of compliance activities (CAB-25-MIN-0126.57 refers). The report is a condition of Budget 2025 funding for developing Inland Revenue's internal capability to assess, based on international best practice, the direct and indirect effects of compliance activity going forward.
- 5 In November 2025 we reported on the establishment of the compliance evaluation development programme and outlined some of the initial projects (IR 2025/409 refers). The programme supports Inland Revenue's ability to meet the Government's medium-term revenue objectives as efficiently as possible, by building an evidence base to support policy advice about the likely returns to further compliance funding, and to guide internal priorities for compliance resource deployment. Inland Revenue is currently able to assess the direct effects of compliance activities in an internationally comparable manner, which is a useful first step and the focus of this report. The next phase of the work will focus on indirect effects.
- 6 The assessment in this report draws on compliance indicator data that is also reported as part of Inland Revenue's Performance Management Framework, and supports the ongoing development of the Framework. We report separately on recommended output performance measures and targets for the 2026–27 financial year (IR2026/027 refers).

#### Relation to Inland Revenue's compliance themes

- 7 Improved assessment of direct and indirect effects supports Inland Revenue's compliance themes. "Compliance" in this context includes registering, filing, reporting and paying tax correctly and on time. The themes embody our Right From The Start (RFTS) and Compliance Risk Management (CRM) approaches, which focus on systems and processes to make it easy to comply and difficult not to comply. This includes not only enforcement, but also promotion of voluntary or automatic compliance through targeted campaigns, reporting and withholding systems and other activities. RFTS and

CRM aim to optimise the mix of our resources to balance targeted, risk-based compliance and enforcement with strong customer service.

- 8 The four compliance themes advocate:
- a measured, risk-based approach to compliance,
  - a transparent and adaptive focus that monitors and builds on public perception of Inland Revenue’s compliance activity,
  - advanced analytics that apply the right intervention to the right place, reserving one-to-one interaction for those who pose the highest risk, and
  - a high-quality data and contextual understanding that enables Inland Revenue to operate effectively in an increasingly digital ecosystem.
- 9 Inland Revenue keeps the activity mix under constant review, to keep up with new and changing compliance risks, minimise tax gaps at least cost to the Crown and wider economy, and raise the highest net revenue over time with available resources. The emphasis on more targeted and managed end-to-end compliance incorporates learnings from Inland Revenue’s Business Transformation process, and draws on OECD and IMF guidance on best-practice tax administration, which has also evolved towards increasingly sophisticated targeting of enforcement resources.

### **Direct effects of compliance activities, the tax gap and Right From The Start**

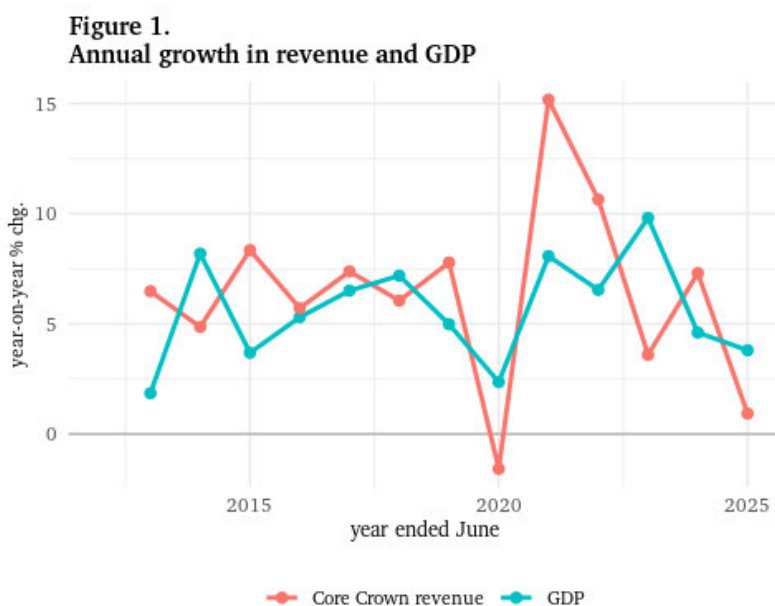
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- 10 Understanding the direct and indirect effects of compliance activity, in the context of the broader economic and technological drivers of compliance, helps quantify the extent and nature of tax gaps. “Direct effects” means additional tax immediately assessed or collected from taxpayers subject to an enforcement intervention, while “indirect effects” means deterrence of continued non-compliance by such taxpayers (“specific deterrence”), and deterrence of non-compliance by other taxpayers linked to them socially (“general deterrence”, sometimes called spillover, social contagion or diffusion effects). The tax gap is the difference between taxes legally owed and tax actually collected. It measures the potential returns to scaling up compliance activity. The overall tax gap can be disaggregated by source (registration, filing, reporting, payment), product and customer segment, and includes both gaps in assessed revenue and tax not duly paid. The Appendix has a diagram of the tax gap and its components.
- 11 The tax gap is influenced by both “downstream” enforcement and reinforcing “upstream” voluntary or automatic compliance systems and risk assessment processes. The tax gap diagram also shows “revenue assured”, a measure which complements tax gap measures by highlighting the component of revenue where we can be confident that the taxpayer is complying with all tax obligations. Revenue assured is underpinned by strong upstream compliance systems, including tax policy design and the Generic Tax Policy Process. These contribute to efficient administration and better compliance, and can also be a powerful way of reducing tax gaps and increasing revenue assured. For example, our GST system design, emphasising a broad and uniform base, is often cited as contributing to high compliance performance compared to other countries.
- 12 Evaluation of specific compliance activities and their impacts on tax gaps needs to take account of interactions among these processes and of external factors such as such as tax morale and economic conditions. The various influences are not always easy to disentangle, and require consideration of multiple indicators, channels and impacts.
- 13 For example, a successful upstream intervention that makes it harder for taxpayers to make genuine mistakes may reduce audit yield or debt collection. This would indicate a more effective overall compliance system, rather than poorer audit or collection performance. Investments in IT and machine learning systems to improve risk-scoring and investigator decision-making enhances their productivity and hence audit yield. Finally, community compliance campaigns may spread knowledge about how to comply and lift tax morale, which may improve return accuracy or elicit larger voluntary disclosures.

## Preliminary evaluative assessment of direct effects of compliance activity

### Trends in annual indicators of the returns to compliance activity

- 14 The overall performance of New Zealand's tax system compares well to that of our peer tax authorities<sup>1</sup> in terms the total cost to collect (46c to collect \$100 in tax in 2025), timeliness of filing (96% of returns filed were on time) and payment (94.5% of tax paid was on time and in full), and customer satisfaction (74% of customers were satisfied with their last interaction with Inland Revenue, and 83% of customers felt confident that they were doing the right thing). Revenue as a share of national income over the past few years has been broadly stable at around 28–30%, although a variety of factors (e.g. policy changes, the carrying-forward of tax losses and fiscal drag) mean that the year-to-year relationship between national income and revenue is not tight (Figure 1).

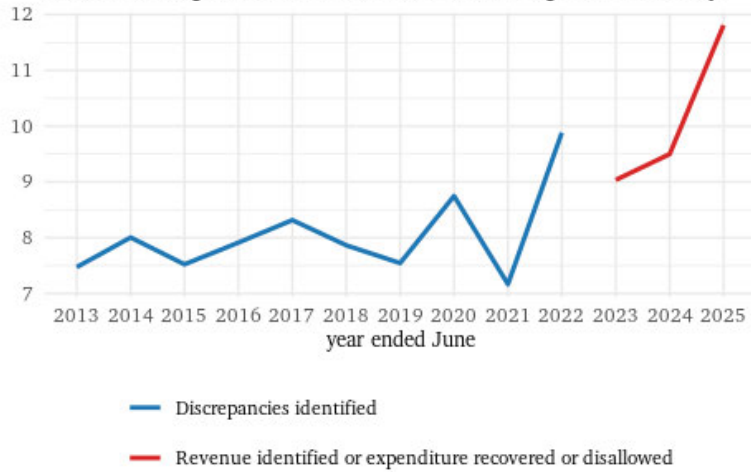


- 15 Total revenue is the sum of revenue raised as a result of voluntary or automatic compliance, and the proceeds from enforcement. The operational measures we already have in our performance measurement framework provide relatively straightforward insights into the contribution of direct effects of compliance activities. These measures continue to show a high ratio of annual compliance returns in dollar terms from discrepancies and voluntary disclosures compared to the cost of compliance activities (Figure 2). This pattern suggests the persistence of material tax gaps, as previously reported (IR2024/321 refers).<sup>2</sup>

<sup>1</sup> noting here the limits to international comparisons due to e.g. structural and measurement differences

<sup>2</sup> Following the broadening of the reporting definitions for compliance returns and costs after 2021/22, returns are now defined as the sum of audit discrepancies, voluntary disclosures, integrity discrepancies and donation tax credit discrepancies.

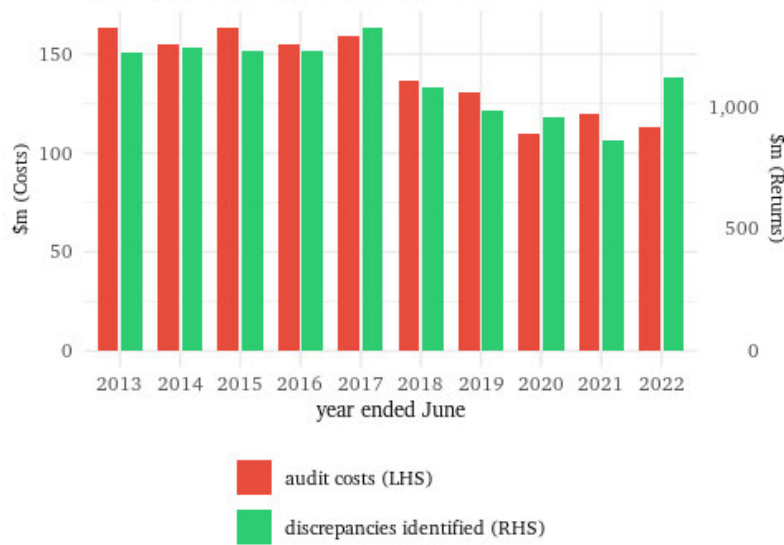
**Figure 2.**  
**Ratio of compliance returns to costs of compliance activity**



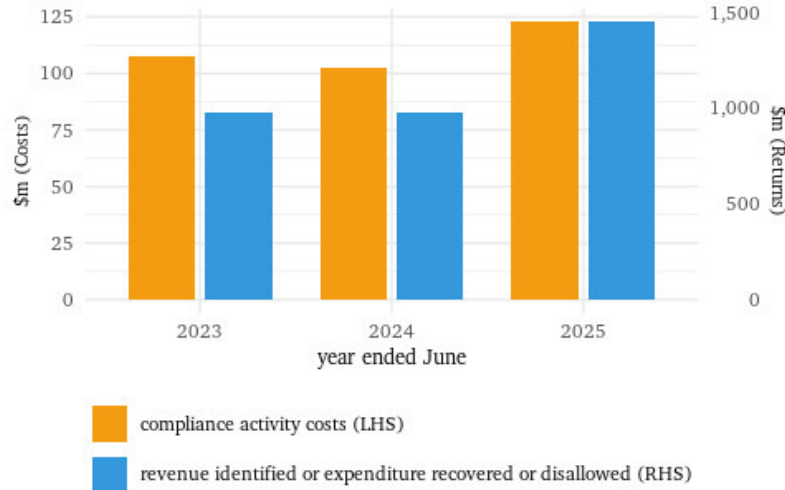
Note: This measure corresponds to the Compliance ROI measure currently reported as an Inland Revenue performance measure. The measure definitions changed from 2022/23 to reflect wider compliance activities than audit.

16 With some noise and lags in the pattern from year to year, the dollar returns to and administrative costs of compliance activities have tended to move together over time (Figures 3 and 4), as reflected in the reasonably stable (perhaps upwardly trending) ratio. The latest data following the increased compliance investment in Budgets 2024 and 2025 continue this pattern, consistent with the returns to compliance activities not yet diminishing.

**Figure 3.**  
**Audit discrepancies and audit costs**



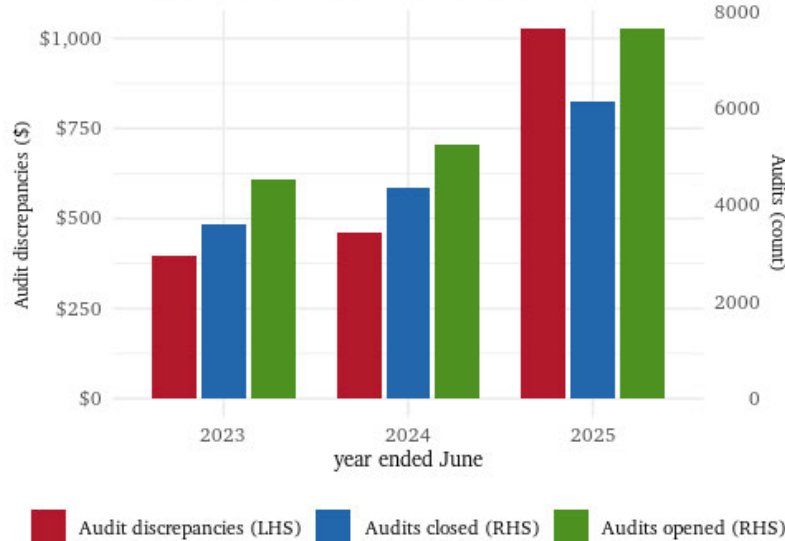
**Figure 4.**  
**Compliance returns and costs of compliance activity**



Note. Compliance returns comprise audit discrepancies, integrity discrepancies, donation tax credit discrepancies and voluntary disclosures.

17 Audit discrepancies are a relatively well-understood compliance indicator easily linked to a corresponding activity, and so have consequently been well-studied in the literature on direct effects. Audit is also the main component of the cost of compliance activities. The 2025 data on audit discrepancies and audit activity show that the increase in Inland Revenue’s audit activity (in terms of both audits closed and audits opened) following the Budget 2024 increase in compliance funding was accompanied by a large jump in audit discrepancies identified, again consistent with the persistence of tax gaps (Figure 5).

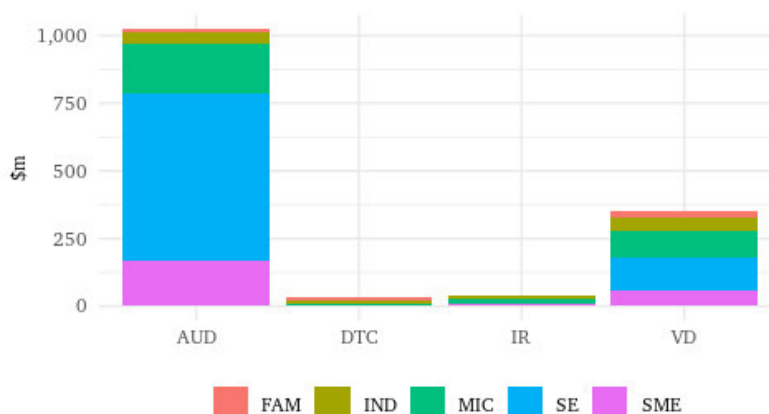
**Figure 5.**  
**Audit discrepancies and audit activity**



18 Disaggregating the data by customer segment suggests that the Micro-business, Small-to-medium Business and Significant Enterprise segments continue to show relatively large compliance returns by value, consistent with overseas experience (Figure 6).

**Figure 6.**  
**Compliance outcomes by customer segment**

Year ended June 2025



Note. AUD = Audit discrepancies, DTC = Donation Tax Credit discrepancies, IR = Integrity Review discrepancies, VD = Voluntary Disclosures. FAM = Families, IND = Individuals, MIC = Micro-business, SME = Small-to-medium business, SE = Significant Enterprise.

- 19 Notwithstanding the apparently persistent tax gaps in some customer segments, other measures of compliance system performance such as filing and paying on time rates indicate that Inland Revenue's upstream compliance activities continue to maintain New Zealand's relatively strong performance in this area. For example, the proportion of returns filed on time has increased from below 80% in 2022 to more than 85% in 2025. The segments that contribute the largest compliance returns do not necessarily perform poorly on timeliness indicators. For example, the Significant Enterprises segment has consistently shown a 93%+ rate of filing on time and 92%+ and 95%+ rates of paying on time by number and by value respectively. The Individuals segment generally has shown poorer performance on timeliness, but generates relatively small audit discrepancies by total value (while showing voluntary disclosures comparable in size to discrepancies in total value). These patterns illustrate the importance of considering compliance behaviour and what it implies for tax gap remediation across a range of indicators.

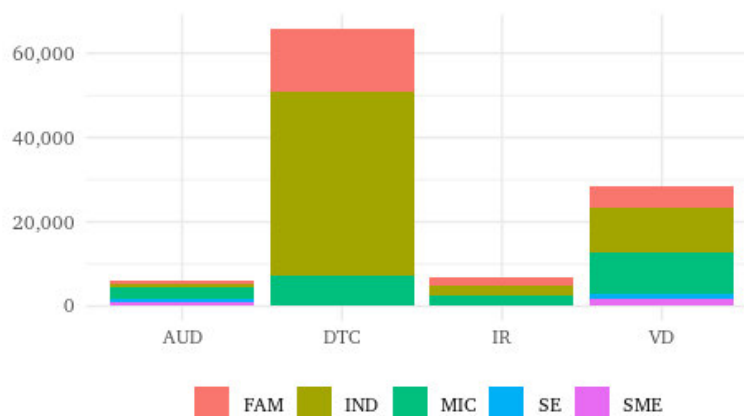
### Relation of direct to indirect effects

- 20 As noted in IR2025/409 and earlier reports, international evidence suggests that indirect effects are likely to be substantially larger than direct effects, but they also require more complex modelling.<sup>3</sup> The New Zealand and international evidence is limited. The analytical task of attributing indirect effects to particular interventions (such as audits), and relating them to direct effects, is made more challenging by potential time lags and diffuse channels between an intervention and indirect effects. Effect magnitudes may also differ for different products and customer segments.
- 21 Since 2022/23, voluntary disclosures have been counted as part of the returns to compliance activity (Figure 6). Depending on their origin, voluntary disclosures may provide some insight into direct and indirect effect dynamics. As Figure 7 shows, the number of voluntary disclosures for 2025 was several times that of audit and integrity discrepancies. At least some of these voluntary disclosures may have arisen through indirect deterrence effects following such interventions, although it is also possible that they were triggered by community compliance campaigns (which are included in the cost of compliance activities shown in Figure 4). The latter would be more akin to a

<sup>3</sup> e.g. Boning, W. C., Guyton, J., Hodge, R., & Slemrod, J. (2020). Heard it through the grapevine: The direct and network effects of a tax enforcement field experiment on firms. *Journal of Public Economics*, 190, 104261.

direct effect of campaigns. We are planning further analytical work to better understand the behaviour leading to voluntary disclosures.

**Figure 7.**  
**Compliance cases by customer segment**  
Year ended June 2025



Note. AUD = Audit discrepancies, DTC = Donation Tax credit discrepancies, IR = Integrity Review discrepancies, VD = Voluntary Disclosures. FAM = Families, IND = Individuals, MIC = Micro-business, SME = Small-to-medium business, SE = Significant Enterprise.

- 22 Notwithstanding the large number of voluntary disclosures compared to audits in 2025, the total dollar value of voluntary disclosures for 2025 was only one third that of audit discrepancies (Figure 6). This ratio was similar across the three segments in which the greatest dollar values of audit discrepancies were found, suggesting that similar behavioural dynamics may be at work. Beyond any voluntary disclosures triggered by interventions, indirect effects also need to count additional revenue from taxpayers who decide to improve their compliance more proactively in the future as a result of being subject to, or observing, enforcement activity. Inland Revenue's regular performance reporting already includes an estimated future value from compliance interventions. The work programme includes further investigation of these effects and ways of measuring them over time and across intervention types.

## Implications of preliminary evaluative assessment

- 23 This preliminary assessment adds to the evidence previously reported that material tax gaps persist across a range of segments, and that the direct effects of additional compliance activity are likely to be comparable in size to the ones observed recently. The Micro-business, Small-Medium Enterprise and Significant Enterprise segments continue show particularly large annual compliance returns from discrepancies and voluntary disclosures. The data on voluntary disclosures suggest that indirect effects may be relevant in at least some segments.
- 24 Compared to other OECD countries, New Zealand raises a much lower percentage of total revenue through audit discrepancies, but we also commit far fewer resources. Inland Revenue also achieves a "hit rate" (percentage of audits resulting in an adjustment) comparable to or better than peer jurisdictions.<sup>4</sup> Despite their higher proportions of resources devoted to direct enforcement, peers such as the UK continue invest in compliance, with the 2025 UK Spending Review (UKSR) providing GBP1.7 billion over four years to fund an additional 5,500 compliance and 2,400 debt management staff. The UKSR also provided £500 million to HM Revenue and Customs to invest in digital services. Australia's Budget 2025-26 provided AUD999 million over

<sup>4</sup> OECD. (2025). *Tax administration 2025: Comparative information on OECD and other advanced and emerging economies*.

four years to the Australian Taxation Office to extend and expand tax compliance activities.

## **Operational Implications**

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- 25 This paper has no immediate operational implications, but the findings will be fed into Inland Revenue's internal business planning and resource prioritisation processes.
- 26 As part of the Commissioner's statutory role, resources are prioritised across services, upstream compliance and downstream compliance. Alongside recent additional Budget compliance funding, we have prioritised further resources to downstream compliance activities, and in particular overdue debt. As noted earlier, our compliance operations are guided by our strategic intent to deliver optimally efficient compliance risk mitigation as compliance risks shift. The compliance evaluation programme will build our understanding of the relation between upstream and downstream interventions and their total effects, likely leading to changes in where and how we intervene.

## **Financial implications**

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- 27 This paper has no immediate financial implications.

## **Tax Revenue impact**

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- 28 This paper has no impact on tax revenue.

## **Administrative impact**

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- 29 This paper has no administrative impacts.

## **Consultation**

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- 30 Treasury has been consulted on our developing evaluation approach. We continue to work with Treasury to develop and apply the approach further.

## **Next steps**

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- 31 A key question for future Budget funding and internal resource prioritisation is the absolute and relative net present value achievable from additional compliance activity, given tax gap estimates, overdue debt growth and their responsiveness to interventions. This report has focused on compliance data relating to relatively direct enforcement measures such as audit and their direct effects in the form of discrepancies. Enforcement will always play an important role in the compliance system because of deliberate or habitual non-compliance, and to strengthen deterrence. However, as noted above, enforcement interacts with upstream measures, and cultural and structural differences across sectors may imply that different proportions of upstream and downstream compliance measures and interventions will be appropriate in each case. The evaluation programme therefore aims for an integrated understanding of these interacting effects.
- 32 As noted in IR2025/409, integrated evaluation will apply the internationally-recognised Behavioural Elasticity of Tax Revenue (BETR) framework. The BETR emphasises that the evaluation of revenue gains from both policy and compliance interventions should account for behavioural change by taxpayers, as well as compliance and administration costs. Applying the framework will ensure analytical comparability of evaluations across intervention types and taxpayer segments.

- 33 Accurately attributing causal effects to specific compliance interventions requires further data, analytical and process design work. Inland Revenue’s compliance and enforcement focus shifts over time to keep up with shifting compliance risks. In this context, analytical work will include assembling samples of similar interventions and constructing valid counterfactuals using intervention-level longitudinal data. Variables of interest include audit duration, outcomes over time, risk characteristics, connections among taxpayers and costs of intervention.
- 34 Specific future work in the programme includes the following.
- Integrated measurement and disaggregation of total effects of compliance interventions with explicit uncertainty bounds.
  - Constructing a tax gap “map” disaggregated by tax product, segment and other dimensions, and layering onto the map compliance intervention effects and perennial compliance risks such as the hidden economy.
  - Supporting operational design of new compliance interventions to facilitate accurate evaluation of total effects after implementation.
- 35 As noted in IR2025/409, we plan to publish our work on the framework and evaluations to enhance transparency and encourage related research. We also plan to proactively publish this report on the tax policy website.

## Recommendations

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We recommend that you:

1. **Note** that compliance activities continue to generate returns of comparable size to those observed in recent years, suggesting that substantial tax gaps persist.

s 9(2)(a)



**Tim Ng**

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Policy | Inland Revenue  
27 February 2026

Hon Nicola Willis  
**Minister of Finance**  
/ /2026

Hon Simon Watts  
**Minister of Revenue**  
/ /2026

## Appendix

### Figure. Tax gap and revenue assured

