# Aggregate Tax: Direct Compliance Costs and Associated Burdens. BAA June 2001.

This document attempts to identify some of the costs which will be incurred by quarry companies in attempting to comply with the requirements of the new aggregates levy, due to be implemented April 2002. It also looks at other, less obvious, costs and the level of provision which could be necessary, to protect company viability. Making projections of this nature is not an exact science, nevertheless it is relatively simple to apply known commercial parameters.

1. There are a number of basic issues to be considered:
2. The tax will reduce sales volume but not fixed costs giving a higher cost per tonne
3. It will not be possible to apply the tax “across the board,” at £1.60
4. Quarries must continue to sell low quality and less popular materials to maintain vital working space
5. There will be significant increase in sales office work and bureaucracy
6. It will not be possible to operate existing sales ledgers without extensive computer software upgrade
7. There will be significant cash flow problems caused by customer resistance to paying inflated bills
8. Customers will switch to cheaper alternatives, often at the expense of build quality
9. Imported aggregates will gain a disproportionate advantage
10. The long term outlook for UK production is bleak.

Annual UK construction aggregate production is currently some 206 million tonnes. The UK Directory of Mines and Quarries lists 1,288 operational quarry sites throughout Great Britain giving a national average output of 160,000 tonnes. However there is a wide variety of quarry operations, within the UK, with small family type concerns doing less than 100,000 tonnes, 5 major operators operating circa 700 quarries accounting for around 80% of production or 164 million tonnes, and a handful of large quarries producing up to 5 million tonnes per annum. Unfortunately, Aggregate Tax legislation makes no provision, for these disparities, and small companies will inevitably incur much higher unit compliance costs.

**Differential Rates**
Although the levy is set at £1.60 per tonne, the industry will have to vary the amount of additional costs allocated to different products and different customers in an attempt to recover the cost of the levy + compliance costs + secondary aggregates + waste + less popular sizes + provision for bad debt + higher unit costs + loss of sales revenue.

**Material Differentials**
Quarries must continue to dispose of by-products such as dust and scalpings, low grade waste such as weak or decomposed rock and less popular sizes, such as 6mm grit, which all have to be sold to maintain working space. These materials are always problematical to sell, often have to disposed of at much less than production cost and will now have to compete with products, such

as recycled, which are exempt. Therefore mainstream popular sizes will inevitably have to bear a higher proportion of the cost of recovering the levy. Although this will vary, from quarry to quarry, almost all producers will need to add a premium onto some products to allow others to remain competitive and recover not only the £1.60 levy but other additional costs as well.

**Customer Differentials**
This procedure will be highly complex and will have to be carried out on the principle that the 'softest targets' pay more. In other words it will be the people who have the greatest need of good quality aggregates with the least choice of outlets who will pay the most.

**Necessity of Differentials**
As tax greatly exceeds normal profit levels, companies will have no alternative but embark on this complicated exercise in an effort to survive. This will mean that any one product will have a range of prices determined by its popularity, destination, availability of competing exempt materials, customer alternatives, customer buying power and, even more worrying, availability of imported materials with no attached compliance costs. Although independent companies are already having to deal with this problem the addition of a £1.60 levy plus its associated costs will render it well nigh impossible.

**Bad Debt Relief**
Although materials / customers will now have to be surcharged by varying amounts these figures will not, of course, appear on invoices. If tax is shown at all, it will only be possible to show the flat rate £1.60. This leads to an additional problem, with bad debt, as although HM Customs will credit some unpaid invoices (the scope of bad debt relief is still being discussed) they are unlikely to take account our compliance costs or that we may have assigned rather more than £1.60 to a particular invoice. This will often lead to a consequent shortfall in funds recovered against tax.

**Cash Flow**
HM Customs has to be paid promptly, however, it will take much longer to recover the money from customers whose own profitability may well have been compromised by this enormous levy. Moreover the tax greatly exceeds current margins and this problem will be magnified in high volume low value materials thus driving up lending charges. With a levy of this magnitude the time taken to collect or assign disputed invoices will also be of critical importance to many companies.

**Action Required**
Almost all quarries will have to engage additional staff who will be responsible for attempting to recover the cost of the levy. Quarries with an existing computerised invoicing system will need to replace or upgrade it and those who do not yet have this facility will find that it has now become an expensive necessity.

**Cash implications, Fixed**

**Additional member of staff**. This person will need to be highly experienced in aggregate marketing and will have a heavy responsibility. Pay, car and bonus say …….. £30,000

Computer system upgrade or supply including , commissioning and glitches. Year one minimum estimate is given as ………………………£25,000

### Cash Implications, Variable

1. Increased borrowing requirement to fund levy payments. All quarry companies, especially the independents, have to sell to companies who are often struggling to survive the current construction and building recession. 90 day credit is common and substantially increasing prices will further exacerbate the situation. Having to fund and recover a levy equivalent to around 30% of turnover, without compliance costs, will completely destabilise many smaller operators
2. Restriction of funding for capital projects. This is much more significant than the plain figures would suggest. Quarry companies are already experiencing difficulty in funding capital projects and although this is most pronounced in the smaller companies some of the majors are also now having to resort to leasing, contract hire and even contract out. Mainly due to;
    i. Static or declining market over past 4 years
    ii. Static prices
    iii. Increased cost of fuel oil
    iv. Large increases in the price of new plant brought about in part by a pound which has weakened against the dollar
    v. Poor capital allowance regime
    vi. High cost of complying with strict new environmental legislation
    vii. High cost of complying with new Health & Safety regulations
    viii. Provision for Climate Change Levy
    ix. Working hours directive
    x. Paternity leave cover.
3. Shortfall of funds recovered against tax coupled with reducing sales. Provision will have to be made for failing to collect 100% of tax payable. There are well documented long-standing problems with selling materials to the construction industry. Fiscal bad debts such as company liquidations are not the biggest problem, there are often problems with invoices being disputed because of queries against quality, performance or even simply proof of delivery. It is also likely to be a feature that it will be the invoices which have been allocated the greatest increases which will be the most difficult to collect due to customer resistance Government is of the opinion that aggregate demand is relatively 'inelastic' however commercial experience dictates otherwise and five major problems representing substantial loss of revenue have become evident. Due to the increasingly restricted nature of the market, it is clear that small companies are going lose out disproportionately in the majority of these cases. It is also relevant that even if sales output drops, fixed costs remain relatively static. Although this may vary from company to company, in year one it would be

prudent to make provision to offset losses in this area at an additional 40p per tonne.

*Areas where sales are particularly at risk*

i. **Local authorities.** The public sector accounts for around 40% of all aggregate sales. If their budgets are not increased to cater for Aggregate Tax and all its associated added costs and bureaucracy, they will have to reduce their intake
ii. **Market Share**. At present the majority of independent companies are experiencing severe difficulty in maintaining their market share of aggregates as the 5 major quarrying companies who control 90% of the added value markets of ready-mix concrete and asphalt as well as a substantial part of the pre-cast industry now operate in house buying schemes which deny a substantial part of the market to the independents. In addition concrete and asphalt requires good quality aggregates which the independents will have to charge out at considerably more than the headline £1.60
iii. **Unfair Competition**. The major companies, due to their virtual monopoly the Ready Mixed Concrete, Asphalt and to a lesser extent the Pre-Cast Concrete sector, will be in an unfair position to recover the cost of Aggregate Tax. This will mean that they will now be able to sell aggregate virtually tax free and this would undoubtedly spell the end for a great number of the remaining independents. Although this is already happening in some areas the advent of aggregate tax with its consequent de-stabilising and inflationary effects will most definitely make this worse
iv. **Alternative Materials**. There are many possible alternatives to natural stone for building and other construction purposes. All too often the choice is dictated by price and we will inevitably find a migration towards cheaper materials such as timber, man-made or reclaimed spoil tips. However timber is much less durable and will inevitably be imported, man-made materials have a greater effect on the environment and reclaimed materials often lead to problems in future years
v. **Import Substitution**. All the major conurbations, with the possible exception of Birmingham, are easily supplied with sea-borne aggregates and this is already starting to happen. Although only a limited amount of aggregate is presently being imported from Norway, France and Eire, Glensanda has proved that it is commercially viable to deliver aggregates using large self discharging vessels, into Forth, Tyne, Humber, Thames, Solent, Devonport, Severn, Mersey and Clyde. There can be little doubt that Aggregate Tax will precipitate an immediate and substantial increase in imports. The problem here is that although imported aggregate will have to pay the £1.60 levy importers will only ship in saleable products and producers will have no compliance costs and will continue to sell their by-products and less popular sizes without tax in their domestic markets. (This subject is dealt with in greater detail in "UK Construction Materials and Import Substitution" BAA June 2001)

## Effect on a Typical Quarry

Quarry producing national average of 160,000 tonnes

160,000 tonnes annual sales @ £4.50 per tonne = £720,000
160,000 tonnes @ £1.60 tax + vat = £300,800 ( 42% of gross sales! )
Additional monthly payment to HM Customs £25,066
Additional funding of 2 months levy = £50,122 @ 8% APR = £4,010 or 2.5p per tonne.

*Therefore;*

| | | |
|---|---|---|
| Additional staff member @ £30,000 | 19.0p | per tonne |
| Computer installation or upgrade @ £8,333 | 5.0p | .(£25K written down over 3 years) |
| Increased borrowing requirement | 2.5p | per tonne |
| Sales Loss & Recovery shortfall provision | 40.0p | per tonne |
| **Total** | **66.5p** | **per tonne** |

· This figure is not an accurate reflection of the commercial problems and destabilising effect on any company attempting to recover a levy which equates to 42% of its annual sales. · Add 50% of tax rate ( 80p.) to help offset by-products, waste and less popular sizes and we find that this size of quarry will have to put a premium of £1.46 per tonne on top of Aggregate Tax = £3.06 to survive. At this level of price increase the viability of the business will be highly suspect. · If you factor in the increased radial mileage costs of £1.20 per tonne end users will be faced with increases of up to £4.26 per tonne, or switch to imports.

**Conclusions.**

1. Although it is not possible to be entirely sure of all the effects attached to Aggregate Tax or what the average compliance costs will be, it is reasonable to draw the following conclusions.
2. Small companies will bear a much higher compliance cost in relation to their sales output
3. Any quarry which is unable to recover additional revenue, on mainstream products, to make up for shortfalls in tax recovery on waste and low demand materials will be in jeopardy as the unit costs of saleable products will become prohibitive
4. The viability of a great number of companies will be compromised
5. The 5 major quarrying companies will be in a position to use Aggregate Tax to finish off what little competition is left
6. The majors are liable to switch a substantial part of their production overseas.