STATES OF JERSEY

GOODS AND SERVICES TAX: EXEMPTION OR ZERO-RATING FOR HEALTH FOODS (P.81/2011) – COMMENTS

Presented to the States on 15th July 2011
by the Minister for Treasury and Resources

STATES GREFFE

COMMENTS

The Minister for Treasury and Resources opposes this amendment and urges members to reject this proposition for the following reasons.

Although the proposition seeks to exclude (by zero-rating) healthy foods, it is really a variation of a theme debated as recently as 17th May, and on numerous occasions since the tax was introduced.

All previous debates focussed mainly on whether to adopt the UK VAT treatment of zero-rating foodstuffs or to retain the Jersey model of a broad-based system with a low single rate.

The difference this time is that the proposition, if adopted, seeks to zero-rate a list of healthy foods which would need to be compiled within a 3 month period by Health and Social Services, i.e. by October 2011.

The timescales indicated are not practical or realistic. The 3 month period indicated for Health and Social Services to prepare the list of healthy foods is not feasible.

Even if Members assume the healthy food list would be more restrictive than the UK list of foodstuffs eligible for zero-rating, most of the issues involved with this proposition are very similar and relevant to those debated previously.

Most States Members will acknowledge that there is a worldwide problem with health-related lifestyles and the need to reduce rates of avoidable disease and that Jersey is no exception.

Members will no doubt understand and agree with the sentiments and aspirations behind this proposition, but based on international research/experience, there does not seem to be an easy solution and this proposition, if successful, could even exacerbate the situation, particularly for those in the lower income groups.

The immediate impact of introducing any form of new exclusion is –

- loss of revenue;
- increased complications;
- increased cost of business compliance; and
- increased cost of administration.

In Jersey the other inevitable consequence of any form of new GST exclusion would be a review/reduction and potential withdrawal of some or all of the measures (increased income support, GST bonus, and increased thresholds) previously introduced to lessen and/or ameliorate the effect of GST on vulnerable groups.

In the past the States has voted for the following measures to compensate the less well-off for the introduction of GST –

- Increased income tax thresholds by an extra 3.5% from 3% to 6.5% for 2008 in the 2008 Budget at a then cost of £4 million;
- Included protection from GST for those on the original income support scheme at a cost of £1.75 million;
- An allowance for those households between the income support scheme and income tax system known as the GST bonus scheme at a cost of £0.4 million;
- The Le Fondré proposition P.138/2008 to further increase income support by £3 million, double the GST Bonus Scheme at a cost of a further £0.4 million and provide an increase in income tax exemption thresholds from 3% to 5% in 2009 at a cost of £2.4 million.

In total, this equated to a total financial benefit from those on low- to middle-incomes of <u>£12 million</u>.

Given the nature of this proposition, it is not possible at this stage to accurately quantify the potential revenue loss or the impact on income support (as outlined above) until the list of healthy foods has been compiled by the Health and Social Services Department.

For **illustrative purposes** only, we have taken fresh fruit and vegetables as being within the list of healthy foods. The projected revenue loss for 2012 would be in the region of £1.5 million (based on adjusted HES data and at 5% GST). It is highly unlikely that a healthy food list would be restricted only to fresh fruit and vegetables, and if the proposition was approved it could result in significant revenue loss.

The intention of removing GST from healthy food or fruit and vegetables is to increase consumption of healthy food proportional to unhealthy food, especially for low-income groups and those who experience a greater burden from nutrition-related disease. There is, however, potential for other unintended consequences, as follows –

- Increased inequality as greater financial gain is achieved fro higher-income population groups;
- No guarantee that the money saved will be spent on healthy food;
- It could discourage businesses from providing healthy food on a small scale, e.g. a café from having a fresh fruit bowl on the counter;
- Increased administrative complexity could be a deterrent to businesses engaging in food related activities;
- Additional business administration and compliance costs may be passed onto consumers; and
- Suppliers or supermarkets may not pass the entire discount on to consumers.

One of the hallmarks of Jersey's GST system is its simplicity, which would be lost if this proposition was adopted.

We need an efficient system of taxation that places the lowest possible burden on local taxpayers, both in terms of the tax charged and the cost of administering the system.

A system of exclusions (whether by zero-rating or exemption) requires detailed legislation and the added complexity greatly increases the scope for fraud and error.

There are over 150 countries worldwide operating some form of GST/VAT system. The vast majority of systems do include foodstuffs in their tax base; some tax food at a low rate (but not lower than 5%); a few exclude foodstuffs (or basic food) by zero-rating (as is the case under UK VAT). Currently, no country attempts to exclude food defined as being healthy and there is no international best practice model that Jersey could easily replicate/mirror.

We have mentioned in the past that internationally, New Zealand is regarded as having the best "model" GST. Their system has provided a template for most countries that have introduced a good modern VAT/GST (including Jersey) since the mid-90s.

It is therefore very relevant to this proposition that we should examine recent developments in New Zealand and the fact that their Parliament debated a GST (Exemption of Healthy Food) Amendment Bill in 2010. The Hansard record provides an interesting insight into all the issues involved, including attempting to agree a list of healthy foods which is the datum for such an amendment.

The following is one quote of many that highlighted the difficulty in agreeing exactly what food is considered to be healthy –

> *"Clause 5, which inserts the definition of "healthy food" in section 2(1) of the Goods and Services Tax Act, contains a flaw in each of its paragraphs. For instance, paragraph (a) talks about canned foods. Can members remember all that sugar swilling around in some of those magnificent canned foods? Paragraph (b) mentions "all bread", and I ask how much nutrition is contained in pure white, refined bread. In paragraph (c), cheese and plain milk are mentioned; to some people, those foods will just clog up the arteries. Paragraph (d) mentions poultry and seafood, but whether they are healthy foods all depends on the way they are cooked. This bill is riddled with flaws, and no one other than Labour members illustrates that so clearly."*

The debate took place in September 2010 and the amendment was defeated. A full account of the debate can be found on www.parliament.nz.

Linked to the above is a background paper: "Removal of GST from healthy food" prepared by the Heart Foundation. Perhaps they could be accused of being somewhat biased, but the document does provide a well-researched and balanced view of what is a very complicated problem. The following is an extract from the report's conclusion –

> *"The intention of making healthier food or fruit and vegetables more affordable is a very good one. There is a clear need to improve the nutrition of New Zealanders, and cost of healthy food in comparison to less healthy food is currently a barrier to achieving this. Improving the nutrition of New Zealanders will lead to substantial health improvements and potentially reduce the growing cost of chronic disease to the NZ Health System. As with many nutrition issues, however, there is no one single answer to making healthy food more affordable, and a range of initiatives will be required.*

Removal of GST from fruit and vegetables is one potential intervention in a multi-faceted approach to make healthy food more affordable. It seems to be one of the few readily available policy levers with which to influence comparative food prices. The main advantage of removing GST from healthy food is that it should improve the affordability of healthy food for all New Zealanders. It will also make GST less regressive provided it does not have to be cost-neutral, although this is not the main objective. However, there are disadvantages which require consideration. The greatest absolute monetary gain is for higher-income groups who spend more on food, therefore it could potentially increase inequalities. There will be complexity and difficulty defining which foods are healthy, both when designing the exemption, and for businesses implementing it. Importantly, there is uncertainty that cost savings made by consumers will be spent on healthy food, and if so it will not meet its intended goal. From a business perspective, it creates an inefficient tax system with greater burden and compliance costs. These costs are likely to be passed onto consumers, and to be greater for small businesses.

The desired impact may be equally well achieved, or more cost-effectively achieved, through a more flexible and potentially targeted approach such as an electronic discount card ("smart card") for healthy food. A similar, but less technologically advanced option, would be use of vouchers or coupons for lower-income groups. The same issues will arise in defining healthy foods as removing GST from food has. The most straightforward and non-contentious option would be subsidising plain fresh and frozen fruit and vegetables only. Further work on smart cards or vouchers would need to be conducted to determine acceptability, and the best methods of implementation. A smart card could either be a whole population approach (either with the same or varying rates of subsidy) or for targeted groups.

Other options include rebates on healthy food purchases; a healthy food tax credit; support across the food supply chain to produce healthy foods, maximise efficiency, reduce costs, and reduce waste; a supermarket code of practice for fresh produce which incorporates maximum levels of mark up and provides transparency; and a variety of community action initiatives.

The worst outcome for New Zealanders would be for this opportunity to pass with no improvement in the affordability of healthy food. There are a range of options that could address this issue, given the political will."

It must also be remembered that the result of the amendment debate and the report conclusions in New Zealand are relative to a GST system with a standard rate of 15%. With a rate of only 5% in Jersey, the potential to actually influence and reduce prices by the tax content is even more questionable.

Timescale

Finally, if the proposition were approved, then the timescales indicated are just not practical or realistic as a result of the following –

- the New Zealand experience indicates that it will be a formidable task to agree a list of healthy food;
- the proposition indicates a 3 month period for the above task, which means it should be completed in October 2011;
- the Taxes office will then need to produce drafting instructions for the Law Draftsman to prepare amendments to the Schedules of the Goods and Services Tax (Jersey) Law 2007;
- this will then need to be debated and approved by the States; and
- at that point and only at that point can the Taxes Office begin to re-educate the taxpayers involved with the revised liability of supplies. This will involve producing website content; leaflets/notices; re-training staff and conducting educational visits.

Given the above steps and the degree of uncertainty involved with even producing a healthy food list, it would not be possible to work to an imposition date of 1st January 2012.