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TAXATION AND INSURANCE

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THIS CHAPTER WILL INCLUDE A REVIEW OF:

- Taxation
- Other government regulations and legislations
- Insurance

INTRODUCTION

In addition to the legal obligations outlined above, an optometry practice will also have to comply with taxation and insurance requirements. Taxation is mandatory in all jurisdictions while insurance is, in most cases, optional. Optometrists must be aware of their taxation obligations and the consequences of not insuring various aspects of their business.

Chapter 2 examines some of the concepts of taxation and discusses a number of types of insurance.

TAXATION

It is critical that a new business understands its taxation commitments and, for this reason, advice from an accountant should be considered essential. Ignorance is not an excuse in the eyes of the law and this is particularly true of taxation. It is expected that all citizens are aware of their obligations. Taxation is an essential, though unpopular, feature of all civilised societies. Funds raised by taxation provide all of the services required in society that are usually not supplied by the private sector. There are two basic forms of taxation, direct taxes and indirect taxes.

DIRECT TAXES

Direct taxes are applied to income and are therefore unavoidable. The tax normally referred to as ‘income tax’ is the most common form of direct taxation. Income tax is usually collected by the employer on behalf of the government. Because it is effectively paid at the time of earning the income it is often referred to as PAYG (pay as you go) or PAYE (pay as you earn). The amount deducted is usually determined by a tax scale provided by the government.

In many countries the taxpayer (the employee) completes a tax return at the end of the financial year showing the amount of money earned and the tax paid. The taxpayer then makes any allowable deductions for costs incurred in earning the income and adds any other income received from other sources and determines if a refund is due from the taxation office for excess tax paid or whether more tax must be paid in the case of insufficient tax being paid.

TAXATION(CONT.)

Progressive Tax

Income tax in most countries is referred to as a 'progressive' tax. That is, as your income rises, so does your relative tax burden. The wealthy will pay proportionately more tax than the poor. The following tax scale is intended to provide an example of how the progressive tax system works. In reality tax rates will vary from country to country and will change periodically within each country.

GROSS INCOME	TAX RATE
0 - $5000	0
$5000 - $12000	25%
$12000 - $30000	33%
>$30000	40%

The following examples show how such a system is applied:

Example 1

A person earning $20000 would pay $4390tax. That is, they pay no tax on the first $5000 (the tax-free threshold), 25c for each dollar between $5000 and $12000 ($1750) and 33c for each dollar between $12000 and $20000 ($2640).

Example 2

A person earning $40000 would pay $11690 tax. That is, they pay no tax on the first $5000 (the tax-free threshold), 25c for each dollar between $5000 and $12000 ($1750), 33c for each dollar between $12000 and $30000 ($5940)and 40c for each dollar between $30000 and $40000 ($4000).

There is a common misconception that moving into the next tax bracket involves paying the higher tax on all the income. This is not the case; the higher tax rate is only applied to that part of the income in the higher bracket.

For example, the person earning $40000 does not pay 40% tax on the whole of their income, but just on the amount between $30000 and $40000 (that is,10 000$ at 40% = $4000). The person earning $40000, however, will pay more than twice the tax of the person earning $20000. In the case of a single tax rate they would pay exactly twice the tax.

	EXAMPLE 1	EXAMPLE 2
0 - $5000	0	0
$5000 - $12000	1750	1750
$12000 - $30000	2640	5940
>$30000		4000
TOTAL TAX PAID	**4390**	**11690**

TAXATION(CONT.)

Flat Tax

A single tax rate for all income earners is referred to a flat tax. It is considered a regressive system since the burden is considered to be heavier for lower income earners.

The following table shows the tax payable for the previous two examples assuming a flat tax rate of 30%.

	EXAMPLE 1	EXAMPLE 2
Taxable income	20000	40000
TOTAL TAX PAID	**6000**	**12000**

It can be seen from the examples that under a progressive tax system the higher income earner pays a higher proportion of his/her income in taxes.

The following table gives a comparison of the two systems showing the percentage of income paid in tax under each system.

	TAXABLE INCOME	PROGRESSIVE TAX SYSTEM	FLAT TAX SYSTEM
EXAMPLE 1	20000	22.0%	30%
EXAMPLE 2	40000	29.2%	30%

Direct taxes are also applied to other forms of income, such as interest from investments.

Other possible forms of direct taxation

Each country will have its own set of taxes or levies, as they may be called.
The following are some examples of other types of direct tax.

1. **Provisional tax**

   Some countries may require sole traders to pay provisional tax. This is tax paid in advance which is based on a prediction of future earning made by the taxation department. This tax was created because sole traders do not normally pay tax as they earn. It is a way for the taxation department to guarantee that tax is paid.

2. **Fringe benefits tax**

   This is a tax paid by the employer for any benefits that the employee receives other than wages and salary. These benefits include such things as company cars and company housing. These benefits are viewed by governments as alternative forms of income and are therefore taxable in some countries.

INDIRECT TAXES

Indirect taxes are taxes levied on goods and services rather than income. They are referred to as indirect taxes because individuals are not taxed directly and can avoid the tax by merely not buying goods or services. Indirect taxes are considered to be regressive taxes, as opposed to the progressive income tax with its varying rates, because the rate is the same for everyone regardless of their earning capacity. A high income earner pays the same rate as a low income earner.

TAXATION(CONT.)

Some examples of indirect taxes are:

1. **Goods and Services Tax (GST)**

   Several countries including Australia, New Zealand and Canada have a GST, while the USA has a GST-type of tax on goods. The United Kingdom and South Africa have a similar tax referred to as value added tax (VAT). A set percentage is added to the selling price of goods and services. The stores or optometry practices would then remit the collected tax to the taxation department on a regular basis.

   One of the problems for retail outlets is that they became the de facto tax collectors and are required to do extensive reporting. For example, in New Zealand businesses produce two-monthly GST returns. Australian businesses produce three-monthly 'BAS' statements (Business Activity Statements).

2. **Import Duty**

   Import duty is levied on goods brought into the country from abroad. They are also referred to as tariffs. As with all taxes they raise money for government expenditure. However they are also used to create a barrier to imports or to make local products competitive with cheaper imports. The disadvantage of using tariffs to protect local industry is that it may lead to retaliatory action by the source countries.

In order to mitigate the inevitable international trade battles a large number of countries formed the General Agreement on Tariffs and Trade (GATT) in 1949. This then evolved into the World Trade Organization in the early 1990s and this organization now monitors tariffs on trade.

OTHER GOVERNMENT REGULATIONS AND LEGISLATION

Government departments or agencies may have requirements that must be met in areas such as occupational health and safety or the treatment of waste products.

In some countries local councils may also have regulations that must be adhered to, such as zoning of buildings for a particular use such as residential, professional or business. The following is a check list. It is indicative and may not include the requirements of all jurisdictions.

- Taxation number (indicating the business is registered with the taxation department)
- Business name registration (to protect the name)
- Optometrist registration (with the appropriate government authority)
- Registration of a shop (required in some countries)
- Registration of a factory (if a workshop is included in the practice)
- Appropriate zoning (e.g. retail, professional, industrial)
- Fire regulations (fire extinguishers, fire plan etc – particularly important if an optical workshop is included)
- Compulsory insurances (e.g. workers' compensation insurance)
- Professional indemnity insurance (usually expected of professionals such as optometrists)
- Waste disposal system (if the practice has an optical workshop)
- Parking (often required for street front practices)
- Disabled access (ramps for wheelchairs)

INSURANCE

Insurance is a necessity in all businesses. In addition to all of the normal business insurances, covering stock, displays andthe premises; professionals, such as optometrists, usually need professional indemnity insurance to cover possible lawsuits from patients who believe that they have been harmed.

The types of insurance needed, and the possible need for professional indemnity, may vary from country to country, however the following list provides some examples of what might be required.

INSURANCE(CONT.)

In some countries several forms of insurance may be compulsory. Professional indemnity may be one of these forms of insurance. Insurance against injuries to staff in carrying out their duties (such as the workers' compensation insurance described below) may also be compulsory in some countries.

EXAMPLES OF FORMS OF INSURANCE

Professional indemnity

Professional indemnity is a form of insurance that is required by optometrists in most countries. This form of insurance is generally associated with doctors and dentists and others who might be sued because of professional negligence. In the case of an optometrist it may be the misdiagnosis of a serious condition such as an ocular tumour or glaucoma that then leads to blindness.

Workers compensation insurance

In some countries employers are required to take out insurance on their employees against injury or illness. The rates for premiums vary depending on the risk of the occupation. For example the premiums for builders are much higher than for office workers. Optometry is not normally considered a dangerous occupation and so the premiums are likely to be lower. However it does vary between countries. Moreover, some countries cross-subsidise the premiums of dangerous occupations with higher premiums on less dangerous occupations.

Public liability

This covers members of the public for injury as a result of accidents in the business premises or as a result of the business activities. This might include a person slipping on a wet floor or tripping over a mat or power cord.

Fire

Fire insurance will cover the business for loss due to fire. Some policies may not cover fire if dangerous chemicals such as acetone were found to have been stored on the premises.

Business interruption

Business interruption will compensate for the loss of income while, for example, repairs are being carried out on a building damaged by fire or flood. It is important to be aware of exclusions in the policy. For example, some policies may cover flood caused by water coming through the roof in heavy rain but not by overflowing ground pipes or rising river water.

Burglary

Insurance for burglary will cover a practice for theft caused through break and enter or armed hold-up. Some business locations are more prone to burglary and some business types tend to be targets, notably optometry practices which display sunglasses.

Loss of money

This will cover loss of money between the business and the bank. Some policies may also cover loss while the money is being kept in the practice.

Income protection

This will cover a self employed optometrist if he/she becomes ill. It would also be wise for an optometrist to take out income protection, where available, to cover any lengthy absence due to illness.

Insurance packages

Many insurance companies or brokers will customise packages to suit a practice's needs. Such a package will include some, perhaps even all, of the above types of insurance. Packaging is also likely to save the practice money through having all forms of insurance with the same provider.

Overview of insurance

It is important that the business insures against potentially disastrous occurrences. Furthermore, many lending authorities expect businesses to take out most forms of insurance to protect their own investment in the business.

SUMMARY

Taxation and insurance are unavoidable in any business. Payment of the correct tax is a legal obligation and so it is essential that any practice owner is aware of how much tax the practice is expected to pay. As with most aspects of law, ignorance is not a defence. While insurance is usually optional, failure to have sufficient insurance could lead to business failure.

SELF ASSESSMENT 2

1. List three forms of direct taxation.

a. _____

b. _____

c. _____

2. What is the difference between a progressive tax and a regressive tax?

3. What is the purpose of professional indemnity insurance?

4. List two forms of indirect taxation.

a. _____

b. _____

ANSWERS – SELF ASSESSMENT 2

1. List three forms of direct taxation.

a. Income tax
b. Provisional tax
c. Fringe benefits tax

2. What is the difference between a progressive tax and a regressive tax?

Progressive taxes impose a greater burden on higher income earners. Regressive taxes impose the same burden on all taxpayers.

3. What is the purpose of professional indemnity insurance?

To cover law suits for professional negligence.

4. List two forms of indirect taxation.

a. Goods and services tax (GST)
b. Import duty