

## **4.4 GOODS AND SERVICES TAX (GST)**

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### **Introduction**

This chapter provides information on the framework that the Government is using to ensure general government sector agencies will be GST compliant by 1 July 2000. The chapter also discusses some of the main implications of tax reform for the ACT's financial position, and outlines in broad detail how the GST will affect the operations of the government.

While it is too early to determine the final effects, the introduction of the GST is destined to have significant implications for the business of government. Many areas of government will need to start taking account of the tax implications of their operations for the first time. Preparation for the GST has required a concerted effort by all Government agencies in order to fully understand the tax treatment of each of their transactions, both within government, and with the private and not-for-profit sectors.

### **Overview**

The broad base of the GST means that Government operations will be subject to the GST. However, the Government, like all registered businesses, will receive a refund from the Australian Taxation Office (ATO) of any GST paid on inputs. Government agencies are therefore in a similar position to businesses, in that GST paid by government on its purchases will need to be properly accounted for, in order to ensure a full refund from the ATO.

### **General Principles Underlying National Tax Reform**

In late June 1999 the States and Territories signed the Revised Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, known as the IGA. The original IGA had been agreed by Heads of Government at the 1999 Premiers' Conference, but was subsequently amended to accommodate the wishes of the Australian Democrats. The major implications of the IGA will be the introduction of a 10% goods and services tax (GST) on 1 July 2000 and the abolition of wholesale sales tax (WST) and a number of State and Territory own-source taxes.

All of the GST revenue will be passed on to the States and Territories, replacing Financial Assistance Grants as the major component of Commonwealth grants. The IGA makes this conditional on the States and Territories fulfilling a number of obligations, primarily abolishing a number of own source taxes and establishing a new First Home Owners Scheme.

The GST will be collected and administered by the Australian Taxation Office (ATO). The cost of the administration will be divided between the jurisdictions on a per capita basis. States and Territories will enter into a formal contract agreement with the ATO, and in

accordance with the guidelines set out in the IGA, this allows for an outcome based contract and oversight by the Ministerial Council.

These matters and their effect on Commonwealth/ACT financial relations is discussed in more detail in Chapter 6.2 titled *Developments in Commonwealth/State Financial Relations*.

## **Operation of the GST**

The GST will be levied at a rate of 10% on most purchases of goods and services. A purchaser will pay an additional 10% on top of the cost of a good or service. The provider of the good or service must remit this 10%, or 1/11th of the total sale price, to the Australian Taxation Office (ATO) on a monthly or quarterly basis. The provider should reduce the amount of this payment to the ATO by the total of any GST they paid when purchasing their inputs. This is known as an 'input tax credit'.

The concept of input tax credits ensures that the effective incidence of the GST falls entirely on the final consumer. Any GST paid by intermediaries in the supply chain is refunded. This is an important difference from WST, where no refunds are available at intermediate steps. This causes a WST cascade through the supply chain, and often results in taxes being levied at several points.

There are two types of exemptions to the general rate of 10%. They are items that are 'input taxed' and items that are 'GST free'. Input taxed items do not have an additional 10% added to the final purchase price, but the provider is not entitled to claim input tax credits, and hence will seek to recoup the costs of GST paid on inputs through an increase in the sale price. This treatment is appropriate where it is difficult to calculate how much additional value has been added by the final provider, and has been adopted for financial services and housing.

GST free items also do not have an additional 10% added to the final purchase price, but the provider is entitled to input tax credits, and hence there is no increase in the final sale price. This treatment has been adopted for food and some health and education services.

## **Major Issues Affecting the Operations of ACT Agencies**

### *Government liability for GST*

All government operations will be subject to GST. However, due to constitutional limitations on taxing powers, each jurisdiction and the Commonwealth will undertake to pay the GST. Taxes and charges of a regulatory nature levied by all levels of government will be exempted from the GST through a Commonwealth Treasurer's Determination. Under the legislation the Commonwealth Treasurer can make determinations at any time allowing some flexibility to accommodate any new taxes and charging regimes introduced by governments.

Where the government provides a service in exchange for payment, this transaction is subject to GST, which will be collected by the government to remit to the ATO. Similarly, where the government makes a purchase, this will generally be subject to GST, which will be paid by the Government to the provider for remittance to the ATO. GST paid by the government in this manner will be refunded by the ATO as input tax credits, where the supplier is registered for GST. The ACT Government is encouraging all of its suppliers to register.

### *Government Grants to the Community Sector*

The Government is committed to minimising the impact of the GST on the community sector. The Commonwealth has adopted a very narrow definition for grants to community organisations. Any conditions on the grant, or any service received in exchange for the grant, will be seen as evidence that the grant is not in fact a grant, but consideration for services received. This results in the services being treated as a taxable supply, and hence the transaction would be subject to GST, assuming that the recipient is registered for GST.

The ACT uses a framework of service purchase payments rather than grants, under which the funding agreements explicitly identify the services to be provided. All service purchase payments to GST registered organisations are likely to be liable for the GST, which will be added to the payment. This GST will then be reclaimed as an input tax credit by the ACT, usually within one month. The community organisation, on the other hand, is likely to have use of the GST component of the payment for up to three months, before being required to remit it to the ATO.

The Government will make use of Recipient Created Tax Invoices (RCTIs). This mechanism removes the need for a community organisation, as the supplier of services, to supply the Government with a tax invoice. This will reduce the administrative burden for the community sector to comply with the GST.

### *Embedded Savings*

The introduction of the GST will be accompanied by the abolition of the existing WST system. Even though governments are exempt from WST on goods they purchase, this exemption only counts at the last point in the supply chain. WST paid on prior steps in the supply chain is 'embedded' in the final price. The abolition of WST will therefore create savings for governments, allowing the same services to be delivered at lower prices. The Australian Competition and Consumer Commission is charged with ensuring that price reductions are passed on through the supply chain to the final users of goods and services.

As discussed in Chapter 6.2: Developments in Commonwealth/State Financial Relations, the Commonwealth has estimated that the ACT will achieve \$8.5m of embedded savings in 2000-01, rising to \$10.1m in 2003-04. The ACT's modelling shows that achievable savings fall short of this amount by \$3.917m in the first year only. In subsequent years, sufficient savings have been identified to allow the ACT to meet the required savings targets. The

reason for the shortfall in the first year is that not all savings will be available immediately, as some will take time to flow through the supply chain, such as savings flowing from purchases of fixed assets. Since agencies' budgets will be adjusted to reflect achievable savings only, there will be a cost to the government of \$3.907m in 2000-01. This cost will be recouped through growth in GST revenue in future years.

### *Embedded Savings in the Community Sector*

Like all organisations that register for the GST, community organisations that register will generally see a reduction in the net price paid for inputs as a result of the abolition of WST. In contrast to businesses, which will be required to pass these embedded savings on to customers, the Government will not be pursuing the embedded savings in its dealings with the community sector.

Service Purchase Payments to the community sector will generally increase in line with forecast inflation, prior to having GST added where necessary. By allowing community organisations to retain their embedded savings the Government is effectively granting them a real increase in funding. The decision not to offset the usual inflation-based increase with a reduction to reflect embedded savings will cost the Government \$0.517m in the first year, rising to \$1.886m in 2003-04. This cost arises because the Commonwealth's estimate of \$8.5m embedded savings was calculated on the basis that the Government would pursue all embedded savings, including those in the community sector.

### *Embedded Savings in the Government Sector*

A significant difference between the embedded savings realised by the private sector and those realised by the general government sector is that savings realised by the private sector must be passed on to customers in the form of lower prices. As noted above and in Chapter 6.2: Developments in Commonwealth/State Financial Relations the Commonwealth Government has clawed back embedded savings in the government sector in the form of a reduction in funding to each State and Territory. As a result, the Government is unable to offset the usual inflation-linked increases in fees and charges with any savings resulting from the removal of embedded WST. Consequently, the Government will increase fees and charges for services provided by the GST tax rate of 10%, which is added to the CPI increase of 2.5% as part of the normal budget process.

### *GST on Government Fees and Charges*

Fees and charges for that a service is provided will be subject to GST. This includes fees for the use of such things as public land, marriage celebrant fees, connection fees and fees for attendance of police officers.

ACT Government taxes and charges which are of a regulatory nature will be exempted from the GST by determination under Division 81 of the GST legislation. These taxes and charges are detailed in the Commonwealth Treasurer's Determination "A New Tax System (Goods and Services Tax) (Exempt Taxes, Fees and Charges) Determination 2000. The list includes such taxes and charges as stamp duties, payroll tax, motor vehicle registration fees, registration board fees for dentists, nurses, doctors and like professionals and business registration fees.

Fines and penalties will not be subject to GST. As they do not constitute a taxable supply under the GST legislation.