indirectax.net
YOUR INDIRECT TAX NETWORK

28 May 2014

Mr Matthew Brine
Secretariat
Board of Taxation

Dear Mr Brine

BOARD OF TAXATION REVIEW: TAX IMPEDIMENTS AFFECTING SMALL BUSINESS

You will find attached Indirectax.net Pty Ltd's submission regarding the tax impediments affecting small business. The submission deliberately focusses on the taxation disciplines practiced by indirectax.net. It also provides a framework to assist the Board of Taxation to accurately evaluate the risk to revenue that otherwise might discourage the Government from removing the tax impediments.

Indirectax.net Pty Ltd

Indirectax.net is a practice that, as its name suggests, specialises in indirect tax, both Commonwealth and State taxes. Its founder, Stephen Baxter has advised on indirect taxes for 28 years. He is on the Board of Taxation Advisory Panel. Indirectax.net is closely associated with the long standing firm, Indirect tax Consulting Group. Its website is www.indirectax.net.

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Please contact Stephen Baxter either directly on 02 9221 2888 or 0421 029 869 or through the Working Group if you wish to discuss the submission.

Yours faithfully

Stephen Baxter
Director

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ATTACHMENT

BOARD OF TAXATION REVIEW: TAX IMPEDIMENTS AFFECTING SMALL BUSINESS

DETAILED SUBMISSION

1.0 INTRODUCTION

1.1 What is a "Tax Impediment" affecting small businesses?

It is Indirectax.net's view that the tax impediments affecting small business fit into seven categories:

- Tax compliance complexities especially regarding thresholds and rates
- Restricted access to tax credits, concessions or exemptions
- Costly and time consuming tax procedures and reporting, and
- Taxation features and outcomes which:
    - impede growth
    - impede the raising of finance
    - hinder the hiring, retaining and rewarding directors and employees
    - encourage commercial behaviour detrimental to the business, business owners, employees and the country.

It should be recognised that an individual impediment might fall into more than one of the categories above. However, where possible, we discuss some specific impediments listed below within the context of a particular listed category.

Some of the specific impediments listed below equally apply to medium & large businesses. However, by their nature, the impact on small businesses is proportionately greater. That is for three reasons:

- The time and resources taken to address many of them is roughly the same as required by medium to large businesses,
- They are more likely to require the involvement of the business owner, directors and senior management of small businesses than they would in a medium to large businesses. In the latter strata of businesses, these tasks are more likely to be within the day to day job description of existing, qualified employees, and
- The small business is less likely to have the resources to seek external advice or undertake the reviews and double checking necessary to detect and prevent errors.

1.2 Framework for Evaluating Tax impediments

Indirectax.net recognises that the various taxation impediments were not installed capriciously or by whim or accident. Rather, Parliament or the ATO imposed the impediments ultimately to meet policy objectives and to protect the revenue.

It is suggested that the removal of the impediments listed in this submission will not undermine any policy objectives. Indirectax.net submits that their removal will not cause a risk to revenue.

In that regard, we submit that the real question is not whether the removal of the impediment creates a theoretical risk to revenue determined from a revenue authority or economic perspective. Rather, we submit that the real question is as follows:

> **Will the removal of that impediment alone be the primary cause of a material increase in the actual risk to the revenue that did not exist already?**

The impediments listed below will be specifically evaluated against that real question, where necessary.

2.0 Tax Compliance complexities

Impediments for small businesses include complex compliance system design features when a simpler feature would achieve exactly the same policy purpose and generate exactly the same (or more) revenue. These unnecessary complexities are more likely to cause small businesses to make errors in compliance or communication, to seek and pay for external assistance, to affect third parties including customers and staff, to require correction for the future and rectification for the past and lead to penalties and GIC. Some of the impediments and Indirectax.net's suggested recommendation are:

- **Car Limit (for income tax depreciation and luxury car tax)** – is currently $57,466 and indexed to price changes each year although unchanged for a few years. This number is utilised by businesses, salary packaging firms, car dealers and finance companies among others. ***Recommendation*** *– Make the limit a round number eg $57,000 (or even $55,000) and leave it unchanged until the underlying index compels change to say $58,000 (or even $60,000)*

- **Fuel Excise Rate and Road User Charge (for fuel tax and fuel tax credits (FTC) purposes) –** currently 38.143 cents per litre (cpl) and 26.14cpl respectively leaving an FTC rate for road transport of 12.003 cpl. The road user charge increase annually hence effectively reducing the claim rate. The excise rate is now proposed to change every six months. While FTCs can be claimed every tax period, most small business fuel users accumulate fuel purchases over a longer period before lodging a claim. They do so because it is more efficient to accumulate claims especially where they have an FTC professional review their claim. With the presence of the carbon tax and blended fuels or gaseous fuels in addition to diesel and petrol, many small businesses will be dealing with up to 12 different FTC rates for an annual claim, each with up to three decimal places. Back claims for certain entitlements can be made in the current BAS at the higher rates applying when the fuel was purchased. Back claims for road transport use if made in a current BAS can only adopt the current lower rates. ***Recommendation*** *– reset the excise rates, road user charges and effective fuel tax credit rates at round numbers eg 39cpl, 27cpl and 12cpl respectively. Ensure that the indexed excise rates be rounded up and down to the nearest cent. Further, enable the FTC claim rate for road travel be the rate applying when the fuel was purchased (as it is for all other FTC entitlements) and not the FTC rate applying when the BAS is lodged.*

- **Medicare Levy (for income tax, FBT and PAYG withholding purposes) –** this separate tax of currently 1.5% adds complexity to HR, Payroll, FBT and PAYG related functions. It is deceptively named because it does not fund Medicare but merely forms part of consolidated revenue. It has its own series of exemptions and thresholds. ***Recommendation*** *– eliminate the Medicare levy and simply incorporate the 1.5% charge within higher income tax rates. This measure could be implemented without removing the capacity to impose an extra tax for hypothecated purposes.*

3.0 Restricted access to tax credits, concessions or exemptions

3.1 GST: Recipient Created Tax Invoices (RCTIs)

The impediment is that RCTIs cannot be issued for many transactions by small businesses where it is practical to use them.

A recipient of taxable goods and services acquired is not entitled to claim an input tax credit unless they are in possession of a qualifying tax invoice. The GST regime recognises that, for certain industries and transactions, the recipient is the party in the best position to produce the tax invoice. That is because inter alia, either they produce the legal document that records the transaction or they are in the best position to know the volume or value of the transaction. A typical example is agricultural co-operatives who produce an RCTI for supplies of produce they acquire from farmers. Unlike the farmer, the co-operative has the facilities to measure the weight or volume of the particularly commodity and the information to determine the current market hence the transaction price agreed with the farmer.

Entitlement for recipients to issue RCTIs is limited to two scenarios:

- **GSTR 2000/10 scenarios** – paragraph 10 of ATO ruling GSTR 2000/10 enables RCTIs to be issued by government agencies, taxpayers with turnover exceeding $20m and for agricultural products
- **Legislative Determination scenario** – supplies of goods and services specifically covered by Legislative Determinations. These are a series of determinations issued by the Commissioner

which tightly define a category of transactions for which RCTIs can be issued. More than 50 of these were issued in the first year of GST. Since the new processes for legislative determinations came in place in 2008, only 4 have been issued. We have been advised that these determinations now need to be tabled as draft documents in Federal Parliament and take 18-24 months to issue. The Commissioner's practice is to only recommend them for issue when requested by an industry body.

It follows that an SME that acquires other than agricultural products cannot issue RCTIs unless they are already covered by a Legislative Determination. If not, then they will not be able to issue them in future unless firstly they are a member of an association that covers their industry. Secondly, that industry association needs to be sufficiently motivated to fund the costly and lengthy exercise to pursue a determination and must be successful in its efforts. This is a very clear impediment to SMEs. By contrast, a larger entity with a turnover exceeding $20million can issue RCTIs and claim the associated credits unconditionally.

In circumstances where a recipient is entitled to claim input tax credits, the main risk to the revenue is that they will claim the credit but the primary GST not be paid by the supplier. That risk, of course, already exists in respect of supplier issued tax invoices as well as RCTIs.

The only theoretical further risk caused by RCTIs relates to a change in the supplier's GST registration status. A supplier might fall below the GST registration threshold and deregister for GST. If so, it is required under the Legislative Determinations and under its written agreement with the recipient to advise the latter of it's de-registration. If it does not do so, the recipient might continue to gross up the supply price for GST, issue RCTIs and claim credits for them. The risk is that the supplier will receive a grossed up price and not remit any amount to the ATO.

However, that risk already exists in GSTR 2000/10 and Legislative Determination scenarios for other entities. In both of those scenarios the failure of the supplier to inform the recipient of it's de-registration provides the circumstance whereby the GST credit could be claimed but the GST liability never remitted.

We tailor the critical question, as follows:

Will the removal of the prohibition on utilising RCTIs by SMEs not covered by GSTR 2000/10 and Legislative Determination scenarios be the primary cause of a material increase in the actual risk to the revenue that did not exist already?

The answer is clearly NO as that risk exists already for the entities covered by the "approved" scenarios. It is submitted that the current prohibition is an unwarranted impediment against small business that cannot be supported under any policy ground.

Recommendation: *the Commissioner exercise its discretion to allow all recipients to issue RCTIs provided they have an agreement in writing with the supplier to do so (subject to the general conditions written into all legislative determinations).*

3.2 Deferred GST Scheme for Imports

The impediment is that small business who wish to use the Deferred GST Scheme for Imports must lodge their BAS and pay their GST monthly. Please note that much of the content that follows for this issue will also be found in the submission lodged by the Institute of Chartered Accountants (ICAA). The author of this submission also prepared part of the ICAA's submission in his capacity as a member of that body.

Entities with a turnover below $20m are entitled to lodge their BAS quarterly (or even annually if below $75,000 turnover). This reduces their compliance cost and eases cash flow compared with larger business who must lodge their BAS monthly.

GST is ordinarily paid on the entry of goods into Australia (where the value of the goods exceeds $1,000). A GST registered importer who sells or uses the goods in the course of making taxable or GST-free supplies can claim input tax credits for the GST paid on the imports in their BAS (that is where they are "creditable importations"). To reduce compliance and cash flow costs, importers can apply to use the Deferred GST Scheme for Imports. Once in the scheme, the GST liability on imports is accrued rather than payable upfront. The next BAS issued to the importer is prepopulated with the GST liability on all their imports during the relevant tax period. If the importer only makes creditable importations, it can include an equal offsetting credit for the GST liability. The effect of the scheme is that GST on imports is both revenue and cash neutral.

Where the Commissioner allows an importer to use the Deferred GST Scheme, it requires monthly BAS to be lodged, even where the entity has a turnover below $20m.

Consider an example comparing a large importer who lodges its BAS monthly versus a small business who lodges quarterly. Assume the following:

- Each entity imports on the 15th day of the month (on average)
- Each entity invoices its sales on the 15th day of the month (on average)
- Each entity accounts for GST on the accruals basis
- The large entity lodges its BAS on the 21st day of the month after the end of the monthly tax period, and
- The SME lodges its BAS on the 28th day of the month after the end of the quarterly tax period

For the large importer, the effect of moving to the Deferred GST Scheme is only positive, as follows:

- Its GST liability on imports is delayed by 36 days (on average)
- It lodges its BAS at the same time as previously (21st day after month end), and
- Its GST liability on sales is payable at the same time as previously

For a small business, the effect of moving to the Deferred GST Scheme also delays the GST liability on imports by 36 days (on average) but it has the following negatives:

- It must complete and lodge twelve BAS a year rather than four
- It lodges its BAS 21 days after month end rather than 28 days after quarter end
- It lodges its December BAS by the 21st of January rather than the 28th of February
- Its GST liability on sales is payable 36 days after invoicing rather than 73 days (on average) as previously. For example, for the June quarter, the average sale is on 15 May and the GST liability would otherwise be due on 28 July but is now payable on 21 June. The small business is required to pay their GST liability on sales 37 days earlier (on average) than previously.

The requirement to have monthly tax periods eliminates much of the benefit of the GST Deferral Scheme for SMEs.

We tailor the critical question, as follows:

> **Will the removal of the requirement for entities with turnover below $20m to have monthly tax periods if using the GST Deferral Scheme be the primary cause of a material increase in the actual risk to the revenue that did not exist already?**

We submit that the answer is NO because:

- The Deferred GST Scheme only applies to imported goods, not locally acquired goods or any services
- GST is not payable on imports with a value below $1,000
- Traditionally, the vast majority of the number and value imports relate to creditable importations because they are sold, or used in manufacture, construction or mining, and
- Even imports for use as remuneration benefits are creditable importations

Even in the very rare case where the imports are not creditable importations, the real risk is merely a timing one. Removal of the impediment simply delays the time that the GST liability is payable on the imports for 37 days. It does not remove the liability.

Recommendation: *allow small business companies and trusts (that is, entities which typically cannot make private or domestic acquisitions) the entitlement to continue to lodge BAS and pay GST quarterly where they apply to use the Deferred GST Scheme for Imports.*

4.0 Costly and time consuming tax procedures and reporting

4.1 Vouchers

The impediment is that sellers of vouchers are required to adopt complex attribution rules which are different from the rules they adopt for all other supplies.

The GST Act requires that GST be calculated on the face value of a voucher and attributed on redemption rather than sale. It is a different calculation and more complex accounting basis that the one they use for sale of then underlying products or service without a voucher. They must run both bases simultaneously.

With the exception of arrangements for phones services and foods, virtually all other vouchers are for taxable supplies. Many small businesses, particularly franchises, have vouchers which can only be redeemed within a closed system, that is, at other outlets within the same group or franchise network. Consider the following stylised example:

15 June 2014

- Book retailer has promotion for June only of a $50 book for the price of $44
- It also has a promotion where a $50 voucher can be acquired for $44
- Customer 1 buys book for $44 – Book retailer pays $4 GST in its June 2014 BAS
- Customer 2 buys book voucher for $44 and gives to friend – No GST outcomes

15 July 2014

- Friend of Customer 2 redeems voucher for the $50 book (back to its normal price) – Book retailer pays $4.54 GST in its July-Sept BAS

It can be seen that **while the same cash is received on the same day and the same book is purchased**, the GST is paid at different times and at different amounts. In the book voucher scenario, the effective GST rate is far more than 10% of the consideration received.

Indirectax.net does not believe that there are valid policy reasons for these two differences. Each one adds actual GST cost and compliance costs to the relevant small businesses. In particular, Indirectax.net submits that small businesses will find it much easier to account for the GST when they receive cash for the voucher rather than when it is redeemed. It needs to be remembered that small retail businesses who will typically have high turnover, relatively untrained, non-financially literate staff at the counter who currently have to understand this deferred GST process.

Complex voucher and loyalty scheme systems involving multiple unrelated parties and some GST-free transactions probably can only be dealt with via a Div 100 type deferred attribution system. However, a large number of retailers operate "closed" voucher systems involving only related entities or other participants within the same franchise. The vouchers are either redeemed at the voucher seller's premises or at the retail outlet of a related entity or fellow franchisee (under a system controlled by the franchisor). Virtually all sales made by these players are fully taxable supplies.

Recommendation: *Players within closed voucher systems making fully taxable supplies be given the option of attributing supplies to the tax period in which the voucher is supplied and on the consideration received. The adjustment event regime within Div 19 can apply to the very rare non-taxable supply or other such eventualities.*

4.2 GST Classifications

The impediment is that small businesses incur considerable costs in classifying goods and services for GST purposes. Ongoing costs include correctly accounting for items at two different rates, plus reconciling the mix of taxable and non-taxable supplies in the event of an ATO audit. Errors in classification can lead to the following outcomes:

- **Treating taxable items as GST-free –** exposures to tax shortfalls and penalties with limited or no avenues to recover unpaid tax from the customer
- **Treating GST-free items as taxable –** loss of custom as prices are uncompetitive, potential breaches of the Trade Practices Act, limited ability to retain refunds of overpaid tax where the tax has not been fully passed onto customers.

The actual GST rates applying to goods and services is a policy issue outside of the remit of this review. However, for the sake of the review and upcoming taxation white paper, it is important not to overlook the costs of compliance that GST concessions impose on small businesses who must collect and remit the tax.

Indirectax.net Pty Ltd
28 May 2014