AGGREGATE NET GST START-UP COMPLIANCE COSTS FOR AUSTRALIAN SMALL BUSINESSES

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Abstract

This paper discusses small business aggregate net GST start-up compliance costs of the 1 July, 2000 Australian tax reform. Using a survey questionnaire and the grossing-up procedure, small business aggregate gross GST start-up compliance costs were estimated, based on 1.2 million Australian small businesses. The mean GST start-up compliance costs per small business and aggregate gross GST start-up compliance costs (with time costs) for the year 2000 for the Australian small businesses were estimated at $7,888 and $5,677 million respectively. Additionally, aggregate gross GST start-up compliance costs for Australian small business represented around 4 per cent of taxation revenue from all sources and around 10 per cent of business taxation revenue. Overall after considering offsets (tax deductibility and $200 government cash subsidy), net aggregate small business GST start-up compliance costs were estimated at $4,695 million. This paper seeks to discuss key findings on small business net aggregate GST start-up compliance costs for the year 2000. To start with, the paper briefly explains the grossing-up procedure used to arrive at the gross aggregate GST start-up compliance costs. Analysis of the effect of small business GST start-up compliance costs, after considering the benefits that they received as a result of complying with the GST requirements is presented. Finally, the conclusion of this paper articulates policy implications for the Australian tax reforms so far as they affect small businesses, particularly for government to ensure that the tax system is not complex.
1-0 Introduction

The past six years of the year 2000 Australian tax reform attracted numerous academic debate and publication of empirical research in the area of small business tax compliance costs of the Goods and Services Tax (GST). The major pre-GST implementation debate focused on start-up compliance costs and their effects on small businesses. More recently, policy implications for small business GST start-up compliance costs have been discussed in a context of tax simplification (Rametse and Pope 2006). Moreover, previous results on GST start-up compliance costs have focused more on costs per small business rather than costs for the overall economy. These estimates (costs per small business) have been disseminated elsewhere and will not be repeated here (e.g. Rametse and Pope 2001, 2002, 2003, 2005, 2006). Suffice it to say that although GST start-up compliance cost may now be a historical issue, its aggregate quantification is important for policy makers. Moreover, amongst other factors, the Australian small business community complained that their high start-up compliance costs were a result of a complex taxation system.

This paper discusses small business aggregate net GST start-up compliance costs of the 1 July, 2000 Australian tax reform. Using a survey questionnaire and the grossing-up procedure, small business aggregate gross GST start-up compliance costs were estimated, based on 1.2 million Australian small businesses. The mean GST start-up compliance costs per small business and aggregate gross GST start-up compliance costs (with time costs) for the year 2000 for Australian small businesses were estimated at $7,888 and $5,677 million respectively. Additionally, aggregate gross GST start-up compliance costs for Australian small business represented around 4 per cent of taxation revenue from all sources and around 10 per cent of business taxation revenue. Overall after considering offsets (tax deductibility and $200 government cash subsidy), net aggregate small business GST start-up compliance costs were estimated at $4,695 million.

This paper is organised as follows. Sections two and three briefly discuss conceptual issues and the grossing-up procedure used to arrive at aggregate GST start-up compliance costs respectively. Section four analyses aggregate GST start-up compliance costs. Section five presents aggregate gross GST start-up compliance costs relative to income tax revenue collected in 1999-2000 and GDP in 1999-2000. Section six discusses net aggregate GST start-up compliance costs for the year 2000 after considering the major offsets. Section seven provides concluding remarks.

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1 Tran-Nam (2000); Pope (2000a, 2000b); Pope and Rametse (2000); Tran-Nam and Glover (2001, 2002a, 2002b) and Tran-Nam, Glover and Wilkin (2004) have researched and published in this area. Dirkis and Bondfield (2004, 2005) have critiqued the Ralph recommendations post the implementation of the GST, so far as they affect small businesses.
2-0 Conceptual Issues

Compliance Costs

Compliance costs, which for a long time have been treated as “hidden costs” of taxation, are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirement laid upon them in complying with a given tax structure, over and above payment of the tax itself (Sandford, Godwin and Hardwick 1989, p10). Thus, the GST start-up compliance costs are those costs incurred by businesses in preparing to comply with the GST legislation. Sandford et al (1989, p16) term these costs ‘commencement costs’, which arise with the introduction of a new tax or a major change in a tax. These costs, strictly speaking, should be spread over a period rather than be considered a cost solely at the time incurred (Sandford et al 1989, p16) since they are mainly of a capital nature and thus benefit businesses over a period of time. GST start-up compliance costs, for the private sector, include new computer systems and time spent on training new bookkeepers and staff to operate the GST.

Start-up compliance costs are distinct from recurrent (or ongoing annual) compliance costs as recurrent/regular costs are continuing costs incurred in running a tax system. Start-up costs do not include temporary costs, which are incurred by the tax officers and taxpayers in learning about the new tax system. Even when a particular tax has been well established to regard the compliance costs as regular/recurrent costs, some businesses will be starting to operate, hence experiencing start-up tax compliance costs as they prepare to comply with the tax legislation for the first time. Thus, within the recurrent compliance costs, there will be elements of start-up compliance costs associated with changes in the taxpayer population (Sandford and Hasseldine 1992, p7). This may occur where either a new business is established or an existing business registers for the GST for the first time.

Compliance costs are private sector costs and together with administrative costs both make up the costs of operating a taxation system. Administrative costs are public sector costs of a particular tax system and are borne by Government. These costs would not have been incurred had the new tax not been introduced. Start-up administrative costs, for the Australian GST (ignoring government legal/legislative costs), are mainly those costs incurred in an education campaign by the Australian Taxation Office (ATO), industry seminars paid for and run by ATO from the government’s $500 million compensation package and staff wages. Costs that relate to administration of any tax dispute are also part of administrative costs and must be included in the calculation of administrative costs, if they are available. These costs must either be directly or indirectly related to the introduction of the GST.

The relationship between administrative and compliance costs may be complementary or competitive to each other. Where tax simplification strategies are apparent, administrative and compliance costs may be reduced. Where certain tasks are delegated to the private sector by the public sector, for example, a situation where small business ‘acts as unpaid tax collector’, compliance costs would be relatively high and administrative costs lower. However, Sandford (1993, p13) suggests that taxes that have high compliance costs, such as VAT, often have high administrative costs as well.
Some empirical studies tend to exclude administrative costs from compliance costs estimation. This is probably because researchers do not have control over data from governments, hence difficult to obtain it. This author recognises the importance of measuring administrative costs, mainly to obtain a complete picture relative to compliance costs, particularly their inter-relationship. However, it was not possible to measure administrative costs due to the difficulty in obtaining data from the ATO.

The GST start-up tax compliance costs are normally broken down into gross and net costs. The former represents the total resource costs to the economy before considering offsetting benefits, while the latter include a reduction with the tax deductibility of the various costs incurred and the value of any cash flow benefits (CFB) arising from taxpayers. CFB arise from the lawful delay in payment of the GST to the tax authorities, and in the delay of remitting GST collected by taxpayers on behalf of the government.

Managerial benefits arising from improved accounting procedures and better record keeping is also an important offset, particularly for small business, although quantification is very difficult (Pope and Rametse 2000, p5). The major offset relating to start-up compliance costs arises from tax deductibility of expenses plus (for Australia’s GST) a subsidy (voucher) of $200 per small business provided by Government. The relationship of CFB to start-up costs is indirect, hence weaker. For example, Small businesses that did not have computers pre-GST acquired them for GST compliance (direct benefit), but could also use these computers in their financial operations to avoid suffering a cash flow cost (indirect benefit).

Compliance costs include both economic and psychological costs. Economic start-up tax compliance costs of the Australian GST for small businesses may be estimated and they include both monetary and time costs in dealing with the requirements of tax authorities. GST start-up compliance costs are divided into internal and external costs. Internal costs represent own time of business owners (self-employed), monetary and staff costs. These costs include time spent in ensuring that accounting processes are compatible with GST requirements, incurring capital expenditure through acquisition of computer hardware and software, cash registers and tills.

Non-monetary costs, which are almost immeasurable (Allers 1994, p55), include psychological costs related to stress and anxiety of small business staff and owners arising from complying with the GST requirements (Pope and Rametse 2000, p6). In this way, increased record keeping requirements of a GST, coupled with knowledge of their intended use as an audit tool for the Pay-As-You-Go (PAYG) system may cause anxiety and distrust (Pope and Rametse 2000, p9). It must be noted that there may also be psychological administrative costs if the ATO staff, in contact with the public, find their job particularly stressful (Sandford et al 1989, p18).

Although psychological costs are recognised, they are normally excluded from compliance cost calculations because of the difficulty in their estimation. Woellner, Coleman, McKerchar, Walpole and Zetler (2000) have developed a research method to measure the psychological costs of tax compliance as they believe that this area has been largely neglected due to the lack of a reliable measurement method. Although this research has made no attempt to measure psychological costs relating to the Australian GST start-up compliance costs, their importance is highly recognised.
Having explained the tax compliance costs framework, it is important to distinguish between aggregate GST start-up compliance costs and business (taxpayer) GST start-up compliance costs. Aggregate GST start-up compliance costs represent costs to the economy, whereas taxpayer GST start-up compliance costs are borne by individual business taxpayers. This paper largely focuses on aggregate GST start-up compliance costs for the whole of Australian small businesses.

**Small Business**

Small businesses, estimated at 1.2 million in 2000 (ABS 2001, p12) play an important role in the Australian economy as they generate significant employment and output. However, the complex Australian taxation system and other myriad of Government compliance requirements have arguably placed this sector at a disadvantage. Literature reveals a general lack of agreement regarding the definition of small business. Due to their diversity, an attempt to employ a single designation invariably creates inaccurate comparisons. Consequently, various parties adopt different definitions based on criteria appropriate for their purposes. The Australian Bureau of Statistics (ABS) definition is small businesses in non-manufacturing industries are those with less than twenty employees, and in manufacturing those employing less than 100 (Bell Report, 1996, p13). By contrast, the ATO had measured small business by turnover, that is, $10 million or less (ATO 2002, p100; Evans and Ryan 1999, p7).

The ATO, however, has since moved away from the $10 million turnover definition, particularly with the introduction of the New Tax System (NTS), to facilitate small business access to various concessions. For example, in order to enter the Simplified Tax System (STS), a small business taxpayer’s annual turnover must be less than $1 million and their end of the year value of depreciable assets must be less than $3 million. Additionally, for GST purposes, businesses with annual turnover of not more than $50,000 may register; those with $1 million annual turnover may use the cash basis of accounting, and so on (Coleman and Evans 2003, p150).

Due to a variety of definitions used by Government agencies to identify small business, The Small Business Coalition (SBC) commissioned Professor Scott Holmes and Brian Gibson of the University of Newcastle to research and recommended an appropriate definition of small business (Holmes and Gibson, 2001). In fact, Holmes and Gibson (2001, p14) have noted that annual turnover of less than $10 million has been modified in many situations from a low of $1 million to a high of $10 million. The ATO (2003, p12) classified businesses with an annual turnover of less $2 million as micro-businesses. Businesses with annual turnover of between $2 million and $100 million were classified as small to medium enterprises (ATO 2003, p18). Holmes and Gibson (2001, p17), however, recommend a definition that is based on the qualitative characteristics of small business as well as a quantitative proxy (less than twenty employees).

Recently, the Australian Taxation Studies Program (ATAX), the University of New South Wales, commissioned by the Institute of Chartered Accountants in Australia (ICAA), released a report recommending the definition of small business that is capable of consistent application, throughout Australia’s income tax (including Capital Gains Tax, Fringe Benefit Tax and GST Legislation (ICAA 2006, p7). The
Report points out that currently there are a myriad of definitions of small business which are inconsistent and apply different criterion to receive concessions. The Report “suggests and uses basic turnover of $2 million and assets threshold of $6 million…” (ICCA (2006, p5)). Thus amongst the recommended criteria by ICCA (2006, p24), turnover remains on the list for access to small business concessions.

The definition of small business also posed a problem for Tran-Nam and Glover (2002a, 2002b) research. Tran-Nam and Glover (2002a, p343) asserted that their research used the turnover criteria to facilitate critical comparisons and analysis of the Review of Business Taxation (RBT) which also uses the same definition. Later Tran-Nam and Glover (2002b, p510) realised that the rural businesses always exceeded $1 million turnover despite the fewer people they employed, and thus recommend the turnover definition to be used in future research. It must be noted that since this study has captured data up until 30th June 2000, a $10 million or less definition is adopted mainly for ease of reference in cross checking this study’s results with ATO data for the year 2000.

3-0 Grossing-up procedure

The methodology for grossing-up to arrive at aggregate GST start-up compliance costs is articulated by Tran-Nam (2001, p57). Tran-Nam notes that the extrapolation of aggregate business compliance costs requires the average compliance costs per business taxpayer (derived from sample observations) to be multiplied by the number of business taxpayers in the economy. Tran-Nam also discusses that many businesses choose to use several business vehicles in a single business entity for reasons such as limitation of legal liability, security, financial planning and tax planning. Thus a distinction between a business entity and a business taxpayer must be made. For example the ABS (2001, p12) estimated small businesses in Australia at around 1,200,000 in 2000, whereas small businesses registered for the GST were estimated at 2,182,444 (ABS 2000a, p5). Tran-Nam et al (2000, p246) concludes that social compliance costs and taxpayers compliance costs are grossed up using the average compliance costs in a particular category (based on sample data) multiplied by the number of taxpayers in that category (based on macro data), summed over all relevant categories. Most compliance costs studies have used this procedure because it has been confirmed to be more reliable.

In order to obtain aggregate start-up compliance costs of the GST, GST registered small businesses were stratified accordingly. This enabled a more accurate and reliable GST start-up compliance costs estimation. Alternatively the number of employees, which the ABS normally uses, could have been applied for stratification purposes. This was considered in this study, but was not adopted since this research follows the ATO’s definition and stratification of small businesses. Thus for comparability reasons, stratification based on the number of employees was not appropriate for this study. The grossing-up procedure was performed using data compiled by the Australian Bureau of Statistics, which was based on data derived from information held on the Australian Business Register (ABR), and supplied by the ATO (ABS 2000a, p.v). The grossing-up procedure was thus carried out as follows.
The small business data for West Australia was assembled in four size ranges of annual turnover and within each of the fifteen trade sectors. It must be noted that the ABS (2000a) used four size ranges of less than $50,000; $50,000 - $99,999; $100,000 - $499,999 and $500,000 - $20,000,000 as opposed to the five size ranges used in this thesis’s survey. Thus for grossing-up purposes, to match the ATO stratification criteria, this study combined its last two size ranges ($500,000 - $999,999 and $1,000,000 - $10,000,00) to one turnover category of $500,000- $10,000,000. Simply, the preferred turnover size was constrained by the way in which the ATO categorised the GST registered small business population. The ABS (2000a) highest turnover range is $500,000 - $20,000,000, which basically includes a significant number of medium sized businesses. Thus sample businesses over $10 million turnover were removed from the grossing-up procedure. To address the issue of overestimation as a result of a number of GST registered businesses operating a single business, the registered small business population was weighted in proportion to the number of small businesses in Australia. Continuing the grossing up procedure, the mean for each size range and each sector was calculated. These means were then multiplied by the number of small businesses in that size and sector group using information from ABS (2000a, p11) supplied by the ATO. The summation of all the categories arrived at the total overall estimated GST start-up compliance costs.

4.0 Aggregate Mean GST Start-up Compliance Costs

The mean gross GST start-up compliance costs comprised equipment costs, mainly computers acquired for GST purposes, professional fees and incidental costs such as stationery, postage and telephone costs. The other main component of these costs was time spent by small businesses for GST compliance.

The number of small and medium businesses ($0 - $20 million turnover) registered for the GST as at 30 October 2000 was estimated at 2,182,444 (ABS 2000a, p5). However, given the number of small businesses in Australia in 2000 (1.2 million), a weighted population was obtained. The mean GST start-up compliance costs per small business and aggregate gross GST start-up compliance costs (with time costs) for the year 2000 for the Australian small businesses were estimated at $7,888 and around $5,677 million respectively (Table 1).

Aggregate GST start-up compliance costs were weighted by population distribution of small business taxpayers registered for GST (815,750 for less than $50,000 annual turnover; 561,401 for $50,000 - $99,999; 680,372 for $100,000 - $499,999 and 60,856 for $500,000 - $10,000,000). The smallest businesses within the annual turnover range of up to $99,999 incurred the highest aggregate GST start-up compliance costs of around $3,016 million, although $1,857 million (33 per cent) was incurred ‘voluntarily’ as they were under the $50,000 registration threshold (Table 1). Those in the annual turnover band of $100,000 - $499,999 incurred $2,096 million. Finally, businesses within the annual turnover range of $500,000 - $10,000,000 incurred the lowest amount of $565 million, even though their mean GST start-up compliance costs were the highest. This is because of the lowest number of small business GST registrants within this particular category.
In checking the reasonableness of consistency, the total gross GST start-up compliance costs reported by the registered GST respondents were compared with estimates derived from question 27 of the questionnaire that asked respondents the following:

“If you could claim from the ATO for the time and money spent by the business in setting-up new systems specifically for the GST, for the period up until June 2000, how much would you claim as fair compensation”?

Small businesses reported that if they were to claim from the ATO for the costs they incurred in preparing to comply with the GST, they would claim around $4 billion, a figure which is less by around $2 billion in comparison with the aggregate gross GST start-up compliance costs of this study. Factors relative to attitudes such as small businesses lobbying for a policy change as well as time valuation could be attributable to this difference.

### TABLE 1

**MEAN AGGREGATE GROSS GST START-UP COMPLIANCE COSTS**

**(INCLUDING TIME COSTS) FOR AUSTRALIAN SMALL BUSINESSES**

**YEAR 2000**

<table>
<thead>
<tr>
<th>Business Size (Taxable turnover per annum)</th>
<th>Mean Start-up Compliance Costs $</th>
<th>GST Registered Population*</th>
<th>Weighted Small Business Population</th>
<th>Aggregate Start-up Compliance Costs $Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>4,019</td>
<td>815,750</td>
<td>462,099</td>
<td>1,857</td>
</tr>
<tr>
<td>$50,000 - $99,999</td>
<td>3,645</td>
<td>561,401</td>
<td>318,017</td>
<td>1,159</td>
</tr>
<tr>
<td>$100,000 - $499,999</td>
<td>5,438</td>
<td>680,372</td>
<td>385,411</td>
<td>2,096</td>
</tr>
<tr>
<td>$500,000 - $10,000,000</td>
<td>16,390</td>
<td>60,856</td>
<td>34,473</td>
<td>565</td>
</tr>
<tr>
<td><strong>Overall</strong></td>
<td><strong>7,888</strong></td>
<td><strong>2,118,000</strong></td>
<td><strong>1,200,000</strong></td>
<td><strong>5,677</strong></td>
</tr>
</tbody>
</table>

*Figures obtained from Australian Business Register – A Snapshot. 1369.0, ABS (2000a, p5) – Sample businesses over $10 million were excluded from the grossing-up procedure.
Aggregate Equipment Costs

Using ABS (2000b) data, the number of small businesses using computers was estimated at 442,750. Overall, small business aggregate GST start-up compliance costs for equipment amounted to $1,939 million. Economies of scale are apparent as small businesses in the turnover range of less than $50,000 incurred aggregate equipment costs of $75 million. Those between $50,000 to $99,000 turnover band incurred aggregate equipment costs of $148 million and aggregate equipment costs for businesses between $100,000 and $499,999 amounted to $414 million. Finally, the highest turnover range of $500,000 to $10,000,000 incurred aggregate equipment costs of $1,302 million (Table 2).

TABLE 2
AGGREGATE EQUIPMENT COSTS FOR GST PURPOSES
BY NUMBER OF SMALL BUSINESSES USING COMPUTERS
YEAR 2000

<table>
<thead>
<tr>
<th>Business Size (Taxable turnover per annum)</th>
<th>Number of Respondents</th>
<th>Weighted Population</th>
<th>Mean Equipment Costs $</th>
<th>Aggregate Equipment Costs $ 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>15</td>
<td>33,884</td>
<td>2,226</td>
<td>75,421</td>
</tr>
<tr>
<td>$50,000 - $99,999</td>
<td>26</td>
<td>58,732</td>
<td>2,524</td>
<td>148,248</td>
</tr>
<tr>
<td>$100,000 - $499,999</td>
<td>74</td>
<td>167,161</td>
<td>2,474</td>
<td>413,592</td>
</tr>
<tr>
<td>$500,000 - $10,000,000</td>
<td>81</td>
<td>182,973</td>
<td>7,113</td>
<td>1,301,565</td>
</tr>
<tr>
<td>Overall</td>
<td>196</td>
<td>442,750</td>
<td>3,141</td>
<td>1,938,827</td>
</tr>
</tbody>
</table>

Unfortunately, stratified data based on turnover for small businesses using computers in the year 2000 was not available to facilitate reliable comparison with this study. A sensitivity analysis for equipment costs for GST compliance has been adopted. This is to establish the impact on the overall aggregate equipment costs if the number of small businesses in Australia was used for grossing up as opposed to the number of businesses that used computers in 2000. Whilst this may be academically acceptable, in practical terms, the use of sensitivity analysis may be questionable since different estimates are reported.

Thus if the extrapolation of aggregate equipment costs was performed using the number of small businesses in Australia, the gross aggregate start-up compliance costs for equipment would be slightly higher. The survey results confirmed that on average small business incurred $3,141 per small business on computer equipment for GST
purposes and aggregate GST computer compliance costs of $2,174 million. This amount does not deviate much from the former aggregate equipment costs of $1,939 million. Nonetheless, the survey amount is more reliable as it represents a generalisation of the survey results for the GST weighted population registrants. Moreover, the ABS data does not stipulate whether small businesses used those computers for GST purposes or not.

Aggregate External Advisers Costs (Professional Fees) and Other Costs

The computation of grossed up figures for professional fees amounted to $1,117 million (Table 3). This represents around 20 per cent of mean aggregate GST start-up compliance costs. Businesses that incurred the lowest aggregate professional fees (around $88 million) are those in the highest turnover band of between $500,000 - $10,000,000. Though these businesses incurred the highest mean professional fees of $2,548, the lowest aggregate professional fees of $88 million was the result of the lowest number of small businesses registered for GST (34,473) within this category. Other incidental costs were predominantly stationery, postage and telephone costs incurred in preparing for the GST compliance and these amounted to an aggregate of $57 million.

### TABLE 3
AGGREGATE TIME SPENT BY EXTERNAL ADVISERS FOR GST
YEAR 2000

<table>
<thead>
<tr>
<th>Business Size (Taxable turnover per annum)</th>
<th>Weighted Population</th>
<th>Mean Time Spent $</th>
<th>Weighted Mean Time Spent $</th>
<th>Aggregate Time Spent $ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>462,099</td>
<td>617</td>
<td>581</td>
<td>268</td>
</tr>
<tr>
<td>$50,000-$99,999</td>
<td>318,017</td>
<td>976</td>
<td>919</td>
<td>292</td>
</tr>
<tr>
<td>$100,000-$499,999</td>
<td>385,411</td>
<td>1,291</td>
<td>1,216</td>
<td>469</td>
</tr>
<tr>
<td>$500,000-$10,000,000</td>
<td>34,473</td>
<td>2,706</td>
<td>2,548</td>
<td>88</td>
</tr>
<tr>
<td>Overall</td>
<td>1,200,000</td>
<td>1,735</td>
<td>1,634</td>
<td>1,117</td>
</tr>
</tbody>
</table>

### Aggregate Time Spent

Computation of aggregate time spent by small businesses for GST compliance comprises staff time spent in:

i) learning about the new tax system
ii) record keeping for GST purposes
iii) Australian Competition and Consumer Commission (ACCC) compliance

It must be noted that these costs are inclusive of owners and managers costs (paid). Estimated aggregate time compliance costs for Australian small businesses were
around $2,329 million. Small businesses of less than $50,000 turnover incurred the highest time costs of $1,050 million. Whilst small businesses in this category incurred a higher weighted mean time cost of $2,273 as compared to the two subsequent categories, ($1,429 and $1,684 respectively), this amount is attributed to the highest number of small business GST registrants in this category (462,099). Small businesses between $100,000 - $499,999 turnover incurred time costs of $649 million whilst those in the highest turnover band of between $500,000 - $10,000,000 spent the lowest amount of $176 million in preparing for GST compliance (Table 4).

### TABLE 4

**AGGREGATE TIME SPENT**

**YEAR 2000**

<table>
<thead>
<tr>
<th>Business Size (Taxable turnover per annum)</th>
<th>Weighted Population</th>
<th>Mean Time Spent $</th>
<th>Aggregate Time Spent $ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>462,099</td>
<td>2,274</td>
<td>1,050</td>
</tr>
<tr>
<td>$50,000-$99,999</td>
<td>318,017</td>
<td>1,429</td>
<td>454</td>
</tr>
<tr>
<td>$100,000-$499,999</td>
<td>385,411</td>
<td>1,686</td>
<td>649</td>
</tr>
<tr>
<td>$500,000-$10,000,000</td>
<td>34,473</td>
<td>5,105</td>
<td>176</td>
</tr>
<tr>
<td>Overall</td>
<td>1,200,000</td>
<td>2,882</td>
<td>2,329</td>
</tr>
</tbody>
</table>

**Aggregate Internal Time Costs by Staff and Record-keeping**

In aggregate, small business owners and their staff incurred around $955 million in the year 2000 in preparation for complying with the GST. The smallest businesses (annual turnover of less than $99,999) incurred the highest aggregate gross GST start-up compliance costs of $574 million.

Aggregate internal time costs for record-keeping by Australian small businesses in preparing to comply with the GST amounted to $768 million.

**Aggregate Internal Time Costs for Australian Competition and Consumer Commission Compliance**

Aggregate internal time costs by Australian small businesses in preparing to comply with the ACCC regulations for the year 2000 were $786 million (Table 5). This represents around 14 per cent of aggregate gross GST start-up compliance costs. The ACCC targeted small businesses to ensure that they “understood their rights and obligations” under the Trade Practices Act. Small businesses had to read compliance guidelines and other numerous literature released by the ACCC containing some examples and illustrations on the Commission’s price exploitation guidelines. The
ACCC released a Report on their work during the New Tax System transition period which confirms that “there was no evidence of significant opportunistic pricing by businesses to increase margins…” (ACCC 2003, p3). Suffice it to say that $786 million incurred by small businesses in preparing to comply with the ACCC requirements is a significant amount.

**TABLE 5**
**AGGREGATE INTERNAL TIME COSTS (ACCC COMPLIANCE)**
**YEAR 2000**

<table>
<thead>
<tr>
<th>Business Size (Taxable turnover per annum)</th>
<th>Weighted Population</th>
<th>Mean Internal Time Costs (ACCC) $</th>
<th>Aggregate Internal Time Costs (ACCC) $ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>462,099</td>
<td>1,049</td>
<td>485</td>
</tr>
<tr>
<td>$50,000-$99,999</td>
<td>318,017</td>
<td>369</td>
<td>117</td>
</tr>
<tr>
<td>$100,000-$499,999</td>
<td>385,411</td>
<td>352</td>
<td>136</td>
</tr>
<tr>
<td>$500,000-$10,000,000</td>
<td>34,473</td>
<td>1,390</td>
<td>48</td>
</tr>
<tr>
<td>Overall</td>
<td>1,200,000</td>
<td>836</td>
<td>786</td>
</tr>
</tbody>
</table>

*Distribution of Aggregate Gross GST Start-up Compliance Costs*

The summary of aggregate start-up compliance costs and their distribution is presented in Table 6. Mean aggregate estimated equipment costs amounted to $2,174 million, representing 38 per cent and 65 per cent of aggregate start-up compliance costs, including and excluding time respectively. Aggregate gross external compliance costs, mainly professional fees, amounted to $1,117 million or 20 per cent of aggregate gross GST start-up compliance costs (including time) and 33 per cent excluding time. These were external advisors such as accountants and lawyers. Other costs were mainly incidental costs and amounted to $57 million or only 1 per cent and 2 per cent of the overall costs (including and excluding time respectively). Overall, aggregate small business start-up compliance costs without time were $3,348 million.

Aggregate time costs for GST compliance were $2,329 million and comprised staff, owners and managers costs of learning about the GST and staff training of around $1 billion (which accounts for around 50 per cent of mean aggregate time costs), record keeping of $768 million and compliance with ACCC costs of $786 million. Overall, time costs represent the most significant costs at 41 per cent, followed by equipment costs at 38 per cent, professional fees at 20 per cent and incidental costs, such as stationery, telephone calls and postage of 1 per cent (Table 6).
TABLE 6
DISTRIBUTION OF ESTIMATED MEAN GROSS AGGREGATE SMALL BUSINESS
GST START-UP COMPLIANCE COSTS
YEAR 2000

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>Mean Cost $</th>
<th>Aggregate Costs $ Million</th>
<th>Percentage Costs (including time)</th>
<th>Percentage Costs (excluding time)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment costs*</td>
<td>3,141</td>
<td>2,174</td>
<td>38</td>
<td>65</td>
</tr>
<tr>
<td>Professional fees</td>
<td>1,634</td>
<td>1,117</td>
<td>20</td>
<td>33</td>
</tr>
<tr>
<td>Other, e.g. stationery</td>
<td>231</td>
<td>57</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Overall without time</td>
<td>5,006</td>
<td>3,348</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Total time costs**</td>
<td>2,882</td>
<td>2,329</td>
<td>41</td>
<td>-</td>
</tr>
<tr>
<td>Overall with time</td>
<td>7,888</td>
<td>5,677</td>
<td>100</td>
<td>-</td>
</tr>
</tbody>
</table>

*Does not include weighting of businesses that upgraded software only.
**Includes owner and manager (paid) time as it is not possible from the data to estimate owner’s and manager’s paid time separately.

Comparison with the Major Australian Recurrent Compliance Cost Study and the Regulation Impact Statement (RIS)

Nationally, there is no doubt that estimated aggregate start-up compliance costs of the Australian GST are significant compared to those of the whole Australian business tax system estimated by Evans et al (1997). This research has estimated aggregate gross GST start-up compliance cost for the year 1999-2000 at around $5,677 million, representing around 59 per cent of aggregate gross compliance of Australian business taxes ($8,877 million, increased by 8 per cent inflation = $9,587 million) estimated by Evans et al (1997). The Regulation Impact Statement (RIS, 1998) reveals that the government had estimated overall start-up costs at $2.2 billion, a figure which is lower than this study’s aggregate gross GST start-up compliance costs (which excludes large businesses) by around $3 billion.

Overview

In addition to measuring small business GST start-up compliance costs in absolute monetary terms, estimated aggregate GST start-up compliance costs as a percentage of tax revenue and as a percentage of Gross Domestic Product (GDP) was performed. Whilst almost all major (recurrent) compliance costs studies have used percentage cost figures in measuring compliance costs, Sandford and Hasseldine (1992, p2) have asserted that caution must be taken.

Sandford and Hasseldine’s view is that whilst compliance costs as percentage of tax revenue is useful, “as an input to output relationship… they are only valid for the year to which they relate. The reason being that revenue may alter significantly (for example, by a change in tax rate) with little or no change in compliance costs, and this may significantly affect the ratio” (Sandford and Hasseldine 1992, p2). As regards expressing compliance costs as percentage of GDP, Pope (2000c, p18) asserts that this should be restricted to business taxation. This is due to the opportunity costs included in compliance costs. However, non-working time valued by taxpayers is not recorded in GDP statistics.


In 1999-2000 financial year, the ATO collected taxation revenue from all sources amounting to $153,288 million (ATO 2000a, p33). Small business GST start-up compliance costs represented around 4 per cent of taxation revenue from all sources in 1999-2000 (Table 7).

<table>
<thead>
<tr>
<th>TABLE 7</th>
<th>ESTIMATED SMALL BUSINESS GROSS GST START-UP COMPLIANCE COSTS RELATIVE TO TAXATION REVENUE</th>
<th>1999-2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGGREGATE GST START-UP COMPLIANCE COSTS</td>
<td>ATO TAX REVENUE</td>
<td>AGGREGATE GST START-UP COMPLIANCE COSTS AS % OF TAX REVENUE</td>
</tr>
<tr>
<td>$5,677 million</td>
<td>$153,288 million</td>
<td>4 per cent</td>
</tr>
</tbody>
</table>


Taxation revenue from businesses (excluding PAYG) in 1999-2000 amounted to $59,649 million (ATO 2000b). This includes company tax, GST, excise tax,
Superannuation Funds, Fringe Benefit Tax, resource rent tax, sales tax and other withholding tax (non-resident withholding tax and mining withholding tax). Thus estimated small business gross GST start-up compliance costs represented around 10 per cent of business taxation revenue in 1999-2000 (Table 8).

### TABLE 8

**ESTIMATED SMALL BUSINESS GROSS GST START-UP COMPLIANCE COSTS RELATIVE TO BUSINESS TAXATION REVENUE**

1999-2000

<table>
<thead>
<tr>
<th>AGGREGATE GST START-UP COMPLIANCE COSTS</th>
<th>BUSINESS TAX REVENUE</th>
<th>AGGREGATE GST START-UP COMPLIANCE COSTS AS % OF TAX REVENUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,677 million</td>
<td>$59,649 million</td>
<td>10 per cent</td>
</tr>
</tbody>
</table>


*Aggregate Gross Small Business GST Start-up Compliance Costs Relative to GDP in 1999-2000*

Small business GST start-up compliance costs relative to GDP in 2000 is shown in Table 9. Aggregate small business GST start-up compliance costs (without time) in 1999-2000 represent around 0.5 per cent of Australia’s GDP in 1999-2000. Gross aggregate GST start-up compliance costs (without time) figure is used because the GDP is exclusive of owners’ time. It is important to be cautious with the reliability of these figures as this study does not separate owner’s time from staff time, and as such, staff time has been excluded. However, assuming that staff time represents around two thirds of time costs, gross aggregate GST start-up compliance costs in 1999-2000 would represent around 0.7 per cent of Australia’s GDP in 1999-2000, a figure which is around 40 per cent higher than the former.
TABLE 9
ESTIMATED SMALL BUSINESS GROSS GST START-UP COMPLIANCE COSTS (WITHOUT TIME) RELATIVE TO GDP
1999-2000

<table>
<thead>
<tr>
<th>AGGREGATE GST START-UP COMPLIANCE COSTS (WITHOUT TIME)</th>
<th>GDP</th>
<th>AGGREGATE GST START-UP COMPLIANCE COSTS AS % OF GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3,348 million</td>
<td>$620,962 million</td>
<td>0.53 per cent</td>
</tr>
</tbody>
</table>


6-0 Net Aggregate GST Start-up Compliance Costs

As discussed above, net small business GST start-up compliance costs was defined as gross compliance costs less offsets. These offsets are cash flow benefits (CFB), tax deductibility of costs incurred by taxpayers and managerial benefits. Whilst CFB arise from the lawful delay in payment of the GST to the ATO and its remittance, managerial benefits are a result of improved accounting procedures and better record keeping imposed by GST compliance. However, quantification of CFB is not applicable to start-up compliance costs due to its weak relationship with these costs.

Australia and many other countries’ income tax systems allow tax compliance activities as tax deductible, except for time spent on business tax affairs by owners and unpaid helpers (Evans et al 1997, p12). Thus legitimate expenses incurred by small business taxpayers for GST compliance are tax deductible. Tran-Nam (2001b, p281) discusses studies that considered tax deductibility benefits. Tran-Nam (2001b, p281) explains that theoretically, these benefits were first considered by Johnston (1963). Allers (1994) quantified tax deductibility benefits and Pope (1994) discussed these benefits as offsets, but did not quantify them. Tran-Nam further clarifies that the ATAX team appeared to be the pioneers of a framework for tax deductibility estimation. It must be noted that tax deductibility offsets reduce tax revenue, hence is a cost to the ATO. Thus quantification of small business tax deduction expenses is an important offset of gross GST start-up compliance costs.

Another offset is the cash subsidy of $200 provided to small businesses by the Australian government. Theoretically, managerial benefits are also a vital offset, but quantification is difficult. This study has estimated managerial benefits for small business, using in-depth interviews with thirteen small business participants, but has not deducted them from the gross GST start-up compliance costs for three major reasons.

First, managerial benefits do not directly relate to the GST start-up compliance costs as small businesses noticed improvement in their systems mostly after one year of the
GST implementation. Arguably managerial benefits have a direct relationship with recurrent compliance costs. Secondly, this study follows the Sandford (1981, p96) conclusion that managerial benefits, whilst not unimportant, by their nature, are elusive and realistically difficult to value. Thirdly and most importantly, with a low sample of thirteen participants, disaggregate findings could not be grossed-up.

**Tax Deductibility, Cash Subsidy and Net Aggregate Small Business GST Start-up Compliance Costs.**

Tax deductibility estimation was derived by using the ATAX study’s framework by Evans *et al.* (1997), which Tran-Nam (2000) suggests as suitable for GST implementation costs. The ATAX study estimated the overall marginal tax rate of small businesses at 29.4 per cent, whilst the proportion of businesses that can receive tax deductibility benefits was estimated at 84.7 per cent. Tran-Nam explains that:

“Of the remaining 30.6 per cent non-taxable businesses, it is assumed that half of them (i.e. 15.3 per cent) can still receive tax deductibility benefits, so that a total of 84.7 per cent (= 69.4 per cent + 15.3 per cent) of business tax payers can take advantage of these benefits” (Tran-Nam 2000, p339).

Tran-Nam draws caution that this formula may overstate tax deductibility benefits a little because some GST registrants, such as non-profit organisations and the budget sector are not taxable.

Tran-Nam (2001b, p285) provides a formula for small business tax deductibility benefits of the GST as:

\[
\text{Tax deductibility benefits of the GST} = 0.294 \times 0.847 \times \text{Aggregate gross GST start-up compliance costs (without time)}.
\]

Thus for this research, small business tax deductibility benefits are:

\[
= \$(0.294 \times 0.847 \times 3,348) \text{ million}
= \$834 \text{ million}.
\]

In this way, on aggregate, small businesses that incurred GST start-up compliance costs would receive tax deductibility benefits of around $834 million. This figure is thus an offset to small business GST start-up compliance costs of $5,667 million.

In the survey, 62 per cent of small businesses confirmed that they used the $200 voucher provided by the government. Given 1.2 million small businesses in Australia, roughly the overall cash subsidy received by small business is around $148 million (62 X 1.2 million X $200).

Considering these offsetting benefits, the net aggregate GST start-up compliance costs for Australian small businesses is $4,695 million ($5,677 million - $834 million - $148 million). Thus the value of the tax deductibility and the cash subsidy decreased the mean gross GST start-up compliance costs by around 17 per cent.
7-0 Concluding Remarks

The mean GST start-up compliance costs per small business and aggregate gross GST start-up compliance costs were estimated at $7,888 and $5,677 million respectively. Gross aggregate GST start-up compliance costs represented 4 per cent of 1999-2000 taxation revenue from all sources. Furthermore, these costs represented 10 per cent of business taxation revenue in 1999-2000. Gross start-up compliance costs relative to Australian GDP in 1999-2000 were around 0.5 per cent. As a measure of magnitude, aggregate GST start-up compliance costs of around $5,677 million, represented around 59 per cent of aggregate gross compliance of Australian business taxes estimated by Evans et al (1997).

Aggregate gross mean GST start-up compliance costs for Australian small businesses were reduced by the offsetting benefits of tax deductibility of $834 million and the $200 cash subsidy provided by the government, amounting to $148 million. The cash flow benefit was excluded as it related more to recurrent compliance costs than start-up compliance costs. The decision to exclude managerial benefits from the calculation of net GST start-up compliance costs was mainly because small businesses noticed the benefits after the implementation of the GST. Moreover, with a lower sample of thirteen participants, disaggregated findings can not be grossed-up. Australian small business net GST start-up compliance costs amounted to $4,695 million.

As discussed above, this author acknowledges that GST start-up compliance costs may be a historical issue. However, their estimation is important for policy makers as they can provide a basis for calculation of compliance costs of other taxes. Internationally, countries yet to introduce the GST, should benefit from findings and recommendations of this study.

This research found that small businesses incurred high aggregate GST start-up compliance costs. Thus a major policy implication for minimising start-up tax compliance costs is for government to ensure that the tax system is not complex. This particular point has long been emphasised by leading taxation scholars, such as Sandford et al (1989). In fact, lessons and experience from many countries suggest that for any tax reform system, simplicity is a precondition. Sandford et al (1989, p213) recommend a simple tax structure for regular compliance costs, such as single rate, minimum borderlines, high threshold, minimum of special exemptions, beliefs and provisions. Pope (1998, p29) asserts that simplicity of a tax system is often ignored by tax policy makers. Although Sandford et al discuss simplicity of a tax structure from regular compliance costs viewpoint, this is also applicable to start-up compliance costs.
References


