The Case for Specific Exemptions from the Goods and Services Tax: What should we do about Food, Health and Housing?

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‘Of all the preposterous assumptions of humanity over humanity, nothing exceeds most of the criticisms made on the habits of the poor by the well-housed, well-warmed and well fed.’

Herman Melville

Introduction

In 1975 the Taxation Review Committee argued in what is generally referred to as the Asprey Report, that in a complex society where there is a high level of government spending it is necessary to raise revenue through a variety of taxes, as no one form of tax can hope to raise sufficient revenue in the most appropriate manner for all purposes.1 This Report along with other reports and researchers also stated that the key criteria to evaluate a taxation system are equity, simplicity and efficiency.2 Unfortunately, as Hill argues ‘these criteria are often, and probably always, incompatible with each other’.3

This article examines the Australian goods and services tax (GST) which was introduced in 1999\(^4\) in the context of three ‘exemptions’ from GST, the supply of basic food, healthcare and the supply of residential housing, both rented and sold. It examines the arguments for these exemptions on the basis of equity and also considers other arguments in their favour including health considerations relating to unhealthy eating and the public perception that imposing tax on basic food, health and homes is unjust and unfair.

The article commences with a background discussion of the different major forms of taxation that combine to make up our tax system. It then moves onto a discussion of tax policy and the policy rationales for GST exemptions for food, healthcare and housing. It canvasses some arguments against the exemption and finishes with concluding thoughts on the exemptions.

**Australia’s tax mix**

Before we commence our discussion of the consumption tax that exists in Australia it is necessary to briefly consider Australia’s tax mix. Australia has a large number of taxes however only four are significant in terms of the amount of revenue collected. These are income tax (including company tax), the GST, excise duties and pay-roll tax.\(^5\) Personal income tax counts for nearly 40% of revenue and the GST for 13%\(^6\).

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\(^4\) *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

\(^5\) In 2014 the taxes that generated the most revenue were individual income tax at $170 billion or 39.3% of all revenue collected in Australia, income tax on enterprises at $77 billion or 17.7% of all revenue, GST at $55.5 billion or 12.8% of all revenue, and excise taxes at $26.4 billion or 6.1% of all revenue. Payroll tax generated $21 billion or 4.9% of all taxes, see John Freebairn and Helen Hodgson, ‘FactCheck: how much of Australia’s tax is collected by states and territories?’ 12 November 2015 The Conversation [https://theconversation.com/factcheck-how-much-of-australias-tax-is-collected-by-states-and-territories-50457](https://theconversation.com/factcheck-how-much-of-australias-tax-is-collected-by-states-and-territories-50457); Commonwealth of Australia, ‘Australia’s Future Tax System, Report to the Treasurer: Part One Overview’ (2010); Commonwealth of Australia, ‘Australia’s Future Tax System, Report to the Treasurer: Part Two Detailed Analysis’ (2010).

In 2011-2012 most individual taxpayers had taxable incomes below $80,000 per annum. This table demonstrates which taxable income brackets paid which amounts of income tax.\(^7\)

**Table 1 * to be updated**

<table>
<thead>
<tr>
<th>Taxable income band</th>
<th>Percentage of individual taxpayers</th>
<th>Percentage Net Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$16,000 or &lt;</td>
<td>18.3</td>
<td>0</td>
</tr>
<tr>
<td>$16,001-$37,000</td>
<td>27.3</td>
<td>3.7</td>
</tr>
<tr>
<td>$37,001-$80,000</td>
<td>37.6</td>
<td>32.8</td>
</tr>
<tr>
<td>$80,001-$180,000</td>
<td>14.5</td>
<td>37.4</td>
</tr>
<tr>
<td>$180,000 and &gt;</td>
<td>2.3</td>
<td>26.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.00</td>
<td>100.00</td>
</tr>
</tbody>
</table>

The income tax system is therefore progressive in that the highest income earners pay the greatest percentage of their income in net income tax, although the above data indicates that it is those around the middle and slightly higher income levels that pay the most, 32.8% and 37.4% respectively.

Although the GST does not account for the largest amount of revenue collected by the Australian tax system, at 13% of overall tax it is a significant amount. Furthermore, it collects the second largest amount of overall revenue.\(^8\)

**Principles of tax policy: Equity**

It is a core principle of social justice that people in similar circumstances be treated (ie taxed) in a similar way and those that are in different circumstances are taxed differently. This policy is referred to as fairness or equity, with horizontal equity the principle of fairness between those in the same circumstances and vertical equity the principle that applies to those

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that are in differing circumstances.\(^9\) The vertical equity principle means that those who have a greater ability to pay, pay the most amount of tax and those with lesser capacity pay less. It confirms the rationale that those who are in a better position to pay should pay a greater share. Both aspects of the equity principle have been adopted in all major Australian reviews of taxation law\(^{10}\) and are said to reflect the concept that tax is a sacrifice and that its imposition should be guided by a taxpayer’s ability to pay.\(^{11}\) It is also important from a tax administration perspective that there is community acceptance of a tax system and fulfilling the criteria of horizontal and vertical equity help to ensure that this acceptance occurs.\(^{12}\)

Consumption taxes are taxes on the supply of a broad range of goods and services that are consumed by everyday taxpayers.\(^{13}\) All OECD countries except the United States have adopted consumption taxes.\(^{14}\) A consumption tax is a tax on final consumption that in practice is levied on all goods and services supplied by businesses for consideration.\(^{15}\) In its purest form is also allows these businesses to claim back any consumption taxes incurred in the making of these taxable supplies.\(^{16}\) However, consumption taxes are widely regarded as failing the tax policy principle of horizontal equity as they usually apply flat rates to consumption of goods and services which means that persons on lower incomes pay, as a

\(^{9}\) Asprey Report [3.7].


\(^{11}\) Asprey Report [3-7].

\(^{12}\) Review of Business Taxation, A Tax System Redesigned (1999) 105 (Ralph Report), ‘Equity or fairness is a basic criterion for community acceptance of the tax system ... There is widespread support for ... horizontal equity. It is also accepted that taxation should be based on vertical equity’.

\(^{13}\) Rita de la Feria and Herman van Kesteren, 'Introduction to This Special Issue-VAT Exemptions: Consequences and Design Alternatives (2011) International VAT Monitor 300.


\(^{15}\) Rita de la Feria and Herman van Kesteren, 'Introduction to This Special Issue-VAT Exemptions: Consequences and Design Alternatives (2011) International VAT Monitor 300, 300.

\(^{16}\) Rita de la Feria and Herman van Kesteren, 'Introduction to This Special Issue-VAT Exemptions: Consequences and Design Alternatives (2011) International VAT Monitor 300, 300.
percentage of their overall income, a greater share of this tax. This begs the question of what should be done to redress the regressive nature of consumption taxes, bearing in mind that these taxes are often part of the price of essential goods and services for everyday consumers.

When discussing the term exemption in the context of consumption taxes we first need to define what an exemption is. The term exemption in the GST context is usually said to refer to supplies that do not bear GST but which are also ineligible for the supplier to claim back the GST that went into the supply. In other words, the supplier cannot claim the input tax credits.\(^\text{17}\) In Australia the legislation refers to these supplies as input taxed.\(^\text{18}\) However, other researchers also use the term exemption when discussing supplies that in Australia are referred to as GST-free.\(^\text{19}\) This is because these supplies, although eligible for the claiming back of relevant GST from the revenue authorities are charged at the rate of zero percent. In many countries they are therefore referred to as zero rated.\(^\text{20}\)

Consumption taxes, exemptions and food

Australia is one of only five countries belonging to the Organisation for Economic Co-operation and Development (OECD) that applies a zero rate to specific food items. The other countries are Canada, Mexico, Ireland, and the United Kingdom. The majority of European countries do however apply reduced rates to various food items or exempt them from GST (or value added tax (VAT) as it is called in many countries) as input tax supplies.\(^\text{21}\)

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\(^\text{18}\) \textit{A New Tax System (Goods and Services Tax) Act 1999} (Cth) (GST Act) s 9-30(2).


The equity issue of taxing food at a flat rate occurs because of the greater proportional cost of food to the income of low income earners as opposed to high income earners. Given the necessity of food expenditure, this ensures that a GST without an exemption for food is considered highly regressive.  

There are different ways to address the regressive nature of a consumption tax. The most common method is to either exempt certain goods and services (generally those that are considered ‘necessities’) or tax them at a lower rate than other ‘luxury’ goods and services. Alternatively, a tax credit method could be used, whereby lower income taxpayers are reimbursed ‘for the tax paid on a minimal or essential level of consumption’. A further solution would be to provide low income families with a direct payment. Carlson and Patrick argue that taxing certain items at a lower or zero rate is ‘probably the most frequently used method of alleviating the regressivity of a consumption tax’.

The interaction between low income earners and consumption taxes has been the subject of a large number of research reports and other publications. A 2007 study looked at the average European Union consumption shares for household groups divided into quintiles (quintiles are from the lowest income to the highest income numbered from 1 to 5). It showed that consumption patterns are rather similar for most sectors, except for food and utilities like electricity and heating. For those sectors, low-income consumption was on average almost

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twice (1.83 and 1.71) the corresponding high income consumption. The researchers therefore concluded that retaining reduced VAT rates on food would benefit high income households, but be much more beneficial for low-income households because they spend a significantly larger share of their income on food.26

In Australia, food is a significant proportion of the cost of living for all households. The table below extracted from an Australian Bureau of Statistics survey for 2015-2016, shows that, after housing costs, people in the lowest net worth quintile spend the largest proportion of their household income on food and non-alcoholic beverages. People in the highest quintile actually spend most on food, but this is only slightly more than they spend on recreation, with transport and housing costs their third and fourth highest areas of expenditure.27

27 The terms quintile, decile and percentile are used. If a distribution, such as household income, is put in order from lowest to highest, and then divided into 100 equal groups, each group is a percentile. Ten percentiles make up a decile (ten equal groups) and twenty percentiles make up a quintile, Australian Bureau of Statistics, 6530.0 - Household Expenditure Survey, Australia: Summary of Results, 2015-16 http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6530.0Explanatory%20Notes12015-16?OpenDocument
This is a shift from 1993-1994 when low income earners in Australia spent five times as much of their income on food as people in the highest income quintile.29

Like Australia, Canada applies a zero rate on basic food and like most other OECD countries, general consumption taxes (federal and provincial) account for an increasingly large share of total tax revenue and social security contributions.30 The Canadian Government has followed the view that, whereas general consumption taxes should be applied as broadly as possible, they are regressive because they have a greater effect on individuals with low incomes. The policy is that lower income individuals spend or consume a greater share of their income than

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do people with higher incomes. This regressive effect of a GST is therefore somewhat mitigated in Canada by the zero rating of basic foods.\textsuperscript{31}

Like Australia and Canada, Ireland gains a significant proportion of its revenue from its VAT.\textsuperscript{32} The Irish standard VAT rate is 23.0\%, which is above the OECD average of 19.2\%.\textsuperscript{33} In Ireland basic food and drink that is of a kind used for human consumption is zero rated.\textsuperscript{34} This rate applies to such items as fruit, vegetables and milk but not alcoholic beverages or confectionary.\textsuperscript{35} Ireland also applies reduced VAT rates of 4.8\%, 9\% and 13.5\% to a number of goods and services.\textsuperscript{36}

A study using the 2004/2005 Household Budget Survey conducted by researchers at Trinity College Dublin found that Irish households in the lowest equivalised income decile paid about 16\% of their disposable income in VAT. The richest households on the other hand paid only about 6\%. The worst off were those in the lowest income decile and the authors concluded that the then VAT system in Ireland was highly regressive.\textsuperscript{37} The study also concluded that increasing the VAT would increase the regressive effect of the tax, particularly on those persons on the lowest income decile, rural households, single adult households with children and households with 6 or more people.\textsuperscript{38} The Irish government

\textsuperscript{32} OECD, OECD Consumption Tax Trends 2016-Ireland, \url{https://www.oecd.org/tax/consumption/consumption-tax-trends-ireland.pdf}.
\textsuperscript{33} OECD, OECD Consumption Tax Trends 2016-Ireland, \url{https://www.oecd.org/tax/consumption/consumption-tax-trends-ireland.pdf}.
\textsuperscript{34} Irish Tax and Customs, Revenue, Zero Rate of VAT, 2 August 2018 \url{https://www.revenue.ie/en/vat/vat-rates/what-are-vat-rates/zero-rate-of-value-added-aax-vat.aspx}.
\textsuperscript{35} Value-Added Tax Consolidation Act 2010 (Ireland) sch 2, part 2.
\textsuperscript{36} OECD, OECD Consumption Tax Trends 2016-Ireland, \url{https://www.oecd.org/tax/consumption/consumption-tax-trends-ireland.pdf}.
\textsuperscript{38} Eimear Leahy, Sean Lyons and Richard SJ Tol, ‘The Distributional Effects of Value Added Tax in Ireland’ (2011) 42(2) The Economic and Social Review 213.
ignored this research and increased the highest rate of VAT although maintaining the zero rating for basic foods and beverages.\(^\text{39}\)

The standard rate of GST in Mexico is 16\%.\(^\text{40}\) The supply of non-industrialized animals and vegetables and certain specific food products, patent medicines and fertilizers are among the supplies that are zero rated.\(^\text{41}\) The original policy behind zero rating basic food was similar to other countries in that the GST was considered to impact more harshly on low income households.\(^\text{42}\) However Cotis’ research into the Mexican economy suggests that ‘zero-rating of basic staples, such as food and medicine, is a very inefficient way of using taxes for redistribution. People at higher income levels are actually compensated more in absolute terms than low-income people. They are being heavily subsidised by the non-taxation of food in particular’.\(^\text{43}\) Dalsgaard agrees with this.\(^\text{44}\) But a contrary argument is that there are many micro businesses in Mexico that may operate outside the tax system and as many low income consumers purchase food from these suppliers they would not pay GST on food even if it was taxable.\(^\text{45}\)

\(^\text{43}\) Jean Philippe Cotis, ‘What are the OECD’s views about the Mexican Tax Reforms’ 14-15 October 2003, 4.
The top rate of VAT in the United Kingdom is 20% however most foods and children’s clothes are zero rated.\footnote{United Kingdom, VAT, VAT Rates \url{https://www.gov.uk/vat-rates}.} This policy is based in history as the UK had a VAT prior to joining the European Union and was allowed to continue with zero rating anything that was zero rated at that time.\footnote{EU Sixth Council Directive (77/388/EEC) of 17 May 1977.} As Rita de la Feria states ‘The decisions were based on evidence available in 1972…In order to keep the zero rates, the UK basically had to stop in time’.\footnote{Camila Ruz and Maisie Smith-Walters, BBC News Online, 28 October 2015, ‘The mysterious world of zero-rates of VAT’ \url{https://www.bbc.com/news/magazine-34649495}.} The policy in 1972 was that of protection of lower income households and anything that was considered healthy such as basic food and beverages was zero rated and luxury goods, such as biscuits were not.\footnote{Camila Ruz and Maisie Smith-Walters, BBC News Online, 28 October 2015, ‘The mysterious world of zero-rates of VAT’ \url{https://www.bbc.com/news/magazine-34649495}.}

A 2018 OECD report found that reduced VAT for basic food ‘provide in general greater support to the poor than the rich as a proportion of household income or expenditure’.\footnote{OECD, ‘Consumption Tax Trends 2018: VAT/GST and Excise Rates Trends and Policy Issues’ 2018, 47.} However, despite this progressive effect, the report argues that reduced VAT rates are a very poor distributive tool. Indeed, better-off households tend to benefit more in absolute terms from VAT reduced rates. This is because their consumption of the tax-favoured goods and services is generally greater than that of poorer households as they tend to consume greater quantities and more expensive products than poorer households.\footnote{OECD, ‘Consumption Tax Trends 2018: VAT/GST and Excise Rates Trends and Policy Issues’ 2018, 47.}

Some believe that the impact of a consumption tax should be assessed over the lifetime of an individual and not on an annual basis. In theory, annual income is low when an individual is young, because that individual is still in school or is just starting employment. It should peak in middle age and then start decreasing in old age because of a loss of efficiency or...
retirement. Analysing the impact of VAT on the basis of annual income thus presents a more regressive result for the young and old, whereas the same analysis carried out over a lifetime’s income might lead to a different conclusion.\(^{52}\) This analysis assumes, however, that all individuals have the same life expectancy and earn on average the same income. The salary of a lower qualified person may not reach a peak at middle life.\(^{53}\) Furthermore, it does not take into account that even in developed countries women face a gender pay gap that is not reduced despite years of working.\(^{54}\)

**The exemption for food and low income households in developing nations**

Although there is not a substantial amount of research into the issue of developing nations and the impact of VAT/GST exemptions on their low income households, there is some emerging research. For example, Peru has a VAT/GST equivalent, although basic food is zero rated.\(^{55}\) A 2013 study found that indirect taxes such as VAT/GST have a significant effect on incomes across the wealth distribution. However, their effects are higher among those with higher incomes. This is likely to be a result of high informality levels, as richer households usually buy from formal establishments, while poorer households are more likely

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to buy products in informal conditions, such as from street vendors or in informal markets, thus not paying any VAT/GST.\textsuperscript{56}

An earlier study by Younger and others\textsuperscript{57} in Madagascar suggests that most taxes in that country are progressive, meaning that wealthy households pay proportionately more of these taxes relative to their expenditures than do poor households. Younger and Sahn\textsuperscript{58} reached the same qualitative conclusion for Côte d'Ivoire, Guinea, and Tanzania. These studies indicate that the consumption taxes in these countries are progressive as they impact more on the wealthier households. But this result cannot be assumed for all developing countries. A study in Bangladesh, found that while zero rating food would greatly mitigate the adverse impact of replacing the pre-existing indirect tax regime by a VAT/GST, it would not eliminate it.\textsuperscript{59} A South African study\textsuperscript{60} found that poor South African households spend around 61\% of their income on food as opposed to high-income households which spend 15\%. In this context Charlet and Owens argue that ‘the poor would suffer more from a VAT on food’.\textsuperscript{61}

\textbf{Health and zero rating of food}

There is emerging research about the implications of a rise in the price of fruits and vegetables for the Australian diet and consequently health. Estimates of the price elasticity of demand for fruits and vegetables in the United States conclude that the removal of zero rating

\textsuperscript{61} Alain Charlet and Jeffrey Owens, ‘An International Perspective on VAT’ (2010) 59 (12) Tax Notes International 943, 950.
of 10% in Australia would mean that fruit consumption would decline by 4.9% and vegetable consumption by 4.8%. Veerman and Cobiac argue that reduction in fruit and vegetable consumption is associated with an increase in the incidence of ischaemic heart disease (IHD), ischaemic stroke, and cancer of the lung, oesophagus, stomach and colon, leading to increased prevalence and mortality in later years. They calculate that adding GST to fruits and vegetables could cost about 100,000 healthy life-years over the lifetime of the 2003 Australian adult population, due to an additional 90,000 cases of IHD, stroke and cancer. This extra disease burden could add a billion dollars in health care costs over the same period.

This suggests that abolishing the GST exemption for fruits and vegetables could have a large detrimental impact on health and health care budgets. Although it should be pointed out that the removal of all zero rating would result in complex shifts in diet that have not been rigorously studied.

**Reducing VAT on food and increasing employment**

In 1999 the European Union allowed member states to set a reduced VAT rate for no more than three years on a limited number of items that are labour intensive services. These were home renovations, small repair services such as shoe repairs, home cleaning, domestic care services and hairdressing. The policy rationale was that this would stimulate employment in these areas. It would also reintegrate small businesses into the tax system which had drifted

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out of it. However, a subsequent review of the impact of the VAT reduction demonstrated that the reduced rate had very little, if any, impact on prices or job creation. The review concluded that a reduction in VAT rates ‘would therefore seem to be a waste of budget resources which could be deployed more usefully elsewhere’.

A 2007 study by Copenhagen Economics raises some theoretical elements in favour of reduced consumption tax rates impacting positively on employment rates provided that specific circumstances are met. The report argues that reduced VAT rates applied in carefully targeted sectors may increase employment of low-skilled local workers. Where there are many low-skilled workers and high levels of unemployment, for example in food retail, hospitality and food production, reducing the VAT on food can lead to an increase in demand for this labour force. But, the report concluded that the increase was very slight.

**Self-supply and underground activities**

Taxing of some services that are often provided by microbusinesses and which can be alternatively provided by consumers such as house cleaning or haircuts may be sensitive to the imposition of a consumption tax. Piggott and Whalley argue that taxation at the full tax rate may actually encourage self-supply of these services thereby reducing employment and not raising the expected revenue. This argument could also apply to the production of basic foods, a proportion of which could be grown at home.

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68 Ibid.

If some supplies are added to the consumption tax base, such as small scale construction, which are difficult to tax when provided by small scale suppliers, Piggott and Whalley also argue that one effect is to stimulate underground or outside market activities which avoid the tax.\textsuperscript{70} Again, this argument is also applicable to purchasing fruit and vegetables from local markets as these businesses are usually family owned and run and difficult to capture in the tax base.

**The political importance of zero rating food**

Apart from the reasons discussed above it is also likely that food is zero rated in Australia, Canada, Ireland, Mexico and the United Kingdom because the potential political cost of increasing the consumption tax on food would be too high.\textsuperscript{71} In Australia, food was considered one of the most essential GST-free categories in terms of equity by some groups, with the Australian Democrats refusing to support the GST legislation until the Liberal National Coalition agreed to its GST-free or zero rated status.\textsuperscript{72} Several years before Australia introduced a GST, the Australian Council of Social Service (ACOSS), business groups and other peak bodies had met to discuss tax reform.\textsuperscript{73} They had agreed in principle to the introduction of a broad based consumption tax that would replace the existing wholesale sales tax and many of the existing State taxes, such as Financial Institutions Duty, Debits Tax, Payroll Tax and Franchise Taxes. Throughout the conference ‘emphasis was placed on...


the need to protect those on social security and those on low wages from any adverse changes’.  

**GST and healthcare**

Traditionally, the concept of healthcare as a public good has afforded it special treatment in terms of consumption tax. This is the basis for exempting (input taxed) basic medical services from VAT in the European Union.75

Specific services by healthcare professionals such as doctors, dentists, optometrists and others, together with hospital services in Australia are GST-free.76 When the GST was proposed by the Liberal-National party coalition led by Prime Minister Howard it had always been the government’s policy that specific health care services would not be subject to the GST. In the policy document ‘Not a New Tax: A New Tax System Report’ (ANTS) it was visualised that these services would be those attracting a Medicare benefit.77 The ANTS proposal did not rely on merit as its argument for GST-free status of health care services. Instead, the rationale for the GST-free status of healthcare was competitive neutrality of the public and private sectors.78 The proposal argued that in view of the fact that many public healthcare services were provided free or at small cost ‘applying taxes to healthcare would place the private health sector with its heavier reliance on direct fees at a competitive disadvantage with the public health system’.79 This policy proposal was originally raised in 1991, when a previous conservative coalition, then in opposition noted that it was not

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76 GST Act subdiv 38B.


possible to apply GST to the public health system as no direct charge was made for its services.\(^{80}\) It pointed out that although private services could be included in the tax base, ‘to do so would be highly arbitrary and discriminatory’.\(^{81}\)

Before being legislated in 1999 the proposal for a GST in Australia had been examined by the Tax Consultative Committee (the Vos Committee).\(^{82}\) The Committee’s terms of reference required it to limit discrimination between private and public provision of goods and services in the GST-free areas, health being one of these areas.\(^{83}\) This Committee confirmed that the policy underpinning the recommendation that healthcare services were GST-free was maintenance of competitive neutrality.\(^{84}\) Similar arguments have been effective in respect of European countries exempting health from consumption tax.\(^{85}\)

**GST and residential housing**

Australia’s average net wealth per household is $936,000, of which 39% is held in the main home, 20% in superannuation, 19% in shares and other financial assets, 12% in investment real estate, and 10% in other non-financial assets such as cars.\(^{86}\) The family home is therefore a significant asset to the majority of Australians.

If we return to Graph 1, which sets out the proportion of weekly household spending on goods and services, by low, middle and high wealth households we see that the lowest income households spend 30% of their income on housing as opposed to high income

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\(^{85}\) Liam Ebrill et al, *The Modern VAT* (International Monetary Fund, 2001) 93, 94.

households who spend around 13-14% of their income on housing. Housing is the fourth highest area on which high income households spend their money.

**Residential premises**

Technically real property is a 'good' within the GST/VAT regime that is consumed by customers through purchase of, licence or rental. The GST Act defines real property as including any interest in or right over land; a personal right to call for or be granted any interest in or right over land; or a licence to occupy land or any other contractual right exercisable over or in relation to land. Therefore if we consider GST on residential premises from a legal perspective, the supply of real property should be taxed and characterised as a taxable supply with creditable acquisitions (for both business and private use) and there should be some form of consumption tax on the rental value. If the consumption of residential premises were taxed in the normal way then this would result in a large compliance burden. Every home owner and tenant would need to register and GST would need to be imposed each year on the value of annual consumption of the owner-provided assets.

Australia, like many other countries does not do this. Instead the supply of residential premises (either sale or lease) in Australia will generally be input taxed (exempt) unless it is a newly constructed property or commercial residential premises.

The policy rationale is to tax the value of housing consumption in a manner that equates the treatment of those who rent their dwellings with owner-occupiers. Owner occupiers, when

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87 GST Act s 195-1.
89 GST Act s 40-65.
selling their residences would not be subject to the GST as they would not be selling their house in the course of carrying on an enterprise, but essentially selling their home.\textsuperscript{91} The effect, from a tax perspective is that they are making an input taxed supply. No GST is charged on the sale and no input tax credits can be claimed. To realise this policy objective, residential premises are only input taxed to the extent that they are actually used to provide accommodation outside the course of business, and then only to the point that accommodation is comparable with home ownership. To the extent that business-related activity is associated with either the use or supply of premises, housing supplies are taxable to enable both the commercial supplier and user of premises to claim a tax credit in respect of supply-related acquisitions and hence ensure their immunity to the tax.\textsuperscript{92}

As Ebrill states:

Owner-occupied housing is problematic, however, because this involves final consumption on which one would like the tax to “stick.” While attempts have been made in the past to impute value to services enjoyed from owner-occupation for the purposes of income tax, the experience has not been a success and is now rarely made. Thus services enjoyed from owner occupation are—with no exception that we know of—exempt from VAT. To avoid distorting the choice between house ownership and renting, the commercial leasing of residential property is commonly also exempt.\textsuperscript{93}

\textsuperscript{90} Explanatory Memorandum, A New Tax System (Goods and Services Tax) Bill 1998 (Cth) 5-164.
\textsuperscript{91} The GST Act s 9-5(b) states that a taxable supply must be made in the course of carrying on an enterprise; See Wei Cui, ‘Learning to Keep the consumption Tax Base Broad: Australian and Chinese VAT Design for the Housing Sector’ in Christine Peacock (ed) \textit{GST in Australia Looking Forward from the First Decade} (Thomson Reuters, 2011) 367, 370; M Evans ‘The Value Added Tax Treatment of Real Property – An Antipodean Context’ in Chris Evans and David White (eds) \textit{GST in Retrospect and Prospect} (Thomson Reuters, 2007) 255-257.
\textsuperscript{93} Liam Ebrill et al, \textit{The Modern VAT} (International Monetary Fund, 2001) 98.
Housing services are also widely exempt from consumption tax on the basis of regressivity.\textsuperscript{94} This is particularly relevant when comparing owner occupation and renting as those on lower incomes are more likely to rent and therefore be disadvantaged by increases in the cost of renting through the imposition of an indirect tax.\textsuperscript{95}

A final argument for exempting residential premises from a consumption tax is that home ownership is viewed in many jurisdictions as an important policy objective which is actually encouraged through various taxation incentives.\textsuperscript{96} Australia has enacted a suite of tax concessions over the years that encourage home ownership. These include the First Home Owners Grant, First Home Saver Accounts Scheme\textsuperscript{97} and negative gearing, which is the ability to deduct expenses relating to renting residential premises from a taxpayer’s other income and which has encouraged investment in second and third properties.\textsuperscript{98} Other significant tax concessions are the capital gains and land tax exemptions on owner-occupied housing and the 50 per cent capital gains tax discount available to individuals who sell residential property that is not their home.\textsuperscript{99} Although some of these concessions are actually counter to equity arguments, for example, it is not low income earners that take advantage of negative gearing.\textsuperscript{100}

\textsuperscript{94} Liam Ebrill et al, \textit{The Modern VAT} (International Monetary Fund, 2001) 99.
\textsuperscript{95} See generally Judy A Kraatz, Johanna Mitchell, Annie Matan and Peter Newman, ‘Rethinking Social Housing: Efficient, Effective & Equitable, Progress Report 1’ (Sustainable Built Environment National Research Centre, 2015).
\textsuperscript{97} The Senate, Select Committee on Housing Affordability in Australia, ‘A good house is hard to find: Housing affordability in Australia’ June 2008, 4.
\textsuperscript{98} The Senate, Select Committee on Housing Affordability in Australia, ‘A good house is hard to find: Housing affordability in Australia’ June 2008, 2.
\textsuperscript{99} The Senate, Select Committee on Housing Affordability in Australia, ‘A good house is hard to find: Housing affordability in Australia’ June 2008, 2.
\textsuperscript{100} Cameron Murray, ‘Game of Homes: How the vested interests lie about negative gearing’ The Conversation, 11 March 2019. Murray comments that the occupations most likely to negatively gear are surgeons and anaesthetists.
Arguments against exempting food, healthcare and housing from the GST

Although the objective of this paper is to justify specific exemptions from the GST, like all arguments, there are always counter arguments. Exemptions from the tax base significantly reduce the amount of revenue that can be collected by the government and then used to provide public goods and services. In fact, a review of the Australian 2017 Tax Expenditures Statement reveals that out of all the GST-free categories, food has the largest monetary impact. It was estimated in 2013-14 that making food GST-free cost the revenue $6200 million which will increase to $7900 million in 2020-21.

Furthermore, any exemption provision, no matter how well drafted can also lead to ambiguity at the margins and increase complexity and therefore implementation costs. An example of the complexity of the legislation when referring to zero rated supplies is the exceptions and exclusions that surround the supply of food. In Australia the supply of basic foods and beverages such as fruit (including grapes), vegetables, milk and water are GST-free or zero rated which at first glance seems an easy object to achieve. However, the difficulties around foodstuffs, how they are delivered to the consumer and whether or not they are heated prior to sale has become so complex that the Australian Taxation Office (ATO) has had to publish a comprehensive list that extends for many pages listing different types of foods and beverages and whether or not they are taxable or GST-free. An example of the complex and unusual operation of the GST is the supply of wine grapes that are used to make wine. Are grapes food and therefore GST-free or one of the ingredients of an alcoholic beverage

101 Asprey Report [27.20].
104 GST Act ss 9-30 and 38-2.
105 ATO, Detailed Food List, Details of the GST status of major food and beverage product lines (17 January 2018).
which is a taxable supply? This issue so concerned the wine industry that its representations to the Australian Taxation Office have successfully resulted in the categorisation of wine grapes as GST-free.\textsuperscript{106} As Peter Hill comments in relation to exemptions ‘…one of the results is that Australia is experiencing, once again, costly arguments over the indirect taxation status of things such as dietary supplements and frozen yoghurt’.\textsuperscript{107}

There are a number of exceptions and provisos that relate to the GST exemption for residential premises. For example, in Australia the supply of new residential premises is a taxable supply.\textsuperscript{108} These exemptions have led to complexity in the GST system which has meant that it is difficult to administer.\textsuperscript{109} The complexities created by exempt treatment suggest that officials and politicians should aim for a simple GST system if they wish to reduce compliance costs both from a revenue perspective and a business perspective. Peacock argues that this is necessary in developing countries where embryo tax administrations may struggle to administer a more complex system.\textsuperscript{110}

Furthermore, the exemptions for residential premises and all the exceptions and carve outs in this area such as the imposition of GST on ‘new residential premises’ and the making of residential premises in retirement villages provided by charities GST-free\textsuperscript{111} are far more


\textsuperscript{108} GST Act s 40-65(2)(b).

\textsuperscript{109} Christine Peacock, ‘Why simple GST treatment of real property is important’ (2010) 13(4) Tax Specialist 216, 222.

\textsuperscript{110} Christine Peacock, ‘Why simple GST treatment of real property is important’ (2010) 13(4) Tax Specialist 216, 222.

\textsuperscript{111} GST Act s 38-260.
complex than would appear on a first reading of the legislation. As Evans and Wolfers have separately argued, a significant problem occurs because the legislation on GST and real property vacillates between a legal or juristic concept of real property and the physical characteristics of property. Issues around statutory interpretation in this area have been at the core of several court cases.

Exemptions allow inroads into the legislation that tempt advisors to push the boundaries and make the exemptions wider. Exemptions can also lead to increased litigation costs, which add to the administrative costs of businesses and the revenue. This is demonstrated by the significant number of cases that have been referred by national courts to the European Union Court regarding interpretation of exemptions. In Australia, issues regarding the GST on real property and residential premises have been the subject of the largest number of court and contractual disputes, ATO rulings, legislative changes and tax avoidance behaviours although this could also be because large sums of money are usually at stake. Furthermore, exemptions are often the subject of aggressive tax planning which some might argue is also a cost to the revenue and which is not productive.

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Conclusion

This article has demonstrated that there are strong arguments on the basis of equity for lower consumption taxes on basic food and beverages, housing and health. Although such lower rates may also benefit the wealthier households, it is clear that low income households suffer when there is tax on food, due to the necessity to consume this item. Healthcare and housing exemptions similarly assist low income earners and it is arguable that, as they are already disadvantaged, increasing consumption tax on essential and merit goods would impact on these households to a disproportionate degree.

Countering these arguments is the complexity of exemptions which leads to high compliance costs and the possibility of exploitation of loopholes and additional litigation.

However, at least in Australia, it appears that these exemptions are now, after 20 years, reasonably settled and that a combination of ATO rulings and guidelines and advice and publications from tax specialists means that the boundaries of these exemptions are now reasonably well defined.

In conclusion, it seems unlikely that the voting public would consider removing the exemptions for food, healthcare and housing as these items are considered essential by them to maintain a reasonable standard of living in Australia.