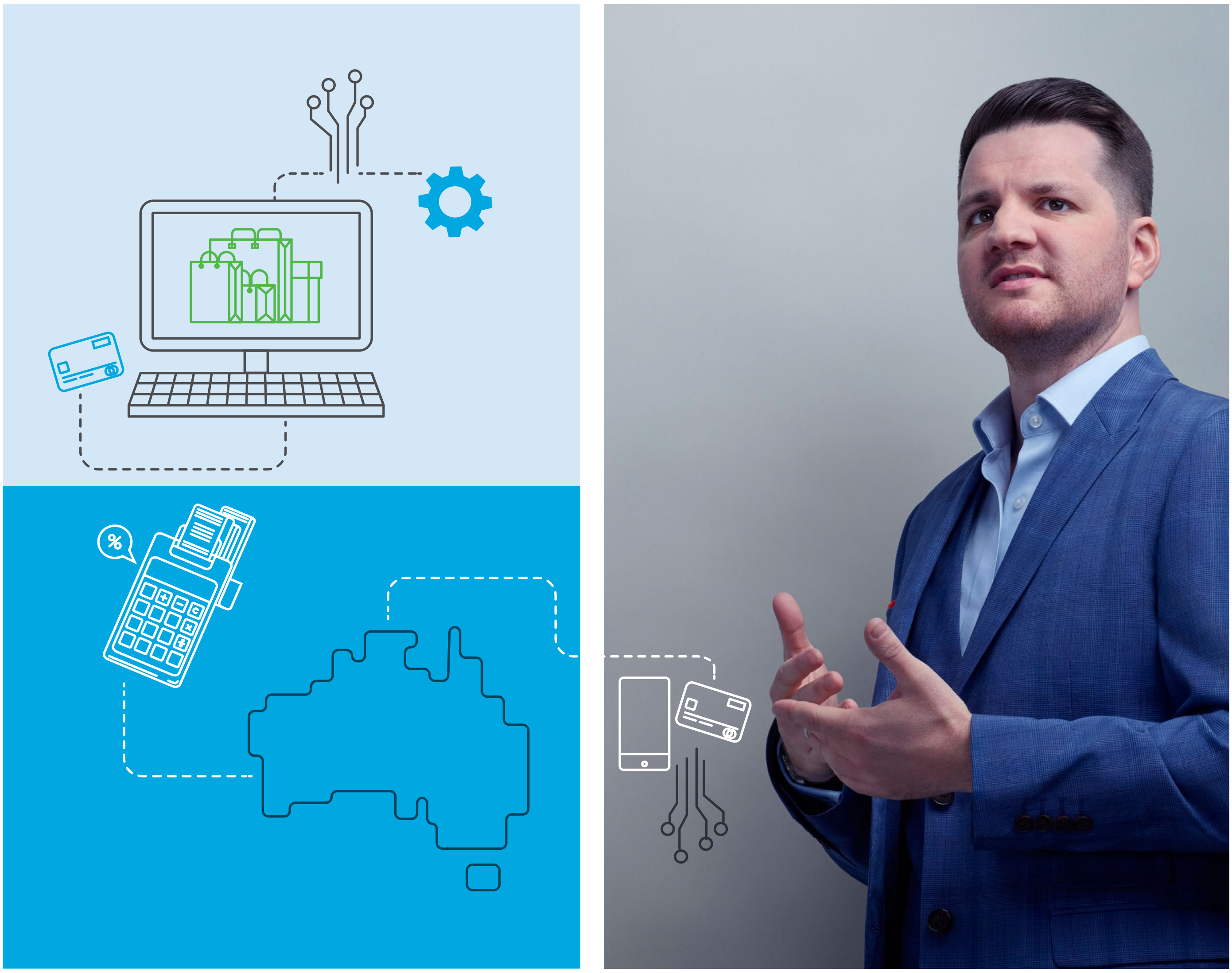
# GST reform in post COVID-19 Australia

## THE OPPORTUNITIES, CHALLENGES AND IMPLICATIONS



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# INTRODUCTION

Since Australia's Goods and Services Tax (GST) was introduced in 2000, there have been numerous opinions over the years on what role GST has in the tax reform agenda.

The reality is, most Australians switch off when they hear about tax reform.

In a post COVID-19 environment, GST reform has returned to the fore as a means through which to achieve economic growth – generate revenue to support ongoing government expenditure.

Whether it's broadening the base to remove exemptions or increasing the rate, GST reform has been a politically-sensitive topic for years. However, given the pandemic-induced deficit and long-term economic impacts, GST reform may well have a central role to play in providing sustainable revenue growth and productivity gains through the abolition of less efficient taxes.

This report presents the varied perspectives and viewpoints of key tax specialists around the country on proposed GST tax reform.

## CONTENTS



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# The case for GST reform in Australia

Australia's Goods and Services Tax celebrated its 21st birthday in 2021 amid a continuing clamour for substantial tax reform. Introduced in July 2000, the GST was based on the value-added tax (VAT) model, as part of a broader package of taxation reform.

It replaced the Wholesale Sales Tax (WST), first introduced in 1930, as well as a range of inefficient state taxes, in conjunction with reforms to federal financial relations.

According to the Commonwealth Department of Treasury's History of Australian Taxation, revenue from the GST is paid to the states and territories, providing them with a stable and growing source of revenue and removing their reliance on general assistance grants from the federal government.

Yet as the GST moved solidly into its 22nd year, there are plenty of calls for its reform. Unfortunately, successive governments, tax policy experts and industry bodies suggest GST reform is not the most pressing issue. Put bluntly, Australia's whole taxation system needs reform.

Commenting on the GST in his October 2021 paper on the Australian Future Tax System (AFTS), Paul Tilley said of the Coalition Government's 2015 *Time to Re:Think Our Tax System* white paper barely mentioned the GST. In fact, the paper found the "GST's invoice-based design makes it operationally complex, so some simplifications were proposed, such as allowing GST-free business-to-business transactions".

A visiting Fellow at the Tax and Transfer Policy Institute at ANU's Crawford School of Public Policy, Tilley outlines in the AFTS that the "lack of comprehensiveness of the GST's base made it less efficient than it could be and recommended that, over time, a broad-based cash flow tax could replace remaining inefficient consumption taxes and payroll tax".

"Australia's GST rate is significantly below the OECD average, and its coverage is slightly below. The proportion of total consumption covered by GST has decreased from a peak of 56% in 2005–06 to 47% by 2012, as the relative prices of exempt categories, mainly health and education, have increased," Tilley wrote in the paper.

"Because incomes are taxed heavily, and savings lightly, it means young workers subsidise the old, who disproportionality own capital," he said.

The main conclusion to be drawn from Tilley's paper is the whole taxation system needs to change and fiddling around the edges looking at GST reform is probably not the answer.

Bearing this in mind, the pandemic and its aftershocks do present an enormous opportunity to really examine the whole structure of Australian taxation as Professor Robert Breunig from Crawford School's Tax and Transfer Policy Institute, pointed out last year "the system needs to change, and now presents a perfect opportunity".

Professor Breunig said a national taxation summit could clearly and publicly map out the costs of not undertaking reform as well as suggest a realistic reform path.

"Our political leaders can take this crisis and move us together towards a fairer and better Australia," Professor Breunig said.

# The background for reform globally

Back in October 2021, at the G20 Finance Ministers and Central Bank Governors meeting in Italy before the COP26 Summit in Glasgow, attendees acknowledged the COVID-19 pandemic had precipitated a sharp decline in economic activity that is without precedent in recent history.

In just a few months, the COVID-19 pandemic turned from a health crisis into a global economic crisis causing a much larger contraction in global GDP than the global financial crisis in 2008, reaching nearly 10% in the first half of 2020 and an estimated 3.4% overall in 2020.

In a report to attendees, the OECD Secretary-General stated "swift and sustained policy actions have supported the health and economic recovery with global GDP now returning to pre-pandemic levels".

"The policy response to the COVID-19 crisis has involved considerable fiscal support for businesses and households, which has prevented even greater declines in employment, income and output."

As part of the Secretary-General's report[1] to the finance minister it was recommended all nations needed to revisit the design of their tax systems.

The report stated that while "improving the design of individual taxes is important, it is not sufficient on its own, as a 'tax systems' approach is needed to develop a coherent tax system that promotes inclusive and sustainable growth".

The report found that at the same time, the crisis has exacerbated some existing inequalities and hit many vulnerable households hardest.

"In this context, raising taxes on labour and consumption, as was done in the wake of the 2008 global financial crisis, might be less desirable from an equity and growth perspective and very difficult politically.

"Thus, the current crisis is prompting reflection on the need to turn to new or under-utilised sources of revenue. Taxes on personal capital income and property are among the taxes that governments are reconsidering given their potentially significant role in reducing inequality and their currently limited role in most countries' tax mixes."

# Local calls for reform

Crawford School's Professor Breunig has asked whether "our leaders (will) take this once-in-a-generation's chance while they have it?"

Interestingly, we've been here before. Back in 2008-2009 during the Global Financial Crisis the then federal Labor government spent an enormous amount on stimulus which increased public debt levels markedly. At the time, there were a number of calls for major tax reform as tax revenues dropped and cuts to government expenditure were ruled out as being potentially ruinous to economic confidence.

In the wake of the GFC, a paper from the Crawford School's Tax and Transfer Policy Institute by Matthias Sinning and Syed Hasan titled *GST Reform in Australia: Implications of Estimating Price Elasticities of Demand for Food*[2] argued for GST tax reform.

In the paper they outline that both major parties in Australia have made a case for increasing the rate of the GST to 15%, and an increase (without broadening the tax base) would increase tax revenues by about $29.4 billion[3] according to a 2015 study.

The same study finds that broadening the base (without changing the rate) to cover health, education and water/sewerage would yield $11.5 billion, while including currently exempted food categories would raise another $7.1 billion.

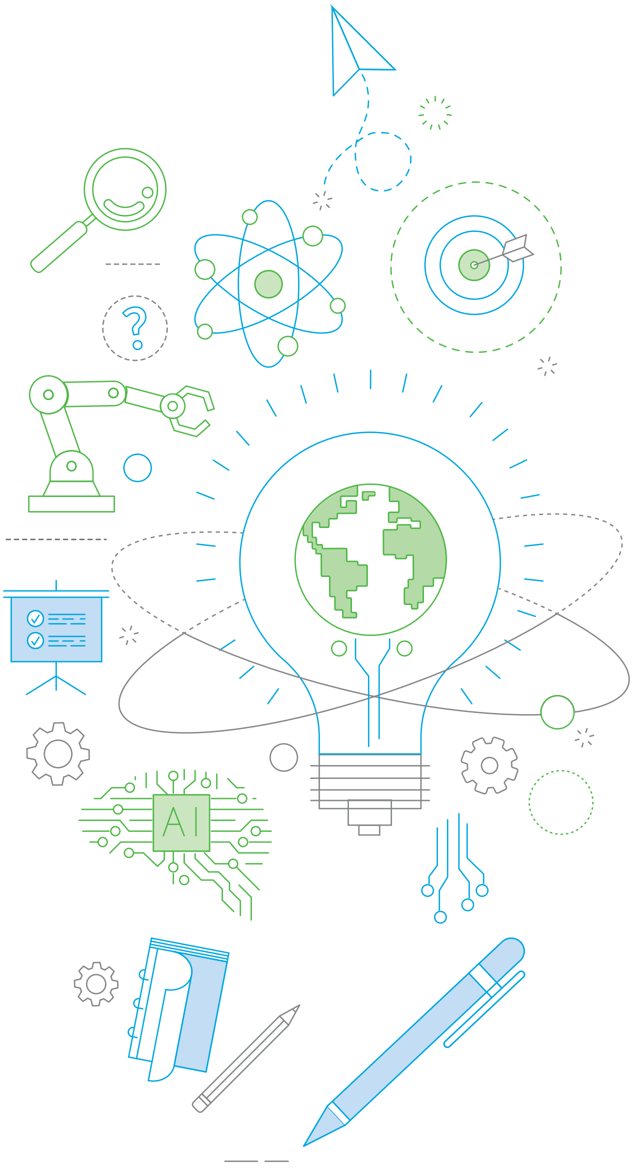
Yet despite the great potential of GST reform to mitigate fiscal pressures, outlined by Sinning and Hasan, governments have remained reluctant to make changes to the GST because of its regressive nature and negative public attitudes towards tax increases.

As RSM Partner Sam Mohammad who leads the firm's national indirect tax practice said, "the issue with GST reform, unlike say income tax or state taxes, is we have much more of a political element in the way of getting any GST reform through".

"All of the big picture stuff around GST reform has probably already been said over the last 20 years. The reason why it's just been said is because it's actually very hard to do. That's the critical issue we have with GST – you need the unanimous support of all of the states and the federal government to get anything through," Mohammad said.

With this general federal government reticence to GST reform, it doesn't look likely despite there being models around the world which seem to be working.

Mohammad accepts that one of the challenges is that GST is a regressive tax rather than a progressive one, such as income tax. That is, GST is regressive in the sense that it impacts those within the lower socioeconomic demographic, because they pay a higher proportion of their salary and their income on taxable activities. However, the focus on GST impacting those on lower salaries or on welfare ignores the other side of the equation, which is the transfer system. By raising more revenue, Mohammad suggests that there is a greater pool of revenue that can be used to compensate, or even over-compensate, those on within the lower socioeconomic demographic but still generate significant additional net GST revenue.



# Broadening the base, reducing inequality

So, what does potential GST reform look like. The big challenge is trying to ensure no one is worse off post-reform.

Sinning and Hasan suggest there is considerable scope for broadening the tax base and increasing the rate, "even if the bottom 40% of the households were compensated for the loss in consumption associated with a GST reform."

"Our analysis reveals that imposing a GST rate of 15% on all food categories would raise up to $7.9 billion, while up to $2.2 billion would be required to compensate low-income households."

They argue we could broaden the base to include selected (unhealthy and environmentally unfriendly) food categories and increase the GST rate to 15%, and which would generate revenues of about $3.7 billion and require $1.0 billion to compensate low-income households.

For Sinning and Hasan, these numbers illustrate that a reform of the GST on food in combination with compensation of low-income households would reduce fiscal pressures considerably while addressing issues related to the regressive nature of the tax.

They conclude the most efficient form of a GST includes all goods and services, similar to the "best practice" GST regime in New Zealand which covers practically all goods and services. Estimates suggest New Zealand's GST regime applies to over 95% of all consumption, compared to half that in Australia.

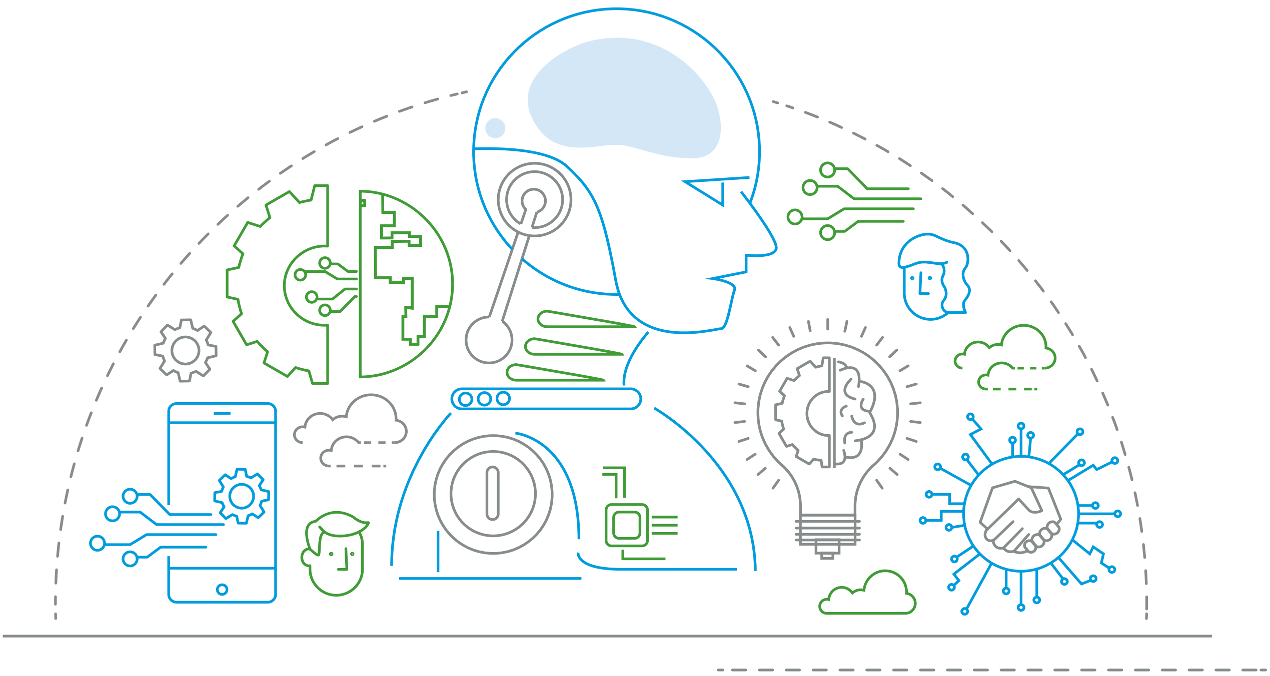
"Such a tax does not affect relative prices of goods and services and is therefore the least distortionary. It appears likely that broadening the GST to all food categories would also mitigate tax compliance cost by eliminating administrative ambiguity.

"Because compensation payments can be used to make the distribution of the tax burden fair, a broad-based GST can contribute to improving the Australian tax system by fulfilling the main criteria of a good tax system – equity, efficiency and simplicity," Hinning and Hasan said.

RSM's Mohammad agrees broadening the base and adding GST to all food, health, or education would be sensible but it does adversely impact lower socio-economic groups.

Again, he agrees the only way to mitigate against people being negatively impacted by GST reform is to compensate them by "raising the pension, or it might be to give income tax relief".

"Essentially, we tax more, but we're also going to have to give some of it back to those that are negatively impacted. So, that's not usually part of the discussion. Everyone's just focused on the one side without having a look at the other side of the equation," Mohammad says.



# Too much complexity

While a broader based tax and compensation to low-income households might bring in more tax revenue and help mitigate against the effects of a rise in the GST rate, broad-based GST reform is not something that would be welcomed by Australian business as a whole.

For example, the Chief Executive of the Council of Small Business Australia (COSBOA), Alexi Boyd, said "leave GST alone".

"It will impact small businesses through the compliance burden and COSBOA has always been about better regulation."

Boyd warned against foisting more compliance and regulations on small business because "even slight changes" have a massive impact on the administration burden small businesses have to bear.

According to Boyd, changing the rate might sound like a small thing for the small business owner but it's a massive shift involving change across business.

More pointedly, Boyd said we're not digitised to the point yet where it's a one-step process.

"There are just so many burdens on small business and reforming GST seems to be the shiny thing that's easy to talk about and reflect on but for our members, it's a big jump."

Boyd said small business just wants better regulatory reform and a cut to red tape rather than GST reform which could be ruinous for many in the sector.

If there was to be reform, COSBOA suggest changing the threshold as a starting point by potentially raising the amount where business has to start charging GST from $75,000 to $150,000 for example. For Boyd, this would be a change that takes away some compliance burden rather than adding more.

Another reason to not rush into GST reform before other changes, from COSBOA's perspective, is that it potentially stifles innovation.

Boyd says small business relies really heavily on the software market to adapt and change, but having technology companies more worried about updating programs for changes in tax law, stifles innovation.

"Every change software companies have to make means they're focusing on government regulation instead of focusing on the next best product for their customers, the small business owners. So instead of innovating, they're stuck in this rut of dealing with compliance that is always changing. The burden is pushed down the chain to small business."

# Inside the GST basket

For RSM, GST reform is one of the debates that's continually put straight into the too-hard basket. No one really wants it politically but, it's a no-brainer if it's part of wide-ranging tax reform.

The problem is most Australians switch off when they hear about tax reform.

For Mohammad, one obvious area to include in a broader base is private education for example. To the OECD's point on the global rise in inequality, GST on private education does make some sense as people in lower socio-economic groups are not "sending their kids to $25,000-a-year private schools".

"The people who are putting them there are the people who can pay the extra $2000 a year to put their kids through private school," he said.

As for imposing GST on fresh food, it makes sense from a revenue perspective and from a potential compensation perspective.

For example, someone who's on a fixed income, a pension, or a low income, might buy $10 worth of fruit when they go to the shops, while higher income groups might spend $50 on fruit and vegetables.

The point is someone on a low income will pay a $1 in GST and the person on the higher income would pay $5.

When it comes to compensation, the person on a lower income could get their GST component back plus a little of the extra $5 (around $1) collected from the higher income individual.

So rather than a low income person paying $11 for their basket of fruit including GST, they would be compensated so they're only paying $9.

There would be income tax cuts as well but by broadening the base as well as slightly increasing the GST rate, the above example "might get people to really understand that actually raising GST is not a bad thing".

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