WHY ANY CHANGE TO THE GST WILL UNFAIRLY IMPACT ON LOW-INCOME HOUSEHOLDS

Scott Morrison has said numerous times that the Government is having a dialogue with the Australian public about tax reform. Malcolm Turnbull has said numerous times that he wants a tax system that is fairer and less complicated.

However, there is a dearth of discussion with the real Australian public: with households, individuals, tax payers, welfare recipients and self-funded retirees. In particular, there is no discussion about how much they will be out of pocket if there are any GST changes and what compensation they will receive, if any.

At the same time, information available to the general public indicates that any GST change will be far from fair and will result in a far more complicated tax system.

As members of the general public, and given the problems in being able to trust our politicians, we should look at the worst case scenario: the New Zealand GST model, introduced there in 1986 and which at 15% covers close to 100% of their expenditure on goods and services.

The Australian GST, introduced in 2000, is set at 10% on only 47% of expenditure on goods and services.

Moving to the ‘full GST model’ like New Zealand’s, means15% GST on practically everything defined as a good or service. This means (a) increasing the GST from 10% to 15% on items that are currently taxed and (b) broadening the base and putting 15% on the 50% of expenditure not currently taxed.

In particular, all fresh food, health and education, and some household services will have 15% applied: a private health insurance premium of $4,000 would cost $4,600 (up by $600), a kilogram of salmon currently at $40 a kilo would cost $46, a dozen free-range eggs at $5 will cost $5.75, an $80 visit to the physio will cost $92. Items currently taxed will go up by around 5%: a $100 dinner out will become $105, a $4 meat pie becomes $4.20, a $900 TV becomes $945, your $2,000 electricity expenses become $2,100, and so on.

If this ‘full GST model’ is introduced, it is clear that:

- Consumer prices in general will rise by around 10%. Thus, the cost of living will go up on average by around 10%. People’s living standard will have to fall by around 10% if they receive no compensation.
- People on low incomes cannot be properly compensated without creating another welfare class or without making the tax system far more complicated than it currently is.
- People who are not on welfare and not in the tax system, in particular, self-funded retirees and those on part pensions, will not receive fair compensation, if any at all.
- Where the Government used to collect $4,000 from a household’s purchases, they will now collect $12,000 from the same household.
- A 15% increase in the cost of fresh food, (including fish, meat, fruit and vegetables) will exacerbate this country’s ever worsening obesity and diabetes problem putting even greater strain on the health care system, when state premiers are arguing it is under too much stress already!
- We see tax evasion/avoidance/minimisation on an extraordinary scale, yet a higher GST will add to this ‘corruption’ because there will be more incentive to avoid it.
- Instead of changing the GST, and making the tax and welfare systems even more ludicrously complicated, the same net revenue effect as a ‘15% GST on everything’ can be obtained by simply altering the marginal tax rates of those on high taxable incomes ($80,000 or above).

All this can be explained or inferred by examining cash flow effects for the typical household or individual.

Cash outflows – The cost of living will go up by 10%

As explained above, under the full model, those 47% of items currently subject to GST will go from 10% to 15%, approximately a 5% increase in the retail prices of those items. The other 50% of items that are currently GST free will go from 0% to 15%.

Thus, it is easy to estimate that if this ‘full’ model goes ahead consumer prices in general will rise by around 10%.

The impact of the full model on your household budget for goods and services can be illustrated as follows. (Mortgage payments are not classified as a good or service but there is evidence that financial institutions increase mortgage charges as much or more than any GST rise. Rents might also go up due to GST flow-ons.)

- If your current expenditure is around $1,000 on goods and services per month or $12,000 per annum, expect the need to find an extra $100 a month, or $1,200 a year. Or expect to reduce the ‘volume’ of goods and services you consume by around 10%. Your GST contributions to the government will go from $600 per annum to $1,800.
- If your current expenditure is around $4,000 per month or $48,000 per annum, expect the need to find an extra $400 a month, or $4,800 a year. Or drop your living standards by 10%. Your GST contributions to the government will go from $2,400 per annum to $7,200.
- If your current expenditure is around $80,000 per annum, expect the need to find an extra $8,000 a year, or to reduce your consumption or switch to cheaper products. Your GST contributions to the government will go from $4,000 per annum to $12,000.
- In particular, expect to be able to find an extra 15% to maintain your current consumption of fresh food, health and education. Or be willing to move to cheaper, unhealthy processed food ….
- And that is for every year for the rest of your life! Or until the GST goes up again!

Cash inflows – Why compensation to households will not be fair

Those politicians pushing for a GST increase have insisted on compensation for those on low incomes. Commentators have put $80,000 or less as the definition of ‘low income’. To be fully compensated those households will need to receive back 10% of the value of their expenditure on goods and services. Otherwise, with no more in their pockets, they will only be able to buy about 90% of the purchases that they normally made.

However, full and fair compensation for all these households will be impossible, or at least not possible without creating another welfare class or without making the tax system even more complex. This means that many, if not most, of these households will be worse off and (a) have to reduce their living standards by consuming less or by moving to cheaper, inferior, products or (b) have to dig into their savings (or take on other work) to maintain their current living standards.

To illustrate, consider households in three broad categories: those in the welfare system, those in the taxation system and those outside the welfare and tax system.

Welfare recipients are the easiest to compensate as it would seem easy enough to increase welfare payouts for those on full benefits. But how would those on partial benefits, for example, a part pension, be compensated?

Those in the tax system will be difficult to compensate. At first thought one would assume that those in the tax system and on low incomes (below $80,000) could be compensated by lower taxes or by rebates. But this only seems possible through ludicrous changes to the tax-free threshold and to marginal tax rates and by introducing a new class of citizens receiving ‘welfare’ handouts. Thus,

- Consider someone with an income on the tax-free threshold income of $18,200 and who currently spends it all on consumer goods and services. Under the ‘full GST model’, their taxable income stays at $18,200 but their cost of living goes up by 10% to $20,020. They need compensation of $1,820. There is no marginal income tax rate to alter and raising the tax-free threshold doesn’t help them either. They would have to go into the welfare system or be compensated via lump sum payouts. But will these payouts be continued forever by fickle governments?
- Someone who works a full week on the minimum hourly wage with few if any tax deductions, will earn around $35,000 per year. At a marginal tax rate of $0.19 they are paying about $3,200 in income tax. If there is an average GST increase of 10% and no change in wages, if they spend all their income on consumer goods and services their cost of living would rise from $35,000 to $38,500, an increase of $3,500. Thus, even if the tax-free threshold were moved to $35,000, meaning they would pay no tax, they would still be worse off by a few hundred dollars. Do they, and those on lower incomes, join the welfare system or receive government handouts too?
- By raising the tax-free threshold to around $38,000, those on that taxable income would be fully compensated through the tax system. Their cost of living would go up by around $3,800 yet they currently pay tax of around that amount.
- Someone on a taxable income of $50,000 who spends it all on consumer goods and services would find their cost of living, but not their income, goes up by $5,000 to $55,000. If the tax-free threshold was set at $38,000 the marginal tax rate from there to $50,000 would need to be $0.10, not the current $0.325, for full compensation. They would then pay $5,000 less tax which would offset their $5,000 cost of living increase.
- Taxable income of $80,000 is a convenient figure to use as the marginal tax rate increases above that (from $0.325 to $0.37). With a 10% average price rise, someone on that taxable income would find their cost of living (assuming they spent their whole income on goods and services) would increase by $8,000. If the tax-free threshold were set at $38,000 the marginal tax rate from there to $80,000 would need to be $0.19 (not the current $0.325) for full compensation. They would then pay $8,000 less tax which would offset their $8,000 cost of living increase.

These calculations, show how ludicrous the tax system could get: the tax-free income threshold more than doubling, and marginal tax rates dropping substantially from $0.19 to $0.00 and from $0.325 to $0.10 or from $0.325 to $0.19.

Those outside the welfare and the tax system may be impossible to compensate. Self-funded retirees form a large group but there may be others. Does the government even know how to identify people outside the welfare or tax system? Will their cost of living go up by 10% with no prospect of compensation in any form? A retired couple with $60,000 expenditure per annum will need $6,000 extra. Did the Government offer a one-off lump sum in 2000 when the GST came in? A one-off lump sum of $6,000 is callous compensation for a retired couple who could reasonably expect to live another 30 years or more: it could <u>effectively wipe $200,000 or more off their current superannuation balances</u>.

Is there a better option than a GST change?

Assuming the Government is committed to compensation for (some or all) low income households and individuals under a GST change, under the full 15% model, most of the money collected will be returned as compensation.

One indication given by commentators and economic think tanks is that 30% would go back to welfare recipients and 30% to those on taxable incomes up to $80,000. Compensating self-funded retirees and others independent of the welfare and tax system will be very difficult if not impossible – 0% compensation has been mentioned. Assume another 10% of the GST collection will be required to administer a far more complex tax and compensation system, employing thousands more public servants foisting more red-tape complexities on the public.

That leaves 30% of revenue left after complicated changes to the GST and tax system. This 30% will be paid by those on high taxable incomes (over $80,000) through the 10% increase in prices via the 'full GST model'.

However, instead of using the GST to raise revenue from high income earners, <u>exactly the same effect</u> can be obtained by increasing their 'effective marginal tax rates'. Currently, from $80,001 to $180,000 the marginal tax rate is $0.37, over $180,000 it is $0.45. The required 'effective marginal tax' is not simply a 10% increase on $0.37 or $0.45; new marginal rates can be determined so that the effect would be exactly the same as them paying 10% extra on average on their purchases.

This change would be simple to implement. There would be no need to change the GST or change the tax system for low income workers or change welfare arrangements. There would be no impact on the black market, no 'new poor' by people missing out on compensation or being forced back into the workforce. It would be far more efficient and cost effective for the Federal Government to run, and would leave no low or fixed income people worse off and at the same time the Government would collect the same amount of net revenue!

And for state governments which claim a major argument for an increase in the GST is to fund state government health budgets, it does not make sense to have a 15% increase in the cost of fresh fruit and vegetables, seafood, etc. in a country with a growing obesity and diabetes problem! Non-fresh foods – the highly processed ones - will go up by only 5%. Even despite compensation, we would expect many, if not most, consumers to turn from fresh produce to consume even more processed foods than they do now because they will be relatively cheaper!

For a Government which says it is loath to increase taxes, under the full model there will be a 200% increase in the GST tax rate. On the face of it, increasing the GST from 10% to 15% on current items might appear as just a 5% increase in the tax rate. However, a change from 10% to 15% on current items is in fact a 50% increase in the tax rate. And a 15% tax on non-current items is in effect a brand new tax. Combined, if the full model is implemented at 15%, using broad figures and assumptions, the total GST collected by the Government will in fact be around 200% higher: where the Government used to collect $4,000 from a household's purchases, they will now collect $12,000 from the same household.

There may well be flaws in all the analysis given above, but based on what has been put in front of the public, it seems that Australians would find that consumer prices will increase on average by about 10% under the 'full' model. There are severe doubts about any compensation system for low income earners being fair, with the possibility that some could be significantly worse off. The tax system would become far more complex, rather than simpler. The system itself is inefficient and might eat up 70% of GST collections.

Some commentators doubt that a full 15% GST model will be agreed to – it is the most extreme model put forward. If not, then a partial GST model might well be debated, for example, 12.5% on everything. But the above arguments will still apply and we need to ask, is any GST change fair or necessary and can the objectives be achieved in other ways?

If any GST change is to go ahead, the following questions need to be answered:

- On what and how much?
- How will welfare recipients be compensated?
- How will those on low taxable incomes be compensated?
- What will be the new tax-free threshold?
- What will be the new marginal tax rates?
- Will those independent of the welfare and tax system, self-funded retirees in particular, receive any compensation and, if so, how and how much?
- Does the government hope to maximise net-GST intakes by deliberately under-compensating or not compensating at all many of those on low incomes?
- What proportion of the new GST collections with be returned as compensation and how much will it cost to run the new system?
- How will the black market be tackled given the greater incentive to avoid the GST?
- How will the diabetes and obesity problem be tackled if people are forced onto less healthy diets?

Some will just hone in on the flaws in the analysis given above. But wouldn't it be refreshing to also correct the flaws and give us the full and true story!

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References and notes:

1. https://www.ato.gov.au/Business/GST/
2. Here 'cost of living' and 'living standards' are used as very general terms to refer to the cost of day-to-day purchases of 'goods and services' as defined in Ref. 1 above. Mortgage costs are not in that definition. Thus, in working out how much one spends on 'goods and services' certain expenses should be excluded. One obvious item that is outside the Australian GST is overseas travel and should be excluded from calculations too. (Note though, that with the state of the Australian dollar the cost of international travel has gone up as well and with loss of disposable income under a higher GST, Australians may be more inclined to stay in Australia.)
3. http://www.abc.net.au/news/2015-11-02/gst-hike-would-raise-130b-modelling-shows/6903782
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