

# GST Impact on Legal Services

by Ian McAuley

## Introduction and Summary

At first sight, it could be assumed that the price to be charged for legal services would rise by 10%, but this ignores the probability of cost reductions resulting from the abolition of sales tax on some inputs and a reduction in certain state taxes (FID/debits tax, stamp duties).

In sum, my estimate of the impact of a 10% GST is:

High:	10.0 %
	(a theoretical upper limit)
Most probable:	8.1 %
Low:	5.6 %

I have assumed the profession has no capacity to absorb cost increases - cost increases would be passed through to clients. These are largely business clients, who would, in turn pass these increases on to ultimate consumers.

## Estimate of the Impact

Legal services are high value-added. If there were no inputs other than labour then there would be a full 10% cost increase. There are, however, business inputs, and some of these are already subject to wholesale sales tax and some other taxes which would be abolished.

## LEGAL SERVICES - VALUE ADDED

### Business Revenue/Expense Percent

Income	100.0
Expenses	38.3
Value Added	61.7

Source: Derived from Table 1 ABS Legal and Accounting Services 1995-96 ABS Cat 8678.0

We have data on these inputs. Most inputs are presently subject to low levels of taxation; the only significant item subject to tax is motor vehicle expenses. I have assumed a full 22% tax on this item, which is the sales tax on motor vehicles. There is also a large unclassified "other". This would include some items taxed at 22%, such as computers and stationery. It would also include many other untaxed labour-intensive or otherwise untaxed services, such as expert witnesses, cleaners, subscriptions etc. I have assumed an average 5% tax on this category to cover the mixture of taxed and untaxed items.

I have also included in the analysis a general 2% "background" tax, being the general diffuse impact of wholesale sales tax and other

indirect taxes on indirect inputs. (This figure is confirmed in separate research based on reconciling national accounts and taxation data).

Under a GST, I have assumed a 10% tax on all inputs except for interest. The composition of inputs and the taxes on those inputs is shown below in table 1. The classification is taken from the ABS Survey of the legal and accounting professions, and therefore, by implication, presents an average classification across all sectors of the profession. This is why barristers' fees, for example, appear in the table.

Table 1.

## Composition of inputs and tax effects

Item	Present expenditure per \$100 of output	Present tax%	Background tax%	Pre-tax expenditure per \$100 output	Expenditure after GST
Rent, leasing, hiring	8.54	0%	2%	8.37	9.21
Telecommunications	1.90	0%	2%	1.86	2.05
Library	1.43	0%	2%	1.40	1.54
Post, mail, courier	0.83	0%	2%	0.81	0.89
Motor Vehicle expenses	0.77	22%	2%	0.62	0.68
Audit and other running	0.68	0%	2%	0.67	0.74
Barristers' chambers fees	0.90	0%	2%	0.88	0.97
Barristers' clerk's fees	0.34	0%	2%	0.34	0.37
Interest	2.57	0%	2%	2.52	2.52
Depreciation and amortisation	1.65	0%	2%	1.62	1.78
Other	18.63	5%	2%	17.41	19.16
	<u>38.25</u>			<u>36.51</u>	<u>40.16</u>
				Rise	5.00%

Source: derived from Table 4, ABS Legal and Accounting Services 1995-96 ABS Cat 8678.0

The result is an expected rise of 5% in the cost of these inputs. In sum, the rise in total costs expected from this analysis is just over 8%:

Item	Present expenditure per \$100 output	Increase	Total
Value -added	61.7	10%	6.17%
Input	38.3	5%	1.91%
			<u>8.08%</u>

The tax actually paid by the legal firms would be only 6.17%, but there would still be a passing through of the other 1.91%.

## Sensitivity

This analysis has already made fairly generous assumptions about the present level of taxes. As an outside scenario, to find the lowest possible impact, I have assumed that all of the

19% of expenditure which the ABS classifies as "other" is presently taxed at 22%, which is a common rate of sales tax. This would be significant enough to result in a reduction in the tax on inputs (a reduction of 7.1%), resulting in an overall increase of 5.56%.

## Who Pays

Almost two thirds of legal income is from the corporate sector, and a small amount is from governments; cost increases would therefore be passed through to these sectors and would be diffused throughout the economy. Around a third, however, would be borne by individu-

als (particularly conveyancing clients) and non-profit organisations. The figures in the table below are aggregate across all practices, and are not necessarily representative of particular practices. Some smaller practices, for example, specialise in conveyancing.

## Sources of income of legal practices

Individuals and non profit:	
Funded by legal aid	4.3%
Not funded by legal aid	28.1%
	<u>32.4%</u>
Sole proprietors, partnerships & trusts	13.6%
Financial institutions	12.1%
Other companies	35.6%
Commonwealth government departments	1.5%
State government departments	3.4%
Local government	1.3%
	<u>67.6%</u>
	100.0%

Source: Derived from Table 3 ABS Legal and Accounting Services 1995-96 ABS Cat 8678.0

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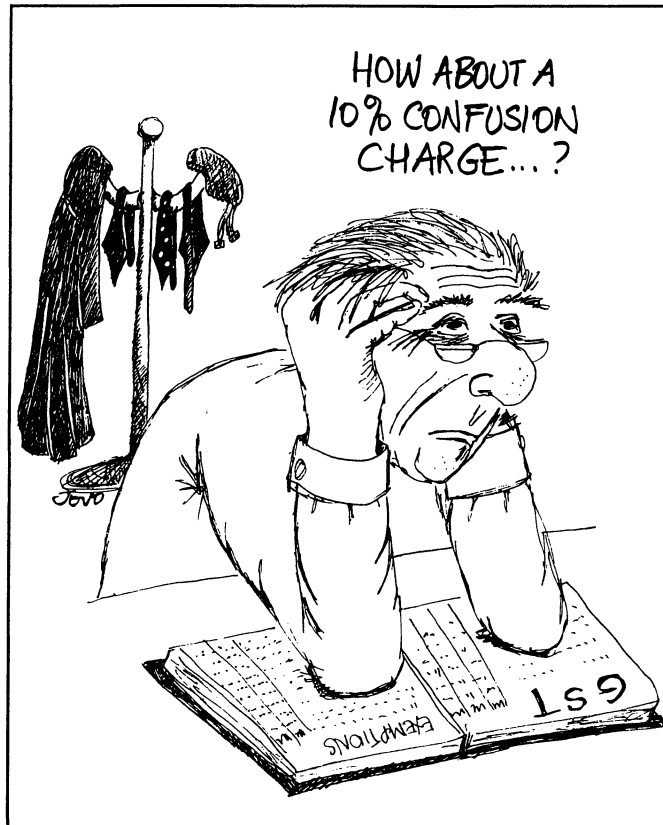
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The situation of legal aid commissions is not clear. There are three possible situations:

- (1) They are treated as government business enterprises, and are liable for full taxation, in which case the analysis above (8.1%) would hold. This would require some means of invoicing, on a funder/provider split. While this is not now the practice, governments, particularly the commonwealth, is moving away from block grant funding towards fee-for-service contracts.
- (2) They are exempt from GST, which means they have to pay taxes on their inputs, with no credits for taxes paid on outputs. This would raise their costs by about 1.9% in accordance with this analysis.
- (3) They are zero related, in which case there is an unconditional credit on input taxes paid, and not output tax. That would represent no change - in

fact, possibly, a small cost decrease

Government documentation states that legal aid would be "GST-Free" - an undefined term which appears many times in the tax documentation. It is not clear whether this means legal aid commission would be exempt or zero-rated. Clearly zero-rating is preferable to exemption.



## New Software streamlines Document - delivery for law firms

National Transport Service has developed an interactive courier booking and information system using the Internet as its key platform.

The new system, called NetSHUTTLE, is particularly suited to the legal profession which is a high consumer of courier/delivery services for sensitive and important documents. The system automatically tracks and notifies the customer of the job's progress and delivery, removing the uncertainty of its whereabouts.

NetSHUTTLE is significantly different from similar systems currently available as it is LAN based and will operate on Windows 3.11 and up and NT. It can be used by legal firms of any size.

As the progress of each job is flashed up on the customer's screen (pick up,

delivery), NetSHUTTLE removes the necessity of having to phone the courier company, in turn wait for the company to contact the driver, in order to check the status of the delivery. The system frees up staff, increases productivity and reduces telephone expenses. It also allows for booking statistics to be exported to a spreadsheet for comparison of monthly accounts to aid reconciliation.

NetSHUTTLE developer, James Taylor, said the increasing use of electronic-commerce and the growing number of firms using the Internet to conduct business means that NetSHUTTLE will become an essential business tool. 'At the moment, one courier company is doing 20% of its \$15 million turnover via NetSHUTTLE, making it an invaluable e-commerce application.

The NetSHUTTLE software is provided free either on disk or downloading from the Internet. The user is charged a normal courier fee per job.

NetSHUTTLE is an Australian innovation and the only one of its kind in the world. IBM which is a business partner of National Transport Services, is supporting and installing NetSHUTTLE nationally as an approved product.

For further information:

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