



**The Pharmacy
Guild of Australia**

Submission to

The Board of Taxation

Review of Tax System Impediments Facing Small Business

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National Secretariat

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Introduction

The Pharmacy Guild of Australia (the PGA) is pleased to provide a submission to the Board of Taxation: *Review of Tax System Impediments Facing Small Business*.

The Pharmacy Guild of Australia

The Pharmacy Guild of Australia is the national peak pharmacy organisation representing community pharmacies. The Guild strives to promote, maintain and support community pharmacies as the most appropriate primary providers of health care to the community through optimum therapeutic use of medicines, medicines management and related services.

Community Pharmacies in Australia

There are over 5,300 community pharmacies across Australia. Most of these are either small or medium sized businesses. Community pharmacies dispense 286 million prescriptions annually, including 201 million PBS/RPBS subsidised prescriptions.¹ The average community pharmacy dispenses 54,534 prescriptions per year² and pharmacy staff have a range of professional obligations and a duty of care to their patients. This positions pharmacy as uniquely important for each local community, but also restricts the nature and options for the business. Prescribed medicines account for 70.5% of sales, whilst other controlled medicine, health and retail products make up the remaining 29.5%.³

In addition community pharmacies operate as a primary health destination which customers will attend for immediate medical advice and health services. 94% of Australians will visit a pharmacy every year, and for those with chronic conditions visiting a pharmacy is part of their essential health management routine.

Community pharmacies are a trusted network in Australia. The *Roy Morgan Image of Professionals Survey 2014* found that 86 per cent of respondents rate pharmacists highly on ethics and honesty – up two per cent on last year's result and equal second of all professions. This annual survey has confirmed that pharmacists are valued and respected. The community pharmacy network is Australia's most accessible health care destination where people can seek advice, services and lifesaving medication in many cases seven days a week, after hours and without an appointment.

Community Pharmacies are Small Businesses

The Australian Taxation Office (ATO) refers to businesses with turnover of less than \$2 million per annum as 'micro businesses'. Businesses with turnover between \$2 million and \$10 million are generally regarded by the ATO as 'small businesses' although for statistical purposes they are usually included in the 'small and medium enterprises' category, which contains businesses with turnover between \$2 million and \$100 million.

¹ Pharmacy Guild of Australia Guild Digest 2013

² *ibid*

³ *ibid*

The PGA's Guild Digest 2013 (for the financial year 2011-12) shows the average community pharmacy has a turnover of \$2.92 million. This same publication has reported average turnover for community pharmacy businesses of greater than \$2 million since 2003. An average community pharmacy employs 3.7 full time staff and 6.9 part time or casual employees.⁴

It is reassuring to note that the terms of reference for this review do not constrain the Board of Taxation to the use of any specific definition of small business.

The PGA is of the view however that there would be merit in this current review of the tax system in reconsidering the finding of the Board of Taxation in 2007, specifically Finding 17 of the "*Scoping study of small business tax compliance costs*":

Some progress has been made in standardising the definition of 'small business' in tax law, but different definitions are still used in other parts of the law, making it difficult to define clearly the boundaries of the small business sector. There would be merit in exploring the broader application of a standard definition across all legislation.

It is the PGA's position that the problems with the definition of a small business are a point of consideration in the application of Capital Gains Tax (CGT), a matter that is addressed later in this submission.

Key Tax Compliance Concern

The Board of Taxation found in the December 2007 report to the Treasurer "*Scoping study of small business tax compliance costs*" that:

Tax system complexity and compliance costs are of concern because they reduce economic efficiency and can limit participation in economic activity, and those with the least economic capacity, such as small businesses, have the most difficulties coping with them.

In considering the request made by the Government of the Board of Taxation on 28 March when this review was announced, the PGA intends to focus on one key concern for community pharmacy in relation to how the current tax system creates unnecessary impost on community pharmacies as small businesses and impedes the business growth for small business operators in the sector.

The key tax compliance concern for community pharmacy is:

- The Capital Gains Tax (CGT) irregularity where a small business that operates as a company receives less favourable treatment than a small business that is not incorporated.

The PGA would also like to highlight issues for some of our members regarding payroll tax. The PGA acknowledges that this review is being conducted by the Board of Taxation, an Australian Government non-statutory advisory body. However, given that the review is to identify features of the tax system that are unreasonably or unnecessarily hindering or preventing small businesses from pursuing and achieving their commercial goals, payroll tax and its inconsistency between state and territory jurisdictions is still a concern for our members.

⁴ Pharmacy Guild of Australia Guild Digest 2013

Capital Gains Tax starving small business company growth

As business opportunities expand, many community pharmacy proprietors find that there are advantages in incorporation. Becoming an incorporated enterprise reduces the risks to the owners of running a business by providing limited liability to all shareholders. It also helps to simplify the paperwork and reporting around any changes to ownership (e.g. bringing on new partners or changes in partners' holdings). In addition, a company structure is advantageous, or sometimes necessary, when seeking to enter into business contracts, such as for the supply of medicines and services, such as dose administration aids to nursing homes.

According to ATO data based on small businesses with turnover between \$2 million and \$5 million, by far the most popular business structure for small business is a company.

Business Structure	Percentage of Total Number
Companies	63%
Trusts	23%
Partnerships	9%
Individuals	5%

This composition of the small business sector appears to have been overlooked when the Capital Gains Tax (CGT) concessions were introduced for small business.

Individuals, trusts and superannuation funds are eligible for the general CGT 50% discount whilst companies are not. Individuals, companies and trusts may also be eligible for the application of the Small Business Exemptions whilst superannuation funds do not carry on a business.

Given the high percentage of businesses with turnover of less than \$5 million that are companies, the lack of access to the general discount can be considered to discriminate against those small businesses that are incorporated. It is understandable that the Government may be of the view that to extend this discount to ALL companies would not serve the interests of protecting revenue and maintaining an equal sharing of the tax burden.

The PGA is of the view that access to the general discount should be extended to an appropriately considered level of incorporated small businesses.

It is considered that for the purposes of considering the application of the general discount to private companies, the definition under the Income Tax Act of a small business entity (aggregated turnover under \$2 million) is too low. Were this definition adopted for access to the general CGT discount for companies, a large percentage of small businesses would be significantly disadvantaged. As noted in our introduction, a more appropriate small business definition is currently in general use by the ATO, where a small business is defined as such when within the range of \$2 million to \$10 million in annual turnover.

Ineligibility for the general CGT exemption is taxing valuable equity growth for small business companies.

A further example distinguishing between small and large companies can be found under the Corporations Act 2001. Section 45A(2) defines a small private corporation is defined as follows:

(2) A proprietary company is a small proprietary company for a financial year if it satisfies at least 2 of the following paragraphs:

(a) the consolidated revenue for the financial year of the company and the entities it controls (if any) is less than \$25 million, or any other amount prescribed by the regulations for the purposes of this paragraph;

(b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than \$12.5 million, or any other amount prescribed by the regulations for the purposes of this paragraph;

(c) the company and the entities it controls (if any) have fewer than 50, or any other number prescribed by the regulations for the purposes of this paragraph, employees at the end of the financial year.

A large proprietary company is defined in Section 45A(3) as being the opposite of this.

The table set out on page 4 shows that, for businesses with turnover up to \$5m, over 60% choose to use a company structure. We would expect that in the next bracket - \$5m - \$10m (the ATO ceiling of ‘what is a small business’ noted on page 2), the percentage would be higher. With over 60% of small businesses deciding to operate under a company structure, the lack of access to this CGT concession for these entities is acting to tax considerable amounts of capital in the small business sector that would otherwise preserve capital for small businesses seeking to expand and grow their enterprises.

Greater access for small business companies to this CGT concession would result in a more equitable capacity for small business growth and entrepreneurship in the sector. Small businesses should not be deterred from taking sound and prudent steps to incorporate their business activities simply to be able to more easily access their own equity to expand or grow their business, an activity that generally leads to greater risk which some small businesses are being forced to carry without the protection of incorporation. Such businesses are usually at a greater risk of failure yet taxation is penalising those who seek this protection.

In addition, in the case of individuals and discretionary trusts, this CGT discount can flow through to the individuals or trust beneficiaries tax-free and this can then be re-invested, providing more opportunities for growth. If small business companies are granted access to this exemption, consideration should be given to allowing the exempt income to flow through to shareholders tax effectively, either tax-free or with a notional franking credit.

It is the PGA’s position that this current review by the Board of Taxation should consider the opportunity to expand the access for small business companies to the general CGT discount in order to promote the opportunity for growth. The PGA is mindful that the Government may wish to protect CGT revenue by restricting the capacity of larger corporations to access CGT concessions. As noted above, the Corporations Act already provides one example of where the Government

Knowing that more of their capital is retained would encourage small business companies to continue to invest, grow and create opportunities for themselves to expand their operations into medium and large businesses.

has sought to remove burdens for small business through an appropriate definition of small and large private corporations.

Payroll Tax

State and Territory payroll tax is an area of confusion and some cost impost for our members. Some community pharmacy owners may own pharmacies in different states and territories and therefore have compliance obligations that vary between their businesses. The variable rates of payroll tax (from 4.75% in Queensland to 6.85% in ACT) and the varying thresholds at which payroll tax applies are frustrating.

Whilst it is recognised that effort has been made by State and Territory Governments since 2007 to achieve greater legislative and administrative harmonisation of payroll tax requirements there is still work to be done to further progress this, and the Australian Government is encouraged to further push such harmonisation across jurisdictions. It is also noted that there are varying laws as to when pharmacy businesses may need to pay payroll tax when engaging contractors.

Additionally, it needs to be recognised that payroll tax can be a disincentive that discourages businesses from employing additional staff. This is particularly the case if a small business is approaching a payroll tax threshold and this additional on-cost can be the deciding factor in deciding whether to increase staffing levels or not. Unlike most businesses, the ability of pharmacies to defray these additional employment costs by absorbing them into the prices they charge for their products and service is severely limited. This is because up to 70% of pharmacy remuneration is derived from the dispensing of prescriptions. The Federal Government sets reimbursement prices for these medicines as well as the remuneration that pharmacies receive for dispensing them. It also sets the maximum co-payments that can be charged to patients.

Community pharmacy has always had the best interests of the health of the Australian public, forefront in its business model. But pharmacy recognises it needs to strengthen its position as a trusted health service destination, whilst identifying additional new funding sources and revenue streams to offset diminishing returns from the traditional dispensing of medicines. In doing this, pharmacy now provides a greater whole-of-health model of practice offering a greater focus on personalised management of health conditions and the provision of professional services. This necessitates an increased investment in professional staff including more pharmacists providing advice and services to patients. This is clearly in the interests of patients, pharmacies and the pharmacy profession. However, it will inevitably result in increased labour costs to deliver these services, creating a higher payroll tax burden.

Conclusion

Community pharmacy is an essential, cost-effective and highly accessible health care destination and the provider of over \$15.31 billion dollars' worth of medicines and other health products and services to its customers from over 5,300 outlets. Despite its primary health care role, community pharmacy operates as a business and must survive in a commercial environment.

For the most part, community pharmacies are small business enterprises.

Pharmacy profitability has declined in recent years due to lower sales growth, increased operating expenses and the impact of government reforms to the PBS. The viability of many pharmacies within the network is now being threatened. Pharmacy owners are finding they have no choice but to cut costs and reduce services at a time when they should be pushing forward with innovation and an increased emphasis on patient services. The opportunity to grow the role of

pharmacy and provide extra and better services to the community is being discouraged by elements of the current tax system.

The PGA welcomes the opportunity to draw to the attention of the Board of Taxation a key component of the current tax system that acts as real and tangible impediment to the capacity of community pharmacy owners to expand their businesses. The current lack of access to the general CGT discount for a small business that decides to incorporate is an immediate disadvantage because they lose access to a tax provision that is available to other types of taxpayers.

It is the PGA's position that this current review by the Board of Taxation should consider the opportunity to expand the access for small business companies to the general CGT discount in order to promote the opportunity for growth.