

THE GST FOOD EXEMPTION

By Paul Kenny

This article evaluates the Goods and Services Tax ("GST") food exemption. It examines the policy rationale for exempting food and the design features of the exemption. The article finds that there are strong equity grounds for exempting food.

1. INTRODUCTION

The issue of exempting food in *A New Tax System (Goods and Services Tax) Act 1999* ("GSTA") provoked intense debate within the community where industry groups, professional bodies, the Business Coalition for Tax Reform¹ and the Federal Commissioner of Taxation² called for food to be taxed whilst religious groups and welfare bodies argued for its exemption. This article examines the policy rationale for exempting food and finds much support for its exemption on equity grounds. In fact, concessionary tax treatment of food is a world wide phenomena.³ The article then moves on to consider the relevant GST legislation and relevant sales tax case law as well as the Government's administrative responses. Although there will be teething problems and ongoing classification issues, the legal framework put in place is regarded as being sufficiently clear and workable.

2. THE RATIONALE FOR THE FOOD EXEMPTION

The exemption of food was crucial to the successful passage of the GST legislation through Parliament, being a prerequisite for the approval of the legislation by the Democrats who held the balance of power in the Senate. Examining the food exemption with regard to the traditional tax policy criteria of equity, economic efficiency and simplicity provides some stark tradeoffs. In particular, there are strong arguments for and against the exemption on equity and simplicity grounds. The Democrats viewed that it was highly inequitable to tax food,⁴ whilst the Government believed that such an exemption would impose heavy compliance costs on business.⁵

2.1 Equity

It is a core principle of social justice that people in similar circumstances be treated (ie

¹ M Grattan, "GST Exemption on Food a Nightmare" *Sydney Morning Herald* (28 January 1999) 1 quoting the Chairman of the Business Coalition for Tax Reform, Fergus Ryan, "excluding food from the GST would create a nightmare that would quickly become a laughing stock"; and Senate Select Committee, *First Stage of Senate Select Committee on A New Tax System* (18 February 1999) 17 available at [www.aph.gov.au/senate/committee/gst/report1/] citing evidence from the ACPA that excluding food "would be a bonanza for lawyers and I can say, for accountants ... If we want huge accounting GST practices all around Australia, please exempt food."

² M Carmody, "Preparing for Tax Reform and the New Millennium: Don't Draw a GST Line around Food" (1999) 2(4) *Tax Specialist* 170.

³ Senator Andrew Murray, *Senate Select Committee on A New Tax System Supplementary Report* available at [www.aph.gov.au/senate/committee/gst/report1/] noted that 23 out of 27 OECD countries either exempts or concessionally taxes food.

⁴ *Ibid* 18, "Food should be exempted from the GST because the equity case is compelling, the economic efficiency case of taxing food is neutral and the simplicity argument for taxing food is somewhat overstated and should always be sub-ordinate to the equity and efficiency principles."

⁵ Senate Select Committee, above n 1, 12. taxed) in a similar way.

taxed) in a similar way.⁶ In taxation policy, this principle known as horizontal equity has been readily adopted in all major Australian reviews of taxation law.⁷ The equity problem of taxing food at a flat rate occurs because of the greater proportional cost of food to income for low income earners as opposed to high income earners. Given the necessity of food expenditure, such a GST is highly regressive. The table below, extracted from an Australian Bureau of Statistics survey, shows that low income earners spend five times as much of their income on food as people in the highest income quintile.⁸

Also, lower income earners spend a greater proportion of their food expenditure on basic food rather than takeaway or restaurant food.⁹ Thus, it is further argued that any food exemption be limited to basic types of foods.

2.2 Simplicity

There is no doubt that the exemption of food from GST will add to complexity, imposing higher compliance costs on business and administration costs on the Government. It is also alleged that such an exemption will create definitional problems that would wreck havoc for business and the Australian Taxation Office. Food businesses will have to separately account for taxable and exempt food sales. Indeed, the New Zealand experience shows that businesses with GST exemptions have compliance costs 5% higher than businesses with fully taxable goods and services.¹⁰ The impact of these additional compliance costs may be quite severe for small business.¹¹

Although the United Kingdom has a wide exemption for its value added tax that includes

Regressivity of Taxing Food and Related Products: 1993-94						
	Gross Income Quintiles					
	1	2	3	4	5	Total
<i>Expenditure Relative to Income:</i>						
Food	30.3%	18.2%	12.8%	9.1%	6.1%	10.2%
Non-Alcoholic Beverages	2.2%	1.6%	1.4%	1.1%	0.8%	1.1%
Meals Out and Take-away	7.2%	4.7%	4.2%	3.9%	3.7%	4.1%

⁶ R Krever and N Brooks, *A Capital Gains Tax for New Zealand* (1990) 43.

⁷ 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"; Taxation Review Committee, *Full Report* (1975) paras 3.7-3.18 ("Asprey Report"); Reform of the Australian Taxation System, *Draft White Paper* (1985) 14.

⁸ Australian Bureau of Statistics, *Household Expenditure Survey: Detailed Expenditure Items Australia 1993-94*.

⁹ ATO Extract, "The New Tax System and GST Food Guide" 35(1) *Taxation in Australia* 49, 53: "Democrats' Taxation spokesperson, Senator Andrew Murray, said the exclusion of confectionery, cakes, takeaway and restaurant meals ensured that 69 per cent of the food consumed by low income families was GST-free. In contrast, only 51.5 per cent of the food consumed by high income families was exempted".

¹⁰ J Pope, "Food and the Compliance Costs of GST" (1999) 1(1) *Business Council of Australia Papers* 55 referring to C Sandford and J Hasseldine, "The Compliance Costs of Business Taxes in New Zealand" *Working Paper*, Institute of Policy Studies, Victoria University of Wellington, Wellington (1992) 70.

¹¹ N Warren, "Food: Staple of Life or Staple of the GSTT" *Working Paper*, ATAX, Faculty of Law, University of New South Wales (16 December 1998) 24.

exemptions for most foods, children's clothes and shoes, its compliance costs are lower¹² than New Zealand,¹³ a country with far fewer exemptions. Thus, other factors such as the design of the GST legislation, administrative responses and level of experience with the GST may be more influential on compliance costs than a slightly greater number of exemptions.¹⁴

The real issue is whether these costs are too onerous or are in fact manageable. Certainly, the use of computerised accounts and simplified accounting methods will help to defray such costs. Also, the GST regime will provide managerial benefits through better record keeping required for a GST and there will be cash flow benefits provided to business. It is very difficult to estimate what these extra costs will be for the Australian GST, but, as in other countries, these costs will fall over time as the community becomes familiar with the legislation. There is no evidence which shows that the exemption of food from GST would impose prohibitive costs.

2.3 Economic Efficiency

Economists generally consider that a tax will promote efficiency if it has a neutral effect on the economy, that is, it has minimal influence on decision making. From a GST perspective, a neutral tax imposes a single rate of tax that applies to all goods and services with no exemptions. Under a GST that exempts basic food, consumers can choose between "basic food" and other taxable (ie takeaway and

restaurant) food and, thus, will substitute one course of action for another. In this way, it is argued that demand and market prices will be unjustifiably distorted resulting in a loss of economic efficiency. However, the link between taxing or not taxing food to economic growth appears to be somewhat remote. Certainly, this was borne out by the economic modelling results provided to the Senate Committee inquiries into the GST and a New Tax System.¹⁵

2.4 Compensation Alternatives to Exempting Food

It is argued that food should be taxed and that equity concerns be addressed in other ways, such as compensation measures.¹⁶ However, what one Government promises, another or even the same Government can take away. This was the case with the introduction of New Zealand's GST in 1987. The New Zealand GST, which included food and accompanying compensation measures for low income earners were wiped out in the across-the-board welfare cuts in 1991.¹⁷

2.5 The Policy Compromise

It is evident that whether or not food is exempt from GST will have minimal impact on economic efficiency. Thus, a policy choice must be made between the equity and simplicity goals. In resolving such a conflict, the Review of Business Taxation took the view that the choice should be made on "the course which, on balance, delivers the best social outcome." Working out what

¹² Ibid 16, where Warren referred to a United Kingdom report on compliance costs of their Value Added Tax (which exempts food). It found that the total compliance costs for business of around 4.3% of revenue.

¹³ New Zealand (which taxes food) has significantly higher costs of compliance with an estimated cost of 7.3% of revenue in 1990/91, see Pope, above n 10, 53:

¹⁴ Ibid 53-55.

¹⁵ Senate Select Committee into the GST and a New Tax System, *Economic Modelling of the Tax Package* (1999) 12-13 available at [www.apg.gov.au/senate/committee]. The Senate Select Committee commissioned Peter Dixon and Chris Murphy to investigate the efficiency effects of exempting food from GST. Both Dixon and Murphy concluded that the exemption of food would have negligible long term effects on economic performance.

¹⁶ Senate Select Committee, above n 1, 19.

¹⁷ J Quiggin, "Equity and Efficiency Effects of Food Taxes" (5 May 1999) 7 (Submission to the Senate enquiry on the GST) available at [http://econ.jcu.edu.au/JCU:Submissions:FoodGST9812.html].

provides the best social outcome is obviously a highly contentious issue.¹⁸ Australia's recent major reports into tax reform appear to have elevated the goal of equity above simplicity.¹⁹ Thus, there exists considerable support for the food exemption. Having highlighted the policy tradeoffs, and given the Government's decision to exempt basic food, this article will focus on the relevant legislation and measures taken by the Government to reduce the associated compliance and administration costs.

3. THE SCHEME OF THE FOOD EXEMPTION

Under the sales tax regime, food for human consumption was generally exempt save for savoury snacks, confectionery, biscuits and certain beverages. The GSTA has dramatically widened the taxation of food as the Act only exempts various "basic foods" for human consumption. In designing the parameters of the food exemption, the Government opted for an extensive definition of taxable and GST-free food in an attempt to maximise certainty. Notwithstanding this detailed approach, the legislation creates many borderlines on such matters as food categories, degrees of processing, marketing, taste, temperature, concentration, alcoholic content and location of consumption.

Whilst s 38-2 of the GSTA initially adopts the seemingly generous stance that a supply of food is GST-free,²⁰ this is severely limited by the operation of s 38-3, which taxes certain supplies of food. Before attempting to classify taxable and GST-free food, it is first necessary to consider what constitutes food.

4. WHAT IS FOOD?

Section 38-4 widely defines "food" as food/beverages for human consumption; ingredients for food/beverages for human consumption; goods to be mixed with, or added to, food for human consumption; fats and oils marketed for culinary purposes; and any combination of these. Food that is not consumable (for example, rotten food) or marketed as pet food will not be classified as food.

The GSTA does not define "food" and "beverages", thus, these key terms bear their ordinary meaning. In *Bristol-Myers Co Pty Ltd v FC of T*,²¹ Lockhart J stated:

I prefer the simpler definition attributed to the word "beverage" by the Macquarie Dictionary which is simply "a drink of any kind".

"Drink" when used as a noun is defined in slightly different ways by the dictionaries, but in my view it means any liquid which is swallowed to quench thirst or for nourishment.

"Food" is what is eaten or taken into the body for nourishment, to maintain life and growth. What constitutes foods does not admit of any absolute definition because different societies accept and use different substances as food. Foods which maintain a defined shape are generally referred to as solids and, by contrast, foods which are not "solid" but which take up the shape of the container in which they are placed are either liquid foods paste. Most beverages are foods, though tea is one notable exception. Tea is certainly a beverage and a drink but is not generally accepted as a food because it is not nutritious; it is a

¹⁸ There is no known way of measuring equity, economic efficiency and simplicity on a comparative basis and there exists much disagreement as to the relative weightings of these criteria.

¹⁹ The Draft White Paper considered equity to be "crucial" whilst simplicity was "essential" and economic efficiency "necessary". The Asprey Report, at paras 3.19 to 3.20, considered that simplicity was subordinate to equity. Both the Ralph Report and Draft White Paper listed simplicity as the last of the three tax policy criteria, implying a lesser importance.

²⁰ GSTA, s 38-2.

²¹ 90 ATC 4553.

stimulant: see *Hinde v Allmond* (1918) 87 LJKB 893; *Sainsbury v Saunders* (1918) 88 LJKB 441 especially per Darling J at 445 and *Diet Tea Co Ltd v A-G* [1986] 2 NZLR 693.

A beverage is consumed either hot or cold and is normally taken to quench the person's thirst or for stimulation or as an accompaniment to solid foods either at meal times or between meals. Beverages may contain stimulants such as caffeine and they may be used for refreshment or to overcome thirst. Beverages are not generally formulated to provide nor do they invariably provide essential nutrients to the meals with which they are consumed. An important part of a beverage is to replenish fluids. It is an important element in the concept of a beverage that it is something one drinks not eats. This is quite a usual means of distinguishing beverage from other types of liquid foods which are not beverages such as gravy, sauce and syrup.²²

In determining borderline substances between food and beverages, Lockhart J found it necessary to "pay regard to the constituent qualities or ingredients of the goods themselves as well as how the goods are sold or marketed or put up for sale."²³ Thus, the Court found that "Sustagen Gold" constituted a beverage notwithstanding that it maybe consumed as a meal replacement, being a concentrated milk drink it is properly characterised as a beverage. The distinction between food and beverages is important as the GSTA separately deals with exemptions for food and beverages.²⁴

Where products can be consumed as food and have other uses, the item will be GST-free. For example, rice flour that is used as an ingredient

for food will be exempt and where the same quality of flour is used in the processing of aluminium, it will remain GST-free.²⁵

5. WHAT IS NOT FOOD?

Section 38-4 provides four exclusions from food:

- live animals (other than crustaceans and molluscs);
- unprocessed cow's milk;
- untreated grains, cereal or sugar cane; and
- plants under cultivation.²⁶

As a result, many primary producers will not have to worry about distinguishing between GST-free and taxable food as the supply of many animal and plant products will be taxable. Grains, cereals and sugar cane are not GST-free until they have been processed or treated resulting in an alteration of their form. Fruit, vegetables, herbs and spices are not food until harvested.

6. THE GST FOOD CHAIN

A New Tax System (Goods and Services Tax) Bill 1998 Further Supplementary Explanatory Memorandum ("Explanatory Memorandum") provides the following example of the GST food chain:

As the sales to the wholesale market, pet food manufacturer and retailer are GST-free there is no input tax credit that can be claimed in respect of those purchases. In the case of the vegetables

²² Ibid 4556-4557.

²³ Ibid 4557.

²⁴ GSTA, s 38-3.

²⁵ Australian Taxation Office, *Food Industry Register Issue No 1*.

²⁶ GSTA, s 38-4(1)(g)-(i).

purchased by the final consumer they have remained GST-free throughout the chain. The vegetables used in the manufacture of pet food only remain GST-free while they are still food for human consumption. When the vegetables are used to manufacture pet food they cease to be food for human consumption and the sale of pet food is subject to GST.²⁷

7. CLASSIFYING TAXABLE AND GST-FREE FOOD

Notwithstanding that a supply of food is GST-free under s 38-2, s 38-3(1) provides five broad means of taxing a supply of food:

- food for consumption on the premises from which it is supplied;
- hot food for consumption away from those premises;
- food of a kind specified in Sch 1;]
- beverages of a kind that are not listed in Sch 2; or
- food of a kind specified in regulations.

Classifying food will not always be a simple matter because of the conditional exemptions,²⁸ interpretational issues²⁹ and the interaction between the five categories of taxable supplies.³⁰ It should be noted that even though some supplies of food fall within the five categories, they may still remain GST-free. For instance, a non-commercial supply of food by a charity falling within one of the five categories will remain GST-free.

7.1 Food for Consumption on the Premises

Food provided for consumption on premises will be taxed. This will include food supplied by restaurants or cafes for consumption on premises. Section 38-5 defines premises supplying food as the place where the supply takes place; the grounds surrounding a café or public house; other outlet for supply; or the whole of any enclosed space (for example, a football ground or show ground). Premises does not include a public thoroughfare unless it is a designated area used in connection with the supply of food.

*Mylos of Reading (Catering & Ices) Ltd*³¹ adopted a broad interpretation for the concept of premises. The Court held that food provided from a shed located in a 360 acre country park was held to be consumed on premises even though there were no tables and chairs near the shed.³² Similarly, the Commissioner has adopted a broad view of "premises" in *GST Taxation Determination* GSTD 2000/5, which states:

- (a) at the place where the supply takes place - for example, restaurants, cafes, snack bars, hotels, motels, bed and breakfasts, clubs, reception lounges, aircraft, boats, trains, venues for catered functions or university dining halls;
- (b) in grounds surrounding the food supply outlet - for example, at tables on a footpath or in a food court;
- (c) at any venue with defined limits or boundaries associated with leisure, sport or entertainment - for example, football

²⁷ A New Tax System (Goods and Services Tax) Bill 1998 Further Supplementary Explanatory Memorandum, para 1.15 ("Explanatory Memorandum").

²⁸ Sometimes food is exempt if marketed in a certain way, for instance, prepared meals.

²⁹ The meaning of key terms such as "food of a kind" and "principally" are crucial to the operation of the exemption.

³⁰ A food may be listed specifically as GST-free but lose its GST-free status because one of the other taxable supply rules apply. For example, a roll purchased from a baker is GST-free, but a roll purchased as part of a restaurant meal will be taxable.

³¹ (1986) LON/86/575 (2538).

³² The courts may well determine that a narrower definition of premises is more appropriate. For instance, *IRC v Ross & Coulter (Bladnoch Distillery Co Ltd)* (1948) 1 All ER 616, where Lord Thankerton considered that any ambiguity in taxing statutes be resolved in favour of the taxpayer.

grounds, gardens (that are on private property or have restricted access), show grounds, amusement parks, racecourses, zoos or concert halls.³³

The concept of premises poses a dilemma for food outlets that provide seating, as orange juice consumed on premises will be taxed but if taken away it will be GST-free. Will food suppliers really ask their customers if they are eating in or not? This will not create a problem for supplies of hot food as they will generally be taxed per s 38-3(1)(b). To ease this problem for supplies of cold food, *GST Tax Determination* GSTD 2000/5 allows otherwise taxable supplies to be GST-free:

If your business operations do not identify take-away supplies from dine-in supplies, food will remain GST-free if:

- ⊙ it is served in its original or takeaway form (for example, an unprocessed apple or unopened bottle of water); and
- ⊙ it is not served in circumstances indicating that consumption will take place on the premises (for example, the food is not served at a table).³⁴

7.2 Hot Food for Consumption Away from the Premises

Hot takeaway food is subject to GST. For instance, hot chicken, chips, pies and pizzas will all be subject to GST. The problem of determining what constitutes hot food should not be difficult as there is no need to check the precise temperature of the food. Hot food is food that has been heated above the generally

surrounding temperature.³⁵ Food that is hot as a result of being freshly baked but is otherwise GST-free (eg, plain bread) will remain GST-free.³⁶ Where hot and cold food are supplied together such as in a hamburger or hot dog, such food will be taxed.

7.3 Schedule 1 Listed Food

Paragraph 38-3(1)(c) provides that a supply of food of a kind or food specified in the third column of Sch 1 is not GST-free (for an extract of the table in Sch 1, see Appendix 1). Also, food that is a combination³⁷ of these specified foods is not GST-free.

Schedule 1 raises a number of difficult matters of interpretation. The foods listed will generally be taxable, although a number of food items are conditionally exempt. That is foods that are marketed, prepared or processed in a certain way are exempt. Schedule 1 will operate to include foods that are not listed as the schedule extends to "foods of a kind". Further, it is necessary to determine the meaning of key terms such as "marketed", "principally" and "similar". The categories of food listed in Sch 1 may also play an explanatory role notwithstanding that wording is not operational.³⁸

7.3.1 "Food of a Kind"

If a particular food is "food of a kind" listed in Sch 1, it will be subject to GST. If a particular beverage is a "beverage of a kind" listed in Sch 2, it will be GST-free. There are some striking similarities between the wording used in the food

³³ *GST Taxation Determination* GSTD 2000/5, 1.

³⁴ *Ibid* 2.

³⁵ This is made clear by the Explanatory Memorandum, para 1.28.

³⁶ Australian Taxation Office, *GST Food Guide*, 16. This is in line with the approach taken in the United Kingdom where hot freshly baked pies were not heated for the purpose of consumption so value added tax did not apply: *Pimblett (John) & Sons v C & E Commrs* [1988] STC 358.

³⁷ Where there is a combination of GST-free food and taxable food, the food is subject to GST. For example, where a hot sausage is provided (taxable takeaway food) on a piece of bread (GST-free), that meal is classified as taxable.

³⁸ GSTA, s 182-10(2).

exemption and the sales tax exemptions. Firstly, they use similar wording with the sales tax term "goods of a kind" replicated with the term "food of a kind" in s 38-3. Also, many of the categories in Schs 1 and 2 are based on the wording used in sales tax exemptions.³⁹ Accordingly, sales tax experience will continue to be highly relevant.

The courts developed various tests for determining whether "goods" are "goods of a kind" for sales tax purposes. Frequently, the courts and tribunals have applied an "essential character" test in determining classification. In *Thomson Australian Holdings Pty Ltd v FC of T*,⁴⁰ Davies J described the "essential character" test as:

... the task of the Court is to determine the essential character of the goods, what essentially the goods are, not some characteristic that the goods might have. Essential character derives from the basic nature of the goods, from what they are, though composition, function and other factors necessarily play a part.⁴¹

In *Diethelm Manufacturing Pty Ltd v FC of T*,⁴² Hill J prescribed a test based on the genus or class of the goods, rather than opting for a test based on essential character,⁴³ stating:

The use of the words "goods of a kind" entail the determination of a relevant genus. Therein lies an initial difficulty. The wider the genus is stated, the more likely it will be that it will be found that that class of goods is commonly used for a par-

ticular household function.⁴⁴

This is similar to the approach taken in *Hygienic Lily Ltd v DC of T*⁴⁵, where paper cups were held to be the same genus as glassware used for household purposes because of the nature of the class or genus of goods, rather than their use. Also, Lockhart J found in *Feltex Commercial Interiors Pty Ltd v FC of T*.⁴⁶

The words "of a kind" in the context of item 83 do not refer to the uses for which the particular goods in question are designed or manufactured, nor to the purpose to which it is intended that those particular goods shall be put, but "rather to the nature, quality and adaptation of goods in the class or genus in question": cf *Hygienic Lily Limited v DC of T* (NSW) (1987) FCR 396 per Gummow J at 399; 18 ATR 619; *Customs and Excise Commrs v Mechanical Services (Trailer Engineers) Ltd* [1979] 1 WLR 305 at 312-3, 315, 316-7.⁴⁷

In *K Mart Australia Ltd v FC of T*,⁴⁸ the Full Federal Court considered whether paint brushes fell within the sales tax item that included "brooms, mops, dusters, brushes, buckets and basins". In a joint judgement, the Court found:

... the collocation or context can affect the meaning of a term and give it a connotation different to that which might otherwise be attributed if the term appeared in isolation.

It is not necessary in this case to decide whether there is a specific genus of goods used for clean-

³⁹ Explanatory Memorandum, para 1.4: "The amendments will ensure that basic food for human consumption is GST-free. In addition, they will ensure that the current WST exemptions for food are, in general, maintained."

⁴⁰ 88 ATC 4916.

⁴¹ *Ibid* 4917.

⁴² 93 ATC 4703.

⁴³ *Ibid*, 4719 where Hill J stated: "Phrases such as "essential character" have sometimes been used to express this search for objective criteria, as is illustrated by the judgment of French J which I have had the privilege of reading. And there may be cases where the search for the essential character of an item may be useful in determining whether particular goods constitute advertising matter or a catalogue: cf *Thomson Australian Holdings Pty Ltd v FC of T* (1988) 20 FCR 85; 19 ATR 1896. In other cases the phrase "essential character" may be thought itself to suffer some lack of precision."

⁴⁴ *Ibid*.

⁴⁵ 87 ATC 4327.

⁴⁶ 90 ATC 4925.

⁴⁷ *Ibid* 4933.

⁴⁸ 96 ATC 4155.

ing or having a common characteristic associated with the activity of cleaning.

If the word "paint brushes" were to be included as one of the meanings attributable to brushes, then it would sit uneasily with the description of the other goods specified in the paragraph. It would be inappropriate given the context to say that the word "brushes" included for example tooth brush, a nail brush, a hair brush, a clothes brush or a pastry brush. They are primarily directed to matters of personal grooming, or in the case of the pastry brush, to the activity of cooking.

A "paint" brush is not a brush used for cleaning or analogous purposes. Its use is as an implement or tool in order to apply paint to a surface.⁴⁹

Some inkling of the Commissioner's likely approach to this issue can be gleaned from *Sales Tax Ruling SST 5* which considered the classification of goods (furniture) of a kind for sales tax purposes, stating:

Identifying the class of goods to which an item of furniture belongs involves determining the common characteristics that turn a collection of individual articles into a kind or class. Many articles of furniture fall into more than one class of furniture. A kitchen table, for example, could reasonably be said to fall into the classes, tables and kitchen furniture, as well as the class of kitchen tables. An arm chair might belong in the classes, chairs, lounge room furniture or lounge chairs.

The class that is most important for sales tax classification is the one in which all the characteristics of the particular furniture to be classified are properly represented. As a practical approach, you should always look at the narrowest class. If the narrowest class or most precise description of the goods establishes them as being of a kind used for household purposes, then the particular piece of furniture will pass the

test.⁵⁰

Given the divergence of views provided by the Federal Court and the Commissioner creates much uncertainty. This is an area where the Australia Taxation Office needs to clarify its approach to interpreting the words "food of a kind" by issuing a public ruling.

7.3.2 "Marketed"

The term "marketed" is not defined in the GSTA. In Case 10/97,⁵¹ the Tribunal found:

Marketing as a concept is clearly dynamic. It is to have expanded or contracted meanings in different contexts. A good commercial definition can be found in Volume 11 of the new Encyclopaedia Britannica Fifteenth Edition at page 505 in the following terms:

In Western business organizations the marketing function was once seen as encompassing only sales and advertising and perhaps, also, marketing research. The purpose of the staff engaged in marketing was primarily to maximize sales volume. More recently the marketing manager's responsibilities have broadened to include all activities relating to the firm's customers, including product development, customer communications, and customer services; in some firms, the principal marketing executives have even been given authority over credit, physical distribution, public relations and research and development. In a few firms, the integrated marketing concept has been pushed to the point where the head of marketing becomes the chief executive officer.

Whatever approach is adopted in giving content to the word "marketing" it would seem that core requirements include promotion and sale of products with or without delivery.⁵²

⁴⁹ Ibid 4161-4162.

⁵⁰ *Sales Tax Ruling SST 5*, para 3.10.

⁵¹ 97 ATC 167.

⁵² Ibid 171.

Marketing was an important factor in *Nicholas Kiwi Pty Ltd v FC of T*⁵³. In this case, the Federal Court decided that a health drink (Staminade) did not constitute a medicine, although it could in the proper context be a medicine. However, the advertising, labelling and appearance of the product showed that it was not sold as a medicine, rather it was sold to healthy people. Although the Court found in *Nomad Industries Pty Ltd & Anor v FC of T*⁵⁴ that marketing did not include delivery, this differs from the approach taken by the Commissioner. The Commissioner has established the following relevant factors in applying the marketing test:

- the name of the goods;
- the price of the goods;
- the labelling on any containers for the goods;
- literature or instructions packed with the goods;
- how the goods are packaged;
- how the goods are promoted or advertised; and
- how the goods are distributed.⁵⁵

7.3.3 "Principally"

Certain foods will fall within Sch 1 if they consist "principally" of certain foods (ie confectionery) or are marketed principally in a certain way (ie malt extract). The GSTA does not define "principally". Relevantly, the *New Shorter Oxford Dictionary* defines "principally" as:

1. In the chief place; above all; pre-eminently;
2. In a special or marked degree; especially;
3. For the most part; in most cases.⁵⁶

The Commissioner has adopted a similar approach in *Sales Tax Ruling* STNS 4 in determining the meaning of "principally":

For goods to be used primarily and principally for a particular purpose or in a particular way, that use must be the most important or most significant of all the intended uses. A primary and principal use must exceed any other and, whilst it need not account for a majority of the use of the goods, it will usually do so. Primarily and principally have such similar meanings, that the presence of the two of them in conjunction adds nothing to the meaning of principally by itself.⁵⁷

7.3.4 "Similar"

Schedule 1 provides that similar food to certain itemised foods will be subject to GST. "Similar" is not defined by the GSTA. *The New Shorter Oxford English Dictionary* defines "similar" as:

1. of the same substance or structure throughout; homogeneous; or
2. having a resemblance or likeness; of the same nature or kind.⁵⁸

What foods are in fact "similar" may be quite difficult to determine. Where are the borderlines drawn between similar and dissimilar foods?

7.3.5 Categories of Food

Importance of Category Headings

Whilst the category headings are not operative,⁵⁹ these categories can be considered in accordance with s 182-10(2) to assist:

- (a) in determining the purpose or object underlying the provision; or
- (b) to confirm that the provision's meaning is the

⁵³ 90 ATC 4662.

⁵⁴ 86 ATC 4036.

⁵⁵ Australian Taxation Office, *Food Industry Issues Register Issue No 5*.

⁵⁶ *New Shorter Oxford English Dictionary* (1993).

⁵⁷ Paragraph 3.10.

⁵⁸ *New Shorter Oxford English Dictionary* (1993).

⁵⁹ See GSTA Sch 1, Note 2 and s 182-15.

ordinary meaning conveyed by its text, taking into account its context in the GSTA and the purpose or object underlying the provision; or

(c) in determining the provision's meaning if the provision is ambiguous or obscure.

The food industries register adopted this approach in determining the meaning of "pudding".⁶⁰

Prepared Food

The Explanatory Memorandum provides that the category of prepared food is intended to cover a range of food that directly competes against takeaway and restaurant food and thus this food is taxable.⁶¹ It does not matter whether they are served hot, cold or frozen or require any cooking, heating, thawing or chilling before consumption.⁶²

Prepared Meals

Item 4 covers food marketed as a prepared meal. Relevantly, the ATO states in *Food Industry Issues Register No 5* that:

The term "prepared meal" is not defined in the GST Act and will therefore bear its ordinary meaning.

The *Macquarie Dictionary* provides that "meal" means "the food eaten or served for a repast". This definition could be applied to a single food item or to a meal consisting of several food items.

The *Macquarie Dictionary* defines "prepare" in relation to food as "to get ready for eating, as a meal, by due assembling, dressing or cooking" ... For food to be regarded as a "prepared meal"

in accordance with Item 4, the food needs to be assembled, dressed, cooked or partly cooked and it is only necessary to heat to make them ready for consumption.⁶³

Food such as sushi, frozen lasagne and frozen TV dinners will all be prepared meals as they have been assembled, dressed, cooked or partly cooked only needs to be either eaten or heated before consumption. Uncooked pasta products, frozen vegetables and fish fingers are not prepared meals as they require other foods to be a meal or require further cooking.

Food Platters

In *Food Industry Issues Register No 5*, the ATO states:

The term "platter" is not defined in the legislation and therefore its ordinary meaning is to be adopted. "Platter" is defined in the *Macquarie Dictionary* to mean:

1. a large shallow dish, commonly oval, for holding or serving meat etc.

Item 5 of Schedule 1 is referring to platters and arrangements of food that can be uncovered and placed on the table ready for serving (eg as a catering product at parties, BBQs etc).⁶⁴

Confectionery

Confectionery follows the wording used in sales tax definition. The term "confectionery" is not defined so the ordinary meaning will apply.⁶⁵ In the High Court decision of *Landau & Anor v Goldwater & Anor*,⁶⁶ Aickin J relevantly found that:

... one of common usage which embraces a wide variety of articles, many readily recognisable as

⁶⁰ Australian Taxation Office, *Food Industry Issues Register Issue No 13*.

⁶¹ Explanatory Memorandum, para 1.31.

⁶² GSTA, Sch 1.

⁶³ Australian Taxation Office, *Food Industry Issues Register Issue No 5*.

⁶⁴ *Ibid*.

⁶⁵ See *Zeroz Pty Ltd v DFC of T 97 ATC 4277*; *Allied Mills Industries v FC of T 87 ATC 4387*; and *Candy Maid Confections v C & E Commrs* (1969) 1 Ch 6111.

⁶⁶ 13 ALR 192.

examples of confectionery. They are primarily small articles of a sweet character containing substantial amounts of sugar and regarded as being in the nature of a delicacy in whatever quantity they may be consumed. There is, however, no doubt that in the ordinary parlance the term would now include blocks of chocolate, however small or however large.⁶⁷

The Explanatory Memorandum states that "confectionery includes food that is marketed as confectionery, such as chocolate, boiled sweets, lollipops and sherbet."⁶⁸ However, candied peel is expressly excepted by Sch 1.

Savoury Snacks

This category also uses similar terminology to the sales tax definition, with the main difference being that caviar and fish roe products are now subject to tax. Most savoury and snack food will be taxed given the breadth of items 15 to 18. However, unprocessed or untreated seeds and nuts are GST-free.

Bakery Products

In a major departure from the sale tax regime, some bakery products will be taxed with the notable exception of bread and bread rolls. Most bread will be exempt even where it has a savoury topping, glaze, or contains herbs or fruit. However, if the bread or rolls have a sweet filling or coating, GST will apply.

Ice Cream Food

In accordance with the sales tax approach, ice cream and ice cream substitutes will be subject to GST. This includes frozen yoghurt and frozen

fruit products. Although plain yoghurt and flavoured yoghurt sold in its normal state is GST-free. Also, whole frozen fruit is GST-free.

Biscuits

In accordance with the sales tax approach, biscuits and food that consists principally of biscuits will be subject to GST. Two types of biscuits are exempted - breakfast cereals consisting principally of compressed, rolled or flattened cereal and rusks for infants or invalids.⁶⁹

Combinations of Listed and Non-Listed Food

Where GST-free food and taxed food is included in a food hamper or variety pack, generally the entire product will be subject to GST. For example, a pack or hamper containing cheese and biscuits will be subject to GST. An exception applies if the hamper has a number of individually wrapped foods, then each will be taxed individually⁷⁰ and s 9-80 will tax the hamper as a mixed supply. Note that the ATO has taken the view that a hamper consists of 4 or more products. If the pack has less than four products, the entire pack will be subject to GST even where it consists of a combination of taxed and exempt foods.⁷¹

Conditionally Exempt Food

Food that will ordinarily be GST-free includes meat (raw and processed), fish, fruit, vegetables, eggs, cheese, cream, butter, margarine, yoghurt bread, breakfast cereals, flour, rice (uncooked) and pasta (uncooked).⁷² Also, any combination of the above will be exempt unless one of the taxable⁷³ rules apply.

⁶⁷ Ibid 194.

⁶⁸ Explanatory Memorandum, para 1.45.

⁶⁹ GSTA, Sch 1.

⁷⁰ Explanatory Memorandum, para 1.18.

⁷¹ Australian Taxation Office, *Food Industry Issues Register Issue No 7* and Australian Taxation Office, *Food Industry Issues Register Issue No 8*.

⁷² Australian Taxation Office, *GST Food Index* (19 June 2000).

⁷³ Even though food is listed as GST-free it will be taxable if sold to be consumed on premises ie cheese or bread supplied by a restaurant.

7.4 Schedule 2 Listed Beverages

"Beverages of a kind" listed in the third column of Sch 2 are GST-free unless they are subject to one of the taxable rules provided in s 38-3 (for an extract of the table in Sch 2, see Appendix 2).

Beverages that do not fall within Sch 2 will generally be subject to GST. These taxable beverages include cordial, flavoured milk or beverages, soft drinks, fruit and vegetable juices (if less than 90% minimum by volume of juice), beer, wine, spirits, sports drinks and beverages marketed in a ready to drink form (for instance, a cup of coffee).

It is arguable that a broad interpretation for "beverages of a kind" will apply given that Sch 2 is an exempting provision. In *Diethelm Manufacturing Pty Ltd v FC of T*,⁷⁴ French J stated "classification of goods attracting exemptions or beneficial rates should be liberally construed unless the text or context requires a narrower construction."⁷⁵ Similarly, in *FC of T v Verzyden*,⁷⁶ the Full Federal Court broadly interpreted the expression "of the kinds specified in" that exempted from tax payments for wounds and disability pensions to Australian residents.

7.5 Food of a Kind Specified in Regulations

Section 38-3 provides for food to be specifically taxed or exempted by way of regulation. For example, r 38-3.01 of *A New Tax System (Goods and Services Tax) Regulations*

1999 provides that beverages listed in Sch 2 and supplied on premises from a vending machine for consumption on the premises will be GST-free.

8. PACKAGING FOR GST FREE FOOD

Packaging is generally treated in the same manner as the contents, if food is GST-free then the packaging will also be GST-free.⁷⁷ However, there are limits to the GST-free status of packaging. Where the packaging that is more than is usual and necessary, it will be taxable.⁷⁸

9. GOVERNMENT ASSISTANCE FOR BUSINESS

The Government introduced a simplified accounting method to assist small food businesses reduce compliance costs of dealing with food sales. Other Government initiatives include the Food Industry Register, GST Taxation Rulings, GST Food Guide and GST Fact sheets.

Simplified accounting methods are available to small businesses⁷⁹ that deal with taxable and GST-free food, such as convenience stores, milk bars, grocers and supermarkets, bakeries and hot bread shops, cake shops, sandwich bars, delicatessens, takeaway outlets, fresh fish retailers who sell cooked fish, fish and chip shops (with fresh fish sales), butchers with some taxable sales.⁸⁰ Such businesses can estimate their total GST-free sales at the end of each tax period, rather than having to record each GST-free product when it is sold. The three alternative

⁷⁴ 93 ATC 4703.

⁷⁵ Ibid 4714.

⁷⁶ 88 ATC 4613.

⁷⁷ GSTA, s 38-6.

⁷⁸ Explanatory Memorandum, paras 1.57-1.58 provides the following example of taxable packaging on GST-free food: "For example, if breakfast cereal is supplied in a plastic container intended for re-use, the container will be taxable. The supply will be partly taxable and partly GST-free and will be covered by the mixed supply rule in section 9-80 of the Bill."

⁷⁹ These methods apply to retailers with annual turnover of less than \$1 million. Transitional rule raises the turnover threshold for the snapshot and stock purchases methods to \$2 million for the 2000-01 financial year.

⁸⁰ Australian Taxation Office, *Simplified GST Accounting Methods for Food Retailers* (24 April 2000).

ways to account for trading stock as are follows:

1. Business norms method, where you choose to use standard percentages and apply them to sales and purchases to estimate GST-free sales and purchases.
2. Snapshot method, where you choose to take a snapshot of your purchases and sales to estimate GST-free purchases and sales.
3. Stock purchases method, where you take a snapshot of purchases to estimate the percentage of GST-free purchases and sales.⁸¹

Further business norms have been developed for hot bread shops, convenience stores that prepare takeaway food but do not sell fuel or alcohol. Also, business norms are available for convenience stores that do not prepare takeaway food and do not sell fuel or alcohol.⁸²

⁸¹ Ibid.

⁸² Ibid.

10. CONCLUSION

Whilst the food exemption has added to the complexity of the GST legislation, it is apparent that these additional costs are dwarfed by gains from having a fairer tax system. Given that economic efficiency does not have a significant influence, the food exemption can be strongly justified on equity grounds.

The higher compliance costs for business are offset by the detailed drafting of the food exemption legislation, reliance placed on familiar sales tax terminology and the availability of a simplified accounting system for small business. The design of the food exemption legislation and associated measures means that this exemption will be sufficiently clear and workable.

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THE GST FOOD EXEMPTION

APPENDIX 1 - GSTA, SSCHEDULE 1

Item	Category	Food
1 2 3 4 5 6 7	Prepared food	quiches sandwiches (using any type of bread or roll pizzas, pizza subs, pizza pockets and similar food food marketed as a prepared meal, but not including soup platters etc of cheese, cold cuts, fruit or vegetables and other arrangements of food hamburgers, chicken burgers and similar food hot dogs
8 9 10 11 12 13 14	Confectionery	confectionery, food marketed and confectionery, food marketed as ingredients for confectionery or food consisting principally of confectionery popcorn, confectionery novelties food known as muesli bars or health food bars, and similar foodstuffs crystallised fruit, glaze fruit and drained fruit crystallised ginger and preserved ginger edible cake decorations
15 16 17 18 19	Savoury snacks	savoury snacks potato crisps, sticks or straws, corn crisps or chips, bacon or pork crackling or prawn chips Seeds or nuts that have been processed or treated by salting, spicing, smoking or roasting, or in any other similar way Caviar and similar fish roe Food similar to that covered by item 15 or 16, whether or not it consists wholly or partly of any vegetable, herb, fruit, it consists wholly or partly of any vegetable, herb, fruit, meat, seafood or dairy product or extract and or not it is artificially flavoured food consisting principally of food covered by items 16 to 18
20 21 22 23 24 25 26 27	Bakery products	Cakes, slices, cheesecakes, pancakes, waffles, crepes, muffins and puddings pavlova and meringues pies (meat, vegetable or fruit), pasties and sausage rolls tarts and pastries doughnuts and croissants pastizzi, calzoni and brioche scones and scrolls bread (including buns) with sweet filling or coating
28 29 30 31	Ice-cream food	ice-cream, ice-cream cakes, ice-creams and ice-cream substitute Frozen confectionery, frozen yoghurt and frozen fruit products (but not frozen whole fruit) flavoured ice blocks (whether or not not marketed in a frozen state) any food similar to food listed in items 28 to 30
32	Biscuit goods	food that is or consists principally of, biscuits, cookies, crackers, pretzels, cones or wafers

THE GST FOOD EXEMPTION

APPENDIX 2 - GSTA, SCHEDULE 2

Item	Category	Food
1 2 3	Milk products	any of the following products: (a) milk, skim milk or buttermilk (whether liquid, powdered, concentrated or condensed); (b) casein; (c) whey, whey powder or whey paste beverages consisting of products referred to in item 1 (or a combination of those products), to the extent of at least 95%, but not including flavoured beverages lactose
4	Soy milk and rice milk	beverages consisting principally of soy milk or rice milk, but not including flavoured beverages
5 6 7 8 9	Tea, coffee etc.	tea (including herbal tea, fruit tea, ginseng tea and other similar beverage preparations), coffee and coffee essence, chicory and chicory essence, and malt malt extract, if it is marketed principally for drinking purposes preparations for drinking purposes that are marketed principally as tea preparations, coffee preparations, or preparations for malted *beverages preparations marketed principally as substitutes for preparations covered by item 6 or 7 dry preparations marketed for the purpose of flavouring milk
10 11 12	Fruit and vegetable juices	concentrates for making non-alcoholic beverages, if the concentrates consist of at least 90% by volume of juices of fruits non-alcoholic carbonated beverages, if they consist wholly of juices of fruits or vegetables non-alcoholic non-carbonated beverages, if they consist of at least 90% by volume of juices of fruits or vegetables
13	Beverages for infants or invalids	Beverages, and ingredients for beverages, of a kind marketed principally as food for infants or invalids
14	Water	Natural water, non-carbonated and without any other additives