

# Small Medium Enterprises Total Tax Contribution Report

Commissioned by the Department of the Treasury

December 2009



## 1.0 Executive Summary

This study analyses the impact of Australia's taxation system on a sample of 50 Australian small to medium enterprises (SMEs) for the year ended 30 June 2008 (or equivalent 2008 tax year end). SMEs are defined as businesses with turnover of less than \$100 million.

The study examines the amount of taxes imposed on SMEs, the amount of taxes collected by SMEs and the compliance costs incurred in relation to their taxation obligations. The purpose of this study is to observe whether any relationship exists between the level of compliance costs borne and the size of SMEs.

### 1.1 Tax burden

The survey results highlight the tax burden facing the SME sample:

- The 50 participants incurred \$82.7 million in business taxes.
- Of the total business Taxes Borne<sup>1</sup> by survey participants, 68%, or \$56.2 million, was corporate income tax.
- Payroll tax also represents a significant impost on the SME sample, 22% of total business Taxes Borne or \$17.8 million, was payroll tax.
- In addition to Taxes Borne, the Australian system imposes an obligation on SMEs to collect and remit taxes on behalf of the Government from its customers and employees. The 50 participants collected \$106.8 million in these taxes.

### 1.2 Tax compliance costs

The survey results highlight that complying with Australia's taxation system represents a significant cost for the Australian SME sample.

Participants were required to differentiate between internal costs (compliance activities undertaken in-house) and external costs (outsourced compliance activities) in response to the questions in relation to tax compliance costs. The results show that:

- Survey participants estimated they incurred average annual compliance costs of \$71,053, including both internal and external costs.
- The mean Compliance Tax Rate Equivalent, which measures compliance costs as a percentage of profit before tax plus compliance costs, is 12.9%. This is significantly higher when compared to the mean for the large business sample of 3.8%.
- The Australian SME sample identified that the majority of resources spent on compliance costs relate to income tax 43%. Significant resources were also utilised in complying with GST, payroll and PAYG tax obligations.

### 1.3 Taxes Borne and Collected

The survey results further indicated that:

- Taxes Borne by survey participants on average represented 47% of profit before all business taxes. The mean Total Tax Rate (TTR) of 47% for the SME sample is significantly higher than the Australian large business sample mean of 40%.

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<sup>1</sup> The PricewaterhouseCoopers Total Tax Contribution framework defines Taxes Borne as all taxes that impact the income statement.

- This is due to a disproportionate impact of payroll tax on the SME sample. We hypothesise that this may be a result of a higher labour to capital ratio for the SME sample. Therefore, the impact of such taxes when compared to lower profits is to increase the TTR, in percentage terms.
- At \$56.2 million, corporate income tax represented the most significant proportion of Taxes Borne by survey participants, comprising 68% of all corporate taxes which they reported.
- Employee related taxes comprise 59% of survey participants' total taxes Borne and Collected. This compares to 21% in relation to the large business sample<sup>2</sup>.
- Taxes Borne and Taxes Collected averaged 11% of participant companies' turnover.
- The mean employment taxes (Borne and Collected) per employee is \$34,508 for survey respondents.

#### 1.4 Comparison between SMEs vs Australian large businesses

The following table summarises the key comparisons between the data obtained from the SME sample as compared to the Australian large business sample (bracketed figures represent the number of responses contributing to the statistic<sup>3</sup>):

Metric	Mean		Median <sup>4</sup>	
	SMEs	Large business	SMEs	Large business
Australian turnover	\$40.7 million (50)	\$6,182.3 million (76)	\$26.6 million (50)	\$2,117.7 million (76)
Australian profit before income tax	\$433,679 (50)	\$945.5 million (75)	\$837,505 (50)	\$248.0 million (75)
Number of Australian employees	95 (50)	8,099 (70)	40 (50)	2,849 (70)
Compliance costs	\$71,053 (50)	\$2,269,088 (64)	\$55,511 (50)	\$1,433,285 (64)
Compliance tax rate equivalent <sup>5</sup>	12.9% (43)	3.8% (70)	2.8% (43)	0.2% (70)
Taxes Borne	\$1,653,965 (50)	\$397.7 million (79)	\$594,236 (50)	\$88.9 million (79)
Taxes Collected	\$2,179,992 (49)	\$425.8 million (79)	\$678,193 (49)	\$82.5 million (79)
Taxes Borne and Collected to turnover	11.1% (50)	16.0% (76)	11.7% (50)	11.6% (76)
Employment taxes per employee	\$36,288 (42)	\$37,718 (70)	\$22,918 (42)	\$31,290 (70)
Total Tax Rate (TTR) <sup>6</sup>	46.8% (43)	39.5% (69)	39.1% (43)	33.8% (69)
Income Tax Rate <sup>7</sup>	25.1% (43)	19.9% (63)	28.5% (43)	17.6% (69)

As has been mentioned above, the impact of the tax system in smaller business is significantly different to larger business. Both the rate of tax and impact of compliance costs is higher for SMEs.

<sup>2</sup> All results for the large business sample are references to *What is your company's Total Tax Contribution: 2008 survey results*, PricewaterhouseCoopers

<sup>3</sup> Some respondents, for example in relation to the Compliance Tax Rate Equivalent, were excluded from the calculation of the mean and median on the basis that their result was negative (for example, due to the entity reporting a loss before tax)

<sup>4</sup> The median is the middle value of data ordered from lowest to highest (i.e. the middle observation).

<sup>5</sup> The Compliance Tax Rate Equivalent measures the percentage of profit that is consumed by tax compliance costs.

<sup>6</sup> The Total Tax Rate (TTR) is all business Taxes Borne as a percentage of profits before all business tax.

<sup>7</sup> The Income Tax Rate is income tax borne as a percentage of profits before all business tax

## 2.0 The survey framework

The survey used the PricewaterhouseCoopers Total Tax Contribution framework. This framework defines the components of a company's overall economic contribution in taxes, examining three specific areas of taxation:

1. Business Taxes Borne by the business – taxes that impact the Income Statement
2. Business Taxes Collected – Taxes Collected from customers and employees that are then remitted to government and
3. Tax Compliance Costs – administrative costs incurred in assessing and remitting Taxes Borne and Taxes Collected.

PricewaterhouseCoopers has conducted the Total Tax Contribution survey for the 2006, 2007 and 2008 years, with the survey sample centred on large Australian businesses. The latest findings are reported in the publication *What is your company's Total Tax Contribution: 2008 survey results*.

This Total Tax Contribution framework is used by the World Bank in its annual Paying Taxes study of tax systems.

A significant finding of the 2008 TTC study is that compliance costs increase as a percentage of total taxes borne as business size (by turnover) declines. The purpose of this study is to observe the impact of Australia's taxation system on SMEs in Australia, defined as businesses with turnover of less than \$100 million<sup>8</sup>, to observe (among other things) if a similar relationship exists between compliance costs and SMEs.

We surveyed 50 Australian SMEs, enquiring about the number of taxes they are exposed to, the amount of tax they pay and collect on behalf of government, and the cost of tax compliance.

We have selected a survey sample of SMEs which represents a cross section of industries operating in different States, with varying levels of turnover.

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<sup>8</sup> Please note that whilst we targeted SMEs with turnover less than \$100m, there are 5 respondents in the sample with turnover greater than \$100m.

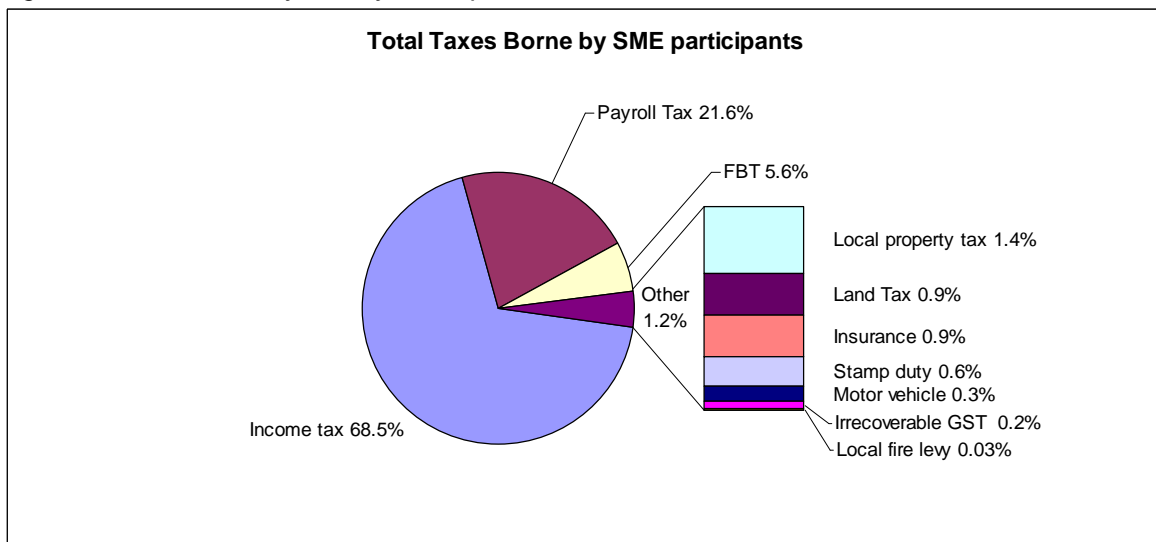
### 3.0 Tax Burden

#### 3.1 Taxes Borne

In relation to Taxes Borne:

- SME survey participants incurred \$82.7 million in Australian taxes.
- At \$56.2 million, corporate income tax represented the most significant proportion of Taxes Borne by survey participants, comprising 68% of all corporate taxes which they reported.
- The other business Taxes Borne by participants totalled \$26.5 million in 2008. In other words, for every dollar of corporate income tax paid, SMEs paid a further 47 cents of other business taxes.
- The other major business Tax Borne by survey participants was payroll tax of \$17.8 million or 22% of all Taxes Borne, as shown in Figure 1.
- This is a significant difference to the large business sample, for which payroll tax comprised 8% of total Taxes Borne.
- Together, corporate income tax and payroll tax represented almost 90% of total Taxes Borne by SMEs.

Figure 1: Taxes Borne by Survey Participant



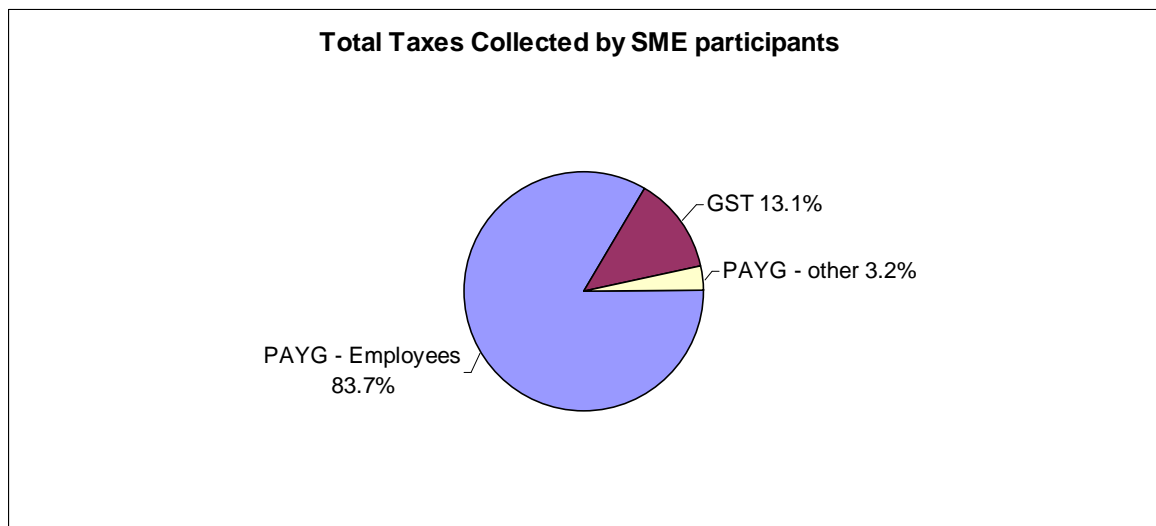
### 3.2 Taxes Collected

In addition to Taxes Borne directly, SMEs also have a substantial obligation to collect a range of taxes from customers and employees on behalf of the various governments.

- Survey participants collected taxes of \$106.8 million in 2008 on behalf of all Australian governments.
- For every \$1 of Taxes Borne by the SME sample, Taxes Collected were \$1.29. This is significantly greater than the Australian large business sample, which collected \$1.07 for every \$1 of Tax Borne.

The major Taxes Collected by the SME sample in Australia, as identified by survey participants, were PAYG on employees' remuneration and GST, as shown in Figure 2.

Figure 2 Taxes collected by survey participants



- Survey participants reported GST collected of \$14.0 million, which is the net amount of GST that was remitted to government. This represents gross GST collected net of GST input tax credits. Gross collections of \$133.6 million are also an important indicator of the size of sample SMEs obligation under the GST system and the risk that they assume.<sup>9</sup>
- The survey participants who bore the most tax, generally, were also the largest collectors of tax.

<sup>9</sup> Taxpayers have the responsibility to ensure that the full amount of GST is collected and remitted to the ATO.

### **3.3 Taxes Borne and Taxes Collected as a percentage of turnover**

Taxes Borne and Taxes Collected as a percentage of turnover is a useful measure of what a company contributes to government tax receipts, with respect to their size as measured by turnover.

- The mean of total Taxes Borne and Collected as a percentage of turnover of the survey participants was 11%, this compares to the result for the large business sample of 16%.

### **3.4 Employment taxes per employee**

The SME sample provided data on employment taxes including payroll tax and FBT (Taxes Borne) and PAYG collected from employees (Taxes Collected). Most respondents also provided the number of employees in their organisation.

- The mean employment taxes borne and collected per employee for the SME sample was \$36,288.

#### 4.0 Tax compliance costs

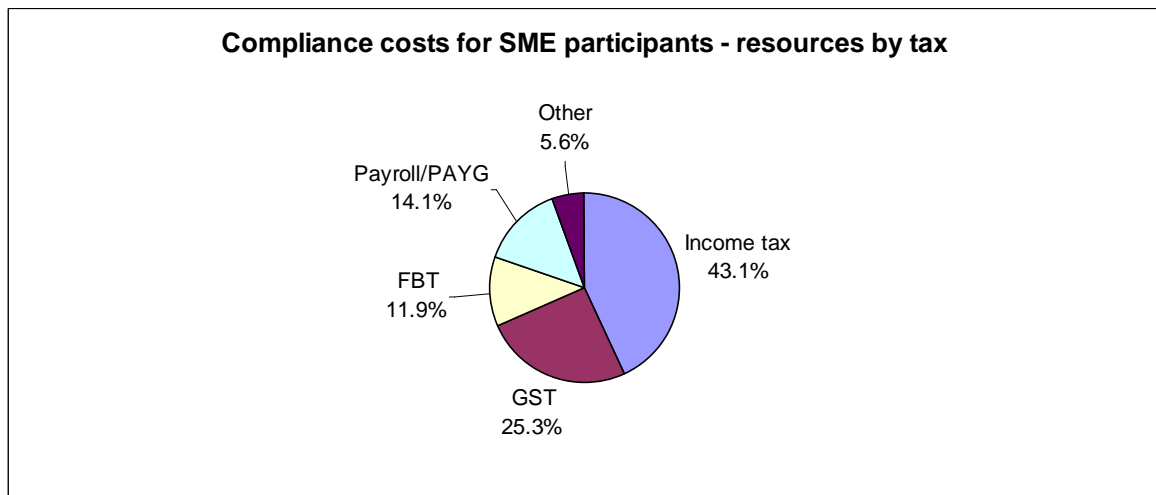
‘Total tax compliance cost’ measures the cost of complying with all Australian governments’ tax laws. It is based on the time and cost of undertaking any activities relating to the need to lodge returns, make payments to the ATO or a State Revenue Office, and seeking advice on the application of the law. Survey participants were asked to provide an estimate of both time spent and external costs incurred in relation to complying with all tax obligations. Data was requested in respect of time spent – measured in ‘person days’ – by internal resources in addition to external costs incurred in complying with tax obligations.

A standard cost of employment (including salary and on-costs) was applied to the time spent in people days to estimate internal costs incurred by each respondent<sup>10</sup>.

The majority of time and costs incurred by respondents related to corporate income tax. However, other business taxes, particularly goods and services tax and fringe benefits tax, consumed a significant amount of time and cost of the SME sample.

Figure 3 illustrates the percentage of resources spent on tax compliance by the SME sample, by tax.

Figure 3: Compliance costs – resources spent by tax



The cost of complying with the Australian tax system is an additional cost borne by all businesses. Not only does business incur taxes which are paid to the government, business also incurs the cost of complying with the system, or a “compliance surtax”. The compliance surtax is calculated as total compliance costs as a percentage of taxes borne.

<sup>10</sup> The cost per day of internal resources was estimated using average salaries for a typical level of employment undertaking these activities (majority of which is done by the CFO on an estimated annual salary of \$150,000), plus on-costs (estimated at 30%). This produced a figure of \$886 per working day. This compares to the cost per day incurred by the large business sample of \$1,216 per working day.

The table below sets out the compliance surtax for the SME sample on specific taxes, namely corporate income tax, payroll tax and fringe benefits tax (FBT).

Tax	Mean surtax
Income tax	15.3%
Payroll tax	14.8%
FBT	31.2%

- The heaviest compliance surtax incurred by business in Australia relates to FBT. The mean FBT surtax for the SME sample is 31.2%.
- For the large business sample, the mean FBT surtax is 7.6% (compared to 1.6% and 0.7% for income tax and payroll tax, respectively).
- We make two observations in relation to the comparison between the SME and large business samples. Firstly, the FBT surtax is the largest surtax for both samples and represents a significant compliance burden on the samples. Secondly, the mean surtaxes for the SME sample are much larger than the large business sample.

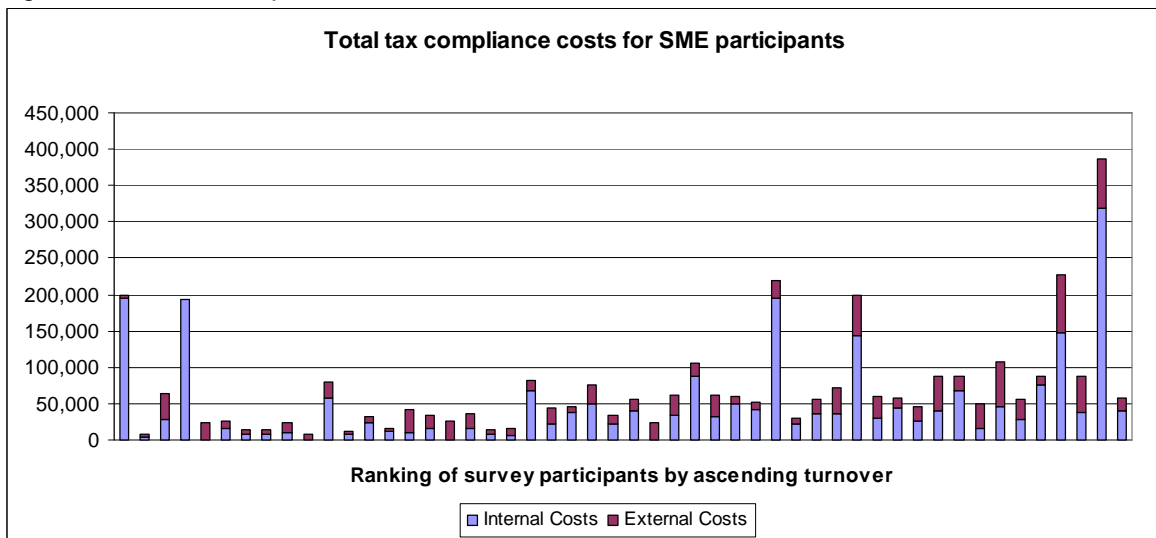
#### 4.1 Total tax compliance costs

The main observations in relation to compliance costs are as follows:

- The total tax compliance costs (including the cost of internal resources and external costs) were estimated at \$3.6 million, with a mean of \$71,053.
- Total internal costs comprised 69% of total compliance costs. Total external costs comprised 31% of total compliance costs.

The range of compliance costs reported by each participant is shown in Figure 4 below, ordered by turnover ascending along the horizontal axis.

Figure 4: Total tax compliance costs



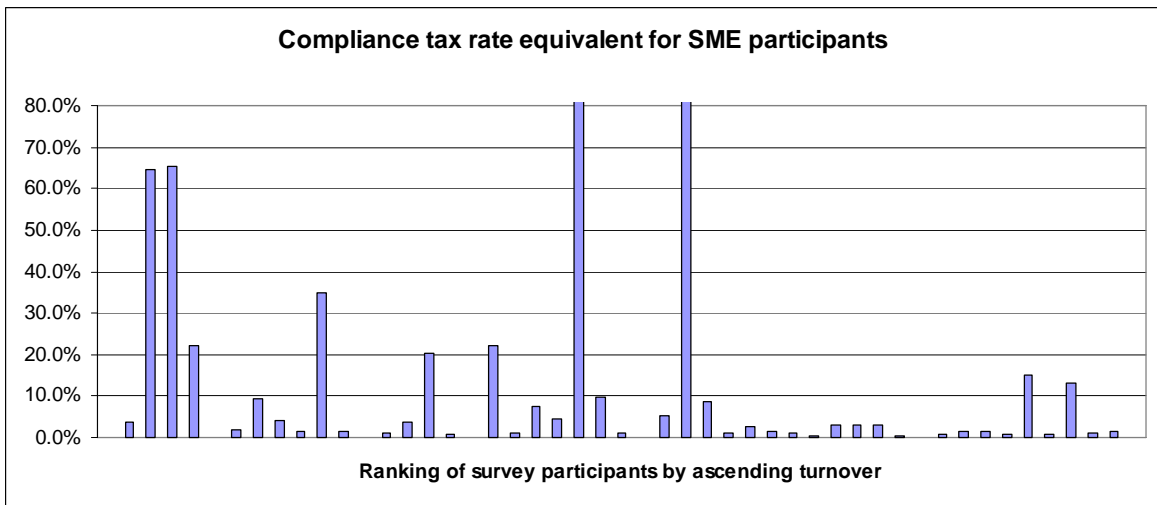
#### 4.2 Compliance tax rate equivalent

The Compliance Tax Rate Equivalent measures the percentage of profit that is consumed by tax compliance costs.

- The mean Compliance Tax Rate Equivalent for SMEs is 12.9%. That is, the SME sample reported that 12.9% of profit before tax is consumed by compliance costs.
- This is significantly higher than the mean for the large business sample of 3.8%.

Figure 5 below graphs the Compliance Tax Rate Equivalent for each survey participant, ordered by turnover ascending along the horizontal axis.

Figure 5 Compliance tax rate equivalent



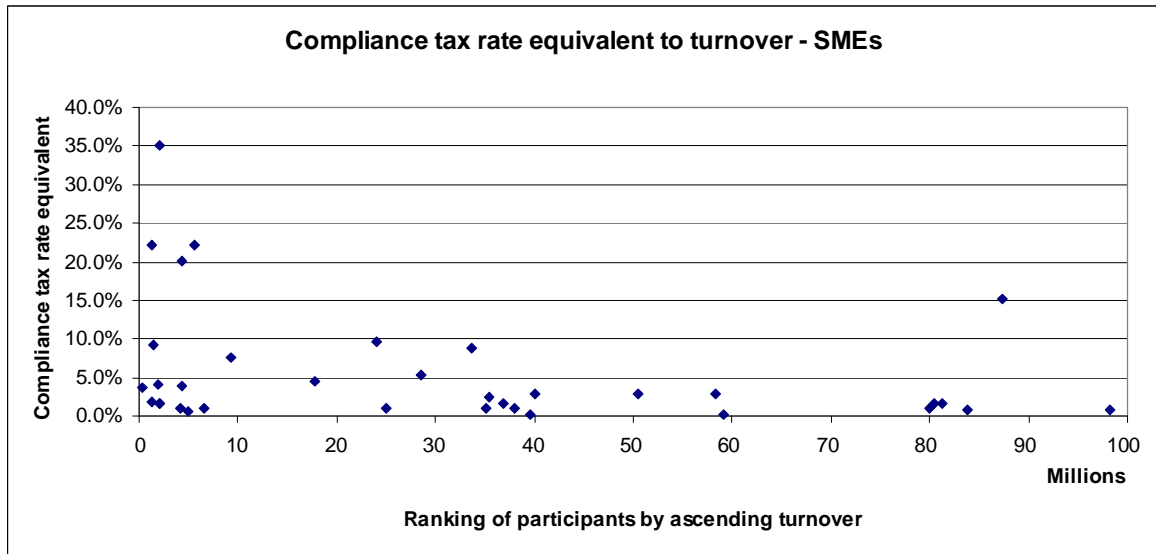
Note: participants disclosing loss before tax will not have Compliance Tax Rate Equivalent calculated, as represented above by the zero results. For illustrative purposes the graph is capped at 80%. Two participants reported a Compliance tax rate equivalent greater than 80.0%, being 110.2% and 93.5% respectively.

**4.3 Disproportionate compliance burden on SMEs**

We observe that there is an inverse correlation between the size of business (measured by turnover) and the Compliance Tax Rate Equivalent. In general, we observe that the smaller the business, the larger the Compliance Tax Rate Equivalent.

We have plotted each participant's Compliance Tax Rate Equivalent against turnover in figure 6 below.

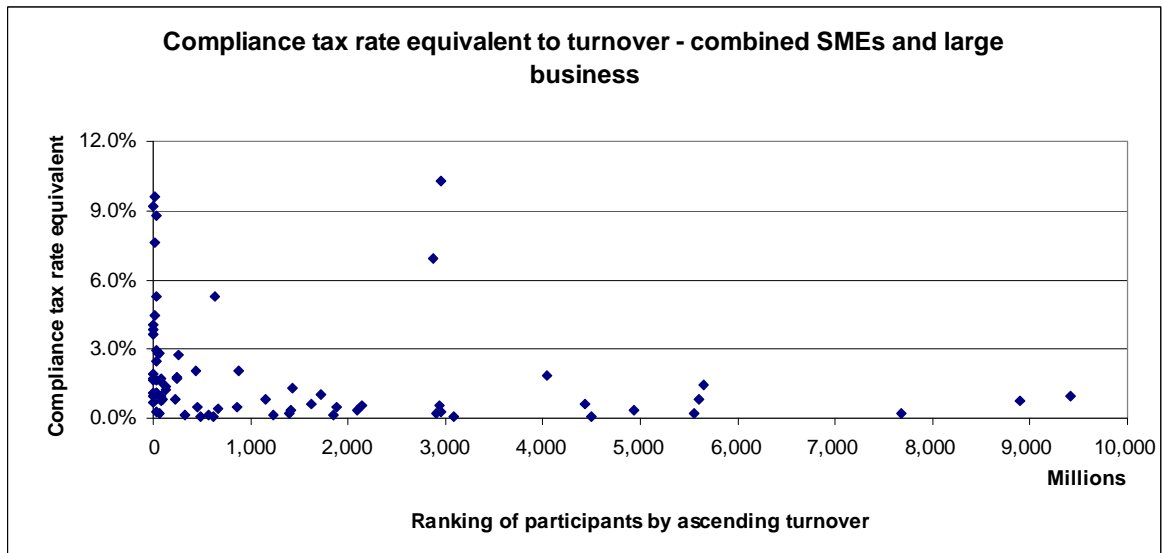
Figure 6: Compliance Tax Rate Equivalent to turnover



Note: for illustrative purposes the graph above excludes four participants with a turnover greater than \$100 million. The average compliance tax rate equivalent for these participants is 4.4%. This graph also excludes four participants with a compliance tax rate equivalent greater than 40%. The average turnover for these participants is \$14.1 million.

Figure 7 below combines the results from the large business survey “PricewaterhouseCoopers large business survey “What is your Total Tax Contribution? - 2008 survey results”, together with the SME results from this survey.

Figure 7: Compliance tax rate equivalent to turnover – combined SMEs and large business



Note: this graph excludes nine participants with turnover greater than \$10 billion. The average Compliance Tax Rate Equivalent for these participants is 0.2%. The graph also excludes twelve participants with a Compliance Tax Rate Equivalent greater than 12%. The average turnover of these participants is \$207.7 million.

Our observation that Compliance Tax Rate Equivalent and turnover are inversely related is reinforced by analysis of the responses of companies grouped by turnover. We have grouped companies which participated in both the SME survey and the large business survey as follows:

- turnover less than \$100 million (39 results)
- turnover between \$100 million and \$2,000 million (28 results)
- turnover greater than \$2,000 million (27 results)

The mean Compliance Tax Rate Equivalent for companies in each turnover category is as follows:

Participants turnover	Mean
Less than \$100m	13.7%
Between \$100 million and \$2,000 million	5.5%
Greater than \$2,000 million	1.0%

## 5.0 Total Tax Rate (TTR)

The TTR is all business Taxes Borne as a percentage of profits before all tax, and is therefore impacted by three key factors:

- the profitability of the business,
- statutory rates of tax on profits, and
- the extent to which the business is subject to taxes irrespective of profits.

The mean TTR for survey participants was 47% in 2008. This is considerably higher than the TTR of sample Australian large businesses, which was 40% in 2008.

The TTR can be divided further by tax or category of tax. The SME sample's mean TTR comprises the following:

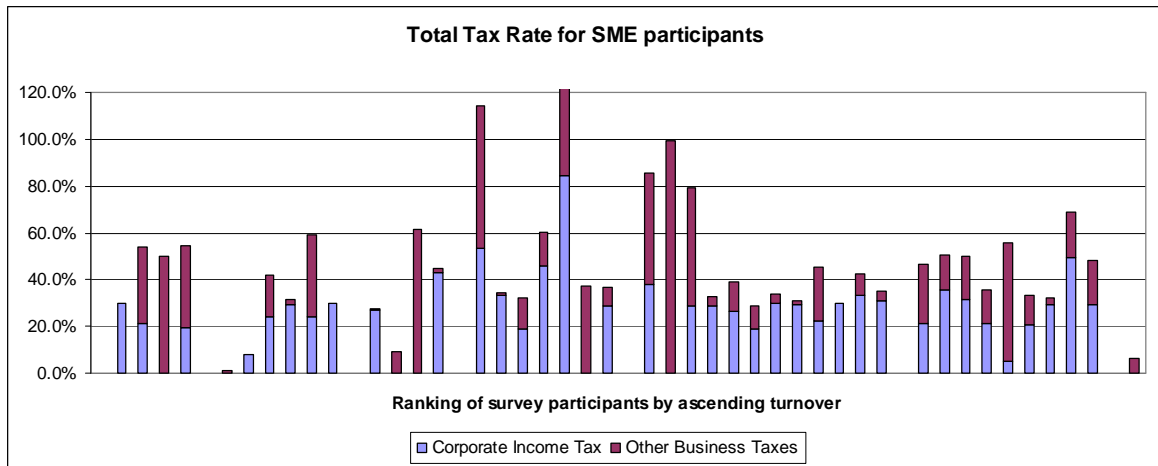
- Income tax rate – 25%
- Employment taxes rate – 17%
- Other taxes – 5%
- TTR – 47%

We observe that:

- a significant element of the SME sample's mean TTR relates to employment taxes borne (17%).
- That is, on average, 17% of the SME sample's profit before all business taxes is absorbed by taxes such as payroll tax and FBT.
- This is consistent with the observation at point 3.1 above, that SMEs bear significant taxes other than corporate income tax.

Figure 8 below graphs the TTR for each participant ordered by turnover ascending along the horizontal axis. The TTR for each respondent is graphed to illustrate both the income tax rate and all other taxes component of the TTR.

Figure 8: Total Tax Rate for survey participants



Note: participants reporting accounting losses before tax will not have a TTR calculated, as represented above by the zero results. Please also note that for illustrative purposes the graph above is capped at 120%. The TTR for one participant was 185.1%, with the percentage of income tax to TTR 84.2% and the percentage of other business taxes to TTR 100.9% (denoted above by the bar sitting slightly above 120%).

In relation to the large business sample, the mean TTR of 40% comprised:

- Income tax rate – 20%
- Employment taxes rate – 10%
- Other taxes – 10%
- TTR – 40%

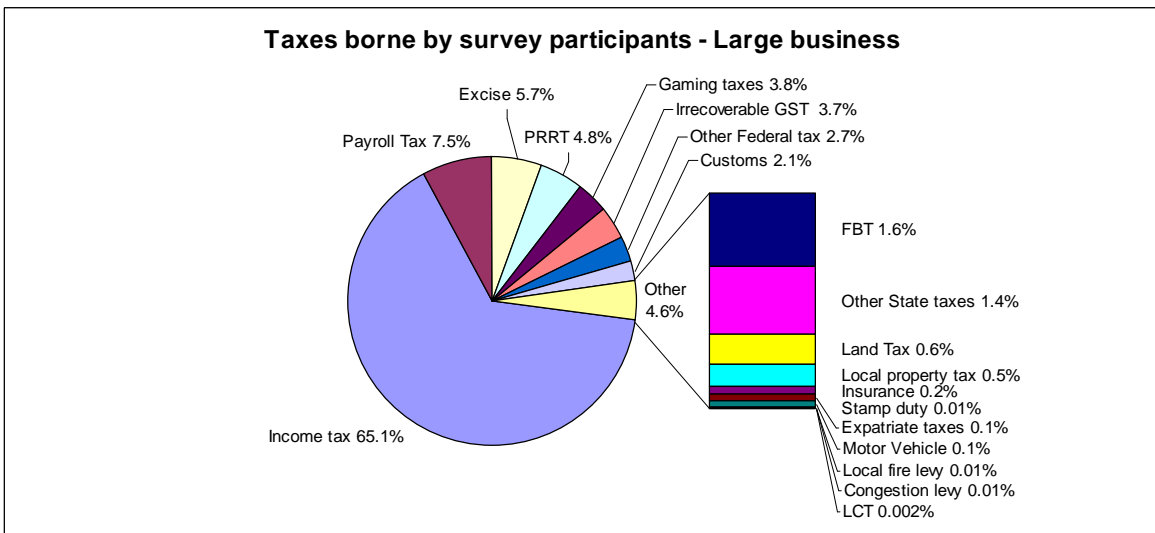
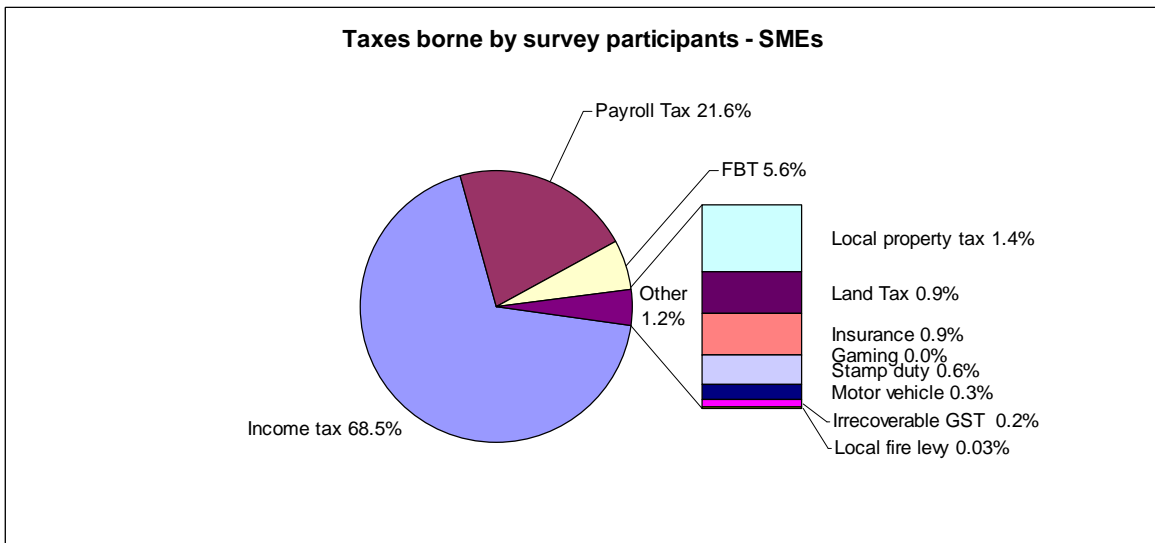
The most significant difference between SMEs and large business relates to the employment taxes component of the TTR. The result of 17% for the SME sample compares to 10% for the large business sample. The higher rate of employment taxes to profit before all business taxes for SMEs supports the hypothesis that SMEs generally have a higher labour to capital ratio.

## 6.0 SME sample vs large business sample – comparison of charts

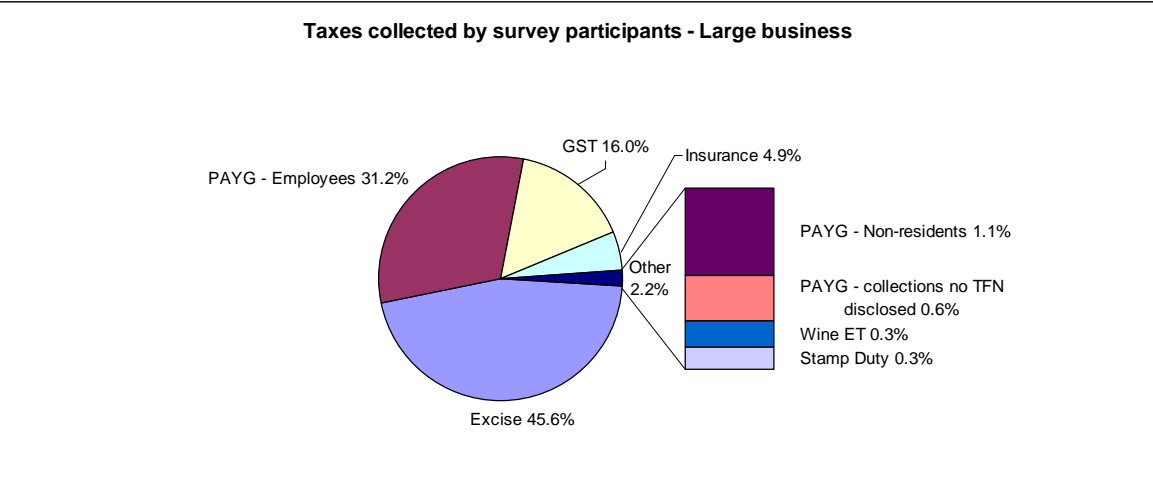
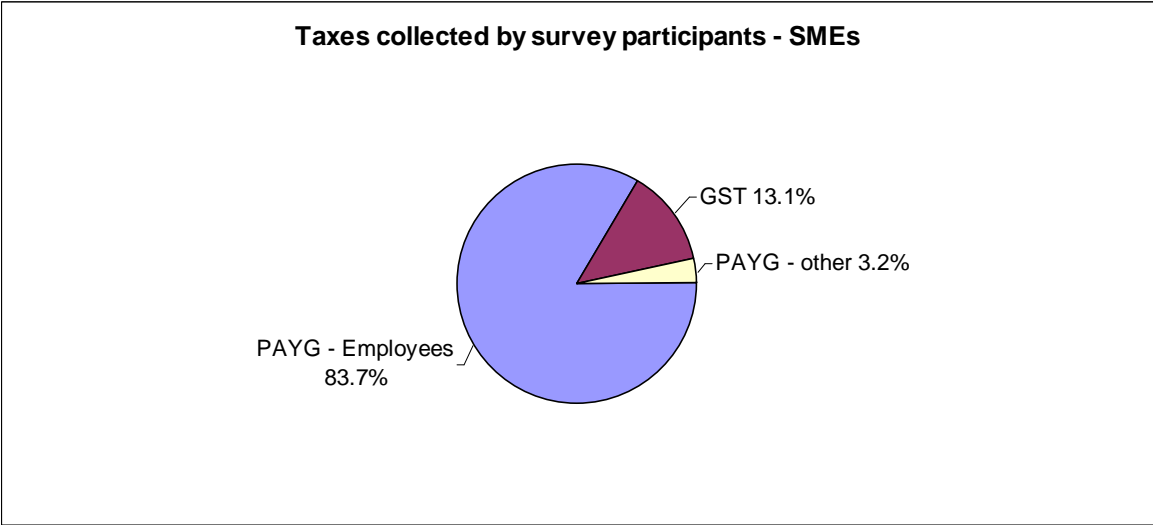
We provide below a comparison of the following charts, between SME and large business:

1. Taxes Borne
2. Taxes Collected
3. Total Tax Rate (ordered by turnover)
4. Compliance costs – resources by tax

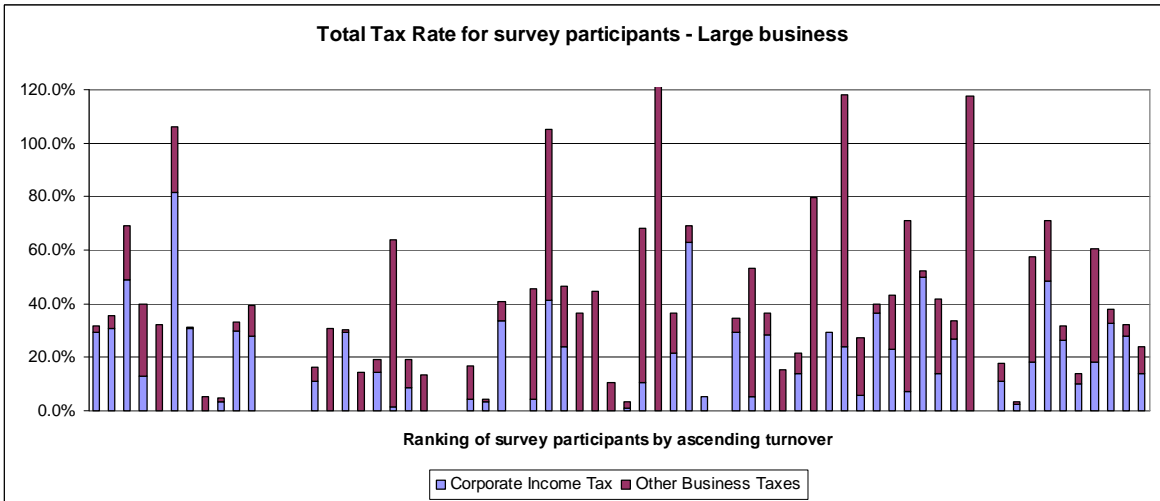
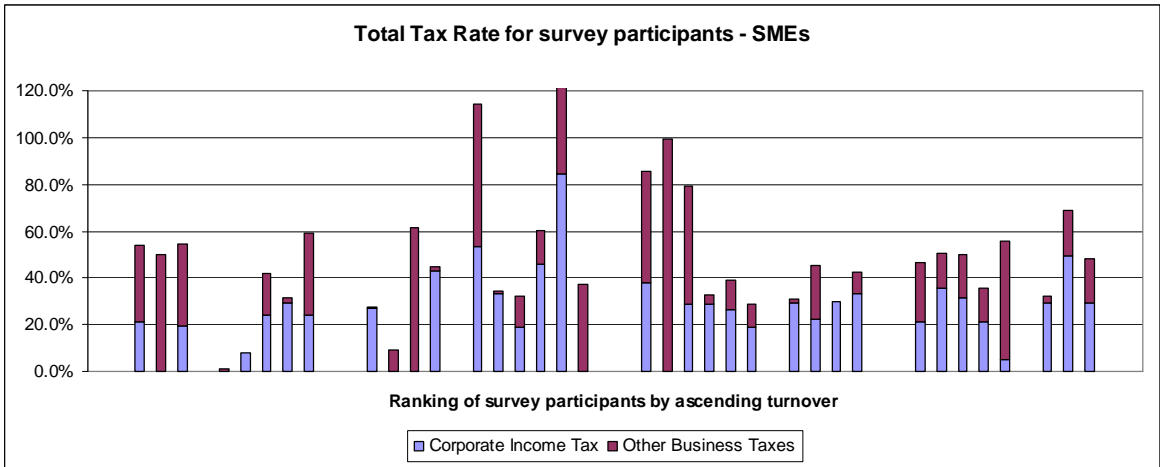
### 6.1 Taxes Borne – SME vs large business



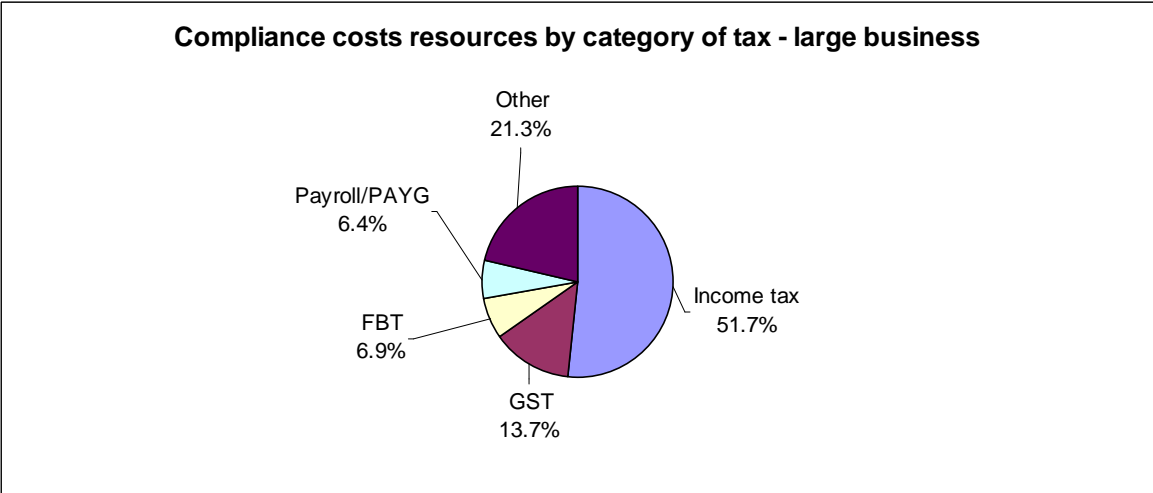
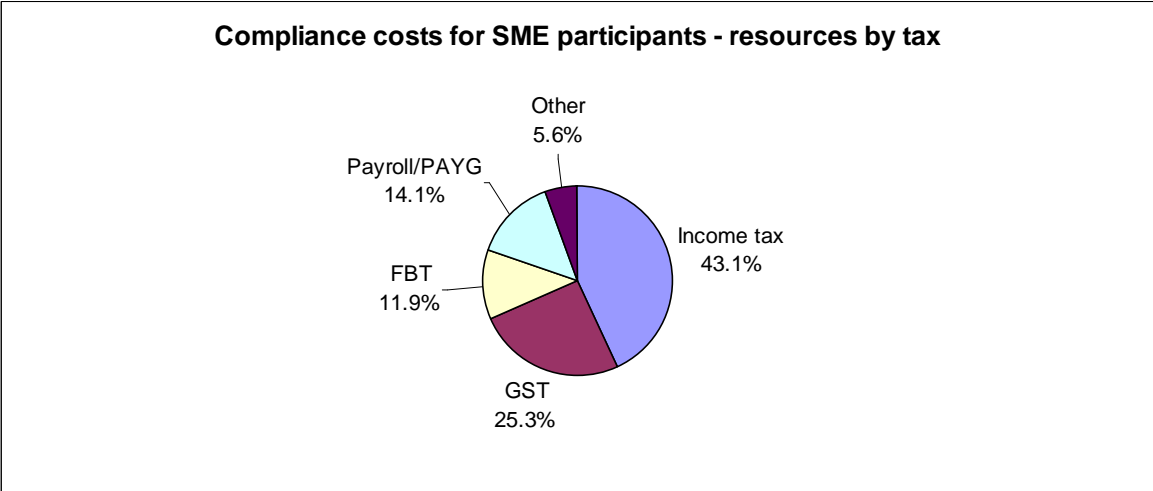
**6.2 Taxes Collected – SME vs large business**



6.3 Total Tax Rate – SME vs large business



6.4 Compliance costs – SME vs large business



## A. Sampling method

The sample size for this survey consisted of 50 small to medium enterprises which conducted business in the majority of States and Territories.

The sample was selected in an unstructured manner from small and medium enterprises operating in a number of States within Australia.

The sampling response rate was 53 responses.

## B. Analysis of survey participants

The characteristics of the sample are summarised below.

### *1. Turnover of the sample*

Turnover ranged from \$28,321 to \$245.0 million, with 45 out of the 50 respondents reporting turnover less than \$100.0 million.

The mean turnover was \$40.7 million.

### *2. Major place of business of the sample*

The majority of the sample has New South Wales or Victoria as their principle place of business.

- New South Wales – 27 (respondents)
- Victoria – 21
- Queensland – 1
- South Australia – 1

### *3. Primary industry of the sample*

A good cross section of industries is covered by the sample. We can broadly summarise the industries as follows:

- Wholesale / Retail – 19 (respondents)
- Diversified financials – 6
- Property and real estate – 7
- Materials / Manufacture – 5
- Commercial services and supplies – 4
- Transportation – 2
- Other – 7

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