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Estimating and Alleviating the Goods and Services Tax Compliance Cost Burden Upon Small Business

Abstract
The burden of small business acting as an 'unpaid tax collector', particularly for the Goods and Services Tax (GST), is currently subject to much political debate in Australia. However, realistic proposals as how best to alleviate this burden are few and far between. This article reviews international estimates of small business tax compliance costs, particularly for the GST, that clearly demonstrate regressivity and the large relative burden faced by small business. Estimates of small business GST start-up costs and their relevance for recurrent costs are considered, with the importance of offsetting benefits, including cash flow and managerial benefits, being recognised. The key part of the article assesses four major ways of alleviating the 'GST paperwork' burden upon small business: (monetary) compensation; raising the GST registration threshold level; improved tax payment arrangements; and taxpayer education. Based on UK and French experience, it appears that, for Australia, an extension of existing policies, particularly simplified tax payment arrangements, offer the best prospects. However, such policies need to be carefully crafted with some degree of innovation and less emphasis on the tax revenue foregone.

Keywords
tax compliance, GST, small business, goods and services tax

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ESTIMATING AND ALLEVIATING THE GOODS AND SERVICES TAX COMPLIANCE COST BURDEN UPON SMALL BUSINESS

By Associate Professor Jeff Pope

The burden of small business acting as an 'unpaid tax collector', particularly for the Goods and Services Tax (GST), is currently subject to much political debate in Australia. However, realistic proposals as how best to alleviate this burden are few and far between. This article reviews international estimates of small business tax compliance costs, particularly for the GST, that clearly demonstrate regressivity and the large relative burden faced by small business. Estimates of small business GST start-up costs and their relevance for recurrent costs are considered, with the importance of offsetting benefits, including cash flow and managerial benefits, being recognised. The key part of the article assesses four major ways of alleviating the 'GST paperwork' burden upon small business: (monetary) compensation; raising the GST registration threshold level; improved tax payment arrangements; and taxpayer education. Based on UK and French experience, it appears that, for Australia, an extension of existing policies, particularly simplified tax payment arrangements, offer the best prospects. However, such policies need to be carefully crafted with some degree of innovation and less emphasis on the tax revenue foregone.

Introduction

The compliance cost burden of taxation on small business is a worldwide phenomenon. It is part of a much wider regulatory burden imposed by government. Society generally accepts a reasonable level of compliance costs because the benefits to the community arising from regulation and taxation are greater. Of course, it is debatable what comprises a reasonable level of compliance costs. However, the primary issue affecting small business is that such compliance costs are not proportional to size of business. The 'fixed cost' nature of many tax compliance costs and ensuing economies of scale - whereby average costs fall as business size increases - have been well established by reliable studies in various countries. Small business tax compliance costs are thus regressive in nature.

This regressivity in tax compliance costs gives rise to a competition policy concern, as it conflicts with the aim of establishing a 'level playing field' (as far as practicable) between all types and sizes of business. It raises the

important economic question of the incidence of taxation - essentially who bears the final burden of any particular tax. Usually, businesses seek to pass any increased costs fully on to consumers, but may be prevented from doing so by market forces and, in some circumstances, government regulations on prices and anti-profiteering. However, small businesses in competition with large business may have difficulty passing on larger compliance costs, possibly of around 2% of their annual turnover, compared with large business compliance costs of a fraction of their annual turnover. Thus, nearly all discussions concerning the small business compliance cost burden focus on the overall situation. It must be remembered, however, that compliance cost research generally demonstrates a wide variation in costs by industry as well as size; many other internal and external factors can also account for large variations in cost. These determining factors of tax compliance costs are well discussed in the literature, for example Sandford *et al* (1989)[1] and, more recently in the context of Australian Goods and Services Tax (GST) compliance costs, Pope (2001).[2] With this caveat in mind, it is nonetheless appropriate to consider the compliance cost burden facing small business overall.

When considering the international literature on small business tax compliance costs, one major deficiency stands out, namely an absence of possible ways or policy measures to relieve the undoubted tax compliance burden on small business. As this is rather broad it seems reasonable to narrow this down to one particular tax - the GST - that is currently generating much angst in the Australian small business community. The aims of this article are threefold. First, to review the international literature on this topic, particularly regarding the GST (known as Value Added Tax in many countries). Secondly, to consider the limited Australian data on GST compliance costs to date and, thirdly, to discuss the various policy options available to the government that would help alleviate this burden on small business. It should be noted that the overall tax burden on small business is recognised as very important[3] but is outside the scope of this particular paper.

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1 CT Sandford, MR Godwin and PJW Hardwick, *Administrative and Compliance Costs of Taxation* (1989).

2 J Pope, 'Factors affecting the Compliance Costs of the Goods and Services Tax in Australia' in C Evans, J Pope and J Hasseldine (eds), *Taxation Compliance Costs: A Festschrift for Cedric Sandford* (2001) 139-157.

3 Some commentators argue that in many European countries (other than the UK) it is the absolute level of small business taxation that is of critical importance; the issue of tax compliance costs remains relatively unimportant. Cynics may say this is because of high levels of tax avoidance and/or evasion, eg in Italy.

The political importance of small business 'acting as an unpaid tax collector' since the introduction of the Australian GST is worth emphasising. One of the leading lobby groups was the Council of Small Business Organisations of Australia Ltd (COSBOA), who advocated strongly on behalf of their members. They argued for compensation for collecting the GST (with no success) and, arguably, made an important contribution to the government's GST amendments in February 2001,[4] which alleviated, or were intended to alleviate, the compliance burden upon small business.

International small business compliance cost estimates and issues

Data

A useful recent literature review of tax regulation and small business has been made by Chittenden *et al* (2001),[5] covering the USA, UK, Australia and New Zealand. They classify reports of the regulatory burden on businesses into four broad categories: synthesis of findings from a number of studies; data collection from government programmes; primary data collection from businesses across a range of activities; and primary data collection from businesses on the impact of one particular area of regulation. In the USA the first two types predominate, whilst in the UK, Australia and New Zealand the latter two predominate.

In the USA, tax compliance and payroll record-keeping are the most burdensome regulatory areas, accounting for around 80% of the small business total regulatory burden, or nearly twice as much as for larger firms.[6] There is, however, a wide variation across different types of industries and regions. Depending on estimation methodology, small firms' average regulatory costs per employee are 20-30% higher than for all firms.[7]

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4 Essentially more generous GST return dates and the option of simplified GST quarterly returns, known as the simplified BAS [Business Activity Statement] method. However, the number of small businesses using this option remains low, possibly as low as 17-20% based on findings from a survey of 600 small businesses and 100 CPA public practice accountants in June/July 2001, and seems likely to remain so. The so-called simplified BAS method is not viewed as being 'easier' than the alternative. ('Small Business Survey' (July 2001 CPA Australia) at 16, Table 15).

5 F Chittenden, S Kauser and P Poutziouris, 'Tax Regulation and Small Business: A Review', paper presented to the Institute for Small Business Affairs/Small Business Service Workshop on the Taxation of Small Business (26 September 2001 Manchester Business School).

6 Ibid 8, derived from data from Hopkins TD, 'A Survey of Regulatory Burdens' prepared for the US Small Business Administration Office of Advocacy (1998).

7 Ibid 7.

In the UK, recent research has shown that small businesses with one or two employees typically spend around 5 more hours per person per month dealing with government regulations compared to firms employing 50 or more. Once again taxation dominates the paperwork burden for small business, accounting for between 50% and 70% of recent increases for small businesses employing less than 10 persons.[8]

For GST (called Value Added Tax in the UK), UK research shows that GST compliance costs fall from 1.94% of annual turnover for the smallest businesses (up to around A$100,000 using current exchange rates), through 0.78% for businesses with a turnover of between approximately A$100,000 and A$250,000, down to 0.26% for businesses between A$2.5 million and A$5 million. For comparison, the UK's largest business (A$30 million plus annual turnover) incur 0.003% GST compliance costs.[9]

Recent research by the Manchester Business School[10] confirms that small business GST compliance costs are at least six times as much as for larger businesses. Further, the study found that the psychological costs of complying with GST - usually ignored in compliance cost research - appear to be significant, and at least as much as measurable costs.

The regressivity of small business GST compliance costs has been clearly established by Cnossen (1994)[11] in his comparative analysis in US$ of data from three countries, the UK, Canada and New Zealand.

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8 Small Business Research Trust (SBRT), NatWest SBRT Quarterly Survey of Small Businesses in Britain (2000) 16, 3.

9 Sandford et al, above n 1; turnover bands adjusted for UK inflation and converted to A$ using the exchange rate of One Pound = A$2.9 in early October 2001.

10 S Kauser, F Chittenden and P Poutziouris, 'On the VAT Affairs of Small Firms: Emprirical Evidence from the UK SME Economy', paper presented to the Institute for Small Business Affairs/Small Business Service Workshop on the Taxation of Small Business (26 September 2001, Manchester Business School) at 12.

11 S Cnossen, 'Administrative and Compliance Costs of the VAT: A Review of the Evidence' (1994) 8 *Tax Notes International* June, 1649.

Table 1
GST Compliance Costs of Small Businesses in the UK, New Zealand and Canada

Size of business Taxable turnover in US$ thousands pa	UK 86/87 % of turnover	New Zealand 90/91 % of turnover	Canada 92 % of turnover
Under 50	1.49	2.06	na
50-100	0.70	0.91	0.39
100-200	0.50	0.67	0.36
200-500	0.44	0.47	0.15
500-1,000	0.34	0.28	0.09
1,000-10,000	0.07	0.04	0.06

Source: Cnossen (1994).[12]

The UK has a good database on small business tax compliance costs arising from the work by Sandford *et al* (1989),[13] partially updated by the Inland Revenue (1998),[14] and more recent research by the Small Business Research Trust (1998)[15] and Manchester Business School in 2000.[16] The UK data clearly demonstrates the regressivity of UK GST compliance costs, as shown in Tables 2 and 3. Comparisons between the authoritative Sandford study and later studies are very difficult because of differences in the quality of data, sample frames and response rates. Such differences are discussed in greater detail in Kauser *et al* (2001).[17] They also make the important point that 'businesses tend to report different costs depending on the questions asked'. Their distinction between what they term additive compliance costs and reported compliance costs should be noted.[18] The former comprises more easily measurable internal and external costs (including time), whereas the latter also includes more problematical psychological, opportunity and

12 Ibid 1666, Table 9, reproduced in full with thanks and acknowledgment. Data extrapolated from original studies; exchange rates for 1991 as reported by the OECD.
13 Sandford et al, above n 1.
14 Inland Revenue, *The Tax Compliance Costs for Employers of PAYE and National Insurance in 1995-96* Centre for Fiscal Studies University of Bath (Inland Revenue Economics Paper No 3 Volume 1, 1998).
15 Small Business Research Trust (SBRT), NatWest SBRT Quarterly Survey of Small Businesses in Britain (1998) 14, 1.
16 Kauser et al, above n 10.
17 Ibid.
18 This distinction is an important area of compliance cost research needing much further work.

overhead costs. Caution is needed in interpreting reported compliance cost estimates. Sandford's estimates are classed as additive compliance costs, should any comparison be attempted.

Table 2
Sandford *et al* UK GST Compliance Cost Estimates

Turnover Bands (1986/87) UK Pounds	Turnover Bands (2001) Adjusted for Inflation UK Pounds	GST Compliance Costs as % of Turnover
0-20,499	0-33,999	1.94
20,500-49,999	34,000-82,999	0.78
50,000-99,999	83,000-165,999	0.52
100,000-499,999	166,000-832,999	0.42
500,000-999,999	833,000-1,664,999	0.26
1,000,000-9,999,999	1,665,000-16,649,999	0.04
10,000,000 +	16,650,000 +	0.003

Source: Sandford *et al* (1989).[19]

Table 3
More recent UK GST Compliance Cost Estimates

SBRT (1998)		**MBS (2000)**		
Annual Turnover UK Pounds	**% (2)**	**Annual Turnover UK Pounds**	**% (1)**	**% (2)**
0-19,999	1.58	0-20,499	0.24	1.52
20,000-49,999	2.22	20,500-49,999	0.18	2.17
50,000-149,999	2.93	50,000-99,999	0.15	1.91
150,000-349,999	2.48	100,000-499,999	0.11	1.15
350,000-749,999	1.66	500,000-999,999	0.07	0.45
750,000-1,499,999	0.90	1,000,000-9,999,999	0.02	0.20
1,500,000 +	1.23	10,000,000 +	0.11	0.22
All	2.07	All	0.12	1.09
Sample	547	Sample	257	245

(1) Additive Compliance Costs **(2)** Reported Compliance Costs

Source: Kauser *et al* (2001).[20]

19 Sandford et al, above n 1, 116 (Table 8.3); adjusted turnover bands from Chittenden et al, above n 5, at 14, Table 7.

In New Zealand, nearly 60% of gross compliance costs of GST fell on small businesses with a turnover below NZ$250,000.[21] In Canada, estimates per small business by Plamondon (1993)[22] were lower than for New Zealand (refer Table 1), although it must be emphasised that a different methodology, possibly less reliable, was used compared with other studies cited in this article.[23]

The key policy issue: illustrative data

The major policy question is what size of small business should be relieved of participating in the GST system, either partly (through simplified rules) or entirely (through optional registration). This issue may be clarified by considering New Zealand disaggregate compliance cost data for 1990-91 from the reliable study by Sandford and Hasseldine (1992).[24] With the then GST registration threshold at NZ$30,000, this example focuses on the NZ$30,000-100,000 annual turnover range. These small businesses incurred average compliance costs of NZ$1,066 (1.639% of turnover) and paid net GST of NZ$3,765, ie, average compliance costs were 28.3% of average net GST paid. In other words, they remitted just NZ$3.53 for every dollar of compliance costs. They derived average cash flow benefits of NZ$149, or 14% of their gross compliance costs of NZ$1,066. Managerial benefits are also an important offset, eg, 52.5% of respondents in this category reported improved purchase records since the GST's introduction, but unfortunately these managerial benefits could not be realistically estimated in monetary terms.[25]

For New Zealand small businesses overall the GST net revenue per dollar of compliance costs ranged from $1.14 for voluntary registrants (turnover less

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20 Kauser et al, above n 10, Table 1.6, from original studies by Small Business Research Trust (1998) and Manchester Business School (2000) (see above notes 15 and 10 respectively).

21 CT Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand* (1992) Institute of Policy Studies Victoria University of Wellington, 78.

22 Plamondon and Associates Inc, *GST Compliance Costs for Small Business in Canada* (1993) Department of Finance Government of Canada [Summarised in B Wurts, 'Report on the Plamondon Compliance Cost Study for the Canadian Goods and Services Tax' (1995) in C Sandford (ed), *Tax Compliance Costs Measurement and Policy* (1995) at 299-320].

23 The Plamondon study was a 'depth study' of 200 small businesses compared with large scale surveys undertaken by other researchers. There were also other differences in methodology. Refer Wurts (1995), especially at 317-320, and Sandford (ed) (1995) 392-393; ibid.

24 Sandford and Hasseldine, above n 21 at 57-79.

25 Ibid, 76-78.

than NZ$30,000 pa) up to $25.55 for businesses in the NZ$2 million - $10 million category. For comparison, the figure for large business is significantly higher at over NZ$333.99, or 0.3% of net GST paid. New Zealand small business GST compliance cost data is presented in Table 4.

Table 4
New Zealand GST Compliance Cost Estimates, 1990-91

Turnover NZ$	Average compliance costs NZ$	Average net GST paid NZ$	Average compliance costs as % of average net GST paid	GST net revenue per NZ$ of compliance costs	Average value of cash flow benefits NZ$
0-30,000	665	758	87.8	1.14	31
30,000-100,000	1,066	3,765	28.3	3.53	149
100,000-250,000	1,266	9,448	13.4	7.46	356
250,000-500,000	2,390	18,438	13.0	7.71	486
500,000-1million	3,173	28,708	11.0	9.05	817
1 million-2 million	3,521	51,429	6.8	14.61	1,304
2 million-10million	4,374	111,747	3.9	25.55	2,898

Source: Sandford and Hasseldine (1992).[26]

Thus the key policy issue is whether it is worth imposing GST compliance costs on the smallest businesses in order to collect relatively small amounts of net GST revenue. The point is re-enforced if the Australian Taxation Office's administrative costs are also included, ie, net GST revenue is expressed as a percentage of GST operating costs.

Australian small business compliance cost data

26 Ibid, 65 and 75 (right column), Tables 6.8 and 6.14 respectively.

Preliminary OECD research[27] underlines the economic importance of the compliance burden upon small business. Survey data from Australia shows that the tax compliance costs for small and medium businesses (with 1-499 employees) accounted for around 1.3% of Business Gross Domestic Product in 1998.[28] Moreover, sales taxes were cited as the largest source of tax compliance costs in 8 out of 11 OECD countries surveyed.[29] Small business gross compliance costs were estimated at $7.9 billion in 1994/95, and accounted for 89% of all business costs.[30] Net compliance costs after allowing for offsets were $5 billion in 1994/95. Small business, using the Australian Bureau of Statistics definition based on employment, accounted for around 97% of all private sector businesses in 1994/95.[31]

It is too early for estimates of GST recurrent compliance costs to be available. Indeed, the political sensitivity of this topic makes major funding of such research problematical. However, it seems reasonable at this stage to expect Australian small business GST compliance costs to follow a similar pattern to that of the UK, New Zealand and Canada (refer Table 1).

Australian data on small business GST start-up costs is now more reliable with a number of published studies. The Economic Development Committee of the Victorian Parliament (2000),[32] in its review of available evidence, estimated these at around $6,000 for each small business. Findings from the major published studies are summarised in Table 5. As can be seen, some estimates of start-up costs have been up to $20,000 per small business. However, some of these studies fail to identify the importance of joint costs, whereby costs such as computers are used for normal management purposes as well as for GST compliance. Studies also show that small business significantly underestimated or failed to appreciate the necessary magnitude of start-up costs – more recent estimates are around twice as high as early

27 C Cordova-Novion and C De Young, 'The OECD Management Service Multi-Country Business Survey: Benchmarking Regulatory and Administrative Business Environments in Small and Medium-Sized Enterprises' in C Evans, J Pope and J Hasseldine (eds), *Taxation Compliance Costs: A Festschrift for Cedric Sandford* (2001) 205-228.

28 Ibid. Derived from data at 219 and 220, Figures 6 and 8 respectively.

29 Ibid, 224.

30 C Evans, K Ritchie, B Tran-Nam and M Walpole, *Taxpayer Costs of Compliance* (1997) [often referred to as the 1997 ATAX study] 82.

31 Ibid, 78 and 77 respectively.

32 Economic Development Committee, Parliament of Victoria Report, 'Inquiry into the Impact of the Goods and Services Tax on Small and Medium Sized Business in Victoria' GST Report No 1 (November 2000).

survey estimates made in 1999. These issues are discussed more fully in Pope and Rametse (2001).[33]

33 J Pope and N Rametse, 'Small Business and the Goods and Services Tax: Compliance Cost Issues' (2001) *Small Enterprise Research*, 9 (2), 42-54.

Table 5
Summary of Small Business GST Start-up Compliance Cost Estimates from Major Studies, 1999-2001

	Average start-up costs ($)	Average time spent (hours)	Number of respondents
Ernst & Young 1999	17,016	64	4
AC Neilsen 1999	2,618	64	602
Pope et al 1999	3,500	n/a	129
VECCI 1999	3,500	80	328
VECCI 2000	6,814	142	70
RSM Bird Cameron 2000	5,000-20,000	100-300	170
EDC, Victorian Parliament 2000	6,000	n/a	-
Victoria University 2001	12,380*	Included**	6
Patterson 2001	5,587	n/a	264

Notes:

* Time period was from early June to mid November 2000, ie, up to the lodgment of the first quarterly 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 refer to small business respondents only, and exclude respondents in other categories in some surveys, with the exception of the VECCI (1999) survey 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, Parliament of Victoria (2000) 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) survey findings, albeit with a conservative estimate cited.

3 There may be other smaller and/or unpublished studies not known to the author.
4 A few studies have focused on large business or have not distinguished between large and small business, eg, PricewaterhouseCoopers (2001), and these are not included.

Sources: Original studies or citations.[34]

A study of WA small business based on 868 useable responses by Rametse and Pope (2001)[35] estimated small business GST start-up costs at around $7,600, based on preliminary findings. The estimate includes 131 hours in time costs valued at $20 per hour. Details are presented in Table 6. It is worth noting that this study attempts to allow for joint costs and is likely to provide a good source of data, once results are fully analysed.

34 Ernst & Young, 'The Impact of the Goods and Services Tax on Small Business in New South Wales' A report to the New South Wales Department of State and Regional Development (1999); AC Nielsen, 'CPA Small Business Survey', for the Australian Society of Certified Practising Accountants [ASCPA] (August 1999); J Pope, P Fernandez and A Hawke, 'GST and Small Business: A Preliminary Study' (1999); Victorian Employers' Chamber of Commerce and Industry [VECCI], 'Special Questions - GST Compliance Burden, Survey of Business Trends and Prospects' September Quarter Performance and December Quarter 1999 Outlook, No 20 (1999); Victorian Employers' Chamber of Commerce and Industry [VECCI], 'Impact of the GST on Victorian Business' September 2000 [Refer Economic Development Committee, Parliament of Victoria Report (2000), above n 32, at 186-196]; RSM Bird Cameron, 'Survey on Compliance Costs', commissioned by and cited in the Economic Development Committee, Parliament of Victoria Report, above n 32, at 40-45; Economic Development Committee, Parliament of Victoria Report, above n 32; Victoria University, 'Goods and Services Tax Implementation and Victorian Small Businesses' Final Report (2001 Small Business Research Unit); Patterson, 'Market Research Survey' cited in *The West Australian* 'GST hit hard: businesses' (28 June 2001); PricewaterhouseCoopers, 'Survey of GST Start-Up Costs' (July 2001) (private communication).
35 N Rametse and J Pope, 'Start-up Compliance Costs of the Goods and Services Tax for Small Businesses in Australia' Paper presented at the Conference of Economists The University of Western Australia Perth 23-26 September 2001.

Table 6
Estimated Gross Small Business GST Start-up Compliance Costs (WA)

	N	Hours	Costs $
Equipment Costs			3,044
Other Costs eg Professional Fees,			1,962
Stationery	808		5,006
Total costs (without time)	826	131	2,620
Total time costs			7,626
Total start-up compliance costs			

This survey shows, 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 7.

Table 7
Mean Gross GST Start-up Compliance Costs as a Percentage of Turnover (without time costs)

Business size Taxable turnover in A$ pa	N	Mean costs $	Percentage of turnover
Less than $50,000	103	3,721	14.88
$50,000 - $99,999	139	3,375	4.50
$100,000 - $499,999	314	5,035	1.68
$500,000 - $1,000,000	129	10,809	0.44
$1,000,000 - $10,000,000	168	11,559	0.32

For businesses with less than $50,000 turnover, GST start-up compliance costs (excluding owner/staff time costs) are estimated at 14.88% (of annual taxable turnover). Businesses in the range of $50,000 - $99,999 incurred GST start-up costs of 4.5%, followed by 1.68% for those in the range of $100,000 - $500,000 and 0.44% for those with a turnover of between $500,000 -

$1,000,000. Businesses with $1,000,000 - $10,000,000 turnover incurred GST start-up costs of 0.32%. GST recurrent costs are expected to follow a similar pattern. Indeed, in the admittedly very limited literature it is suggested that start-up costs follow nearly a one-to-one ratio to recurrent costs.[36]

It is also important for researchers, small business owners, lobby groups and policy-makers to recognise offsetting GST compliance benefits, particularly cash flow benefits and managerial benefits, as well as the tax deductibility of compliance costs (apart from owner time costs). As a rule of thumb and comparing like-with-like, the higher the start-up costs the lower the ongoing or recurrent costs are likely to be. For example, take two small businesses in the same industry, with a similar annual turnover and number of employees. The first invests in new GST compliant computer equipment and software and incurs high staff training costs, with electronic lodgment of GST returns to the ATO. The second firm 'muddles through', maintaining traditional manual systems, with owners refusing to incur staff training costs, and makes hard-copy returns to the ATO. It is therefore reasonable to surmise that the former small business will have lower recurrent compliance costs vis-à-vis the latter business. Such a comparative advantage is likely to be in terms of both gross costs, ie, before taking into account the value of offsetting benefits, and net costs, ie, gross costs minus the value of offsetting benefits.

Preliminary findings from Rametse and Pope (2001)[37] show that around one-third of small businesses consider that they are likely to achieve managerial benefits. This is supported by a small business GST electronic lodgment estimate of 28%. Early, tentative research by Sandford *et al* (1981)[38] and the National Audit Office (1994)[39] into managerial benefits suggests that they may be around 10% of gross compliance costs. Further investigation into this topic is currently being undertaken by Rametse and Pope.

Although now a 'sunk cost' for most businesses, with up to 10% of small businesses newly established each year, start-up costs remain an important policy issue. It is also important to estimate start-up costs as a benchmark for future Australian tax policy. Such research also contributes to the international literature on which there is very little on tax start-up costs.

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36 Pope, above n 2, discusses this further 143-144.

37 Rametse and Pope, above n 35.

38 C Sandford, M Godwin, P Hardwick and M Butterworth, *Costs and Benefits of VAT* (1981).

39 National Audit Office, *HM Customs and Excise: Cost to Business of Complying with VAT Requirements* (1994 HMSO) 19-20.

Possible ways of alleviating the small business GST compliance cost burden

Given that the burden of tax compliance on small business, particularly with the GST, is so well established internationally, what, if any, are the possible ways of alleviating such a burden that seriously disadvantages small business compared with their larger competitors? This is an extremely difficult question to answer - one that many people including policy makers and even researchers gloss over. A Small Business Taxation Workshop held at Manchester Business School on 26 September 2001 comprised UK tax policy-makers, small business representatives and researchers. Whilst there was excellent analysis and discussion of the latest international research data, there was surprisingly little debate as to the best way forward to alleviate this obvious burden. To be fair, that may come later. Nonetheless, from discussion at this Workshop, the limited literature and this author's work to date, four major ways may be identified.

First, monetary compensation for small business having to act as 'unpaid tax collectors' - a familiar cry throughout the world not just in Australia. Based on the 'user pays' principle, compensation could be paid as a % of business turnover or GST revenue collected, probably on some sort of sliding scale. This would certainly require reliable GST recurrent cost estimates similar to those in the UK and New Zealand, although a simpler flat rate scheme could be devised.[40] However, as a policy option there are two major arguments against any direct compensation. The first is the obvious cost to the Treasury - with up to one million small businesses (depending upon definition) in Australia the compensation sums rapidly become expensive if they are to be worth having at an individual business level. The government's GST start-up compensation of $200 per small business, dismissed by many as derisory or an insult, comes to mind. The second argument is one of equity. Referring to the example given above, would it be an appropriate use of government resources to compensate to a higher relative level small businesses that invested less in their start-up costs than better planned businesses that invested more? Any such compensation policy may also lead to similar claims for compensation by other taxpayers that essentially act as a third party. In short, it could open the floodgates to compensatory claims for the government tax and regulatory burden. It is worth noting that in the UK there were no small business group demands for the government to go down this path.

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40 In the November 2001 Australian federal election, the Greens Party proposed returning the first $1,000 of GST collected by small business (up to $2 million pa turnover) as compensation (*The West Australian*, 'Promises, Promises, Keeping the Bastards Honest' 10 November 2001, 8).

The issue of compensation is recognised by Sandford and Hasseldine (1992),[41] in a New Zealand context, who recognise some 'justice' in the argument but do not support the claim. They further state:

> Given the wide range of compliance costs within a size range but especially between firms of different size ranges, as well as variable cash flow benefits, it would be virtually impossible to find a method of payment which would be fair.

Secondly, the GST business registration threshold could be raised significantly, to $100,000 (as this author advocated in a submission to the Senate Select Commission on the GST[42]) or even $150,000. Currently the UK's threshold is relatively high, at nearly $150,000. The obvious advantage is that firms not registered avoid GST compliance costs of perhaps 2% of their annual turnover (based on UK data). The major disadvantage from a policy perspective is that it would weaken ATO tax data collection and efforts to reduce the cash or hidden economy. That worthy government objective, however, weakens in the light of back-downs on other aspects of tax reform, such as entity taxation. A more important difficulty concerns the very high GST registration level already achieved by the government and the attitudes of large business to unregistered businesses. To now encourage de-registration on the grounds of high compliance costs - however subtly this could be marketed by the government - would represent a major policy reversal and additional administrative costs. In short, the costs may now outweigh the benefits. A further complication is that, based on UK experience, a high GST threshold level can distort registration levels around the threshold and affect competition between registered and unregistered small businesses (especially given the UK's GST rate of 17.5%).

Thirdly, what might be termed tax payment arrangements may be adjusted in favour of small business as a *de facto* compensation measure. These include giving small business less frequent returns, eg, annually, or longer remittance time after collection (generating cash flow benefits), and simplified methods of calculating the GST liability, including cash as opposed to accruals accounting (generating time savings). Many

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41 Sandford and Hasseldine, above n 21, 122-123. For two European examples of compensation see C. Sandford, 'Minimising the Compliance Costs of a GST', in C. Evans and A. Greenbaum (eds), *Tax Administration: Facing the Challenges of the Future* (1998) 129-139, at 136.

42 J Pope, 'The Compliance Costs of the Goods and Services Tax: A Comment on Current Major Issues' (1999 Business Coalition for Tax Reform Discussion Paper) Submission to and cited in the *Senate Select Committee on A New Tax System, Main Report* at 322-324, April. [A slightly amended version is: J Pope, 'The Compliance Costs of the Goods and Services Tax: Major Issues' (1999) 18 2 *Economic Papers* 61].

governments, including those in the UK and Australia, already adopt such measures, although many argue that they should be more generous and/or extended to a larger proportion of small business taxpayers. The UK - with higher thresholds for such schemes - is certainly more generous than Australia. For example, measures introduced in April 2001 will raise the GST turnover limit for cash accounting to 600,000 pounds (nearly A$1.8 million), thereby benefiting an additional 40,000 businesses. Over 100,000 firms will benefit through being allowed to make their GST payments once a year, known as the annual accounting scheme. For the first time traders entering the GST system will be able to join this scheme without having to wait for 12 months. Further, the UK is currently considering a scheme to assist new GST entrants (with annual turnover under around $300,000) to base their GST payments on a % of their turnover without recording GST on every purchase and sale. Consultation is taking place on how to let such businesses grow without having to incur the full cost of compliance with GST regulations - similar to arrangements operating in France.[43] For comparison, the current Australian (annual turnover) threshold level is $1 million for cash accounting,[44] with a number of simplified GST calculation schemes for particular groups of small business traders eg food retailing, but no overall scheme. More detailed annual returns (with simplified quarterly returns) are possible under two schemes with thresholds of $2 million and $20 million.[45]

The Australian Labor Party (ALP) proposed a 'Simpler BAS[46] Option' up to an annual turnover threshold of $2 million. Similar to the UK and French systems, small business could simply base their GST on a % of their turnover.[47] Whether such an approach will be adopted by the re-elected Coalition (Liberal-National Party) Government is problematical.

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43 Chittenden et al, above n 5 at 15.

44 The Tax Commissioner Michael Carmody has announced that those small businesses with an annual turnover greater than $1 million that already lodge income tax returns on the cash basis will be able to continue with this basis of accounting for GST and there will be no need to separately seek permission.

45 On 22 February 2001, changes to simplify GST reporting arrangements were announced. The original Business Activity Statement (BAS; essentially the GST return) required quarterly reconciliations. To ease the paperwork, the changes allow businesses with less than $20 million turnover an option to use simplified quarterly remittance forms instead of the original BAS, with only an annual reconciliation (the simplified BAS method: see above n 4). Businesses with less than $2 million have an added option to pay an amount calculated by the Australian Taxation Office (ATO), with reconciliation at the end of the year.

46 Business Activity Statement.

47 The ratio would be calculated by the ATO and would be '… individual or industry specific … with an allowance for large or irregular business cost items' (Australian Labor Party [ALP], 'Kim Beazley's Plan for a Simpler GST' (2001) 6 at <www.alp.org.au>).

Fourthly, and more tenuously, the government could use tax education to reduce the burden upon small business. For example, the government could organise regular 'free' seminars for established as well as new small business on issues such as tax compliance, use of technology, electronic lodgment, cash flow and managerial benefits. Businesses in particular sectors might be especially targeted. Indeed, the UK government recently announced a scheme to make specialist advisers available to small business prior to their incurring financial difficulties. A view was expressed at the Manchester Workshop that tax education should be incorporated as part of 'good citizenship' skills taught at school and colleges. Such an approach, however commendable, is a long-term one, its focus, target audience and cost is problematical, and it would do nothing to relieve the immediate burden on small business.

Concluding remarks

To sum up, there is undoubtedly a high GST burden imposed on small business, especially 'micro' business; the evidence is well established internationally. However, for Australia to alleviate this burden now requires carefully considered and crafted policies, possibly introducing innovative measures that have yet to be adopted or fully implemented in other countries. Arguably, the importance of economic growth, particularly employment generation, by this sector far outweighs any possible GST revenue losses. The most fruitful ways of alleviating small business GST compliance costs appear to be a continuation and extension of existing policies, particularly simplified payment arrangements. Specifically, a much higher threshold for cash accounting and a scheme similar to that of the UK and France, whereby GST payments are based on annual turnover and firms can grow within such a system without being penalised. The ALP clearly identified a similar approach as the appropriate way forward with their ‘Simpler BAS Option’ plan. The argument for a higher GST registration threshold level is normally persuasive but, in Australia's case, given the large number of firms now registered and high overall start-up costs, it is now probably better to pursue other measures. If the government continues largely to ignore or merely 'pay lip service' to the GST compliance difficulties facing small business, then it can only hope that, as time goes by, small business lobby groups 'bite the bullet' and discover other causes! Of course much further research on the policy trade-offs is required. Hopefully this article may be seen as a useful starting point.