

The PHARMACY GUILD of AUSTRALIA



Submission to the

Senate Employment, Workplace Relations and Education References Committee

into

Small Business Employment

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Introduction

The Pharmacy Guild of Australia welcomes the opportunity to make a submission to the Inquiry into Small Business Employment by the Senate Employment, Workplace Relations and Education References Committee.

The Pharmacy Guild of Australia is a national employers' organisation registered under the Federal Workplace Relations Act. It was established in 1928, bringing together several small retail pharmacy organisations then operating in the various states. Its members are the pharmacist proprietors of some 4,500 community pharmacies throughout Australia. The Pharmacy Guild seeks to represent the interests of its members and to maintain community pharmacies as the most appropriate primary providers of health care to the community through optimum therapeutic use of drugs, drug management and related services.

Community pharmacy makes a significant contribution to the Australian economy with an annual turnover of \$8 billion and \$200 million in tax revenue.

Community pharmacy employs some 15,000 salaried pharmacists and 25,000 pharmacy assistants across Australia. Through the Pharmacy Assistant Training Scheme, the Pharmacy Guild provides one of the most significant career paths for young Australians, particularly young Australian women.

Community pharmacies are small businesses and the cost associated with complying with Government regulations in areas such as workplace relations, taxation, superannuation, occupational health and safety, local government, planning and tenancy laws, is certainly a major factor in the ability of pharmacies to employ additional staff.

The cost for small business of complying with **unnecessary** Government regulations is an issue which has been canvassed with Government by the small business community and organisations representing small business over several years. Details of the concerns of small business in this regard have been set out in great detail in the comprehensive submission prepared by the ACCI for your Inquiry. The Guild, as a member of the ACCI, supports the arguments put forward by ACCI in its submission and does not feel it is necessary to cover these issues again in this paper.

The Guild instead wishes to focus specifically on the effect which the GST has had and continues to have on community pharmacies in Australia in relation to the treatment of GST-free goods in pharmacy.

Problem of Treatment of GST-Free Products in Pharmacy

The issue for pharmacy is as follows. GST-free products in pharmacy, which account for close to 85% of sales, only become tax-free at the point of retail sale rather than being tax-free all the way through the supply chain. This means that the pharmacy has to pay the GST on these goods and then claim the tax back as an input credit, which in many cases is a quite substantial sum, from the Tax Office.

Pharmacies are therefore placed in a negative cash-flow situation which means that they need to lodge monthly Business Activity Statements in order to retrieve the money paid out as soon as possible. They cannot take advantage of the reduced administrative workload offered by quarterly returns, available to other small businesses, which are in the reverse situation of needing to remit the tax to the ATO.

The problem for pharmacy has been caused as a result of the insistence by the Treasury that pharmacy must accept this particular model for tax-free goods. The Guild has been trying to have this matter addressed through the appropriate channels from well before the GST was implemented. However, for some reason, the Treasury officials from the outset claimed that the GST-free model that they had developed could not be tampered with, even though we demonstrated to them that their model caused extra work for both pharmacy and the ATO and disadvantaged pharmacy financially.

It was particularly galling for pharmacy when fresh food was made GST-free and the model we had wanted for pharmacy was applied to fresh food; that is, GST-free ex-farm not at the point of retail sale as occurs in pharmacy.

The negative cash flow situation that the GST causes for pharmacy, combined with the need to lodge monthly BASs, places unnecessary imposts on community pharmacies.

Attached are two separate papers which provide more detail in relation to this problem. These are as follows:

- GST Administrative Burden on Pharmacies and a Proposal to Streamline the System;
and
- Cost Impact of GST on Community Pharmacy

Conclusion

The Pharmacy Guild believes that the unnecessary burden that the current GST-free model imposes on community pharmacy has a negative impact on pharmacy business and on the ability of pharmacies to employ additional staff.

We can see no down side for the Government in changing the arrangements for the handling of GST-free products in pharmacies so that community pharmacy is not disadvantaged in this way. In fact, there would be some advantage to Government as a result of the savings in administrative costs to the Australian Taxation Office if pharmacies were able to lodge BASs on a quarterly rather than a monthly basis.

The Pharmacy Guild would appreciate the current Senate Inquiry considering the concerns raised in this submission and including in its recommendations a proposal to change this model so that community pharmacy is not disadvantaged in this way.

The Guild would be delighted to appear before the Senate Committee to provide any additional information as required in support of this submission.

GST Administrative Burden On Pharmacies And A Proposal To Streamline The System

The Pharmacy Guild of Australia (the Guild) commissioned two separate reports on GST and pharmacies.

The first report, by Sirianni International, uses the results of a survey of pharmacies to provide a general overview of the costs arising from the New Tax System for community pharmacies. The second report, by Econtech, uses information in the Sirianni Report and the 2000 Guild Digest to analyse the Guild's proposal to streamline the tax administration of pharmaceuticals.

The Sirianni Report finds that over 80 per cent of pharmacies lodge their BAS forms monthly rather than quarterly. Those lodging monthly spend an average of 1,029 hours each year in internal and external labour costs on GST compliance. Of this, 178 hours is accounted for by time taken in BAS preparation and lodgement.

Not surprisingly, the relatively small number of pharmacies that lodge their BAS forms quarterly spend less time each year in BAS preparation and lodgement. Each year, quarterly lodgement takes an average of 98 hours, a saving of 80 hours in the time taken under monthly lodgement.

The Econtech Report notes that pharmacies pay GST on their purchases of pharmaceuticals but sell them GST-free. They do not receive a refund of the GST paid on their purchases until after they lodge their BAS forms. This can cause cash flow problems. It also adds to GST compliance costs by putting pharmacies under pressure to lodge their BAS forms monthly rather than quarterly to receive their refunds as soon as possible. This is the reason that most pharmacies lodge their BAS forms monthly even though virtually all pharmacies, as small businesses, are legally entitled to lodge their BAS forms quarterly.

The Econtech Report analyses a proposal to streamline this system by making pharmaceuticals GST-free from the time of their manufacture, so that pharmacies no longer pay GST on their purchases of pharmaceuticals. It finds that this change would:

- have no significant impact on the amount or timing of GST revenue received by the ATO and no impact on prices paid by consumers for pharmaceuticals;
- eliminate cash flow problems for pharmacies caused by them being in a situation where the ATO always owes them about \$35 million in GST refunds on their purchases of pharmaceuticals;
- shift annual GST financing costs of about \$4 million from pharmacies, which are small businesses, to pharmaceutical manufacturers better able to arrange finance;
- cut an estimated \$5 million from the annual costs of preparation and lodgement of BAS forms for pharmacies, by making it feasible for pharmacies to lodge their forms quarterly, like most other small businesses, rather than monthly; and
- remove an anomaly by bringing the tax administration of making pharmaceuticals GST-free into line with that for basic food.

Econtech Pty Ltd and Sirianni International
August 2001

Cost Impact Of GST On Community Pharmacy

The cost impact of the new GST on Community pharmacy is divided into five broad areas:

- net negative cash flow;
- once-off implementation costs;
- compliance costs;
- increased costs to pharmacy as a result of changes in wholesaler terms; and
- reduction in manufacturer base price of PBS & RPBS items.

1. Net Negative Cash Flow

On average, 80% of pharmacy turnover will be GST-free (the combined turnover of Schedules 2, 3, 4 and 8). This means that under the current proposal, pharmacists will be **required** to pay the GST to their suppliers but not be able to charge the GST to consumers on over 80% of their turnover. Instead, they are expected to claim the GST paid to suppliers as *Input Tax Credits* from the ATO. Pharmacists will always be in a net refund position.

As a result, pharmacists will suffer a ‘double whammy’: not only will they miss out on the positive cash flow that other small businesses will enjoy but they will also be out of pocket because of their own **net negative cash** flow! These costs are quite separate from any general compliance costs across industry.

Conservatively, the quantum of this negative cash flow may be calculated by reference to what the positive cash flow would have been in the absence of GST-free items. Using the average pharmacy turnover as a guide (\$1.3 million), the GST collected would total \$130,000 annually. The ability to hold on to the cash for a period of three months equates to a cash benefit of \$3,250 per annum (\$32,500 at annual opportunity interest rate of 10%). Clearly, this financial burden would vary depending on the level of turnover of the pharmacy: a low quartile turnover of \$750,000 and a high quartile turnover of \$1.8 million are expected to be worse off by \$1,875 and \$4,500 per annum respectively.

These are the levels of compensation required in order for pharmacies to be on par with other retailers which have no GST-free sales. The total cost to pharmacy is conservatively estimated at **\$81 million** – or \$16,250 per pharmacy – over five years.

2. Once-off Implementation Costs

These costs relate to set up costs associated with the acquisition of new equipment, accounting systems, software modifications, stock taking and staff training, to ensure that the pharmacy can fulfil its GST obligations from 1 July 2000.

Based on estimates by Price Waterhouse Coopers and others, these costs would range from 1% to 5% of turnover for the first year of implementation. For a business with a turnover of less than \$500K, the outlay is likely to be greater than 5%. Similar estimates are also suggested by pharmacy accounting specialists, Johnstone Rorke.

For community pharmacy, these costs are likely to average around \$13,000 per pharmacy – based on 1% of average turnover: total cost to pharmacy of **\$65 million**.

3. Ongoing Compliance Costs

Industry estimates range from 0.5% - 1.5% of turnover in the years following implementation. The estimates by pharmacy accounting firms suggest a minimum of 0.25 FTE senior pharmacy staff member, with or without POS assistance. The range of estimates is as follows:

\$19,500 – based on 1.5% of turnover;
\$13,000 – based on 1% of turnover;
\$9,200 – based on salary of \$30,000 + on-costs of 22.47%; and
\$6,500 – based on 0.5% of turnover.

Over a four year period, the ongoing cost of compliance is estimated to be a minimum of **\$130 million**.

4. Increased costs to pharmacy as a result of changes in wholesaler terms

Given that wholesalers will themselves come under significant cost pressures, the current average discount of 2% is expected to be at least halved or withdrawn altogether. This will be particularly targeted at items listed on the PBS and RPBS. Based on a halving of the discounts, the total cost to community pharmacy is expected to be in the order of **\$172.6 million** over a five year period, averaging around \$34,500 per pharmacy.

5. Reduction in manufacturer base price of PBS & RPBS items

The expected reduction in the manufacturer base price is as a result of discounting for embedded WST in the pharmaceutical manufacturing industry. This would directly impact on pharmacists' remuneration through the 10% mark-up component. Unlike other industry sectors, community pharmacists are not able to offset these by maintaining their dollar gross margins.

It has already been costed by the Commonwealth and is estimated to cut pharmacists incomes by **\$37.5 million** over the five year period. Average impact: \$7,500 per pharmacy.

Total cost burden on GST on community pharmacy: \$496 million over five years.