

# SMALL BUSINESS TAXPAYERS' ATTITUDES TO COMPLYING WITH A TAX SYSTEM: LESSONS AND EXPERIENCES FROM AUSTRALIA AND NEW ZEALAND

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## ABSTRACT

This paper discusses Australian small businesses attitudes toward the Australian tax reforms and New Zealand's small businesses and tax agents' perceptions to tax compliance. Overall, Australian small businesses that supported the Australian tax reform relating to the Goods and Services Tax (GST), which was introduced in 2000, incurred lower start-up costs than those who were more critical, at A\$5116 and A\$11 336 respectively. Australian small businesses articulated the overall Australian tax reform as complex, due to differential tax treatments for GST. Although the New Zealand GST was introduced in 1986, and is hence well established, small businesses still perceived the overall tax (including GST) compliance process negatively. The two interrelated studies confirm similar views by the Australian and New Zealand small businesses, regarding their tax obligations and tax complexity. Policy implications, particularly in articulating the existence of small businesses' managerial benefits, derived from tax compliance, are critical.

## I. INTRODUCTION

Small businesses play an important role in the Australian and New Zealand economies as they generate significant employment and output. In Australia, small businesses account for around 37 per cent of Australia's economic production and employ around 3.7 million people.<sup>1</sup> In New Zealand, the number of businesses that employ 0-19 people in the year 2006, constituted 92.1 per cent of total employment.<sup>2</sup> However, the complex Australian and New Zealand taxation systems and other myriad of central and state/local government compliance requirements have arguably placed this sector at a disadvantage. Amongst these government regulations are occupational health and safety, workers' compensation, licensing requirements, local council planning, and so forth, but taxation is the most critical regulation impacting on compliance costs.<sup>3</sup> In New Zealand, Australia and other countries, small business compliance and compliance costs statistics are high and regressive, impacting heavily on the smallest businesses.<sup>4</sup> Empirical evidence from New Zealand small businesses suggest that generally, tax compliance has been perceived negatively by small businesses<sup>5</sup> and tax agents.<sup>6</sup>

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1 Australian Bureau of Statistics (ABS), *Australian Industry* (2004-05).

2 Ministry of Economic Development, *SMEs in New Zealand: Structure and Dynamics* (July 2007) 1-52.

3 Cynthia Coleman and Chris Evans, 'Tax Compliance Issues for Small Business in Australia', in Neil Warren (ed), *Taxing Small Business: Developing Good Tax Policies* (2003), Australian Tax Research Foundation, Conference Series 23, Sydney, 147; Business New Zealand-KPMG, *Summary Report of the Business New Zealand-KPMG Compliance Cost Survey October 2008*, 8.

4 Cedric Sandford and John Hasseldine, *The Compliance Costs of Business Taxes in New Zealand* (1992) 1-2; Chris Evans, Kathrine Ritchie, BinhTran-Nam and Michael Walpole, *Taxpayer Costs of Compliance* (1997) Australian Taxation Office, Commonwealth of Australia [Often referred to as the 1997 ATAX study] 78.

5 Katherine Ritchie, 'The Tax Compliance Costs of Small Business in New Zealand' (Paper presented at the Compliance Cost Symposium, Sydney, 26-27 April 2000) 9.

Defining small businesses is problematic because of their diversity<sup>7</sup>. Thus various bodies and researchers adopt different definitions based on the criteria appropriate for their purposes. The Australian Bureau of Statistics defines small business in terms of employment, which is a non-agricultural firm that employs 20 people or less.<sup>8</sup> The Australian Taxation Office (ATO) refers to businesses with turnover of less than A\$2 million per annum as 'micro business', those with turnover of between A\$2 million and A\$10 million are generally regarded as 'small business' and they are usually included in the Small and Medium Sized Enterprises (SMEs) category, which is between A\$2 million and A\$100 million turnover.<sup>9</sup> Notably, since the Australian study, the research for this paper has captured data up until 30 June 2000, a A\$10 million or less definition is adopted, mainly for ease of reference in cross checking this study's results with ATO data for the year 2000.

As for the second (New Zealand) study, the small business participants were chosen using two criteria: having annual turnover of up to NZ\$1 million and employing less than 10 full time staff. There are two reasons for choosing these criteria. Firstly, these two criteria were identical to the small business definition given by the New Zealand government's attempt to address the compliance concerns for SMEs in 1998. Small business was defined as having annual turnover of up to NZ\$1 million as well as employing less than 10 staff.<sup>10</sup> Secondly, businesses with these two criteria would not be large enough to fully employ a full time in-house accountant for the purpose of delegating their tax obligations to the accountant. With this, they would be expected to have some direct contact with the tax administration and therefore in a position to account for their compliance experiences. The New Zealand study sought participants as a result of networking within the business circles.

This paper largely discusses some key findings on small business perceptions of the Australian tax reform of the year 2000. These reforms included the introduction of the GST, which in other countries is called Value Added Tax (VAT). The GST replaced the Wholesale Sales Tax (WST) and the Pay-As-You-Go (PAYG) reporting system replaced a number of payment and reporting systems – Pay-As-You-Earn (PAYE), Prescribed Payments System (PPS), and provisional tax and company instalments.<sup>11</sup> The New Zealand study aimed to examine the small business tax compliance issues, in particular, their perception of the process of compliance. The Australian findings were achieved by using a questionnaire survey of 4000 small businesses with a response rate of 27 per cent (868 respondents) to determine start-up compliance costs of the GST. Additionally, a five point Likert attitude scale, within the same questionnaire was used to measure and summarise respondents' attitudes to the Australian tax reform. This enabled an analysis of mean gross GST start-up compliance costs by respondents' attitudes. Empirical evidence suggests that although small business supported the overall Australian tax reform, their compliance costs were high. Again, small businesses that were positive about the overall

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- 6 Nthati Rametse and Sue Yong, 'Small business taxpayers' attitudes to complying with a tax system: lessons and experiences from Australia and New Zealand' (Paper presented at the Accounting and Finance Association of Australia and New Zealand (AFAANZ, Adelaide, 5-7 July, 2009) 11; Sue Yong and Nthati Rametse, 'The influence of procedural fairness on the small business entrepreneurs and their perceptions of the tax authority' (Paper presented at the International Business Research Conference, Sydney, 2-4 December, 2009) 3.
- 7 Alan Cameron and Claire Massey, *Small and Medium-sized Enterprises: A New Zealand Perspective* (2003) 4-5.
- 8 Department of Industry, Science and Technology (1996), *Time for Business, Report of the Small Business Deregulation Task Force*, (Bell Report) 13.
- 9 Australian Board of Taxation (ABT), *Scoping Study of Small Business Tax Compliance Costs: A Report to the Treasurer*, Commonwealth of Australia, Canberra, December (2007) 27-28 <[http://www.taxboard.gov.au/content/tax\\_compliance\\_costs.asp](http://www.taxboard.gov.au/content/tax_compliance_costs.asp)> at 8 December 2008.
- 10 Pansy Wong, Chairperson, Commerce Sub-committee, NZ House of Representatives, *Commerce Sub-committee on the Inquiry into Compliance Costs for Business, Interim Report* (May 1998) 4.
- 11 Jeff Pope and Nthati Rametse, 'Small Business Start-up Compliance Costs of the GST: Estimates and Lessons from Tax Reform' (2002) 5(3) *Journal of Australian Taxation* 382.

government's tax reform tended to have incurred lower start-up costs than those who were more critical, at A\$5116 and A\$11 336 respectively.<sup>12</sup>

The New Zealand study, from a social constructivist perspective, uses semi-structured in-depth interviews with the aim of gaining an inside understanding of the small business and the tax agents' perceptions towards tax compliance obligations. This study indicates that generally small businesses do not view their tax compliance activities in a positive light. This is because tax compliance activities involved personal time, business cost, personal stress and penalties. Some of these views are consistent with the previous findings by Ritchie.<sup>13</sup>

Compliance costs have been distinguished into three categories by Sandford and Hasseldine. These costs are:

- Start-up costs, arising from the introduction of a major tax reform like the Australian GST in 2000.
- Temporary costs, which are incurred by the taxpayer in order to be conversant with the new tax requirement.
- Regular costs, which are the continuing costs of complying with the tax system once the taxpayer has become conversant with the tax requirement.<sup>14</sup>

The Australian study only captured start-up costs as the GST was at an implementation stage in 2000, compared to the New Zealand study, which was conducted long after the implementation of the New Zealand GST in 1986. Thus the quantitative approach was used as it provides valuable information on the measurement of the start-up and temporary costs. Again, since the New Zealand business compliance costs are well documented and researched<sup>15</sup>, it was considered more suitable to identify the views of the small businesses rather than to measure their compliance costs, using semi structured in-depth interview approach.

The two research methods adopted in the Australian and New Zealand studies were also used in an attempt to quantitatively and qualitatively identify whether small businesses in both countries recognise the existence of managerial benefits derived from tax compliance activities. The Australian study confirmed that high GST start-up compliance costs were partly due to some SMEs overlooking managerial benefits of better accounting systems. Additionally, the New Zealand study revealed that most New Zealand small business participants continue to under-appreciate the managerial benefits derived from having better accounting systems, as a majority of them still rely on unsophisticated accounting systems. These businesses perceive tax compliance activities negatively as impositions on their time and resources. They under-value the potential useful information that can be generated from having better accounting systems caused by tax compliance obligations. This finding was made possible only by using a qualitative (semi-structured face to face) interview method.

The rest of the paper is organised as follows. Section two discusses conceptual issues pertinent to tax compliance, compliance costs and managerial benefits. The third and fourth sections discuss the literature and research methodologies respectively. Section five provides results and data analysis. Section six concludes the paper. The last part, section seven, provides policy implications and limitations.

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12 Nthathi Rametse, 'Small Business Attitudes to the Australian Government's Tax Reform' (Paper presented at the Australasian Tax Teachers Conference (ATTA), University of Tasmania, 23-25 January, 2008) 8.

13 Ritchie, above n 5.

14 Sandford and Hasseldine, above n 4, 1.

15 Ritchie, above n 5; Cameron and Massey, above n 7; Lin Mei Tan, 'The Compliance Costs of Business Taxes in Australasia' (1996) 2(2) *New Zealand Journal of Taxation Law and Policy* 102; Lin Mei Tan, 'Coping with Tax Obligations: A Preliminary Study of some Small Firms in New Zealand' (1997) 13(4) *Australian Tax Forum* 337.

## II. CONCEPTUAL ISSUES

### A. Tax compliance

Theoretical issues pertinent to tax compliance and tax compliance costs have been widely discussed in the literature. Research has identified numerous factors that affect taxpayers' compliance.<sup>16</sup> These factors are categorised in broad terms as economic, structural, demographic/personal and attitudinal traits and often these factors overlap. The economic factors are based on the premise that taxpayers will respond to sanctions.<sup>17</sup> The taxpayers assumed to be utility maximisers, will undertake a cost/benefit analysis and will comply if the benefit exceeds the cost of compliance.<sup>18</sup> Additionally, taxpayers' non-compliance behaviour depends on their belief of the probability of being detected through an audit and the severity of legal penalties imposed.<sup>19</sup> McKerchar<sup>20</sup> discusses this from the economic deterrence model perspective and traces its origin from Becker who believed that 'the deterrents to illegal behaviour, the probability of being caught and the type of punishment were within the control of society'.<sup>21</sup>

The structural factors, which are beyond the taxpayer's control, are usually exogenously determined, for example, tax administration, tax complexity, tax rate structures and audit possibility.<sup>22</sup> Economic and structural factors are seen as inadequate to fully substantiate the high compliance rate statistics.<sup>23</sup> This is because the low audit rate should theoretically lead to low compliance but in reality statistics have shown otherwise. As asserted by Cullis and Lewis, despite this, the economic approach has an obvious analytical appeal, but it lacks realism and humanity.<sup>24</sup>

The fiscal psychology approach emerged as a result of expanding compliance research by incorporating human factors. Under the fiscal psychology approach, Cullis and Lewis believe that taxpayers tend to operate in social environments and their actions can be moulded by their peers.<sup>25</sup> Collins et al also confirmed a direct relationship between the compliance behaviour of taxpayers and their peers.<sup>26</sup> Taxpayers whose peers are evaders have a tendency to be evaders themselves as they legitimise their unethical acts with reference to their peer's actions.<sup>27</sup> Coleman and Evans<sup>28</sup> discuss the view of the cooperation between taxpayers and revenue authorities by Vogel<sup>29</sup> who believes that if taxpayers are convinced that the tax system is generally fair and all taxpayers contribute by

16 Maryann Richardson and Adrian Sawyer, 'A Taxonomy of the Tax Compliance literature: Further Findings, Problems and Prospects' (2001) 16 *Australian Tax Forum* 137. See also Betty Jackson and Valerie Milliron (1986) referred to in Richardson and Sawyer

17 Coleman and Evans, above n 3.

18 Michael Allingham and Agnar Sandmo, 'Income tax evasion: A theoretical analysis' (1972) 1 (3-4) *Journal of Public Economics* 323.

19 Ibid.

20 Margaret McKerchar, *The Impact of Complexity Upon Tax Compliance: A Study of Australian Personal Taxpayers* (2003) Research Study No. 39, Australian Tax Research Foundation, 38.

21 Ibid 38; Gary Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 *Journal of Political Economy* 169.

22 James Alm, Betty Jackson and Michael McKee, 'Estimating the determinants of taxpayer compliance with experimental data' (1992) 45 *National Tax Journal* 107.

23 James Andreoni, Brian Erard and Jonathon Feinstein, 'Tax compliance' (1998) XXXVI *Journal of Economic Literature* 818.

24 John Cullis and Allen Lewis, 'Why people pay taxes: From a conventional economic model to a model of social convention' (1997) 18 *Journal of Economic Psychology* 305.

25 Ibid.

26 Julie Collins, Valerie Milliron and Daniel Toy, 'Determinants of Tax Compliance: A Contingency Approach' (1992) 14 *The Journal of the American Taxation Association* 1.

27 Ruth McIntosh and John Veal, 'Tax Evasion and New Zealanders' Attitudes Towards It' (2001) 7(2) *New Zealand Journal of Taxation Law and Policy* 80.

28 Coleman and Evans, above n 3.

29 Joachim Vogel, 'Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey Data' (1974) 27 (4) *National Tax Journal* 419.

law and reasonably equally, then they are prepared to pay. Thus perceptions of fairness, equity, efficiency and attitudes towards the tax authority are important compliance factors.

'Prospect theory'<sup>30</sup> has also proven helpful to explain the compliance statistics. This theory brings forth two issues. Firstly, taxpayers tend to over-emphasise the audit probability, and secondly, taxpayers are more risk averse with losses (taxes to pay) than with gains (refunds). It is because of these reasons compliance statistics remained at a high level despite the low probability of audits.<sup>31</sup>

### *B. Tax compliance costs*

Compliance costs, which for a long time have been treated as 'hidden costs' of taxation, are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given tax structure, over and above payment of the tax itself.<sup>32</sup> Thus, the GST start-up compliance costs are those costs incurred by businesses in preparing to comply with the GST legislation. Sandford et al<sup>33</sup> term these costs 'commencement costs', which arise with the introduction of a new tax or a major change in a tax. These costs, strictly speaking, should be spread over a period rather than be considered a cost solely at the time incurred<sup>34</sup> since they are mainly of a capital nature and thus benefit businesses over a period of time. GST start-up compliance costs, for the private sector, include new computer systems and time spent on training new bookkeepers and staff to operate the GST.

Start-up compliance costs are distinct from recurrent (or ongoing annual) compliance costs as recurrent/regular costs are, by their very nature, continuing costs incurred by taxpayers in meeting their tax obligations. As discussed above, start-up costs do not include temporary costs.

Compliance costs are private sector costs and together with administrative costs make up the costs of operating a taxation system.<sup>35</sup> Administrative costs are public sector costs of a particular tax system and are borne by the government. These costs are only incurred with the introduction of new taxes. Start-up administrative costs, for the Australian GST (ignoring government legal/legislative costs), were mainly those costs incurred in an education campaign by the Australian Taxation Office (ATO), industry seminars paid for and run by ATO from the government's A\$500 million compensation package and staff wages. Other major costs included technological/systems costs of software to comply with the GST as well as administration costs relating to tax disputes.

The relationship between administrative and compliance costs may be complementary or competitive. Where tax simplification strategies are apparent, administrative and compliance costs may be reduced. For example, for simplicity, small businesses that meet the required criteria opt to use the cash accounting method for GST and not the accrual method because the accrual method is considered complex. The cash accounting method, which became part of the Australian tax simplification strategies for small businesses, allows businesses to account for the GST only when it is received, thereby minimising their cash flow problems that arise from slow payers and paying tax on bad debts. The cash method is simple and businesses that operate on a simple cash book do not require the services of an accountant. In contrast, the accrual method for GST is relatively more complex and can cause cash flow problems since GST is accounted for using double entry and irrespective of when the cash is received. Thus due to simplicity in the use of the cash method of accounting, time, costs of calculations and accountants' fees for small

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30 Daniel Kahneman and Amos Tversky, 'Prospect theory: An analysis of decision under risk' (1979) 47 *Econometrica* 263.

31 Andreoni, Erard and Feinstein, above n 23.

32 Cedric Sandford, Michael Godwin, and Peter Hardwick, *Administrative and Compliance Costs of Taxation* (1989) 10-12.

33 Ibid 16.

34 Ibid.

35 Ibid 22-23.

businesses may decrease, and hence lead to a reduction in administrative costs of auditing small businesses.

Where certain tasks are delegated to the private sector by the public sector, for example, where (small) business 'acts as unpaid tax collector', compliance costs can be relatively high and administrative costs lower. Thus administrative costs can be shifted to the taxpayer and vice versa with compliance costs. However, Sandford suggests that taxes that have high compliance costs, such as VAT, often have high administrative costs as well.<sup>36</sup>

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

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

Non-monetary costs, which are almost immeasurable,<sup>37</sup> include psychological costs related to stress and anxiety of small business staff and owners arising from complying with the GST requirements.<sup>38</sup> As an example, the increased record keeping requirements of a GST, coupled with knowledge of their intended use as an audit tool for the Pay-As-You-Go (PAYG) system may cause anxiety and distrust.<sup>39</sup> It must be noted that there may also be psychological administrative costs if the ATO staff, in contact with the public, find their job particularly stressful.<sup>40</sup>

Although psychological costs are recognised, they are normally excluded from compliance cost calculations because of the difficulty of their estimation. Woellner et al<sup>41</sup> have developed a research method to measure the psychological costs of tax compliance as they believe that this area has been largely neglected due to the lack of a reliable measurement method. Although this research has made no attempt to measure psychological costs relating to the Australian GST start-up compliance costs, its importance is acknowledged.

The major offset relating to start-up compliance costs arises from tax deductibility of expenses plus (for Australia's GST) a subsidy (voucher) of A\$200 per small business, which was provided by government. The relationship of CFB to start-up costs is indirect, hence weaker. For example, small businesses that did not have computers pre-GST acquired them for GST compliance (direct benefit), but could also use these computers in

36 Cedric Sandford, *Successful Tax Reform: Lessons from an Analysis of Tax Reform in Six Countries* (1993) 13.

37 Maarten Allers, *Administrative and Compliance Costs of Taxation and Public Transfers in the Netherlands* (1994) 5, a summary appears in Cedric Sandford (ed), *Tax Compliance Costs Measurement and Policy* (1995) 173.

38 Jeff Pope and Nthathi Rametse, 'Small Business and the Goods and Services Tax: Compliance Cost Issues' (Working Paper 2000.43, Curtin University, School of Economics and Finance: Perth, 2000) 6.

39 Ibid 9.

40 Sandford et al, above n 32, 18.

41 Robin Woellner, Cynthia Coleman, Margaret McKerchar, Michael Walpole and Julie Zetler, 'Developments in the Measurement of Psychological Cost Compliance: A Research Method' (Paper presented at the 5th International Conference on Tax Administration, Australian Taxation Studies Program (ATAX), University of NSW, Sydney, Australia, 30 April 2002).

their financial operations to avoid suffering a cash flow cost (indirect benefit). Thus the Australian study excluded CFB quantification as it is not applicable to start-up compliance costs, due to its weak relationship with these costs.

Managerial benefits arising from improved accounting procedures and better record keeping are also an important offset against the introduction of any taxes, particularly for small business, although quantification is very difficult.<sup>42</sup> Thus, it is imperative to articulate to small businesses the importance of managerial benefits derived from tax compliance.

### *B. Managerial Benefits*

Compliance costs experts and government have long recognised the importance of managerial benefits for small business. However, the difficulty of evaluating managerial benefits has resulted in most compliance costs studies omitting calculating them as offsets. This problem had been associated with the accounting-taxation overlap issue in tax compliance costs. Thus as it is difficult to distinguish between accounting and tax compliance costs, the same problem is encountered in distinguishing between accounting induced and tax induced managerial benefits.<sup>43</sup> Again, the magnitude of managerial benefits depends on how small businesses value managerial information, as small businesses seem to value managerial benefits information less than large businesses.<sup>44</sup> Consequently, small businesses may underestimate the value of managerial benefits as a lobby for a change in government taxation policy. The Sandford et al and the National Audit Office of the UK studies suggest that the value of managerial benefits can be quite considerable, possibly around a minimum of 7 per cent of gross compliance costs to a maximum of 13 per cent.<sup>45</sup>

The major New Zealand GST study by Sandford and Hasseldine found that smaller businesses obtained considerable managerial benefits from improved accounting as a result of tax compliance.<sup>46</sup> Arguably, benefits that arise from the GST for small businesses may be outweighed by excessive compliance costs.<sup>47</sup> An Australian study undertaken in 2003 by Rametse, found that although small business GST start-up compliance costs were high, after around three years of the GST implementation, some small businesses reported managerial benefits.<sup>48</sup> Lignier also investigated Australian small business managerial benefits of tax compliance and confirmed that these businesses were deriving some managerial benefits from improved knowledge of their financial affairs, in particular from increased complex accounting information systems.<sup>49</sup> Thus although small businesses may have negative attitudes toward the tax compliance process and its high compliance costs, managerial benefits of better record keeping, derived from tax compliance, may reduce these costs.

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42 Pope and Rametse, above n 38, 5

43 Binh Tran-Nam, 'Tax Compliance Costs Methodology – A Research Agenda for the Future', in Chris Evans, Jeff Pope and John Hasseldine (eds) *Tax Compliance Costs: A Festschrift for Cedric Sandford* (2001) 51.

44 Ibid 55.

45 Cedric Sandford, Michael Godwin, Peter Hardwick and Ian Butterworth, *Costs and Benefits of VAT* (1981); National Audit Office, *HM Customs and Excise: Cost to Business of Complying with VAT Requirements* (1994).

46 Sandford and Hasseldine, above n 4, 76-8.

47 Nthati Rametse, 'Small Business Managerial Benefits Derived from the Implementation of the Australian Tax Reform' (Paper presented at the Australasian Tax Teachers Conference (ATTA), University of Canterbury, Christchurch, 19 – 21 January 2009).

48 Ibid 1.

49 Phillip Lignier, 'Are Managerial Benefits Making Tax Compliance Costs More Sustainable for Small Businesses: An Investigation of Managerial Benefit Perception by Small Business Taxpayers' (Paper presented at the Australasian Tax Teachers Conference (ATTA), University of Canterbury, Christchurch, 19 – 21 January 2009).

### III. THE LITERATURE: MAJOR AUSTRALIAN AND NEW ZEALAND STUDIES

#### A. Australian Studies

The Australian GST compliance costs estimates for small businesses follow the framework of the previous overseas studies of the GST, which predominantly focused on recurrent costs, for example, the UK GST<sup>50</sup> and New Zealand GST.<sup>51</sup> However, while Sandford<sup>52</sup> points out the importance of making international comparisons of the GST compliance cost estimates, he also counsels caution about the use of figures, as they 'would be more likely to mislead than enlighten'.<sup>53</sup> This is due to differences such as; taxation cultures, systems and processes of different countries, for example, taxation structure and tax population; GST rate(s); quality of data arising from different research methodologies; newness of the GST (inclusion of temporary or 'learning costs'); degree of computer use and quality of the tax administration, e.g. GST return form design.

The ATAX (The University of New South Wales) study,<sup>54</sup> funded by the ATO, later investigated compliance costs of Australian taxes. This research discloses the magnitude of tax compliance costs experienced by small businesses. The study confirmed that small business bears a highly significant proportion of overall business compliance costs (89 per cent), in particular, internal time costs (90.7 per cent).<sup>55</sup> This situation is revealed by almost all compliance costs studies. Thus this regressivity is the result of the problem of limited resources that the small business sector has, relative to large businesses.

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 businesses' tax compliance costs were around A\$1000 and A\$5000 respectively. In contrast, large businesses enjoyed negative tax compliance costs of A\$30 000 per large business taxpayer after taking into account all offsets.<sup>56</sup> Overall, the ATAX small business taxpayer compliance costs estimates were lower than those of Pope.<sup>57</sup> Evans et al conclude that had Pope's study considered tax deductibility, compliance costs would have been reduced by 25 per cent.<sup>58</sup>

In 1991-92, Wallschutzky and Gibson studied the compliance process of 12 Australian SMEs from various industries using a case study approach.<sup>59</sup> This was a follow up study arising from the ATO's concerns subsequent to the Beddall Report<sup>60</sup> findings. Wallschutzky and Gibson found that small businesses did not have any problems with the tax administration but rather they had problems with the actual taxes themselves.<sup>61</sup> In addition, these businesses did not view the compliance process or compliance costs to be getting any worse. Most found accounting for taxes to be neither difficult nor time consuming. On average, the taxpayers spent 12 hours per month on tax compliance related activities with peak loads occurring when annual income tax returns were due. However, small businesses were reluctant to seek help when encountering tax problems due to high

50 Sandford, Godwin, and Hardwick, above n 32.

51 Sandford and Hasseldine, above n 4.

52 Cedric Sandford, 'Improving the Methodologies', in Cedric Sandford (ed), *Tax Compliance Costs Measurement and Policy* (1995) 405.

53 Ibid 405.

54 Evans et al, above n 4.

55 Ibid 78.

56 Binh Tran-Nam, Chris Evan and Michael Walpole, 'Tax Compliance Costs: Research Methodology and Empirical Evidence from Australia' (2000) 53(2) *National Tax Journal* 229-252.

57 Jeff Pope, 'Compliance Costs of Taxation: Policy Implications' (1994) 11(1) *Australian Tax Forum: A Journal of Taxation Policy, Law and Reform* 85, 85-121.

58 Evans, Ritchie, Tran-Nam and Walpole, above n 54, 83.

59 Ian Wallschutzky and Brian Gibson, 'Taxing Small Business' (1993) 64(2) *Australian Accountant* 14.

60 House of Representatives Standing Committee on Industry, Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990) ('Bedall Report').

61 Wallschutzky and Gibson, above n 59, 521; Ian Wallschutzky and Brian Gibson, 'Small Business Cost of Compliance' (1993) 10(4) *Australian Tax Forum* 527.



external accounting costs, lack of trust towards the ATO, and because taxation was not their business priority.

### *B. New Zealand Studies*

Sandford and Hasseldine<sup>62</sup> also investigated compliance costs of New Zealand's GST. These authors estimated the total compliance costs of New Zealand's GST at NZ\$453 million, or 7.3 per cent of the GST net revenue. Furthermore, the study found that nearly 60 per cent of the compliance costs of the GST fell on businesses with under NZ\$250 000 turnover<sup>63</sup> thus confirming the regressivity of the GST compliance costs. The mean net compliance costs, that is, after taking into account offsets, were estimated at NZ\$141 million.<sup>64</sup> As shown on Table 1 below, even after considering the cash flow benefits for both smaller and larger businesses, the level of compliance costs for smaller businesses still remained higher than those of larger businesses. Thus for small businesses, cash flow benefit and other deductibility benefits are likely to be overshadowed by the excessive compliance costs they incur.

Tan<sup>65</sup> examined a group of New Zealand small business taxpayers in regard to their ability to cope with the increasing tax complexity. The research showed that small businesses were comfortable with filing one to two tax returns per month. The role of tax agents was gaining importance in assisting with filing more 'difficult' returns, but because of their costs, they are not used often. Routine GST and pay as you earn (PAYE) tax returns were filed by the taxpayers but the tax agents were employed to file more technically challenging returns such as the income tax and the Fringe Benefit Tax (FBT). Unlike Australia, there is less differential treatment for GST items in New Zealand.

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62 Sandford and Hasseldine, above n 4.

63 Ibid 78.

64 Ibid 1-2.

65 Tan, above n 15.

**TABLE 1**  
**TOTAL COMPLIANCE COSTS OF NEW ZEALAND GST**  
**ANALYSED BY SIZE OF FIRM AS MEASURED BY TURNOVER,**  
**SANDFORD AND HASSELDINE (1992) STUDY**

Turnover	Mean Compliance Cost	Mean Cash Flow Benefit	Mean Net Compliance Cost	Total Gross Costs	Total Value Cash Flow	Total Net Cost
\$	\$	\$	\$	\$000	\$000	\$000
<30,000	665	31	634	92,746	4,404	88,342
30,000-100,000	1,066	149	917	97,067	13,638	83,429
100,000-250,000	1,266	356	910	74,984	21,097	53,887
250,000-500,000	2,390	486	1,904	66,077	13,438	52,639
500,000-1 million	3,173	817	2,356	50,100	12,904	37,196
1 million – 2 million	3,521	1,304	2,217	30,712	11,373	19,339
2 million – 10 million	4,374	2,898	1,476	30,518	20,222	10,296
10 million – 50 million	3,085	22,017	(18,932)	5,772	41,194	(35,422)
> 50 million	9,615	73,569	(63,954)	4,981	38,109	(33,128)
<b>Totals</b>				<b>452,957</b>	<b>176,379</b>	<b>276,578</b>

Ritchie<sup>66</sup> applied a case study research approach in 1998 to determine the compliance process faced by small businesses in Auckland. Ritchie found that 15 out of the 19 respondents used some kind of computerised accounting system ranging from MYOB to simple excel spreadsheet with the remainder using a manual system. Fifteen of the respondents also relied on their tax agents to complete their year end income tax returns.<sup>67</sup> These businesses mostly used cash accounting systems, and not accrual system. Tax agents were also expected to make year end adjustments for their year end income tax returns.<sup>68</sup>

More recent research conducted in October and December 2004 on 1907 SMEs showed that on average 76.7 hours per SME is spent on tax compliance in a year. A breakdown of hours spent by personnel types were owners/partners/directors/trustees (56.3 hours); paid employees (18.4 hours); unpaid friends or relatives (3.4 hours).<sup>69</sup>

In addition, this study found that the combined mean compliance costs as a percentage of turnover are as follows:

- 21 per cent for businesses with up to NZ\$19 999 annual turnover
- 7.5 per cent for businesses with annual turnover of NZ\$20 000 to NZ\$39 999
- 4.7 per cent for businesses with annual turnover of NZ\$40 000 to NZ\$99 999
- 2.6 per cent for businesses with annual turnover of NZ\$100 000 to NZ\$249 999
- 1.6 per cent for businesses with annual turnover of NZ\$250 000 to NZ\$499 999
- 0.9 per cent for businesses with annual turnover of NZ\$500 000 to NZ\$1 299 999
- 0.2 per cent for businesses with annual turnover of more than NZ\$1.3 million.<sup>70</sup>

This further confirmed the earlier research done by Sandford and Hasseldine<sup>71</sup> regarding the regressivity of compliance costs.

The most recent Business New Zealand – KPMG survey in 2008 revealed that 183 New Zealand small business respondents out of a total of 1334 commented that the government had taken them for granted in their tax collection efforts for GST without any compensation for those efforts. They further felt that New Zealand tax is too complicated, hence requires them to use professional tax advisors to avoid excessive tax penalties.<sup>72</sup>

#### IV. RESEARCH METHODOLOGIES AND DATA COLLECTION

##### *A. Data collection and measurement (Likert Scale): The Australian Study*

The Australian study is a comprehensive research which collected data by a questionnaire survey from 4000 small businesses in Western Australia (WA). The survey was undertaken indirectly from a bought-in small business listing derived from the Yellow Pages Electronic Telephone Directly because the ATO was unwilling to provide a stratified data, due to confidentiality purposes. The response rate was 27 percent (868 respondents). The majority of the survey respondents were from the annual turnover range of A\$100 000 to A\$10 million. These participants represented 39 percent of all the respondents. The lowest response rate was from the less than A\$50 000 and between A\$50 000 and A\$99 999 annual turnover groups. Respondents by business activity indicated the retail trade as the most frequently stated business, at 19 per cent, followed by construction (11 per cent), manufacturing (8 per cent), property and business services and health and community services (7 per cent). The study was used to estimate small businesses GST start-up compliance costs.

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66 Ritchie, above n 5.

67 Ibid 15.

68 Ibid.

69 Colmar Brunton, *Measuring the Tax Compliance Costs of Small and Medium-Sized Businesses – a Benchmark Survey (Final Report)*, prepared for the Inland Revenue (June 2005) 8.

70 Ibid 11.

71 Sandford and Hasseldine, above n 4.

72 Business New Zealand – KPMG, *Summary Report of the Business New Zealand – KPMG Compliance Cost Survey* (October 2007) 38.

In ascertaining small businesses perceptions of the Australian tax reform, the same questionnaire included a five point Likert attitude scale which measured and summarised a particular situation. The Likert attitude scale 'is based upon the assumption that each statement/item on the scale has equal "attitudinal value", "importance" or "weight" in terms of reflecting an attitude towards the issue in question'.<sup>73</sup> In this research three major statements were used to assess respondents' pre-implementation attitudes on start-up compliance costs of the GST. These statements as outlined in the questionnaire are:

- 'I do not mind doing GST work'
- 'GST is unreasonably complicated'
- 'Overall, I support the Government's tax reform'

Respondents were requested to indicate with a tick whether they 'strongly agreed', 'agreed', 'neutral', 'strongly disagreed', or 'disagreed' to these statements. It must be noted that those who ticked "neutral" may either have had problems with understanding the question or were genuinely uncertain. The questionnaire also requested respondents to provide additional comments on the overall Australian tax reforms.

#### *A. Data collection: the New Zealand study –in-depth interviews*

Data was collected from 26 small businesses, including tax agents, in Auckland, as this region has the highest concentration of small businesses in New Zealand.<sup>74</sup> Structured in-depth face to face interviews were conducted, to determine participants' perception of tax compliance and the rationale for their perceptions. Following Cullis' and Lewis',<sup>75</sup> social constructivist perspective, the researcher aimed to obtain the participants' constructions of their views on tax compliance and how they acted on those views. Thus the results can not be generalised to the wider population due to the uniqueness of each participant's circumstances and social constructions.

Prior to the actual interviews, the researcher identified all the potential factors affecting compliance, based on the existing literature and business reports. A pilot study was undertaken with two tax agents to test the validity of the interview questions. The interview questions were further clarified and refined after consulting with other researchers in two rounds. The first round involved researchers from non-accounting disciplines, mainly to ensure the questions were understood by a lay person. The second round of researchers was from the accounting disciplines. This was to ensure that the questions were in line with other business research. Finally, the interview schedule was developed with 5 sections, viz;

1. Introduction: detailing the purpose of the interview and the criteria for selection;
2. Personal circumstances: Business background and the issues for small businesses, views on government spending, their views on taxes;
4. Tax compliance factors: what they are and their interrelationships;
5. Tax compliance process, experiences and attitudes;
6. Suggestions for improvement to information and services with the IRD.

This paper limits the discussion of the findings to the results of the sections 3 and 4. The interviews were tape recorded and transcribed by one of the researchers. The participants were given assurances of confidentiality and that specific individual or organisations will not be identified. All transcribed interviews were later verified by the participants to enhance data reliability as suggested by Patton.<sup>76</sup>

A total number of twenty six SMEs and tax agents participated in the NZ study in 2006-07. To be consistent with the New Zealand Commerce Commission' definition of small

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<sup>73</sup> Randjit Kumar, *Research Methodology: A Step-by-step Guide for Beginners* (1996) 129.

<sup>74</sup> Ministry of Economic Development, above n 2.

<sup>75</sup> Cullis and Lewis, above n 24.

<sup>76</sup> Michael Patton, *Qualitative Research and Evaluation Methods* (2002) 545.

businesses, SMEs participants' annual turnover should not exceed NZ\$1 million and employs less than 10 staff during the year.<sup>77</sup> In addition, these two criteria were chosen to ensure that participants had some direct interactions with the tax authority and were able to comment on their tax experiences. To triangulate their comments, eight tax agents whose core business was to service small businesses were also included in the sample. The industries represented by the SMEs were:

- Retailing,
- Information technology,
- Painting,
- Building,
- Mortgage broking,
- Automotive repair,
- Electrical on-line sales,
- Child-care education.

## V. RESULTS AND DATA ANALYSIS

### *A. Overall response results*

Table 2 below shows that a total of 815 (94 per cent of overall respondents) small businesses in the Australian study responded to the statement, 'I do not mind doing GST work' and 820 (95 per cent of overall respondents) responded to the statement 'GST is unreasonably complicated'. Furthermore, 825 (95 per cent of overall respondents) responded to the statement, 'Overall, I support the government's tax reform'.

### *B. Attitudes on doing GST work and its complexity*

Whilst a greater proportion of small business respondents in the Australian study generally supported the Government's tax reform (48 per cent), many of them (45 per cent) strongly disagreed with the statement 'I do not mind doing GST work' arguably because they believed it was unreasonably complicated (53 per cent). In contrast, 22 per cent disagreed and strongly disagreed to the statement 'GST is unreasonably complicated', while 26 per cent were neutral (see Table 2).<sup>78</sup>

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<sup>77</sup> Wong, above n 10, 4.

<sup>78</sup> Rametse, above n 12, 4.

**TABLE 2**  
**SMALL BUSINESS ATTITUDES ON DOING GST WORK,**  
**COMPLEXITY AND THE OVERALL TAX REFORM**  
**YEAR 2000**

Attitudes	Percentage	Number of Respondents
<b>I do not mind doing GST work</b>		
Strongly agree	5	43
Agree	22	181
Neutral	23	221
Disagree	22	187
Strongly disagree	23	183
<b>Total</b>	<b>100</b>	<b>815</b>
<b>GST is unreasonably complicated</b>		
Strongly agree		
Agree	26	209
Neutral	27	219
Disagree	26	209
Strongly disagree	15	124
	7	59
<b>Total</b>	<b>100</b>	<b>820</b>
<b>Article I. I support Government tax reform</b>		
Strongly agree	13	106
Agree	35	288
Neutral	23	191
Disagree	15	129
Strongly disagree	14	111
<b>Total</b>	<b>100</b>	<b>825</b>

The New Zealand study used word associations with the tax compliance process and participants' experiences with tax audits. Some researchers have suggested that word associations that came spontaneously to people's minds would display the nucleus of their representation.<sup>79</sup> According to Kirchler, when people discuss socially relevant issues such as taxes, they are in fact exchanging lay knowledge and attempt to understand and evaluate the issue at stake.<sup>80</sup> Hence the New Zealand study asked each participant the question:

<sup>79</sup> Erich Kirchler, *The Economic Psychology of Tax Behaviour* (2007) 7-21; Cullis and Lewis, above n 23, 310.

<sup>80</sup> Kirchler, above n 79, 29.

'When the phrase "tax compliance" is mentioned, what kind of image(s) or word(s) come to mind?'

The results of the New Zealand study indicated that tax compliance has been associated with: a huge amount of paperwork and accounting; tax regulations and rules; tax returns and the Inland Revenue Department (IRD); payment of money and penalties; stress; paying tax on time; and correct tax calculated. Thus this demonstrates that small businesses are critical of the compliance process, a similar situation to that of the Australian small businesses who had articulated that the GST is unreasonably complicated.

Moreover, the existing Australian evidence has proven that small businesses have for a long time been complaining about the bureaucratic and complex tax system.<sup>81</sup> Pope<sup>82</sup> researched 250 tax agents in Perth using survey questionnaires to identify their attitudes to tax simplification. Pope explored why individual income taxpayers used an agent, and 66 per cent of the respondents, a majority representing small/medium size agents, ranked the complexity of the income tax system as a major factor.<sup>83</sup>

Coleman and Freeman<sup>84</sup> conducted qualitative research with groups of Australian small business owners. The results of their study revealed that small business owners complained that the law was too complex and thus resented the time and money devoted to compliance.<sup>85</sup> Coleman and Evans reiterate this by asserting that small businesses advocate for clear legislation and low compliance costs.<sup>86</sup> Earlier on, the Small Business Deregulation Task Force confirmed that the complexity of regulations added to the frustrations felt by small businesses.<sup>87</sup> In fact, the studies discussed above were undertaken as a result of the ATO's acknowledgement of the complexity of the Australian tax system.<sup>88</sup> The results of these studies have also been discussed elsewhere.<sup>89</sup>

Qualitative responses of the Australian study<sup>90</sup> confirmed an emotive small business participant who raised various issues such as the psychological cost of the GST and the time taken, in particular, the opportunity cost of complying with the GST system, which arose due to complexity of the GST system. This respondent expressed:

The whole thing is a complete time consuming imperceptible imposition upon my life in general. A complete absurdity and an affront to my freedom to be able to operate my business as a normal business should operate. I am not an accountant and I think the government is expecting far too much from the average small business person. Besides which, I am being paid nothing to collect their taxes. Therefore, I have become an unpaid tax collector and I must do it right, otherwise I shall be punished!!!<sup>91</sup>

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81 Jeff Pope, *Tax Agents' Attitudes to Simplification and the Australian Taxation Office's Lodgment Programme/Deadline System* (1993), Discussion Paper Series, Curtin Business School, Public Sector Research Unit; Bell Report, above n 8; Cynthia Coleman and Lynn Freeman, 'Changing Attitudes of Small Business Owners to the ATO in a Tax Reform Environment' (1999) (Paper presented at the Australian Tax Teachers Conference, hosted by the School of Law, University of Canberra and National Centre for Corporate Law and Policy Research, Canberra, 5-7 February 1999) <http://nla.gov.au/nla.arc-23524> at 14 September 2006; Coleman and Evans, above n 3.

82 Pope, above n 81.

83 Ibid, 4.

84 Coleman and Freeman, above n 81.

85 Ibid, 13.

86 Coleman and Evans, above n 3, 154.

87 Bell Report, above n 8, 16.

88 Wallschutzky and Gibson, above n 59, 511.

89 Nthati Rametse and Jeff Pope, 'Start-up Costs of the Goods and Services Tax for Small Businesses in Australia' (Paper presented at the 30th Annual Conference of Economists, The University of Western Australia, Perth, 23-26 September 2001); Rametse and Pope, above n 52; Nthati Rametse and Jeff Pope, 'Business Start-up Compliance Costs: Policy Perspectives' (2005) (Paper presented at the 17th Annual Conference of Australasian Tax Teachers Association, Victoria University of Wellington, 26-28 January 2005); Nthati Rametse and Jeff Pope, 'Business Start-up Compliance Costs: Policy Perspectives' (2006) 1(3) *Journal of the Australasian Tax Teachers Association* 120.

90 Rametse, above n 12.

91 Ibid 7.

Clearly, this respondent resists his or her role of being an ‘unpaid tax collector’, a situation that concurs with some participants in the New Zealand study. For example, a New Zealand Small Business (SB) participant 13, when asked the meaning of tax compliance, expressed:

I think paying taxes is part of life and it is something that they (the IRD) imposed on you from day one. I suppose it means that we have to comply with what they (the IRD) want and we don't have much of a choice. There is a lot of paperwork involved and I have limited understanding of some of the paperwork. These involve a lot of time and it is part of the compliance that we had to do for the IRD. We are “slaves” in collecting and administering the taxes like the GST for the IRD. We are not paid for doing all these.<sup>92</sup>

SB13 does not have any proper accounting or cash flow management system in place. Consequently, his business has a history of filing late returns thus incurring tax penalties and fines. He is also not accounting literate and therefore is completely reliant on others to fulfil his tax obligations. To him, tax payments are seen as cash flow leakages to the IRD preventing him from using it for the business. However, his perception of the taxes paid is incorrect. This is because the collection of taxes is part of the stewardship function required of any businesses acting as agents for the government. It is understood that the IRD expects these monies collected to be returned to the legal owner, the government, when they are due.

Some New Zealand small businesses associate tax compliance with cash outflows as they tend to make tax payments at year end. This is because they receive their incomes on a gross basis and no tax is withheld at source. Thus it is not surprising that another respondent, SB5, saw the payment of taxes as a cash flow loss and resenting it:

- a) It cost me a fortune, it is like going to the dentist, it will cost me money and it is something you want to avoid and want to put it in the back burner and then you have the penalties for doing so. Tax compliance to me is like a dirty word. For me, it is about inefficiency, dealing with the government, bureaucracy. I just don't like tax.<sup>93</sup>

The importance of having a good accounting system for tax compliance was expressed in the New Zealand study by one tax agent (TA) participant, who claimed that this would make the compliance process much easier. TA 5 expressed that:

Tax compliance is part of good accounting system. If they (the small businesses) have good accounting system, tax compliance and getting the information for the tax returns will take less than 2 minutes.<sup>94</sup>

A lack of sound accounting system may be one of the main causal factors for the small business participants' ill feelings towards the compliance process. It is thus important that small businesses are well informed about the managerial benefits of having a good accounting system. This would probably change their views on compliance. Notably, this can be confirmed by Lignier's<sup>95</sup> research.

Rametse conducted in-depth interviews with 13 small business participants in Western Australia in 2003 to determine the extent of managerial benefits from GST compliance activities.<sup>96</sup> The results confirmed that the managerial benefits derived by small businesses from the use of computers for GST offset 96 per cent of the cost of equipment acquired for GST implementation. In fact, one accountant participant believed that the GST has indirectly benefited his business (accounting firm) ‘because it has motivated our clients to acquire computers and use them. This has made it easier for our business to communicate

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92 Sue Yong, ‘Tax compliance and audit experiences for the small businesses and tax agents: A social constructivist perspective’ (Paper presented at the Accounting and Finance Association of Australia and New Zealand (AFAANZ), Sydney, 6-8 July, 2009) 18.

93 Ibid 21.

94 Ibid 21.

95 Lignier, above n 49, 1.

96 Rametse, above n 47, 14.



with our clients'.<sup>97</sup> This accounting firm incurred high start-up costs because in most cases, clients could be reached telephonically, by correspondence and personal visits to their premises. However, 'it is now easier to communicate with the business's clients since they use computers. We still have to review our clients' accounting activities to verify the allocation of expenditure and other accounts'.<sup>98</sup> Thus, from the client's perspective, due to the accountant having to verify the allocation of expenditure and other accounts, the costs of preparing the Business Activity Statement and other financial accountability requirements will always be high.<sup>99</sup> This indicates that small businesses may not have taken into account that ongoing costs reduce with the acquisition and the use of computer systems. As articulated by Yong (2008), educating small businesses about the significance of managerial benefits could probably change their perception on compliance.<sup>100</sup>

The Australian Board of Taxation Report<sup>101</sup>, which largely investigated the regulatory compliance costs of small businesses in Australia, also reported that small businesses can benefit from the tax compliance process. The report articulates that while in the short term, acquisition of computers may increase business compliance costs, in the long-run, businesses may benefit from this. Thus the use of computerised recording and reporting systems and other technology would enable small businesses to run their core business more effectively and reduce ongoing compliance costs. Additionally, government needs to facilitate the use of technology for industry in designing software packages that are well aligned with tax and business reporting requirements.

Complexity issues were also prevalent in both Australian and New Zealand studies. An Australian small business owner raised the following concern with different GST charging categories: 'why one item is considered GST free and a similar item is not?' Another retail small business owner in Australia stated that 'each line has to be tagged accordingly in the computer... some items are taxable at all parts of the chain, others partly and others GST free.... this is a big mess.'<sup>102</sup> Thus the complexity of the GST and lack of GST knowledge for this particular small business owner made the situation worse, resulting in higher start-up compliance costs. However, complexity of tax rules is not only perceived by the Australian small business taxpayers but also their New Zealand counterparts. For example, New Zealand SB3, who is fairly knowledgeable in accounting, expressed the following with regard to tax compliance and complex tax rules (despite the fact that the GST has been introduced more than 20 years ago):

Tax compliance means filing in the income tax, GST correctly and on time. Following the rules correctly of what you need to declare for GST or pay your tax on. What are the exempt supplies and things like that? For expenses, what you can claim, what you can't claim. Not everything is claimable and what you can deduct. It is not easy to understand what is deductible and what is not even-though I did attend some courses and it seemed to open up a can of worms. Some of the rules can be too detailed.<sup>103</sup>

Thus the tax compliance process can be strenuous as a result of complex tax rules. Consequently, this could result in small businesses seeking expert advice. This situation has the capacity to increase compliance costs.

Despite various simplification measures by the two governments in both countries<sup>104</sup> small businesses continue to have difficulties understanding some taxation rules. This was

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97 Ibid.

98 Ibid.

99 Ibid.

100 Yong, above n 92, 21.

101 Australian Board of Taxation, above n 9.

102 Rametse, above n 12, 5.

103 Yong, above n 92, 20.

104 New Zealand Government, Inland Revenue, *Tax Simplification Issues: Provisional Tax: IR5 Tax Returns* (1996) and *More Time for Business – Tax Simplification for Small Business* (2001); New Zealand Government, Ministry of Economic Development, Ministerial Panel of Business Compliance Costs, *Seeking the Views of New Zealand Businesses* (2001).

evident in the Australian study where for the purpose of tax simplification for small businesses a cash method of accounting in 2000 was to be used for those businesses with an annual turnover of NZ\$1 million. Another respondent said, 'We have limited time to spend on bookwork. The cash system would be good for us, but the ATO won't allow us to use it as our annual turnover is in excess of \$1 million'.<sup>105</sup> Whilst some small businesses understood what the cash versus the accrual method of accounting entailed, others did not. Thus the smallest (micro) business would not have had much understanding of these methods, as compared to medium sized businesses and other small businesses with a turnover of less than NZ\$1 million. This would have forced these micro businesses into outsourcing accounting services to deal with the situation, resulting in increased start-up compliance costs of the GST.

Another small business participant stated that, 'we did not choose accrual method, but it does place a strain on cash flow when debtors payments are slow'.<sup>106</sup> This participant spelt out the main shortcoming of the accrual method of accounting where the GST has to be submitted to the ATO irrespective of cash receipt.

### *C. Attitudes on the government's tax reform*

The Australian study also requested respondents to respond (with a tick on the scale) to the statement 'Overall, I support the government's tax reform'. Thirty five (35) per cent of respondents indicated that they agreed - overall they supported the governments' tax reform and 13 per cent strongly agreed. Thus whilst in total, 48 per cent of these respondents were positive about their support for the overall government's tax reform, 29 per cent were against it and 23 per cent remained neutral (see Table 2 above). It is not surprising that a majority of small businesses supported the overall government's tax reform. Petzke and Murphy also noted that prior to and following the introduction of the GST, 62 per cent of businesses with more than A\$1 million annual turnover supported the GST.<sup>107</sup> Businesses with less than A\$1 million annual turnover (53 per cent) supported the GST both prior and following its introduction, rising to 55 per cent twelve months after its implementation. This is supported by the previous research discussed above, which confirms that small businesses have for a long time been pushing the Australian government for a simple and fair taxation system.<sup>108</sup>

### *D. Mean gross GST start-up compliance costs by attitudes*

The Australian study estimated the mean GST start-up compliance costs by respondents' attitudes and this enabled assessment of the relationship between attitudes and average start-up GST compliance costs (see Table 3). As one would expect, those who do not mind doing GST, who believed GST is not unreasonably complicated and who support the overall government's tax reform, tended to have lower start-up costs than those who are more critical – hence their favourable views towards the GST. For example, for the statement 'I do not mind doing GST work', those who 'strongly agreed' and 'agreed' incurred mean GST start-up compliance costs of A\$5984 and A\$4485 respectively. These figures are lower than those who 'disagreed' and 'strongly disagreed' (A\$8511 and A\$10525 respectively). Their favourable views were presumably, because they were better prepared for the GST and had well established computerised systems to cope with the GST compliance requirements, than those who do not.

In addition, respondents who 'strongly agreed' and 'agreed' to the statement 'GST is unreasonably complicated' incurred higher mean start-up compliance costs of A\$12 018

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105 Rametse, above n 12, 6.

106 Ibid 6.

107 Sue Petzke and Daniel Murphy, *A Survey of Small Regional Businesses and the Impact of the Goods and Services Tax* (2001) 18-19.

108 Pope, above n 81, 4; Bell Report, above n 8, 16; Coleman and Freeman, above n 81, 154; Coleman and Evans, above n 3, 147.

and A\$7833 respectively. Those who were positive (disagreed and strongly disagreed) incurred lower mean start-up compliance costs of A\$5292 and A\$5113 respectively. Finally, those who were negative about the support for the government's tax reform incurred higher mean GST start-up compliance costs of A\$11 336 compared to those who tended to be positive (strongly agreed incurred A\$5116) (see Table 3).

**TABLE 3**  
**MEAN GROSS GST START-UP COMPLIANCE COSTS**  
**(INCLUDING TIME) BY ATTITUDES**  
**YEAR 2000**

Statement/Attitude	Mean \$	Number of Respondents
<b>I do not mind doing GST work</b>		
Strongly agree	5,986	42
Agree	4,485	181
Neutral	7,826	216
Disagree	8,511	185
Strongly disagree	10,525	182
<b>Overall</b>	<b>7,746</b>	<b>806</b>
<b>GST is unreasonably complicated</b>		
Strongly agree	12,018	206
Agree	7,833	216
Neutral	6,774	207
Disagree	5,292	123
Strongly disagree	5,113	59
<b>Overall</b>	<b>8,042</b>	<b>811</b>
<b>Overall I support the Government's Tax Reform</b>		
Strongly agree	5,116	104
Agree	8,051	288
Neutral	7,595	187
Disagree	6,748	128
Strongly disagree	11,336	109
<b>Overall</b>	<b>7,807</b>	<b>816</b>

The major explanatory factors for those respondents who were critical may include the following:

- They may have overstated their costs as part of an effort to lobby the Government to change some GST policy issues.
- They may not have adequate accounting expertise, and hence rely mostly on outside expert advice.
- They probably believed that they would not benefit at all from the GST system but are only 'unpaid tax collectors' for the government, thus voicing their resentment.

- They strongly believed that they lost their leisure time and time to carry out their normal business activities to engage in GST work.
- They generally believed that the cost of getting ready for the implementation of the GST were very high, outweighing any potential benefits.
- Some small businesses whose records were not kept properly would be required to do so with the introduction of GST. Analysis of the relationship of respondents' attitudes with whether they believe their businesses would benefit in keeping records for GST purposes concurs with this<sup>109</sup>.
- Small business participants who used the accrual method of accounting were required to submit their GST monies to the ATO irrespective of the date of receiving GST from their customers.

## VI. CONCLUDING REMARKS

This paper has discussed empirical evidence on small businesses' perceptions of the tax systems, in particular, the compliance costs of the implementation of the Australian GST and the New Zealand tax compliance process. The main finding is that considering different research methodologies and the investigation of two different, although related, aspects of taxation (compliance and compliance costs), small businesses' perceptions tend to be similar. Notably, on one hand, the Australian study investigated small businesses' attitudes to the overall Australian taxation reform with a focus on the year 2000 GST start-up compliance costs. On the other hand, the New Zealand study was conducted on small business owners' general tax obligation experiences while interacting with the tax authority. Despite this, the two studies address the issue that small businesses' negative attitudes to tax compliance predominantly relates to its complexity, and/or possibly their lack of appreciation of the managerial benefits derived from the tax compliance process. Their negative perceptions should be interpreted cautiously as part of this problem is caused by the lack of proper accounting systems and accounting knowledge on the part of the SMEs. For the Australian study, small business not recognising the existence of managerial benefits could be that their excessive GST implementation costs outweighed their resultant managerial benefits. Again, it could be an attempt to lobby the government for GST policy change.

By not acknowledging and addressing internal problems, small businesses may continue to resent their tax responsibilities in both the short and long run. Small businesses with a greater appreciation of the managerial benefits derived from the compliance process and possibly targeted administrative and financial assistance from the tax authorities could lessen their negative perceptions. A more positive orientation towards their tax compliance obligations by both the Australian and New Zealand small businesses can only enhance their voluntary compliance yielding positive benefits for all parties in the long run.

Clearly, a large proportion of the Australian small businesses supported the Australian tax reform (48 per cent), compared with 29 per cent who were against the tax reform. This is despite the complicated nature of GST treatment for different items. However, small businesses from both countries resented the role of 'unpaid tax collectors' thrust upon them by their governments, because of the time, costs and penalties associated with the tax obligations. Moreover, in the Australian study 53 per cent believed GST work was unreasonably complex as opposed to 26 per cent who were neutral and 22 per cent who disagreed that the GST was complex. Around 45 per cent of participants in the Australian study disliked doing GST work, 27 per cent were comfortable with doing GST work and 23 per cent were neutral. However, these statistics need to be interpreted cautiously as they again showed a lack of appreciation of the managerial benefits of complying with the GST requirements. In addition, this may well be an initial negative reaction towards any newly legislated tax requirements.

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109 Rametse, above n 12, 10.

Despite the fact that the New Zealand GST is well established as it had been implemented for more than two decades, small businesses continue to view the tax imposition negatively. The negative perception suggests several issues. Firstly, the GST is viewed as complicated because of the different treatment for exempt, zero rated and taxable supplies. Secondly, their accounting systems are not sophisticated enough to enable tax returns to be filed efficiently. Third, small businesses may have incorrectly viewed the GST monies collected as ownership rather than stewardship. These issues need to be addressed to reduce a persistent negative perception towards the GST tax compliance activity. One may suggest re-educating small business taxpayers in terms of having better and improved accounting systems and accepting their tax obligations as part of the requirements for operating a business. Second, it would also reduce a lot of angst among the small business community if tax legislation is simplified for ease of compliance.

Both the Australian and the New Zealand studies confirmed that small businesses perceived the tax compliance process as a burden as it involved more paperwork, hence was costly. The New Zealand small businesses associated tax compliance with payment of taxes and a resultant loss of cash flow. The emotive comments, from both Australian and New Zealand small businesses included complaints in regard to the complexity associated with exemptions and accounting systems and the time consuming process of compliance. This helps to explain why the results of the Australian study show that small businesses that were strongly critical of the government's tax reform (compared to those who were strongly positive) were those which had incurred higher GST start-up compliance costs. Small businesses that believed that the GST was unreasonably complicated, in total, incurred higher costs than those who were positive.

## VII. POLICY IMPLICATIONS AND LIMITATIONS

Although small businesses in Australia supported the overall government's tax reform, they disliked doing the GST work due to its complexity, compounded by exemptions, various charging categories and more paperwork. Arguably the small businesses surveyed may have overstated costs as a strategy for lobbying the government for a policy change. Both Australian and New Zealand governments have attempted to address the issue of complexity by undertaking some remedial actions. For example, the Australian GST registration threshold has been increased from A\$50 000 to A\$75 000 and the New Zealand GST threshold has been increased to A\$60 000 from A\$40 000. This may keep small businesses out of the GST system; hence reducing the overall compliance costs.

Additionally, both studies have contributed to the knowledge of small businesses' perceptions of the tax compliance process and the associated costs. It should be noted that the perceptions are attributable to both internal and external factors. The internal factors relate to remedial actions required of the small businesses to address their accounting systems and to change their views of taxes collected on behalf of the tax authority. The external factors relate to how the tax authorities need to educate/re-educate the taxpayers in terms of their tax compliance obligations and to simplify the tax legislation making it easier to comply.

It is also important for tax agents and government to educate small businesses about the managerial benefits of a good accounting system for compliance purposes. Additionally, to avoid business failure associated with compliance cost issues, including the stress of filing tax returns, short-term financial relief for setting up a good accounting system for small businesses should be a top priority of government policy.

The main limitation with the New Zealand study is the smaller sample size, which does not allow the results to be generalised for the small business population. Despite this situation, the richness and depth of the data obtained has provided multiple views of the compliance perceptions held by small businesses and tax agents. It is important to note that this research is not an attempt to make comparisons between the SMEs' perceptions as it is understood that SMEs are not a homogeneous group. However, it attempts to provide some

initial insights into their perceptions and the common theme appeared to be that SMEs in both countries still viewed their compliance responsibilities negatively because of the costs and time associated with the activities. In addition, both groups of SMEs also viewed tax regulations as complex thereby increasing their compliance burden.

The potential for future research is to increase the sample size for New Zealand study to verify the present findings. An alternative suggestion is to include smaller and micro businesses as they are the ones that are faced with the highest proportion of compliance costs relative to their turnover.

Previous compliance costs studies have not effectively valued managerial benefits and this remains an area for further academic research. Notably, the managerial benefits arising from the Australian GST were addressed by the Regulation Impact Statement (RIS), articulating that, in the long-run, small businesses will benefit from compliance with GST requirements<sup>110</sup>. However, the Australian government did not specify the magnitude of these benefits, neither per small business, nor by turnover. Further research could address this gap. Consequently, in their tax impact statements, governments, both nationally and internationally, would effectively substantiate the level of benefits that small businesses could expect in their compliance process, when a new tax is introduced or the existing tax is revised.

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<sup>110</sup> *Regulation Impact Statement for the Introduction of a Goods and Services Tax [RIS]* (1998), accompanying A New Tax System (Goods and Services Tax) Bill 1998 <<http://www.taxreform.gov.au>> at 18 January 2000.