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# A Goods and Services Tax for Australia : What Can Be Learned from the Canadian Experience?

## **Abstract**

This paper discusses the basic structural features of the Goods and Services Tax (GST) proposed by the Australian Liberal and National Parties (the Coalition) in their November 1991 policy statement. In doing so, this article will make comparisons with the Canadian Goods and Services Tax. Such comparisons gives insight into what form the legislation may actually take if it is introduced into Parliament, since the Canadian tax has already gone through the exposure to external political forces (lobby groups) that the Australian Colaition proposal faces.

## **Keywords**

consumption tax, Australia, Canada, goods and services tax

# A GOODS AND SERVICES TAX FOR AUSTRALIA: WHAT CAN BE LEARNED FROM THE CANADIAN EXPERIENCE?



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*This paper discusses the basic structural features of the Goods and Services Tax (GST) proposed by the Australian Liberal and National Parties (the Coalition) in their November 1991 policy statement.<sup>1</sup> In doing so, this article will make comparisons with the Canadian Goods and Services Tax. Such comparisons gives insight into what form the legislation may actually take if it is introduced in Parliament, since the Canadian tax has already gone through the exposure to external political forces (lobby groups) that the Australian Coalition proposal faces.<sup>2</sup>*

## Why a goods and services tax?

Why has the Coalition proposed the introduction of a Goods and Services Tax (GST) for Australia? The primary reason given is that the Coalition wishes to abolish the Wholesale Sales Tax (WST)<sup>3</sup> and the GST will provide the revenue lost by the abolition of the WST as well as other taxes.<sup>4</sup> The Coalition has criticised the WST as having a tax base which is "narrow, arbitrarily defined and grossly inefficient".<sup>5</sup> The Coalition also seeks to abolish the excise duty on petroleum as well as customs duties,

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1 *Fightback! Taxation and Expenditure Reform for Jobs and Growth* 21 November 1991.

2 This paper was written prior to the 13 March 1993 Australian federal election.

3 The Sales Tax Assessment Act 1930 (Cth).

4 The other reason given by the Coalition for proposing a GST is to follow the overwhelming trend in other nations. Of the 24 members of the OECD, only Australia, the United States of America and Switzerland do not have some form of goods and services taxation. It should be noted that most of the OECD nations have a GST, in no small part because many of them are members of the European Community, or would like to join. European Community admission requirements mandate that all members have a GST as part of their tax mix.

5 *Fightback!* p 47.

which they see as being inefficient indirect taxes that reduce investment and national wealth. The GST will also fund the abolition of State payroll taxes.<sup>6</sup>

There are many similarities between the introduction of the GST in Canada and the Australian Liberal and National Coalition proposal and the policy rationales given to justify its introduction. In Canada, the Canadian Ministry of Finance (equivalent to the Australian Treasury Department) concluded that the Manufacturers Sales Tax (MST),<sup>7</sup> the legislation upon which the Australian Wholesale Sales Tax was based, had to be replaced. There was no dispute that the MST had outlived its usefulness. The legislation was overly complex, it had too narrow a tax base<sup>8</sup> and it had become the cause of substantial economic distortions.<sup>9</sup> This, however, meant that the government had to decide where the revenue previously raised by the MST (approximately 15% of total federal government tax revenue) would come from. The government concluded that the only appropriate replacement for the MST was a goods and services tax.<sup>10</sup>

## How the GST works

The proposed Australian tax is very similar to the Canadian GST. The discussion of the Australian proposal will include comments on the Canadian law. The GST, as proposed by the Coalition, is a multi-level tax. It means that whenever there is a transaction in the production process, the tax is levied on the full value of the transaction. The tax is also paid by the consumer as the final transaction in relation to the goods or services. At the same time, input credits are given to business taxpayers. These input credits are equal to the total amount of GST paid by them for any goods or services which they use in the course of doing business. The net amount of tax payable by the business taxpayer will be the difference between the amount of GST which they collect in the course of selling goods and services, less the credits representing the amount of GST they have already paid on goods and services which they required to conduct their business. This net amount represents the tax payable on the value added to the goods or service during that stage of production. Hence the name *value added tax*.

6 It is proposed that revenue will be directed to the States to compensate them for revenue lost if they agree to abolish payroll taxes; see *Fightback!* p 62-64.

7 The Manufacturers Sales Tax, the popular name for Part VI of the Excise Tax RSC 1985, c E-15.

8 The MST was introduced at a time when the largest area of economic activity in Canada was in the manufacturing sector. With the shift away from manufacturing and toward the provision of services, the base of the tax had become increasingly narrow and meant that revenue raising opportunities were being missed.

9 For further discussion on the MST, see Greenbaum, "The Canadian Goods and Services Tax" Bulletin, International Bureau of Fiscal Documentation, Vol 45, No 6, June 1991.

10 The GST was actually created through the amendment of seven pieces of legislation. The principal amendments are to the Excise Tax Act. For ease of description, the assortment of legislative provisions will be referred to as the GST Act.

Fifteen per cent<sup>11</sup> tax is imposed at each level of the production process. Contemporaneously, the taxpayer/business is allowed a credit equal to the full amount of the GST paid by them for inputs acquired in the course of production. Since businesses receive credits for the full GST paid by them in the course of their business on goods and services, the entire burden of paying the GST falls on the final consumer. Hence the name consumption tax. This is explained by the following example.

The Sale of a Washing Machine					
Process/Transaction	Purchase \$	Sale \$	GST \$	Input Tax Credit	Net Tax \$
Mine extracts ore	N/A				
Sells ore		100	15	N/A	15
Steelmaker smelts ore and makes steel	100 (+\$15 GST)				
Sells steel		300	45	15	30
Manufacturer makes washer	300 (+\$45 GST)				
Sells machine		400	60	45	15
Retailer sells machine	400 (+\$60 GST)				
Sells to consumer		600	90	60	30
Consumer	600 (+\$90 GST)				
Total Net Tax					90

In this simplified example, the mining company extracts ore and sells it to the steel maker for \$115 (\$100 plus \$15 GST). The mining company receives no input credits because it incurred no GST costs. It did not have to acquire any taxable inputs in the course of its business. When the mining company lodges its GST return, it will show \$15 GST collected and no GST paid for inputs (therefore no input credits). It will then remit the net amount, \$15, to the Australian Taxation Office (ATO). The \$15 represents 15% tax levied on the \$100 value added by the mining company.

The next stage of the process involves the steel maker smelting the ore and making steel. It acquires the ore for \$115 (\$100 plus \$15 GST) and sells the steel for \$345 (\$300 plus \$45 GST). The steel maker's GST return will show the collection of \$45 GST (on the sale of the steel) and the payment of

11 The Coalition proposal is to set the GST at 15%.

\$15 for inputs (on the acquisition of the ore), resulting in a net figure of \$30. Once again, the net amount of GST is remitted to the ATO. The net remittance represents 15% tax on the value added at that stage of the process (\$200 increase in value – from \$100 worth of ore to \$300 worth of steel). This process continues until the washer is sold to the consumer for \$600 plus \$90 GST. The net amounts of tax remitted from all of the earlier stages of production, in total, add up to \$90, the GST paid on the final, consumer, transaction. Although the consumer pays the full GST on the product, only the GST on the value added by the retailer (\$30) is remitted at that stage. The balance of the \$90 is the aggregate of the net amounts remitted at all of the previous stages of the process.

## Categories of goods and services

The Coalition recognised in their policy document that there is a consensus among academics and private sector analysts that the preferred form of GST should have two structural features.<sup>12</sup> It should have a uniform rate of tax and it should be comprehensive in its scope of application. Notwithstanding the recognition of the advisability of applying the GST to a comprehensive tax base, the Coalition implicitly recognised that it would be politically disastrous to do so. The Coalition have proposed three categories of goods and services. These categories are:

- taxable
- zero-rated
- exempt.

### 1 Taxable

The vast majority of goods and services are taxable.<sup>13</sup> This means that the consumer pays GST and the businesses engaged, at all stages of production in providing the goods and services, receive a credit for GST paid on inputs. This was shown in the above example of the production of the washing machine.

### 2 Zero-rated

These are goods and services for which the producers (both intermediate and final) will receive input credits but the consumer pays no GST. For example, the producer of the zero-rated goods or services will file a GST return which will show no GST collected because of the zero-rating and GST paid for inputs. This will leave a net negative amount. A refund equal to this figure will be paid to the taxpayer.

<sup>12</sup> *Fightback!* p 65.

<sup>13</sup> All goods and services are taxable unless they are included in either of the other two categories, zero-rated or exempt.

#### Zero-rating will apply to:<sup>14</sup>

- health
- education
- government provision of non-commercial services
- charitable and religious institutions exports
- businesses sold as a going concern.

### 3 Exempt

The exempt category of goods and services is a misnomer. Only consumers are exempt in the case of these goods and services. As with zero-rating, the consumer does not have to pay GST on the acquisition. However, the producer is unable to get a credit for any GST which they paid in the production or provision of the goods or service. The producer of exempt goods and services bears the burden of the GST.<sup>15</sup>

#### Exempt goods and services include:<sup>16</sup>

- residential rents and residential construction
- other construction
- financial services
- gambling and lotteries.

The various categories of goods and services are discussed in greater detail in the appendix.

In Canada, the same three categories are used and the terms have the same meaning in both countries.<sup>17</sup> The nations differ, however, in the industries included in each of the three categories.<sup>18</sup> The differences will be noted where relevant.

## Registration and administration

The Coalition proposal provides for a system of GST registration by all taxpayers who are likely to collect GST or seek an input credit. Only registered taxpayers will be able to collect the tax or receive input credits.

Almost all businesses will be obliged to register. Only those businesses with gross earnings of less than \$30,000 per annum will have the option not to register. If the business does not register, it will be prohibited from collecting the GST and will be ineligible for the input credit. Questions arise as to how the government can ensure, in a cost effective manner, that those

14 *Fightback!* p 65. *Fightback Mark 2* added certain basic food items to this list.

15 They will attempt to pass on the cost if they are not presented with an elastic price demand for their product.

16 *Fightback!* p 66.

17 GST Act, s 123(1).

who have not registered do not collect the GST and thereby receive a 15% windfall.<sup>19</sup>

Frequency of filing returns varies with the size of the business. Most GST registrants will have to file a GST return every two months. Large businesses (those with an annual turnover in excess of \$24 million) will file monthly. Small businesses (with an annual turnover of less than \$250,000) will be able to apply to the ATO for permission to file every six months.

The GST return will state the amount of GST collected and the amount paid during the reporting period. In the case of taxable industries, the amount paid in GST for inputs will be subtracted from the amount of GST collected in the sale of goods or provision of services. If the balance is positive, that amount will be remitted to the ATO. If the balance is negative, a refund payment will be made to the taxpayer. In the case of a zero-rated industry, as no GST will have been collected, the return will only show amounts paid in GST for inputs. That figure will represent the amount of refund owing to the taxpayer. Conversely, if the taxpayer provides exempt goods or services, there will be no input credit. This means that the taxpayer will collect no GST and receive no credit for GST paid for inputs.

In Canada there is a similar \$30,000 threshold which must be exceeded before a business is obliged to register for the GST.<sup>20</sup> Reporting requirements are somewhat different than in Australia. The report includes the filing of a GST return. Monthly reporting is required for those businesses with turnover in excess of \$6 million per fiscal year.<sup>21</sup> Businesses with a turnover of less than \$6 million but more than \$500,000 per fiscal year will report quarterly.<sup>22</sup> Small businesses (those with a turnover of less than \$500,000) may report annually.<sup>23</sup> Remittance of tax is meant to coincide with the filing of returns, except in the case of annual reporting.<sup>24</sup> Those businesses reporting once a year are required to remit tax on a quarterly basis.<sup>25</sup>

## GST strategies

At this early stage of policy development, there is little benefit to be derived from discussing the details of the proposal or the make up of industry categories. The proposal does not provide very much detail as to

18 Exempt industries are outlined in Schedule V of the GST Act. Zero rated industries are outlined in Schedule VI of the GST Act.

19 For further discussion about the problems of policing the GST when certain businesses are exempt from registration, see Greenbaum, above n 8.

20 GST Act, s 240(1).

21 GST Act, s 245(2).

22 GST Act, s 245(2).

23 GST Act, s 248.

24 GST Act, s 228.

25 GST Act, s 237.



operation and administration of the GST.<sup>26</sup> It must also be kept in mind that the proposal is by the opposition political parties, not the government. A great deal can happen between the time of introduction of this proposal, which forms part of a policy platform for an election, and the time it is introduced in parliament (if that ever occurs). The balance of the paper will look instead at strategies for preparing for the GST. The paper will also discuss some of the implications of the proposal as it currently stands.

Briefly stated, the Coalition GST proposal is as follows:

15% tax at each transaction, with input credits to all but the final consumer except:

- if zero rated – GST is not charged or collected  
businesses are eligible for input credits
- if exempt – GST is not charged or collected  
businesses are not eligible for input credits.

### **GST categories – what to aim for**

If the GST takes the form outlined above, there are some conclusions which can be made regarding its impact on certain industries and products.

#### *The best industry to be in*

Arguably the best industry to be in under the proposed GST is one which involves the purchase and resale of second-hand goods, where the goods are acquired from a private person.

A transaction involving the sale of second-hand goods by a private individual who does not have a GST registration will not attract GST. This approach is necessary, from a practical perspective, because it would be impossible to ensure that every garage sale or transaction advertised in the local *Trading Post* newspaper complied with the requirements of the GST. The treatment of secondhand goods takes a strange twist, however, when the goods are acquired by a business with a GST registration and the goods are subsequently resold. Even though the business/purchaser paid no GST for the goods, it will be entitled to an input credit equal to the amount of GST it would have paid had the acquisition not been exempt.<sup>27</sup>

For example, a used car dealer purchases an automobile from a private individual for \$5000. No GST would be payable by the dealer on the transaction since, as a private individual, the seller is not registered and therefore not obliged to collect GST. The dealer then sells the car, after cleaning it up, for \$6000, plus \$900 GST (15% of \$6000). When the dealer lodges his GST return, he will show \$900 GST collected and a notional input

26 The Coalition states that the details related to the operation and administration of the law will be formalised following consultation with business.

27 The policy rationale for imputing a tax credit is outlined below.

credit of \$750. He will then remit \$150 to the ATO in relation to the transaction. This gives the dealer a windfall of \$750, equal to the notional credit.<sup>28</sup>

The policy rationale behind the notional input credit is not stated, however it may be supposed that it is to ensure that the net amount remitted will represent the amount of GST on only the value added by the car dealer. Two questions arise from this result. First, is it appropriate to give the car dealer a \$750 windfall, notwithstanding the theory of only taxing value added? Second, if it is deemed that the windfall is not appropriate, could not the same policy aim have been served by permitting the second-hand dealer to only charge GST on the value added by him. Thus no imputed credits would be necessary and no tax windfall would take place.

In Canada, the notional credit is equal to the amount of GST which would have been payable to achieve the net sale amount. Using the above example,<sup>29</sup> the notional input credit on the \$5000 car would be  $\$5000 \times 15/115 = \$652.17$ . This notional amount means that the law recognises the car to have been sold to the business for \$4347.83 plus 15% GST, amounting to \$652.17 GST, resulting in a total of \$5000. The notional credit gives the business which buys the secondhand goods a partial credit for GST paid by the original consumer. The author is equally at a loss for a compelling policy reason why Canada provides this windfall. The only policy advantage of the Canadian approach is that the resulting windfall is smaller.

### *The most disadvantaged industry*

The residential building industry is arguably the most disadvantaged by the Coalition proposal. The sale of new houses is tax exempt. Resale housing is also exempt. These exemptions are consistent with the sacrosanct principle of Australian tax law that transactions involving the taxpayer's personal residence are generally free from tax consequences. At this point, all appears fair and equitable as between the treatment of new and resale housing industries. However, once input credits are accounted for, a considerable inequity becomes apparent.

Since new and resale housing are exempt, it means that there is no GST charged on the sale of the house. It also means, however, that no input credits are allowed. Thus, on the sale of a house, whether new or old, no GST is charged on the sale and any GST paid by the seller before the sale must be absorbed by them.

New houses will not attract GST on their sale, however all of the inputs, other than labour and the builder's margin,<sup>30</sup> will have attracted GST and the

28 *Fightback!* Supplementary Paper No 5, p 20.

29 This example is using the proposed Australian rate of 15% for ease of comparison. In Canada, the actual GST rate is 7%.

30 Profit margins and wages are factors which have been excluded from the application of the GST.

tax paid on these inputs will not be eligible for the input credit. The seller of existing housing will not be permitted any input credits either, however it is unlikely that they will have incurred any significant input costs or GST. This being the case, the lack of input credits does not affect them. The resulting situation is that, although both new and resale housing are tax exempt, the new house sector is at a considerable disadvantage.

The builder of new houses is confronted with two choices. One choice is to increase the price of their product to compensate for the additional cost resulting from the taxation of inputs. This behaviour will adversely affect them in the market place vis-à-vis existing housing stock. Alternatively, they can reduce their profit margin and maintain their previous price. Neither prospect would be very attractive to the builder.

A similar disparity of treatment took place in Canada when the GST was introduced. New house builders were disadvantaged in the market. However, this took place in a different manner. In Canada, the resale of houses was made exempt and the sale of new houses was taxable. The differential treatment led to a strong lobbying effort by the housing construction industry. They stated that the additional 7%<sup>31</sup> would severely disadvantage them in the market, since existing housing stock, with which they are competing, was being sold without the addition of the GST. The Canadian government relented and gave a partial GST rebate to the buyer of new housing.

There will doubtless be considerable lobbying efforts from the housing construction industry if GST legislation is introduced as proposed.

### *What to lobby for and what not to lobby for*

The legislative experience in Canada with the housing industry highlights the importance of political action and persuasion in the formulation of tax policy.

The effect of any new tax on an industry (or individual business) will be greatly influenced by the price elasticity of demand for the product. Any industry which is subject to elastic price demand,<sup>32</sup> or whose prices are fixed by regulation, would be advantaged by being classified as zero-rated or taxable, rather than exempt. In the case of exempt industries, no input credits

31 The rate of GST in Canada is 7%. The GST is applied to goods, in addition to Provincial Sales Tax (PST) in nine of the ten provinces. The rates of PST range from 6% to 12%. Five of the nine provinces include the GST in the PST tax base and the balance do not. In Newfoundland the PST is 12% and GST is included in the PST tax base. This results in an effective total tax on goods of 19.84%.

32 A product is said to have an elastic price demand if the number of units sold drops significantly in relation to any price increases, and the decrease in number of units sold is proportionately greater than the rise in price. This results in a situation where an increase in price leads to a decrease in total revenue. Inelastic price demand is the opposite situation. This is where the increase in price results in little or no decrease in number of units sold. Here the total revenue from sales increases with the increase of the per unit price of the goods.

will be available and therefore the GST paid by them on inputs will have to be absorbed by them or added to the sale price of their goods or service. If the demand for the product or service is very elastic, the only alternative for the business is to absorb the GST as an additional cost of doing business and thereby reduce its profit margin. Raising the unit prices would cause a substantial reduction in number of units sold and hence a reduction in total revenue. If zero-rated, the industry will not charge GST but will receive a credit for any tax paid on inputs. The product's net price will therefore be unaffected by the introduction of a GST. As such, any lobbying efforts by these industries should be to achieve zero rating categorisation, or alternatively to at least become taxable so that input credits are available.

An example of a industry with elastic price demand is the sale of new housing, as it competes with the sale of existing housing stock, as discussed above. Since it is in close competition with resale housing and since their products are generally interchangeable, sellers of new housing are very limited in their ability to raise prices while still maintaining their market position. Examples of fixed-price industries are the provision of medical services by doctors who "bulk bill" under Medicare, or the provision of legal services subject to fixed tariffs, such as legal aid services. Since these industries are unable to raise their prices to compensate for GST paid on inputs, it is therefore important for these taxpayers to have the opportunity to claim these credits.

A sobering reminder of the importance of applying the right strategy when lobbying is provided by the medical profession in Canada.<sup>33</sup> In Canada, under the original proposal for the GST, medical services were to be taxable. This decision resulted in an outcry from the medical profession, who thought that it was beneath their professional dignity to be tax collectors on behalf of the government.<sup>34</sup> In response to the lobbying efforts of the medical profession, the government relieved them of their tax collection burden by making their services tax exempt. This placed them in a much worse position than they were under the original proposal. Physicians are now paying GST on their inputs but they can no longer seek credits for the tax paid on inputs. Since physicians cannot raise the price of their services,<sup>35</sup> they must absorb the increased cost of practice as represented by the GST paid by them.

Is there any industry which would choose to be exempt rather than zero-rated? The short answer is no. In either case the consumer is not burdened with the payment of the GST on their consumption of the goods or service, however an exempt producer is unable to obtain credits for tax paid by them.

33 This is an example of the adage that you should take care in what you wish for because you may get it.

34 This was notwithstanding the fact that those same taxes were paying for their fees under Medicare.

35 In Canada, medical services are paid by a federal government program and billing in excess of the government scale (extra-billing) is prohibited.

The disadvantage of being an exempt industry is minimised when the producer requires few or no taxable inputs in transacting their business.

### *What's in a name? – plenty*

The imposition of the GST with its different categories of taxation means that taxpayers should closely consider how their products or services are marketed. While the proposed GST has a uniform rate of 15%, in actuality there are two rates, 15% for taxable items and 0% for exempt and zero-rated items. How the goods or services are categorised, and hence treated for GST purposes, may have a serious impact on their marketability and sales.

For example, under the proposal, education services may be classified as either zero-rated or taxable. Whether the institution or course will be classified as zero-rated is based on a test of whether the course is aimed primarily at developing occupational skills. If aimed at developing such skills, it will be zero-rated. If the course is recreational, the fees will be taxable. Care must be taken in the marketing of products and services to ensure the most advantageous GST categorisation is applied.

On a practical level, this occupational nexus test is potentially problematic. For instance, teaching taxation law to accountants, who require the course for professional accreditation, would clearly be classified as occupational. Is the course occupational if taught to lawyers, who are not required to take such a course for the purposes of accreditation<sup>36</sup> or if they have no intention of practising in that field of law? Does the course cease to be occupational if studied by dentists who wish to know enough about taxation law so that they may rest secure in the knowledge that their tax adviser has structured their finances to minimise tax liability? Does it matter who the student is and what they normally do for a living? Should it matter?

### *Food for thought*

Unlike many other models of GST, the original Coalition proposal decided to tax all food. Taxing food is consistent with the aim of a comprehensive tax base.<sup>37</sup> Making the tax base as broad as possible will mean the GST rate need not be higher to yield the same amount of revenue.<sup>38</sup> Further, the lack of exemptions for food will permit the legislation to be simpler, because it will be unnecessary to draft complex provisions delineating which foods are taxable and which are not. In Canada, a politically less courageous policy was introduced. Zero-rating was applied to certain foods and all other foods were taxable. The political pressure to remove the GST from certain foods resulted in a change in the Australian

36 Taxation law is no longer a required area of knowledge for admission to practise law in the State of Victoria.

37 *Fightback!* p 68.

Coalition approach to this issue.<sup>39</sup> The foreign experience is that there will be considerable consequences resulting from the manner in which certain foods are packaged and marketed.

In Canada, "basic groceries" are zero-rated and all other foods, including prepared foods, are taxed. The difficult question which arises is what is a basic grocery? Basic groceries are described in Schedules appended to the Act as "foods and beverages for human consumption ... other than the supplies of" followed by an exhaustive list of foods and beverages which are not basic groceries.<sup>40</sup> Some very anomalous results stem from these regulations.<sup>41</sup> For instance, the regulations define one donut as excluded from the definition of basic grocery, and therefore taxable, but further provides that if six or more donuts are purchased at one time, and not consumed on the premises, they will be zero-rated as "basic groceries".<sup>42</sup> The introduction of this rule has led to retailers selling donuts and muffins in six-packs so they will be free of GST.<sup>43</sup>

In Canada, packaging becomes crucial in determining the GST treatment of some foods. A single serving size of yoghurt is taxable since it is categorised as a snack food.<sup>44</sup> If the same product is sold in the baby food section, and marketed as such, it is zero-rated, as are all baby foods.<sup>45</sup> Likewise, if the single serving size of yoghurt is sold in package with multiples of that same single serving, it will be zero-rated as a basic grocery item.<sup>46</sup>

Anomalous and irreconcilable results would have been avoided if the Coalition had maintained its resolve to tax all food. Under its revised policy, great care will have to be taken in deciding what shall be taxed and what shall not. It will also be necessary to address whether categorisation should

38 Ibid.

39 Certain foods were zero-rated under *Fightback Mark 2*.

40 Schedule VI, part III, pursuant to the Excise Tax Act.

41 In the United Kingdom a similar approach was taken to the categorisation of food and its treatment under the VAT. This has led to some peculiar results. One dispute arose involving a bakery. The question was whether meat pies sold by them were basic groceries (free of VAT) or were they a snack food (taxable under the VAT). If food was sold hot, it was considered by Customs and Excise to be a taxable snack food. The bakery in question baked the pies continuously during the day and sold them as soon as they were baked. As such, they could be purchased hot and eaten immediately, if desired (a prepared food), or could be taken home and reheated (a basic grocery). The bakery argued that they were not producing a hot prepared snack food. Rather it was a basic grocery item that was cooling down after the original baking. The Customs and Excise department ruled that meat pies sold in a bakery were taxable as snack foods if they were sold before 3 pm, since the presumption was that they were to be eaten for lunch. However, if sold after 3 pm they became basic groceries and were zero-rated.

42 Schedule VI, part III, para 1(m).

43 Questions remain regarding whether the sale of donuts or muffins would be free of GST if the product were mini versions of the baked goods which in aggregate were the same mass as a single unit of the full size version of the food. That is, are six mini-donuts considered one donut or six? The regulations do not address this issue.

44 Schedule VI, part III, para 1(n).

45 Schedule VI, part III, para 1(n).

46 Schedule VI, part III, para 1(n).

be based only on the type of food at issue or whether other factors such as marketing, packaging and where the food is sold should be considered.

## Conclusions

Even though the Coalition lost the March 1993 election, the ALP may eventually introduce a GST or variation of the tax.<sup>47</sup> This being so, it is important to plan strategies to minimise its negative effects or to target lobby efforts to seek the alteration of proposed legislative provisions which are disadvantageous.

Many questions remain unanswered as to how the GST proposal will operate. Particularly important are the details of how the administrative mechanics will operate and the form which accounting rules will take for the calculation of GST payable. It will be important to get answers to these questions so that business plans may be made and business structures introduced.

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## Appendix

### Industry categories under the GST proposal

#### *Health*

Under the Coalition proposal, health services will be zero-rated.<sup>48</sup>

The Coalition proposal is also to zero-rate medicines (both prescription and non-prescription) and medical appliances (such as prostheses). Private health insurance, as with all insurance contracts, will be exempt.<sup>49</sup>

#### *Education*

Education services (both private and public) will generally be zero-rated.<sup>50</sup> This means that tuition and other fees will not be subject to GST.<sup>51</sup>

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47 The GST may be introduced either directly as a means of addressing budget deficits or indirectly by broadening the tax base of the WST. The Prime Minister, in 1985 when he was Treasurer, favoured the introduction of a GST.

48 *Fightback!* Supplementary Paper No 5, p 13.

49 *Ibid.*

50 *Fightback!* Supplementary Paper No 5, pp 14-15.

In the case of private boarding schools, both the tuition and accommodation fees will be zero-rated. Food purchased by, or prepared for, boarders will be subject to tax.<sup>52</sup>

### Public Sector

The general rule is that public sector bodies which are engaged in commercial activity are to be taxed.<sup>53</sup> If the activity is non-commercial or regulatory, it is zero-rated.<sup>54</sup> The test which the Coalition has proposed to use to determine the GST status of public sector activity is taken from European Community regulations. It provides that government activity will be taxed when failure to do so would cause a "significant distortion of competition". This is potentially a helpful test to distinguish between commercial and non-commercial<sup>55</sup> activity by government. It is, however, interesting to note that the Coalition goes on to describe as taxable such government services as the post office, water, gas, and electricity, all of which are monopolies and would not therefore meet the European Community standard for taxation. The Coalition also proposes that the same rule apply to local government operations.<sup>56</sup>

### Building Industry

Sale of new housing and resale of existing housing stock are exempt.<sup>57</sup>

Commercial building will be treated in the same manner as new residential construction. The sale will be tax exempt, most inputs will be taxable and there will be no input credit available.<sup>58</sup>

Leases, both commercial and residential will be tax exempt,<sup>59</sup> so long as they are for a duration in excess of 29 days.<sup>60</sup> The residential tenant will not pay GST on their rent and the landlord will receive no credit for GST paid on inputs used in the operation of the property. This additional cost will, in the long run, be incorporated into the rents paid by the tenants.

51 *Fightback!* Supplementary Paper No 5, p 15.

52 *Ibid.*

53 *Ibid.*

54 *Fightback!* Supplementary Paper No 5, pp 15-16.

55 For the purposes of this provision, "non-commercial" would include activity by government which, while commercial in nature, is providing a service which private enterprise is unwilling or unable to provide.

56 *Fightback!* Supplementary Paper No 5, p 17.

57 *Ibid.*

58 *Ibid.*

59 *Fightback!* Supplementary Paper No 5, p 18.

60 Tenancies of shorter duration will be categorised as akin to the provision of hotel accommodation, and therefore taxable.



### *Export of goods and services*

The proposed GST treatment of exported goods and services is designed to encourage export. All goods which are, or will be exported, are zero-rated.<sup>61</sup> Zero-rating also applies to the export of certain services.<sup>62</sup> Services provided in relation to land or personal property located outside Australia are also zero-rated. For example, if legal work is performed in Australia relating to assembling a financing package for the purchase of land located in Singapore, the work performed will be zero-rated. Likewise, services supplied to non-residents situated outside Australia are also zero-rated. The rules governing the zero-rating of exported services may lead to administrative headaches for professional practices when trying to determine which parts of a file should be zero-rated and which are taxable for billing purposes.

### *Financial services*

The provision of financial services to resident customers is tax exempt.<sup>63</sup> If the services are provided offshore they are zero-rated.<sup>64</sup> The disparate treatment of the provision of financial services is part of the aim to encourage export of goods and services through the GST.

### *Sale of secondhand goods*

The sale of secondhand goods by a private individual who does not have a GST registration will not attract GST.<sup>65</sup>

### *Sale of a business as a going concern*

Under the proposal, the sale of a business is zero-rated.<sup>66</sup>

### *Charities and religious institutions*

Charities and religious institutions engaged in non-commercial activities are zero-rated.<sup>67</sup> The institution must, however, be registered if it is to receive a credit for GST paid on inputs. This approach is more sound from a policy perspective than that taken in Canada. In Canada, most charitable institutions and their activities are tax exempt. As a result, the institution incurs GST on inputs, but is unable to recover the amounts paid through the input credit. The Coalition proposal of zero-rating these groups is in keeping

61 *Fightback!* Supplementary Paper No 5, p 21.

62 *Fightback!* Supplementary Paper No 5, pp 21-23.

63 *Fightback!* Supplementary Paper No 5, pp 18-19.

64 *Fightback!* Supplementary Paper No 5, p 19.

65 *Fightback!* Supplementary Paper No 5, p 20. Also see discussion under subheading "The Best Industry to be In", above.

66 *Fightback!* Supplementary Paper No 5, p 21.

with their insulation from taxes under the income tax regime.<sup>68</sup> Where a charity or religious institution is engaged in commercial activity, that activity is taxable. As such, they will be eligible for the input credit.<sup>69</sup>

### *Non-profit organisations*

Non-profit organisations, such as sporting clubs, will be taxable.<sup>70</sup> The club itself will not incur any GST burden (other than the costs associated with the administration and collection of the tax). Its members, and anyone else consuming their goods and services, will pay the tax.

### *Travel and tourism*

Domestic travel will be taxable and international travel<sup>71</sup> will be zero-rated.<sup>72</sup> Unlike Canada, there is no provision in the proposal to refund GST paid by tourists on goods purchased while visiting.<sup>73</sup> The Coalition proposes that foreigners visiting Australia will have to pay the GST and will receive no refund. If tourism is seen as an important industry for development and growth, it seems odd that a refund of GST paid by tourists was rejected by the Coalition. The only way foreign tourists will be able to avoid the GST is by purchasing goods in a duty-free shop.<sup>74</sup>

### *Precious metals*

Precious metals are, as in Canada, zero-rated on their first supply.<sup>75</sup> Several conditions must first be met. The metal must be supplied by the refiner. It must be the first sale of the metal after refinement and the metal must be used for investment purposes. If all of those conditions are met, the supply is zero-rated. In all other circumstances, the supply of precious minerals is characterised as a tax exempt financial service.

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67 *Fightback!* Supplementary Paper No 5, p 23.

68 Section 23(e) ITAA exempts from assessment the income of charitable institutions.

69 *Fightback!* Supplementary Paper No 5, p 24.

70 *Fightback!* Supplementary Paper No 5, pp 24-25.

71 International travel means where the consumer is leaving Australia.

72 *Fightback!* Supplementary Paper No 5, pp 25-26.

73 In Canada, tourists may apply for a refund of GST paid on goods purchased in Canada and taken from the country at the end of the trip. GST is not refunded on goods and services consumed in Canada, such as hotel accommodation and meals purchased while in the country.

74 *Fightback!* Supplementary Paper No 5, p 26.

75 *Fightback!* Supplementary Paper No 5, p 26.