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Calm waters: GST and cash flow stability for small businesses in Australia

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Abstract

On the 1st July 2000 the goods and services tax (GST) was introduced into Australia as part of an overall reform which saw the GST replace the Wholesale Sales Tax (WST) and various other state taxes. A principle reason for the GST to replace the WST was because while the WST was effective in collecting tax revenue early in the 20th Century when the Australian economy was focused on production of goods, over time this had diminished with services dominating.[3] Since the service sector was excluded from the WST this resulted in a large decline in revenue collected as the service sector grew. Figure 1 illustrates that at the beginning of the 20th Century services accounted for approximately 56 per cent of the Gross Domestic Product (GDP) compared to 79 per cent in 2000.[4] This growth has continued and in 2011 services accounted for 84 per cent of GDP.[5] Consequently the GST is an important tax revenue source for the Government.

Figure 1: Industry shares of GDP 1901 – 2000

Source: Commonwealth Government of Australia, *Century Since Federation at a Glance*,(Canberra, 2001), <

Due to the broad application of the GST it has the capacity to apply to all businesses br( )-42(busi)4(ness)7(es)-3l including small businesses which can have potential positive and negative consequences. This broader application of the GST is of concern as research by Wallschutzky and Gibson[7] into the biggest issues confronting small businesses, found that of all the tax systems in(ch)4(t)6(h44 Tm[( )]Tem)5(s)2 axund implications in any detail. While Reynolds did conduct cash flow benefit analysis for the retail grocery sector in 2001, his results related to the industry norms of that particular sector and are unlikely to be a representation of small businesses as a whole,[16] and did not consider the effect on cash flow stability. Similarly, while the study by Glover and Tran-Nam identified the compliance costs and benefits of the GST for small businesses in the rural sector of Australia from 1999 to 2002, their empirical findings did not focus on receipt of any related cash flow benefit by participants.[17] In a related project, Belle Isle et al. established that small business perceived that there should be a cash flow benefit from GST but in reality (especially for non-cash GST registrants) this was not likely to be achieved.[18]

The aim of the research is to gain a greater understanding of the effect of GST on the stability of small business cash flow. Section Two of this article will provide a broad summary of the characteristics of small businesses and their importance. The third section will then provide an outline of the issue of cash flow stability for small businesses and how this can be influenced by a number of factors, including management, access to finance and competitive markets. Section Four will provide the research methodology undertaken and the demographics of the participants, which will be followed by the results. Through the analysis of the results recommendations will be proposed, with future research being outlined in the fifth section of the article before the conclusion.

The Australian Taxation Office (ATO) and the Australian Bureau of Statistics define small businesses by their quantitative characteristics such as an annual turnover of $10 million or less and a full time workforce of 20 or less employees.[19] Small businesses

being 34.4 per cent in 2011/12. It should be noted that small businesses themselves are heterogeneous, in terms of structure, industry sector, employee capabilities and position in the market.[20] This diversity further extends to owners of small businesses as they can vary considerably in age, nationality, education and experience.[21] In comparison to large businesses their capabilities, control and practices may differ.

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National Association of Retail Grocers of Australia Pty Ltd, April 2001).

17 Glover and Tran Nam, above n 15.

18 M Belle Isle, B Freudenberg and R Copp, *Cash Flow Benefit from GST: Is it Realised By Small Businesses in Australia?* (Working Paper, Griffith University, 2014).

19 Australian Bureau of Statistics (2013), *Counts of Australian Businesses including Entries and Exits (Jun 2008 to Jun 2012),*cat. no. 8165.0 39, <http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/4461C2EEC98E3A47CA257B7100149A76/$File/81650_jun%202008%20to%20jun%202012.pdf>..

20 J Freedman, *Taxing Small Business: Developing Good Tax Policies*, (Australian Tax Research Foundation Conference Series, Sydney, Australia, 2003) 13
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C Evans, J Pope and J Hasseldine, *Tax Compliance Costs: A Festschrift for Cedric Sandford* (Prospect Media Pty Ltd, 2001) 297 316, 300.

21 Commonwealth Department of Industry, Innovation, Science, Research and Tertiary Education, *Australian Small Business Key Statistics and Analysis*, (Canberra, 2010), 9.

Table 1: Major issues of concern for small businesses

Issues for small businesses	
Uncertainty concerning revenue	Lack of suitable staff
Cash flows	Breaking into new markets
The depressed economy	Changing the company’s image
Low profit margins	Maintaining market share
Difficulty obtaining finance	Big business dictating trading laws
Bad debts	Lack of capital
Restructuring	Changes in funding arrangements
Design and development of new products	Property tran.47 175.9u4 reW562.785.06 Tm0 g[i812

imposed. A GST input tax credit is available for GST registered enterprises to offset the GST paid on inputs against GST received on outputs.[35]

GST registration is mandatory for enterprises with a turnover[36] of $75,000[37] or more, although voluntary registration is available to enterprises below this threshold.[38] Accounting for GST can be on a cash or non-cash basis.[39] Pursuant to the cash basis, GST is attributed to the period of payment for goods or services supplied or remittance date of payment for inputs obtained from other traders (and only to the extent of payment).[40] GST for non-cash accounting (also known as accruals) is recognised in the period where the earliest of either an invoice is generated or payment (or part thereof) is received.[41] The two forms of reporting systems discussed are not available to all entities within the economy. Cash accounting is only available to micro businesses with an annual turnover of less than $2 million or who use a cash basis for income tax reporting.[42] Non-cash accounting is available to all registered entities, even those eligible to report on the cash method can elect to use non-cash.[43]

Determining the net amount of GST liability in a reporting period is calculated using total GST liability minus input tax credits.[44] GST is the sum of all GST liability on taxable supplies[45] and taxable importations[46] attributable to the tax period less the input tax credits on creditable acquisitions[47] and creditable importations[48] that are is possible.[53] Those enterprises with turnover above $2 million are required to calculate their net GST liability quarterly.[54] Those earning below $2 million however can pay a quarterly instalment[55] amount based on previous annual turnover.[56] Quarterly payments are due within 28 days of the month following the end of the quarter;[57] effectively this allows businesses to hold GST payments for up to 120 days[58] before the liability is due.

There have been a number of studies into consumption taxes, such as the GST. For example, Sandford et al. conducted a study of compliance costs of the GST equivalent in the United Kingdom the Value Added Tax (VAT). The study identified that compliance cost could be reduced by two possible benefits including managerial benefits and cash flow benefits.[59] The findings of Sandford et al. are supported by number of S( )]TJETBT1 0 0 1 141.86 371.2 Tm[(Aus)15(t)-4(r)-4(al)-2(e)9( )42[(cas)7tis later research conducted in Australia.[60]

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2002.[66] However, their empirical findings did not focus on receipt of any related cash any short term cash restrictions. These restrictions can occur for a number of reasons, such as fluctuations in business cycles and trade credit to customers.

In Australia 85 per cent (or 1 820 952 businesses) have 4 or less employees.[74] Due to the high concentration of small firms with 4 or less employees, it is not unreasonable to suggest that the majority of Australian businesses are managed by their owners.[75] A consequence of this is that the ownership role is a multi-tasking exercise with owners often required to be the production, financial, marketing and operations manager.[76] Unfortunately their decision making as a result may not always be in the best interest

personal abilities.[77] Predominantly the skills of small business owners are refined to the goods and services that they provide and do not extend to these extra management

considerable market or economic downturn.[85]
forecasts are tainted by optimistic and over confident views of the market by owners and the use of previous projections and growth patterns to predict future business activity.[86] Unrealistic forecasting and planning affects rational commercial decision making, which in turn places pressure on the continued viability of the business.[87]

Small businesses can face difficulty managing their cash flow when they do not have a well-established accounting and data management system.[88] Issues with liquidity have diminished with advances in technology and higher concentration of smaller firms implem [89] It has been argued that greater firm success is related to the use of a CAS for cash flow management purposes as well as taxation requirements.[90]

3.2

Research has identified that the availability of finance is different for small business in comparison to large, with access to finance influencing cash flow stability. Important areas that will be discussed below include restrictions to finance, capital availability and alternate sources.

Research has demonstrated that small businesses are disadvantaged in comparison to

The difference in lending standards for smaller business is presumed justifiable by the lending institutions because small businesses face greater volatility in their revenue streams and have a higher debt-to-asset ratio than their larger competitors.[96] While this may be commercially valid, placing funding restrictions on small businesses can hinder growth and effectively place further pressure on their financial stability. Banks and financial institutions substantiate their differential treatment of smaller firms to be a result of the limited managerial ability of small firm owners, inadequate capital for debt security and high single owner concentration.[97]

security of the loan lies with the equipment that is under the finance agreement. Finally, small business can use trade credit as a source of finance.[103] The use of trade credit allows businesses to operate more efficiently,[104] with the time separation between purchasing and payment allowing businesses to maximise the use of those goods or services obtained to produce profit within their own organisation.[105] Where cash flow is tight relying on the maximum amount of credit available from suppliers can be necessary in order to satisfy immediate cash commitments.[106] Trade credit has been identified as a popular alternative for businesses with limited access to finance from banks and lending institutions.[107]

3.3

Another issue confronting small businesses is that they may be disadvantaged when operating in open markets. Larger competitors may have the experience to build business relationships and quite successfully negotiate business contracts as a result.[108] In contrast, small businesses face considerable uncertainty due to their lack of influence over the markets in which they are engaged.[109] Any competitive advantage that smaller firms may have is influenced by many factors including supply cID 1>> BDC BT/F6 1 for example, the GST rather than pass it on.[114] In order to eradicate price and power vulnerability small businesses need to explore other avenues in order to gain power within the marketplace.

In relation to taxation the position of small businesses in the market can influence who bears the burden of a tax in the trading relationship. The incidence of a tax is the term given to define who bears the burden and can be distinguished by the statutory (formal) or economic (effective) incidence. For example, the burden of GST is assumed to be borne by the final consumer (formal), however in reality this may not be the case as the burden maybe absorbed by the last business in the production chain prior to the retail sale (effective), or alternatively it may be placed back on previous suppliers (effective) in the stages of production.[115] Whether the incidence remains statutory or the goods or services that they provide. The extended payment period allows the customer the opportunity to assess the quality of items purchased prior to payment.

However, providing commercial credit is not without its disadvantages. It can result in market power shifting to the customer. Customer dominance occurs when longer payment terms are imposed than are given in the trading contract.[122] This can result in the balance sheet of the small business being weakened and cash flow placed under pressure.[123] This may put the small business in the situation of having to remit the GST on supplies made to the ATO prior to receiving payment. Confrontation with the customer regarding late settlement can place the small business supplier in a problematic situation, as the customer may shift to an alternate supplier.[124]

Versatility of smaller firms could also extend to creating niche markets and engaging in innovative practices.[125] These two practices complement each other and allow the smaller firm to have greater strength in customer negotiation.[126] Authors argue that products should be developed that are of a high quality and require a refined skill set.[127] Concentration on a limited number of higher end products or services allows the smaller firm to create its own market,[128] thus eradicating market competition and removing the pressure to follow market prices set by less financially constrained competitors.[129] This could lead to a situation of being able to fully pass on the GST to the consumer.

3.4

Another factor that may influence cash flow is the industry in which a business operates.[130] For instance the wholesale trade sector is reported as having the greatest issues with internal finance, cash flow and debt management.[131] In comparison, the service sector requires a lower level of capital investment and generally as a result can retain a greater portion of retained profits.[132] Whereas the retail and manufacturing sectors can see prices for their products being forced to lower than their competitors, suggesting a lower profit margin in these industry sectors.[133]

Industry can also have an influence over whether businesses generally trade in cash or on credit.[134] For example cash trading is predominantly linked to those businesses that

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[122] Chittenden and Bragg, above n 106, 27.

are involved in the retail industry whereas providing credit to customers is generally found in industries of wholesale trade, construction[135] and manufacturing.[136] Trade credit is issued to customers to cover the period of time it takes to sell goods once received.[137] Effectively this delay in payment for goods or services received is a form of short term finance available for business customers. For those businesses trading in

incoming cash flow,[138] and may have adverse effects on keeping a stable cash flow. Generally small businesses have a narrow customer base resulting in a majority of income tied up with a limited number of debtors.[139] This can have a large impact in a situation of business failure of a customer when considerable credit has been extended to one customer who fails.[140] Ways to minimise this include shortening credit terms and restricting the amount of money extended to customers.[141] However, the ability to make changes to customer credit terms can have serious effects on retaining the small business customer base, especially with regard to market competition.

From the literature it appears that the factors discussed could have detrimental effects on cash flow stability of small businesses. A consequence of these effects may be that the ongoing viability of small businesses is jeopardised.

sources of data gives results more accuracy and credibility and allows for an increase in the data available for analysis than what would be achievable using a single source.[146]

(two participants). Separation of businesses into sector classification shows that service, wholesale, manufacturing and retail are represented by seven, two, two and one participant respectively. Eight participants report GST quarterly followed by three monthly and one annually. The accounting basis for GST is divided into four registered for cash and eight for non-cash accounting basis.

Participant selection was based on annual turnover and number of full time employees in line with the unit of analysis for this project. Figure 2 illustrates that there were no participating businesses that recognise an annual turnover of between $5,000,000 and $10,000,000. Two-thirds (8 businesses) fell within the $500,000 to $2,000,000 annual turnover range, with the remaining four businesses apportioned equally to the less than $500,000, and the $2,000,000 to $5,000,000 annual turnover range. This means that the experiences of more sizeable small businesses ($5,000,000 to $10,000,000) are

Figure 2: Participants categorised by Annual Turnover

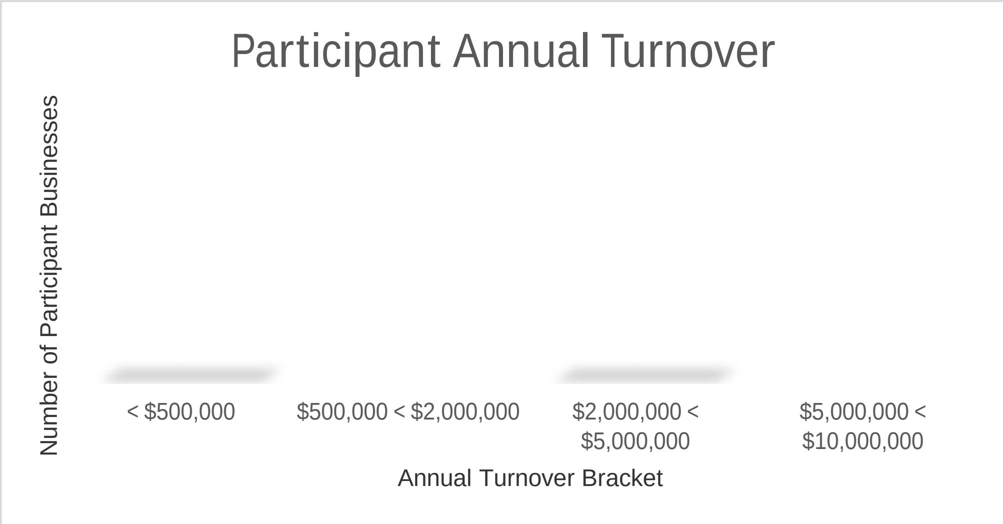

Table 3 separates participant businesses by full time employees within each small business workforce. Half of the participating businesses are responsible for employing 4 or less employees. The remaining businesses fall within the 5<20 bracket. In order to understand the structure of the small businesses within the study in greater depth the researcher has separated this group into 5 to 10 and 11 to 19 employment groups. In consideration that a high proportion of businesses in Australia employ less than 5 employees,[151] it was not surprising that half of the participating businesses would have this characteristic.

Table 3: Participants grouped by number of employees[152]

Number of employees	Participant responses
Non employing	0
1-4 employees	6
5-10 employees	4
11-19 employees	2

[151] Australian Bureau of Statistics, above n 19.

[152] See Australian Bureau of Statistics, above n 19. . Businesses are grouped as non-employing, 1-4 employees and 5-19 employees for micro and small business. To present a more in depth account of the participating businesses the researcher has divided the 5-19 bracket to 5-10 and 11-19 groups.

4.2

The viability of small businesses has a strong relationship with their ability to maintain a stable cash flow.

Table 5: Time allocated to data entry for trading accounts

Participant	1	2	3	4	5	6	7	8	9	10	11	12
Activity												

> We use electronic banking and I review the bank account every couple of days to see what is going in and going out, I keep on top of it that way. I **mostly in my head**. So I have sort of got it all in the top of my head and trying to keep on top of it that way. **I can't really delegate** it to anybody (Participant 3).

> I would have to say that when we are in a high growth period **I spend very little time** worrying about cash flow. However when cash flow is restricted I spend a lot of time keeping my MYOB file up-to-date via the use of online banking in order to work out what debtors have paid and what accounts need to be chased. This also influences the frequency of my invoicing cycle. If we have large amounts of cash available I will invoice irregularly whereas if we are cash poor, I will invoice as close as possible to when the job was completed and ensure that the invoice is received by the customer (Participant 4).

> The only way I monitor my cash flow is **by looking at our bank accounts** (Participant 7).

Of all the participants only two appear to have some systematic process of managing their cash flow:

> We have a really extensive budget that myself and the financial controller are constantly updating. The budget goes over two years, predictions are based on previous years and so we have an idea of the income that is expected (Participant 1).

considered to have some systematic process for managing their cash flow did not record any time for arrangement of finances for GST.

seen that 75 per cent (9) of the participating businesses disagreed or strongly disagreed that they have used long term financial products. From the survey results and the proposition by Kotey,[173] relation to level of capital and requirement of a business plan the results of the survey support the proposition of Basu.[175] A high proportion (83%) of participants confirmed

> The only thing the GST from sales may assist with is I might use it to pay trade creditors if cash flow is short (Participant 4).

The other important comments that were revealed is that tax liabilities including GST can limit the ability of businesses to obtain finance. One participant and one small business accountant suggested that overdue tax liabilities can impede the approval of finance applications:

> All taxes impact the problem because in more recent times a condition that we encountered of being granted finance from institutions was that all our tax liabilities were up to date. I know that in the past when we needed finance we were forced to bring our tax liabilities up-to-date instead of our other liabilities in order to be granted that finance (Participant 4).

> cross against your name anyway. The first thing banks want to see is that your tax liabilities are up-to-date (Accountant 1).

Also results reported elsewhere demonstrate that businesses thought that there should be a cash flow benefit from holding onto GST before remittance, but in reality this was not realised for a number of reasons including unsubstantial time of holding GST, debtors expending payment terms and limited capacity to undertake short term investment.[187] Overall it appears that the small business participants have had limited use of longer term finance. The cause of low engagement in these forms of finance products appears to support those proposed by Basu[188] that small businesses are unable to satisfy lending conditions imposed by financial institutions. Areas of concern for participants in the current study were lack of capital, terms and conditions that are extensive and likely to change and high interest rates.

The findings suggest that as an alternative to long term finance the business participants place high importance on the use of at least one form of secondary finance options. The uptake of the use of personal savings and trade credit to support finance requirements was high across all participants. Whereas the use of personal credit cards and short term credit in the form of leasing or hire purchase is not as extensively used as the former finance possibilities.

A small number of participants suggested that having overdue GST liabilities (and other types of tax liabilities) can further hinder the availability of longer term finance. This raises the importance of businesses managing their GST liability to the ATO, as it may have adverse consequences when seeking external finance.

4.5

The literature review revealed that competition within the marketplace can have detrimental effects on small business viability. Basu[189] identified that smaller firms are often forced to follow prices set by larger competitors in an effort to maintain their customer base and in-turn their sales ratio.

Results discussed elsewhere suggest that receiving payment later than agreed terms can have adverse effects for compliance with GST, especially for those businesses remitting on a non-cash basis.[193]

Bumgardner et al.[194] suggested that another way to eradicate price and power vulnerability is to have a close professional relationship with customers allowing smaller firms to determine customer needs as they arise. All participants within the research project supported the findings of Bumgardner et al.[195] with five participants agreeing and seven strongly agreeing that they try to have a close relationship with their customer base. Withers, D ar ath.

> his services but the sole trader working for himself turning over less than the GST threshold does not. So the second person can charge a cheaper price. if someone is registered for GST, their only concern is that they get the best price (Accountant 1).

> Market competition is the problem more than anything.
>
> specifically charge by an hourly rate, materials and then they add the GST on top of the invoice and that gets paid. This issue is more in the hospitality industry whereby hotels, motels and resorts have not been able to pass. It is working on a GST inclusive basis that creates the problem (Accountant 2).

Accordingly, while the price may have been driven down due to competitive markets, for those supplying to other businesses there is the view that the GST liability is able to be passed on.

The evidence collated in the interviews supports the proposition of Sandford[204] that incidence of GST is not always borne by the final consumer. The findings suggest that those participants that trade on a GST inclusive basis perceive themselves to be disadvantaged by GST incidence in comparison to those that trade on an exclusive basis. Participants 4 and 6 confirm that they have recognised the difference in their own business when they have traded both on an inclusive and exclusive of GST basis. Predominantly those participant businesses trading inclusive of GST are conducting a retail business to final consumers. This suggests that consumers are very price driven and the influence of GST on the final price of goods or services they purchase is not taken into consideration when making a purchase decision. This is probably due to the fact that private customers are not able to claim an input tax credit on goods and services purchased in comparison to business customers.

In summary the results of the study imply that approximately half of the participants

[209] to assess the current status of their financial performance. When viability is in question the tool advises business owners to seek professional advice. The advice from the tool could be the qualifying condition for accessing the tax rebate. Therefore, it is recommended

Finally the study uncovered the possibility that approval of long term finance may be restricted as a result of overdue tax liabilities. If this is the case then the effect it has

A consequence of highly competitive markets for businesses trading with consumers appears to be a change in who bears the incidence of GST. Participants suggest that they have reduced their profit margin to the point that the GST component is absorbed in their final price in order to retain market share. Their perception of the reason for incidence shifting from the consumer back to their business is that prices are displayed inclusive of GST.[210] When small businesses are in competition with enterprises that are not required to be registered for GST, the GST component would make their final price for the goods or services appear higher than their competitors. The purchasing decisions of consumers that are price driven will be made on the final price of the good