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We can afford fair GST reform

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Key findings

The current goods and services tax (GST) system includes exemptions enjoyed by all, including high income earners, who benefit more than low income earners in dollar terms. The Organisation for Economic Co-operation and Development has found that blanket GST exemptions are a 'very poor tool' for targeting support for low income households.

Compensation is both less expensive and can be directed to those who need it. PwC analysis shows compensating the bottom three household income quintiles, which comprise two-thirds of all households, would cost approximately **40 to 50 per cent** of revenue generated from the GST changes assessed.

Turn this around, it means that after compensation for the bottom three quintiles, **50 to 60 per cent** of the additional revenue remains. For example:

- Broadening GST to food, health and education would raise an additional $12.2 billion in 2015-16 terms – Compensation would cost **$5.2 billion** (42 per cent of revenue generated), leaving **$7.1 billion in net revenue**.
- Raising the GST rate to 15 per cent but leaving the base unchanged would raise $30.2 billion in 2015-16 terms – Compensation would cost **$12.0 billion** (40 per cent of revenue generated), leaving **$18.2 billion in net revenue**.

Table 1 presents estimates of revenue raised under each reform option, presented in 2015-16 terms. Where relevant, our estimate of total revenue generated (without compensation) is contrasted against the findings from the Australian Council of Social Services (ACOSS) / National Centre of Social and Economic Modelling (NATSEM), published 5 November. As Table 1 shows, the findings are comparable.

Table 1 Scenarios modelled and revenue raised by each option in 2015-16 terms ($ billions)

2015-16 terms ($ billions)	Broaden to food	Broaden to food health and education	Base unchanged, raise rate to 12.5%	Base unchanged, raise rate to 15.0%	Broaden to food health and education, raise rate to 12.5%	Broaden to food health and education, raise rate to 15.0%
Quintile						
Lowest	1.1	1.6	1.6	3.3	3.6	5.7
Second	1.0	1.5	1.8	3.7	3.7	5.9
Third	1.2	2.0	2.5	5.0	5.1	8.1
Fourth	1.5	2.7	3.4	6.8	6.8	10.8
Highest	2.1	4.4	5.7	11.4	11.2	18.0
Total estimate (PwC)	**6.9**	**12.2**	**15.1**	**30.2**	**30.4**	**48.5**
ACOSS/NATSEM Estimate	7.1	17.6*	18.6*	29.4	n/a	n/a

2015-16 terms ($ billions)	Broaden to food	Broaden to food health and education	Base unchanged, raise rate to 12.5%	Base unchanged, raise rate to 15.0%	Broaden to food health and education, raise rate to 12.5%	Broaden to food health and education, raise rate to 15.0%
		*includes community services	*raise rate to 13%			
Annual compensation required for neutral impact on bottom three quintiles	3.3	5.2	6.0	12.0	12.4	19.7
Revenue remaining after compensation	3.6	7.1	9.1	18.2	18.0	28.8
Revenue used for compensation	48.3%	42.2%	39.6%	39.6%	40.9%	40.6%

Source: PwC analysis

What does this look like for households?

Table 2 considers how these estimates translate to households by quintile.

Table 2 Impacts of GST changes by quintile, $ impact on households per annum in 2015-16 terms

2015-16 terms ($ annual)	Broaden to food	Broaden in food health and education	Base unchanged, raise rate to 12.5%	Base unchanged, raise rate to 15.0%	Broaden to food health and education, raise rate to 12.5%	Broaden to food health and education, raise rate to 15.0%
Quintile						
Lowest	470	706	712	1,424	1,596	2,484
Second	602	868	1,063	2,125	2,148	3,428
Third	747	1,240	1,522	3,043	3,072	4,903
Fourth	876	1,563	1,959	3,917	3,913	6,262
Highest	1,095	2,318	3,028	6,056	5,924	9,531
Average household (PwC)	**747**	**1,319**	**1,625**	**3,249**	**3,273**	**5,228**
ACOSS/NATSEM Estimate	n/a	n/a	2,012*	3,179	n/a	n/a
			*raise rate to 13%			

Source: PwC analysis

To draw a direct contrast with the ACOSS/NATSEM findings, Table 3 presents our estimates of GST paid by an average household in each quintile.

We do not have the calculations which lie behind the ACOSS/NATSEM estimates, but our base GST estimates are comparable, with estimates for the overall average household within a 2 per cent margin.

Table 3 Comparison of current household GST outlays by quintile estimates

2015-16 terms ($ annual)	PwC	ACOSS/NATSEM
Lowest	2,847	3,576
Second	4,251	4,217
Third	6,087	6,296
Fourth	7,835	7,551
Highest	12,111	10,154
Average household	**6,499**	**6,358**

Source: PwC analysis

Both PwC and ACOSS/NATSEM estimates are derived from Australian Bureau of Statistics (ABS) data and use equivalised household disposable income. As the latest ABS data available on this measure is from 2013-14, some margin of difference is likely to occur when adjusting for inflation and population growth. We drew on wage growth and population growth to adjust.

As ABS household expenditure and income data is only available for a limited number of years and is based on a small sample, we then augmented this data with 2012-13 Australian Taxation Office (ATO) Taxation Statistic data, which provides a much larger record of tax collections, to ensure that bottom-up estimates based of tax collections per household sum to total tax collections reported in the Commonwealth Budget 2015-16.

PwC's analysis shows that compensating both low and middle income earners for the price impact of GST changes is both affordable and feasible

The revenue generated by a change in GST can sufficiently compensate lower income earners – even to the extent of full compensation for households earning up to $100k per annum. Indeed, we could afford to over compensate the lowest income earners.

This is because high income earners benefit more, in dollar terms, from GST exemptions than middle and low income earners. The additional money from high income earners (over and above compensation) can be devoted to income tax cuts or government services.

What is important is understanding these impacts and then making informed choices to compensate low and middle income earners.

Compensation has always been a staple of Australian public policy. Our tax and transfer system is set up to manage compensation and precedents exist – similar programs were put in place when the GST was introduced and when the carbon tax was introduced. ACOSS welcomed the compensation arrangements which accompanied the carbon tax.

A criticism of compensation is that it might be clawed back by cash-strapped governments in the future. This goes to the question of trust, which cannot be dismissed. Any compensation strategy must address this concern, which might require legislative or other protections to be put in place.

In response to this same issue the Prime Minister stated: *"It is pretty obvious that if you want to increase the GST without any compensation, without any other arrangements, households on lower incomes would be disadvantaged. That is why it is never done. That is why it was not done in the past. That is why it is inconceivable."*

The debate so far has focussed on the unfairness of possible changes to the GST. But it has ignored the benefits that high income earners enjoy from GST exemptions. Compensation is targeted to protect those in need, whereas universal access to exemptions is both wasteful and unfair. Australia has a highly targeted tax and transfer system (meaning that those who are better off do not qualify for taxpayer funded benefits).

This is not reflected in the design of the GST and fairness of the tax and transfer system should not be judged on the basis of a single proposed tax change.

This is a point that has been made forcefully by the OECD in its 2014 Economic Survey of Australia.

> *"A recent OECD study on the distributional effects of consumption taxes underscores that [GST exemptions] are a very poor tool for targeting support for low-income households. "At best, high-income households receive as much benefit from a reduced rate as those on low incomes, and at worst they benefit vastly more than poor households, as their consumption of tax-favoured goods and services is greater than that of low income households."*[1]

As PwC has argued in a recent publication, both the fairness and efficiency of the tax system can be improved if its two key building blocks – the GST and our personal tax system – are focussed on their respective strengths.

The only effective way to achieve fairness is through the personal income tax system, which directly targets individuals' capacity to pay. The GST, which taxes spending regardless of who is doing it, should never be focussed in this manner. [2]

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1 OECD, 2014, *Economic Survey of Australia*, page 64

2 PwC, 2015, *The GST and personal income tax reform: the yin and yang of tax policy*.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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