SMALL BUSINESS START-UP COMPLIANCE COSTS OF THE GOODS AND SERVICES TAX: ESTIMATES AND LESSONS FROM TAX REFORM

By Jeff Pope* and Nthati Rametse**

The Australian Government’s major tax reform of July 2000 included the Goods and Services Tax (“GST”) and Pay-As-You-Go (“PAYG”) system. This led to controversies arising from the economic impact upon around one million small businesses, particularly regarding their GST start-up and recurrent compliance costs. This article focuses on the former. The article begins by discussing the issue within the theoretical framework of international tax compliance cost studies. The difficulties of estimating start-up costs, particularly assigning joint costs such as computer equipment, are discussed. The main part of the article presents findings from 868 respondents to a survey of WA small businesses undertaken in September/October 2000. Comparisons with other research estimates are included. The article concludes by evaluating the efficacy of the GST/PAYG’s introduction regarding the major compliance cost issues from a small business perspective; current issues of concern and policy options; and the major lessons to be drawn by other countries contemplating tax reform measures that affect small business.

1. INTRODUCTION

On 1 July 2000, the Australian Government introduced the Goods and Services Tax (“GST”),1 combining it with a Pay-As-You-Go (“PAYG”) tax collection system. The GST is levied at a rate of 10%, with most food, health and education services zero-rated (GST free). The GST replaced the Wholesale Sales Tax (“WST”) and the

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1 The term Value-Added Tax (“VAT”) which is often used in other countries, is the same as the Goods and Services Tax (“GST”). For simplicity, the term GST is used throughout this article.
PAYG reporting system replaced a number of payment and reporting systems – Pay-As-You-Earn (“PAYE”), Prescribed Payments System (“PPS”), provisional tax and company instalments. The new tax system overall has been reviewed and analysed elsewhere. This article focuses directly upon the start-up compliance costs of the GST for small businesses in Australia; we believe such research is the first academic study of its kind anywhere in the world.

Research into the compliance costs of the GST emanates from the theoretical framework and methodologies established by Professor Cedric Sandford, “the world’s outstanding authority on the identification and measurement of compliance costs”. However, although Sandford recognises the theoretical importance of start-up costs, this is an area on which he did not make any estimates. This is probably simply because the taxes he investigated were well established in the UK at the time of his various studies. It is worth stressing that, at the time (1970s - early 1990s), even estimating recurrent tax compliance costs was a pioneering and challenging task.

The authors see the value of this research primarily in terms of: estimating Australian small business GST start-up costs (a resource cost to the economy), as a matter of historical record; the costs incurred by new small businesses setting up and registering for GST each year (of the order of 5-10% pa); contributing to Australian policy debate on the burden of the GST on small business (although this will inevitably focus more and more on recurrent costs); and contributing to the international literature on (any) tax start-up costs, of which there is a surprising dearth of information.

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4 The development of Tax Impact Statements in various OECD countries in the 1990s is recognized: C Evans and M Walpole, Compliance Cost Control: A Review of Tax Impact Statements in the OECD (1999). However, their depth in forecasting
follows the Australian Taxation Office (“ATO”) approach of defining small business by turnover, that is, $10 million or less.\(^5\)

Compliance costs 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.\(^6\) Thus GST start-up costs are those costs incurred by businesses in preparing to comply with GST legislative prescriptions.

Like any other tax compliance costs, GST start-up tax compliance costs are normally broken down into gross and net costs. The former represents the total resource cost to the economy before any offsetting benefits are taken into account, while the latter includes a reduction with the tax deductibility of the various costs incurred and the value of any cash flow benefits (“CFB”) arising from taxpayers. Cash Flow Benefits arise from the lawful delay in payment of tax to the tax authorities and in the delay in remittance of tax revenue collected by them on behalf of the government.\(^7\) Managerial benefits arising from improved accounting procedures are also an important offset, particularly for small business, although quantification is very difficult.\(^8\) For start-up costs, the major offset arises from tax deductibility of expenses plus (for Australia’s GST) a subsidy (voucher) of $200 per small business. Theoretically, managerial benefits are positively related to the level of start-up costs. There should be some relationship between CFB and the level

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of start-up costs, although there is probably a much weaker relationship that may be difficult to estimate in practice.\(^9\)

This article is organised as follows. Following this introduction, the second part of this article discusses the start-up compliance costs of a GST within the context of international tax compliance cost studies and theoretical issues and difficulties. The third part then briefly considers the benefits arising from technology and managerial benefits in complying with GST requirements in the context of small business activities overall. Part four reviews other Australian studies’ estimates of small business GST start-up costs. The fifth part then presents preliminary findings from around 868 respondents to a survey of WA small businesses on their GST start-up costs undertaken in September/October 2000. The final part discusses policy implications and the lessons that may be drawn from Australian tax reform. This includes a summary of the key estimates, a short discussion on further work and international policy implications.

2. THE INTERNATIONAL TAX COMPLIANCE COST LITERATURE

2.1 GST Compliance Costs and Start-up Costs

Compliance costs literature identifies Adam Smith in 1776 as first recognising the importance of compliance costs,\(^10\) although economists have largely ignored Smith’s work on compliance costs. Professor Cedric Sandford of the University of Bath, conducted various major studies into compliance costs, including VAT, in the UK.\(^11\) Sandford and Hasseldine\(^12\) also investigated compliance costs

\(^9\) Such theoretical issues are being considered in greater depth in our current research. To the small businessperson, CFB are probably just seen as part of managerial benefits.
\(^10\) Sandford et al, above n 6, 24-25.
\(^11\) Ibid.
\(^12\) CT Sandford and J Hasseldine, The Compliance Costs of Business Taxes in New Zealand (1992).
of New Zealand’s GST. In Australia, Pope, Fayle and Chen\textsuperscript{13} conducted research on the compliance costs of the WST. The Australian Taxation Studies Program (“ATAX”), at the University of New South Wales\textsuperscript{14} also investigated compliance costs of Australian taxes. ATAX reported an inverse relationship between business compliance costs (as a percentage of annual turnover) and business size (measured in terms of annual turnover) in 1994-95. Small and medium size business tax compliance costs were $1,000 and $5,000 respectively. In contrast, large businesses enjoyed negative tax compliance costs of $30,000 per taxpayer after taking into account all offsets.\textsuperscript{15} It must be emphasised that these studies focused on recurrent costs.

Three studies do shed some light on start-up costs; two Canadian and one British.\textsuperscript{16} The Canadian Federation of Independent Business (“CFIB”),\textsuperscript{17} Canada’s largest small business lobby group, undertook a survey of their members in the first year (1991) of the GST’s operation in Canada. They estimated start-up costs of C$3.0 billion and recurrent costs of C$6.6 billion (around 30% of tax revenue at the time). On these estimates, start-up costs represent around 45% of recurrent costs. Brooks cautions that “these estimates may be influenced by selection bias and other threats to validity and reliability ...”.\textsuperscript{18} By contrast, a slightly later study by Plamondon and

\begin{itemize}
\item C Evans, K Ritchie, B Tran-Nam and M Walpole, \textit{Taxpayer Costs of Compliance} (1997).
\item B Tran-Nam, C Evans, K Ritchie and M Walpole, \textit{Tax Compliance Costs: Research Methodology and Empirical Evidence from Australia} (1999).
\item J Pope, “Factors Affecting the Compliance Costs of the Goods and Services Tax in Australia”, in Evans et al, above n 3, 139.
\end{itemize}
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Associates\(^{19}\) found that Canadian GST compliance costs, expressed as a percentage of business turnover, were lower than those in New Zealand for registrants with less than C$1 million turnover pa. Once again, some caution is needed because of the methodology used in this study.\(^{20}\)

The other major study to estimate start-up compliance costs is Gunz, Macnaughton and Kensley,\(^{21}\) in their investigation into Canadian research and development tax incentives. Their findings were that start-up costs were around 84% of recurrent compliance costs, yet only represented 0.4% of the total research and development tax credits claimed. The start-up cost breakdown was 77% for learning about the tax credit program and staff training and 23% for setting up new forms and systems to capture the necessary information. Start-up costs have a regressive pattern (falling from 3.5% down to 0.6% as company size increases), although this is less marked than for recurrent costs. Payments to outside advisers (consultants) accounted for around half of start-up costs compared to about one-quarter for recurrent costs. The study also found that 31% of companies reported management benefits in the specific tax credit program of at least 20-25%.

Although not related to GST, the contribution of Gunz, Macnaughton and Wensley to the literature is important. Whilst its start-up cost estimate vis-à-vis its recurrent cost estimate is higher than the CFIB study, it may well be more reliable than the latter. The Gunz, Macnaughton and Wensley study suggests, in round terms, that a firm has a “double year” of compliance costs in its start-up year – one year’s worth of recurrent compliance costs plus an almost equal amount of start-up costs.

In the UK, the impact of the Single European Market had a compliance cost impact on some 130,000 large businesses.\textsuperscript{22} HM Customs and Excise estimated the 1992 start-up costs (called set-up costs) for the GST component of this change at 72\% of recurrent costs for 1993, at £6.3 million and £8.8 million respectively.

Thus the very limited international evidence to date on start-up compliance costs tentatively suggests a percentage figure that is significant but less than a full year’s recurrent costs. Of course in Australia we will be unable to compare start-up and recurrent GST cost estimates for (at least) several years; currently there is no major study into recurrent costs being undertaken.

It must be noted that GST compliance cost estimates for Australia ("RIS")\textsuperscript{23} are based on recurrent costs of GST of other countries, in particular New Zealand. However, the Government did acknowledge that start-up costs may be up to a similar magnitude of annual recurrent costs. Moreover, the RIS did not provide any breakdown of its aggregate gross compliance cost estimate of $1.9 million for the year 2001-02 by size of business (small, medium and large). Indeed, it could be accused of skirting over the issue of the impact of the GST on small business by failing to recognise the regressivity of GST compliance costs.\textsuperscript{24}

\textsuperscript{22} National Audit Office, \textit{HM Customs and Excise: Cost to Business of Complying with VAT Requirements} (1994) 25, especially Table 4.
2.2 Small Business GST Recurrent Cost Estimates

Sandford notes the importance of making international comparisons of the GST compliance cost estimates, but also articulates cautiousness about the figures, as they "would be more likely to mislead than enlighten".25 This is due to differences in taxation cultures, systems and processes of different countries. For Australian GST, the Government acknowledged that comparison with other countries provided some indication of possible range and level of compliance costs involved. In New Zealand, the size of the business was the most significant factor in determining compliance costs and nearly 60% of the compliance costs fell on businesses with turnover below NZ$250,000,26 a point ignored by the Government.27

Cnossen28 made a comprehensive review of administrative and compliance costs of the GST in the UK, New Zealand and Canada, by converting data from the original studies of these countries into US$ for six annual turnover categories. His analysis clearly indicates that compliance costs of GST, as a percentage of sales, fall with exceptional severity on very small businesses, as shown in Table 1.

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25 Sandford, above n 20, 405.
26 Sandford and Hasseldine, above n 12, 78.
27 RIS, above n 23.
Table 1: GST Compliance Costs of Small Businesses in the UK, New Zealand and Canada

<table>
<thead>
<tr>
<th>Size of Business (Taxable Turnover in US$ Thousands pa)</th>
<th>UK (86/87)</th>
<th>New Zealand (90/91)</th>
<th>Canada (92)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 50 Percentage of Turnover</td>
<td>1.49</td>
<td>2.06</td>
<td>n/a</td>
</tr>
<tr>
<td>50-100 Percentage of Turnover</td>
<td>0.70</td>
<td>0.91</td>
<td>0.39</td>
</tr>
<tr>
<td>100-200 Percentage of Turnover</td>
<td>0.50</td>
<td>0.67</td>
<td>0.36</td>
</tr>
<tr>
<td>200-500 Percentage of Turnover</td>
<td>0.44</td>
<td>0.47</td>
<td>0.15</td>
</tr>
<tr>
<td>500-1,000 Percentage of Turnover</td>
<td>0.34</td>
<td>0.28</td>
<td>0.09</td>
</tr>
<tr>
<td>1,000-10,000 Percentage of Turnover</td>
<td>0.07</td>
<td>0.04</td>
<td>0.06</td>
</tr>
</tbody>
</table>


Table 1 shows the considerable economies of scale for the GST recurrent compliance costs for the three countries. As the size of the business decreases, compliance costs increase as a percentage of turnover. For example, businesses with a taxable turnover of less than US$50,000 pa in the UK incur compliance costs of 1.49% and as their taxable turnover increase, their compliance costs decrease. Overall, this analysis suggests that costs may be as high as 2% of annual turnover for the smallest businesses.

2.3 Theoretical Issues and Estimation Difficulties

Compliance costs literature explains compliance costs of taxation as comprising both economic and non-economic costs. This forms the theoretical framework of the start-up tax compliance costs of the GST. These theoretical issues have been well identified and
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discussed elsewhere.29 Suffice it to say that there are three main areas of focus:

1) Valuing Small Business Time Costs

If time costs have been converted to a monetary cost, the issue of valuing time becomes critical.30 The approach adopted in this study is to value time using a $20 per hour rate (in 1994/95) established for small businesses in the ATAX study.31 The question of whether this figure needs to be updated, at least in line with inflation, is recognised. Nonetheless, with low inflation rates, it is a relatively minor issue.

2) Joint Costs

Allocation of joint costs for both tax and managerial purposes has long been recognised as problematic. The literature confirms that overhead costs, such as office accommodation, lighting, heating, computer equipment, are difficult to allocate where they are jointly used in normal business activities and tax compliance work.32

Our study has attempted to deal with the joint cost problem by carefully worded survey questions that recognised that small businesses may be incurring information technology costs that may be incurred anyway. Simply stated, we distinguished between incurring costs for a computer and/or software for the first time, upgrades and computer/software that would have been purchased or leased irrespective of the GST’s introduction. Nonetheless, we recognise that very careful consideration needs to be given to this sensitive estimation issue.

30 Pope, above n 16.
31 Evans et al, above n 14, 11-12.
32 Pope and Rametse, above n 8.
3) Non-economic Costs

Non-economic costs, which are almost immeasurable\textsuperscript{33} include psychological costs related to stress and anxiety of small business staff and owners arising from complying with the GST requirements.\textsuperscript{34} In this way, increased record keeping requirements of a GST, coupled with knowledge of their intended use as an audit tool for the PAYG system\textsuperscript{35} may cause anxiety and distrust. Such costs are recognised but not estimated in our study.

3. MAJOR BUSINESS ISSUES IN THE CONTEXT OF SMALL BUSINESS GST START-UP COSTS

3.1 Information Technology

It may be argued that technological development is essential for small business, in particular, electronic lodgement of GST and PAYG, although the Government kept it optional for small business. Paradoxically, it could be costly for small businesses to acquire or upgrade computers and accounting software. Major differences on the start-up costs of technology for small and medium-sized businesses were apparent in the Canadian GST study.\textsuperscript{36} Medium-sized businesses reported higher software costs than small businesses but lower equipment costs. This indicated that unlike smaller firms, medium sized businesses already had computers and only needed to spend on upgrades rather than new acquisitions. Research has shown that small businesses, as compared to medium-sized and larger firms, have high compliance cost burdens because they do not generally use automated collection and reporting systems\textsuperscript{37}

\textsuperscript{33} MA Allers, \textit{Administrative and Compliance Costs of Taxation and Public Transfers in the Netherlands} (1994) 55.
\textsuperscript{34} Pope and Rametse, above n 8.
\textsuperscript{35} Pope, above n 7.
\textsuperscript{36} CFIB, above n 17.
3.2 Management Efficiency and GST Benefits

The issue of managerial benefits has been recognised by compliance cost experts and government. The Australian Government is of the view that GST start-up compliance costs, such as the cost of upgrading computer systems, will also lead to managerial benefits.\(^{38}\) This means that businesses will benefit from better record keeping and knowledge of business’s finances forced on them by the GST. The New Zealand study found that smaller businesses obtained considerable managerial benefits from improved accounting as a result of this, but was unable to make a monetary estimate.\(^{39}\)

GST proponents generally believe that the GST will force small businesses to monitor their cash flow, as they have tended not to do so. This view has earlier been contested by Evans and Walpole,\(^{40}\) who argue that it is less certain that small businesses will monitor cash flows better since they are often either too busy or disinclined to monitor their financial situation as closely as they should. The benefit of better record keeping may not be recognised by many and some may regard it as a compliance burden.

Tran-Nam et al\(^{41}\) explain the view that managerial benefits theoretically exist, but are difficult to quantify and are therefore, typically omitted in empirical studies. However, the Sandford et al\(^{42}\) and National Audit Office of the UK\(^{43}\) studies suggest that the value of managerial benefits can be quite considerable, possibly around 10% of gross costs.

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\(^{38}\) RIS, above n 23.
\(^{39}\) Sandford and Hasseldine, above n 12. 76-78.
\(^{41}\) Tran-Nam et al, above n 15.
\(^{43}\) National Audit Office, above n 22.
4. OTHER STUDIES’ ESTIMATES OF AUSTRALIAN SMALL BUSINESS GST START-UP COSTS

To the authors’ knowledge, nine major studies (non-industry specific) are publicly available on the GST start-up costs for small business, as shown in Table 2. As can be seen, there is a fairly wide range of estimates, with many based on very small survey numbers that reflect a depth study rather than a representative survey (of even a narrow population of interest to the researchers rather than the approximately 900,000 small businesses in Australia). Unfortunately it is not possible to critique each study in this article. Moreover, the varied methodologies (mainly telephone, questionnaire survey and case study) and particularly the different treatment of time costs render comparisons and inferences extremely difficult. The reliability of some of the results has been widely discounted on the basis of the joint cost issue and the methodology used. Whilst AC Nielsen, Pope et al and Victorian Chamber of Commerce and Industries (“VECCI”) method of collecting information was a survey, Ernst & Young used a case study method. It must be noted that the Ernst & Young figures have been averaged over the four firms reviewed.

Nonetheless, a pattern does seem to emerge, as identified by the Economic Development Committee of the Parliament of Victoria study, namely that Australian small business GST start-up costs are

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46 VECCI Survey of Business Trends and Prospects included special questions on GST compliance issues. Surveyed businesses were asked to estimate the dollar value and time costs (compliance burden) associated with meeting their GST obligations in the lead up to 1 July 2000.
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roughly of the order of $6,000 per business. It must be emphasised that citing such a figure hides the very wide range of costs incurred by different types of small business, a factor discussed in greater detail later.
<table>
<thead>
<tr>
<th>Study</th>
<th>Average Start-up Costs ($)</th>
<th>Average Time Spent (hrs)</th>
<th>Number of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ernst &amp; Young 1999</td>
<td>17,016</td>
<td>64</td>
<td>4</td>
</tr>
<tr>
<td>Ac Nielson 1999</td>
<td>2,618</td>
<td>n/a</td>
<td>602</td>
</tr>
<tr>
<td>Pope et al 1999</td>
<td>3,500</td>
<td>80</td>
<td>129</td>
</tr>
<tr>
<td>VECCI 1999</td>
<td>3,500</td>
<td>142</td>
<td>328</td>
</tr>
<tr>
<td>VECCI 2000</td>
<td>6,814</td>
<td>100-300</td>
<td>70</td>
</tr>
<tr>
<td>VECCI 2000</td>
<td>5,000-30,000</td>
<td>n/a</td>
<td>170</td>
</tr>
<tr>
<td>RSM Bird Cameron 2000</td>
<td>6,000</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>EDC, Vict. Parl't 2000</td>
<td>12,380*</td>
<td>included above**</td>
<td>6</td>
</tr>
<tr>
<td>Victory University 2001</td>
<td>5,387</td>
<td>n/a</td>
<td>264</td>
</tr>
<tr>
<td>Patterson 2001</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 2: Summary of Small Business GST Start-up Compliance Cost Estimates (from Major Studies, 1999-2001)
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Notes:

* Time period was from early June to mid November 2000 ie up to the lodgment of the first quarterly Business Activity Statement ("BAS") (GST) return. Costs are $6,012 excluding time costs.

** 170 hours, giving a cost of $6,368 at an average opportunity cost of $37.46 per hour (derived from the “employer hourly rate”). Time costs thus account for 51% of the average start-up costs of $12,380.

n/a indicates either not estimated or not cited. Implicitly time costs would be included in the monetary estimate.

1) Number of respondents refers to small business respondents only and excludes respondents in other categories in some surveys, with the exception of the VECCI survey\(^{49}\) where a breakdown was not given. Cost and time estimates refer to small business only (and are mutually exclusive unless stated).

2) The Economic Development Committee Report estimate was based on a synthesis of evidence from other studies and submissions. A high reliance appears to have been placed on the VECCI (2000)\(^{50}\) survey findings, albeit with a conservative estimate cited.

3) There may be other smaller and/or unpublished studies not known to the authors.


4) A few studies have focused on large business or have not distinguished between large and small business eg PricewaterhouseCoopers\textsuperscript{51} and these are not included.

Sources: refer text and References.

Further, it should be emphasised that most studies to date report a wide variation in small business GST start-up cost estimates, perhaps from as little as $200 up to around $50,000. Median estimates are often well below mean estimates, reflecting that a small number of businesses reporting very high compliance costs unduly influence the estimates. The latter may well include expensive upgrades of computer equipment that should not be legitimately attributed to the introduction of the GST, as discussed earlier. Estimates also vary widely by type of industry, with retail/wholesale reporting the highest costs and entertainment, recreation, restaurants and personal services reporting the lowest.

5. PRELIMINARY FINDINGS OF A SURVEY OF SMALL BUSINESSES IN WESTERN AUSTRALIA

5.1 The Survey

A large-scale mail questionnaire survey\textsuperscript{52} was used to collect information from a sample of 4,000 small businesses in Western Australia in September/October 2000. The survey was undertaken through a bought-in small business listing derived from the Yellow Pages Electronic Telephone Directory because the ATO was unwilling to provide a stratified sample.

The researchers were confident that nearly all the businesses surveyed would be registered for the GST because of the low GST registration threshold of A$50,000. We obtained 868 useable responses, giving a response rate of 27% (after allowing for out-of-...

\textsuperscript{51} PricewaterhouseCoopers, \textit{Survey of GST Start-Up Costs}, July 2001 (private communication).

\textsuperscript{52} Available on request.
frame replies). This is reasonably good compared with the compliance cost literature and especially in the light of the antipathy held by many small business-persons and the unavoidable timing of the survey. The latter was close to the time of the first BAS quarterly return in November 2000. Around 75% of respondents were located in the Perth metropolitan area and 25% in rural WA.

Returns were scrutinised for validity and a few questionnaires with extreme or unbelievable outliers were excluded from the analysis. It must be emphasised that the findings presented here are preliminary estimates. Various cross-checking and further analysis remains to be undertaken. Against such caution must be set the need for dissemination of findings because of the current Australian policy debate and lobbying by small business on its “acting as an unpaid tax collector”.

The mean estimates presented below give an indication of the burden incurred by small business in implementing the GST and may be set in the context of and assessed against, estimates from other studies (as presented in Table 2 above). It is worth noting that overall there is a wide or fairly wide range of estimates from respondents i.e. the standard deviation is high or fairly high. A further qualification to the estimates is that they are unweighted i.e. the estimates show the costs incurred by those businesses actually incurring such costs. Further analysis will weight these costs in proportion to the percentage of businesses incurring such costs in order to provide an overall weighted average estimate.

5.2 Start-up Cost Estimates

Small business respondents reported that on average they incurred GST start-up costs (excluding their time costs) of $5,006 plus an average of 131 hours per firm introducing new systems and

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53 Our net sample frame was 3,199. The 801 out-of-frame responses reflect the relatively high turnover in small business composition and addresses and possibly a somewhat dated bought-in address list.

54 Essentially the GST return.
procedures to comply with GST requirements. Time spent valued in dollars amounted to $2,620 (at an opportunity cost of $20 per hour), or 34% of total start-up costs of $7,626 (Table 3). Thus small business respondents reported that their gross GST start-up costs ie before considering any off-sets, were $7,626. This estimate comprises the cost of equipment, particularly computers and software, costs such as professional accounting and IT consultancy fees, training course fees, stationery and phone calls and also (opportunity) time costs.

Table 3: Estimated Mean Gross Small Business GST Start-up Compliance Costs (WA)

<table>
<thead>
<tr>
<th>Number of Respondents</th>
<th>Hours</th>
<th>Cost $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment Costs</td>
<td>3,044</td>
<td></td>
</tr>
<tr>
<td>Other Costs eg Professional Fees, Stationery</td>
<td>1,962</td>
<td></td>
</tr>
<tr>
<td>Total Costs (without time)</td>
<td>808</td>
<td>5,006</td>
</tr>
<tr>
<td>Total Time Costs</td>
<td>826</td>
<td>131</td>
</tr>
<tr>
<td>Total Start-up Compliance Costs</td>
<td></td>
<td>7,626</td>
</tr>
</tbody>
</table>

The total internal time spent in preparing for GST has three main components, namely staff time (particularly on learning and training), improved record-keeping prior to the GST’s introduction and compliance with the Australian Competition and Consumer Commission’s (“ACCC”) pricing and anti-profiteering regulations.  

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Small business owners and their staff typically spent 58 hours (or $1,160 in monetary terms) in preparing for the GST. Record keeping was estimated at 35 hours ($700). Compliance with ACCC regulations accounted for a further 38 hours ($760), as shown in Table 4.

It is worth noting that few if any of the other studies specifically investigated the costs attributable to the ACCC’s pricing regulations. Further, these costs account for around 29% of total time costs and around 10% of overall start-up costs for WA small business. Although not large, this estimate may be higher than many commentators would expect, as the conventional wisdom at the time was that the ACCC regulations would impact primarily on large business.

Table 4: Estimated Mean Total Time Spent on GST Start-up

<table>
<thead>
<tr>
<th></th>
<th>Number of Respondents</th>
<th>Hours</th>
<th>Cost*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal (Staff)</td>
<td>804</td>
<td>58</td>
<td>1,160</td>
</tr>
<tr>
<td>Internal (record keeping)</td>
<td>555</td>
<td>35</td>
<td>700</td>
</tr>
<tr>
<td>Internal (ACC compliance)</td>
<td>643</td>
<td>38</td>
<td>760</td>
</tr>
<tr>
<td>Total Internal</td>
<td>131</td>
<td></td>
<td>2,620</td>
</tr>
</tbody>
</table>

* Assuming an opportunity cost per hour of $20.00

Table 5 below shows that 497 small businesses reported that on average their equipment costs for GST compliance amounted to $3,141 and 48 reported spending an average of $3,218 on equipment used on their normal business activities.
Table 5: Mean Gross GST Start-up Equipment Compliance Costs

<table>
<thead>
<tr>
<th>Equipment</th>
<th>Number of Respondents</th>
<th>Amount $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment for GST compliance</td>
<td>497</td>
<td>3,141</td>
</tr>
<tr>
<td>Equipment update</td>
<td>192</td>
<td>2,536</td>
</tr>
<tr>
<td>Equipment – normal usage</td>
<td>48</td>
<td>3,218</td>
</tr>
</tbody>
</table>

5.3 Start-up Compliance Costs as a Percentage of Turnover

Preliminary results of this survey show, not surprisingly, that start-up costs of the GST are regressive. In absolute terms start-up costs increase with the size of the firm since larger firms generally collect more tax and require more resources for the collection of the tax. However, start-up compliance costs expressed as a percentage of turnover show the considerable economies of scale that are observed in nearly all studies of recurrent compliance costs. As the size of the business increases, compliance costs decrease as a percentage of turnover ie start-up costs are regressive, as shown in Table 6.

Table 6: Mean Gross GST Start-up Compliance Costs as a Percentage of Turnover (including time costs)

<table>
<thead>
<tr>
<th>Business Size (Taxable turnover in AUSS thousands pa)</th>
<th>Number of Respondents</th>
<th>Total Costs $</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>103</td>
<td>3,721</td>
<td>14.88</td>
</tr>
<tr>
<td>$50,000 - $99,999</td>
<td>139</td>
<td>3,375</td>
<td>4.50</td>
</tr>
<tr>
<td>$100,000 - $499,999</td>
<td>314</td>
<td>5,035</td>
<td>1.68</td>
</tr>
<tr>
<td>$500,000 - $1,000,000</td>
<td>129</td>
<td>10,809</td>
<td>0.44</td>
</tr>
<tr>
<td>$1,000,000 - $10,000,000</td>
<td>168</td>
<td>11,559</td>
<td>0.32</td>
</tr>
</tbody>
</table>

For example, for businesses with less than $50,000 turnover, GST start-up compliance cost is 15% (of annual taxable turnover). Businesses in the range of $50,000-$99,999 incurred GST start-up costs of 5% followed by 1.68% for those in the range of $100,000-
START-UP COMPLIANCE COSTS

$500,000 and 0.44% for those with a turnover of between $500,00-$1,000,000. Businesses with $1,000,000-$10,000,000 turnover incurred GST start-up costs of 0.32%. This shows that very small (or micro) businesses bear a very high relative burden in implementing a GST.

5.4 Other Survey Findings

Most small businesses (78%) registered for the GST less than 6 months before it commenced ie January to June 2000, with the remainder (22%) registering in 1999. The Government GST start-up voucher of $200 was used by 62% of respondents. Accounting for the GST is fairly even, with 54% using the accruals system and 46% the cash basis. Just under a third of respondents (29%) indicated that the choice of accounting method presented difficulties, although there was no discernible difference by size of business. By type of industry, primary production and hospitality experienced the highest level of difficulties (42%).

Small businesses were asked to indicate the sources of GST advice they received (from 10 different sources). Findings are summarized in Table 7.
Table 7 Sources of Advice

<table>
<thead>
<tr>
<th>Source of Advice</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accountants</td>
<td>85</td>
</tr>
<tr>
<td>GST Booklets</td>
<td>95</td>
</tr>
<tr>
<td>Industry Seminars</td>
<td>87</td>
</tr>
<tr>
<td>ATO Seminars</td>
<td>84</td>
</tr>
<tr>
<td>ATO Visit</td>
<td>72</td>
</tr>
<tr>
<td>ATO Website</td>
<td>62</td>
</tr>
<tr>
<td>GST Start-up Office</td>
<td>62</td>
</tr>
<tr>
<td>Friends/Relatives</td>
<td>62</td>
</tr>
<tr>
<td>Other Government Departments</td>
<td>38</td>
</tr>
<tr>
<td>Other</td>
<td>67</td>
</tr>
</tbody>
</table>

The majority of respondents (95%) ranked GST booklets as their most important source of advice, followed by industry seminars (87%) and accountants (85%).

Accountants are still ranked amongst the top three sources of advice. This could be that, unlike large firms that usually have accounting departments and employ in-house accountants, GST work for small businesses falls on the owners themselves or they rely on their accountants for advice or outsource their accounting services. However, 64% of small businesses indicated that they would lodge GST returns themselves, whilst 36% said they would use their accountants.

The distribution of both computer and software costs acquired for GST purposes by size of the firm (turnover) is shown in Table 8. It is clear that these costs, in absolute terms, are regressive and demonstrate economies of scale as a percentage of turnover.
Table 8: Mean Computer and Software Cost for GST Purposes by Turnover

<table>
<thead>
<tr>
<th>Business Size (Taxable Turnover in AUS thousands pa)</th>
<th>New Software</th>
<th>%</th>
<th>N</th>
<th>Software Upgrade</th>
<th>%</th>
<th>N</th>
<th>Computer</th>
<th>%</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>2.225</td>
<td>15</td>
<td>68</td>
<td>2.324</td>
<td>26</td>
<td>61</td>
<td>2.474</td>
<td>47</td>
<td>69</td>
</tr>
<tr>
<td>$50,000-$99,999</td>
<td>2.324</td>
<td>26</td>
<td>566</td>
<td>2.474</td>
<td>47</td>
<td>69</td>
<td>4.232</td>
<td>47</td>
<td>69</td>
</tr>
<tr>
<td>$100,000-$499,999</td>
<td>2.474</td>
<td>47</td>
<td>566</td>
<td>4.232</td>
<td>47</td>
<td>69</td>
<td>4.232</td>
<td>47</td>
<td>69</td>
</tr>
<tr>
<td>$500,000-$999,999</td>
<td>4.232</td>
<td>47</td>
<td>98</td>
<td>4.232</td>
<td>47</td>
<td>69</td>
<td>4.232</td>
<td>47</td>
<td>69</td>
</tr>
<tr>
<td>$1,000,000-$10,000,000</td>
<td>4.232</td>
<td>47</td>
<td>98</td>
<td>4.232</td>
<td>47</td>
<td>69</td>
<td>4.232</td>
<td>47</td>
<td>69</td>
</tr>
</tbody>
</table>

* Number of respondents

Table 8 shows that 28 and 12 businesses with less than $50,000 turnover reported a higher cost of new software acquisition (2%) than a software up-grade (1%), respectively. This indicates that many businesses in this range did not have computers as compared to businesses that already had computers. Businesses with computers

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had to only upgrade their software rather than buy new software. For example, 70 and 31 businesses with a turnover of $500,000 to $999,999 reported spending, as a percentage of turnover, 1.7% on new software and 1% on upgrade respectively.

Around a third of respondents indicated that they expect to benefit from keeping GST records. As expected, the benefits are likely to accrue to micro and smaller businesses (up to 41% of businesses indicated potential benefits) more so than larger businesses (around 26% of businesses with $1-10 million turnover), as shown in Table 9.

### Table 9: Potential Benefits from GST Record-keeping by Turnover

<table>
<thead>
<tr>
<th>Turnover</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50,000</td>
<td>41(41%)</td>
<td>60(59%)</td>
<td>101(100%)</td>
</tr>
<tr>
<td>$50,000-$99,999</td>
<td>49(36%)</td>
<td>89(64%)</td>
<td>138(100%)</td>
</tr>
<tr>
<td>$100,000-$499,999</td>
<td>116(37%)</td>
<td>195(63%)</td>
<td>311(100%)</td>
</tr>
<tr>
<td>$500,000-$999,999</td>
<td>38(30%)</td>
<td>91(70%)</td>
<td>129(100%)</td>
</tr>
<tr>
<td>$1,000,000-$10,000,000</td>
<td>39(26%)</td>
<td>117(74%)</td>
<td>156(100%)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>283(34%)</td>
<td>552(66%)</td>
<td>835(100%)</td>
</tr>
</tbody>
</table>

The majority of respondents (72%) use the paper method to lodge their GST returns, followed by 21% using the Electronic Lodgment System and 7% the Electronic Commerce Interface. Although such figures need to be investigated more fully against Commonwealth ATO data, an estimate of 28% electronic lodgment at the outset of the GST system augurs well for improving small business efficiency. Preliminary estimates of start-up costs by method of lodgement are $4,472 for the paper method, $4,346 for the Electronic Commerce Interface method and a much higher $5,869 for the Electronic Lodgement System method. Theoretically, small businesses using technology and on-line lodgment should receive...
benefits through lower GST recurrent compliance costs (ignoring size effects).

The attitudes of small business owners show that 44% dislike doing GST paperwork, 52% consider it “unreasonably complicated”, yet 48% support the Government’s tax reform overall (compared with 28% who disapprove). Findings suggest that those who do not mind doing GST work and who support tax reform tend to have lower start-up costs than those who are more critical. The relationships and “driving forces” that help explain these findings remain to be investigated further.

6. SMALL BUSINESS POLICY IMPLICATIONS AND LESSONS FROM TAX REFORM

Our main finding is that the estimated GST start-up costs for small business (with an annual turnover of up to $10 million) in WA are around $5,000. Including owner and management time costs of 131 hours valued at $20/hour adds approximately another $2,600, giving an overall average estimate of around $7,600. This estimate accords very well with previous smaller questionnaire survey and depth studies undertaken in the eastern states, particularly in Victoria. Thus the VECCI study estimated small business GST start-up costs at around $6,800 plus (unvalued) time costs of 142 hours; RSM Bird Cameron, estimates ranged between $5,000 and $20,000 plus 100-300 hours; and the depth study by the Victoria University estimates were around $6,000 plus time costs of 170 hours valued at over $6,300.

The Economic Development Committee of the Parliament of Victoria, in their review of the evidence, considered the figure of $6,000 to be a reasonable estimate overall, taking into account a

57 Victoria University, Goods and Services Tax Implementation and Victorian Small Businesses (Final Report, Small Business Research Unit, 2000).
58 Above n 48.

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wide range of estimates from studies using various methodologies. This may be regarded as probably conservative given the importance of small business time costs that often remain unvalued in monetary terms. A study in WA,\textsuperscript{59} estimated small business GST start-up costs at around $5,600 and this figure is in line with our findings.

Other key findings from our WA study to date include the importance of: computer hardware and software costs at 40% of overall costs (including time); ACCC pricing compliance time costs at 29% of all time costs; and the regressive nature of GST start-up costs. Businesses close to the GST registration threshold (annual turnover $50,000-$99,999) incurred costs of nearly 5% of their annual turnover in setting up for the GST. This falls to under 2% for businesses with an annual turnover between $100,000 and $499,999. These figures support the views expressed by Pope\textsuperscript{60} prior to the legislation being passed by Parliament for a much higher GST registration threshold, a call that basically fell upon “deaf ears”.

Our findings also support to some degree early claims by Government and supported in the literature that small business management and efficiency may improve as a result of investment in IT, better record-keeping and ensuing decision-making. Just over a third of all respondents (34%) considered that they would achieve managerial benefits from the GST.

Much further analysis of our survey data remains to be undertaken. Investigations will focus on the distribution of start-up costs. Indications are that there is a very wide range in the level of costs incurred and that some of the highest costs may unduly influence the average estimate cited. For example, responses to a question on fair compensation for the start-up costs of the GST incur the following range. The lowest 5% of respondents sought $200 or


less, whilst the highest 5% sought $20,000 or more, the highest 1% sought $60,000 or more and the highest respondent stated $1 million. The mid-point fair compensation sought by the 683 question respondents was around $2,000.

The difficulty of allocating joint costs (between GST and normal business activities) and investment in IT that may have occurred irrespective of the GST’s introduction pose severe estimation problems for compliance cost researchers. For these reasons the authors intend to consider estimates for all major factors based on median figures as well as the mean estimates presented in this article. The distribution of costs by industry is another important area for further data analysis.

A further focus concerns the managerial benefits to small business arising from the GST. Related to this is the increased level of small business computer usage, not only for GST record-keeping and returns but in their business generally. This is a difficult and little investigated area at the forefront of international compliance research and presents many challenges. To some extent this area overlaps any investigation of recurrent GST compliance costs and careful analysis will be required in order to demonstrate the relationship between the level of start-up costs (as a business investment) and lower recurrent costs (benefits arising from technology and better management).

7. CONCLUSION

The policy areas where our work will contribute are as follows:

In Australia, our findings will demonstrate the economic burden placed on new small businesses setting up (assuming an annual turnover greater than $50,000 and compulsory GST registration). If significant, as seems likely, this then raises once again the policy issue of whether the current GST registration threshold level of $50,000 should be increased and to what level. For comparison, the UK’s current level is around A$130,000. Secondly, our research should contribute to an overall indication and hopefully estimation of
both the gross and net\textsuperscript{61} compliance costs of small business GST start-up costs. The prognosis is not good, especially when compared with original Government estimates. Indicatively, one million small businesses incurring an average cost of $6,000 each yields a gross compliance cost estimate of $6 billion.

Further, higher start-up costs may represent an investment in the latest technology yielding lower recurrent compliance costs and (in some cases) managerial benefits. This relationship needs to be investigated in the context of start-up costs. The longer-term benefits may justify the Government’s policy of a low GST registration threshold and offset to high initial costs. Thirdly, our research will contribute to the debate as to whether the Government was over-zealous in the powers given to the ACCC to enforce pricing controls, anti-profiteering and effectively limit the inflationary effects of the GST’s introduction, at least in so far as their powers impacted on small business start-up costs.

Whilst it is recognised that of course the July 2000 GST start-up costs are now “sunk costs” and can never be recovered, there are wider policy implications of relevance for future Australian tax policy and reform in so far as they affect small business.

In an international context, our research should contribute to a much better understanding of the level and incidence of GST start-up costs on small business, for countries still yet to introduce their own GST (such as the USA and many emerging countries). More generally, it will add to the very limited international literature on (any) tax start-up costs.

The major lessons from tax reform based on our research to date and the literature\textsuperscript{62} are as follows:

1. Overall, small business supports tax reform but not its complexity, with a 2:1 majority considering this

\textsuperscript{61} After tax deductions and other offsets, including the $200 Government grant to each small and medium business.

\textsuperscript{62} Word constraints preclude a detailed review and discussion in this article. The economic and political effects of Australian tax reform have been well covered in
“unreasonable”. The phrase “the devil is in the detail” comes to mind, to which should be added, in this context, its implementation.

2. The Government’s amendments to the GST lodgment return dates, BAS form and other amendments announced in February 2001 some 7 months after the GST’s introduction indicate that the Government “did not get it right first time”. This is contrary to well-known compliance cost theory advocated by, for example, Sandford.63

3. The idea of compensation for business GST start-up costs was in principle commendable. However, the impression is that this back-fired on the Government. The $200 voucher was seen by many small businesses as derisory in terms of actual costs incurred.64

4. One lobby group, the Council of Small Business Organisations of Australia (“COSBOA”) strongly lobbied for compensation for high small business recurrent compliance costs but without success. The issue has since faded, due in part to the recent demise of COSBOA. Although there is some merit in the call for compensation, overall compensation is problematical and, on balance, weak.65

5. The GST threshold remains a sensitive issue from a (theoretical) compliance cost perspective. Rather surprisingly small business seems to accept the low Australian threshold of $50,000. However, there are very

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64 See, for example, Economic Development Committee, above n 48.

strong arguments in favour of a higher threshold (especially in terms of lowering both start-up and recurrent compliance costs on small business) but arguments against (especially in terms of equitable competition between firms).66

6. There is a potential for many small businesses to achieve managerial benefits, with around one-third of small businesses (and up to 41% of micro-businesses) indicating potential benefits from GST record-keeping and around 28% submitting their GST returns electronically. If confirmed by national data, this is a sound and probably higher-than-anticipated base on which to build.

Thus the major lesson to be learnt from Australian tax reform from a small business compliance cost perspective is the need or requirement for early and detailed Government consultation with small business to “get it right the first time”. However, given that around 60% of GST start-up costs (excluding time costs) are computer hardware and software equipment such an approach would probably impact more upon recurrent than start-up costs. Our findings provide a good indication of the initial impact of the GST upon small businesses and present monetary estimates to set alongside the largely anecdotal evidence of small business GST start-up costs and benefits

66 Refer to Pope, above n 16, for further discussion.