

The GST/VAT treatment of supplies of residential premises: A new approach

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Abstract

In the traditional European Union VAT system, the supply, before first occupation of immovable property, is generally taxable while other supplies of immovable property are generally exempt. In more modern GST/VAT systems the first sale of residential premises is generally taxable whereas supplies between otherwise unregistered consumers are generally exempt or outside the scope of GST/VAT. The consumption value of residential premises generally appreciates in value over time. Therefore, the value of total consumption may be greater than the value of residential premises at the time of first acquisition. This is problematic, as the objective of GST/VAT is to tax consumption. Application of the current approach means that there may be consumption which is not included in the GST/VAT base.

This thesis considers two alternative approaches to the current GST/VAT treatment of supplies of residential premises. The first of these involves including imputed rent in the GST/VAT base. The second alternative approach involves including sales of residential premises between otherwise unregistered homeowners in the GST/VAT base. This thesis compares and evaluates these approaches to find whether either of these produces a result which is more consistent with the GST/VAT policy objective of taxing consumption compared to the current approach.

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List of Abbreviations

ABS	Australian Bureau of Statistics
AGLC 4	Australian Guide to Legal Citation Fourth Edition
Art	Article
ATO	Australian Taxation Office
AU	Australian dollar
BIC	Brazil, India, and China
BT	Business Tax
CA	Canadian dollar
CGT	Capital gains tax
Cth	Commonwealth
C2C	Consumer-to-consumer
ETA	<i>Excise Tax Act 1985</i> , RSC 1985, c E-15 (Can.)
EU	European Union
EU VAT Directive	<i>Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax</i>
EUR	Euro
GST	Goods and services tax
GSTA	<i>A New Tax System (Goods and Services Tax) Act 1999</i> (Cth)
GSTR	Goods and Services Tax Ruling
HELP	Higher Education Loan Program
HST	Harmonised Sales Tax
OECD	Organisation for Economic Co-operation and Development
PAYG	Pay as you go
RPPI	Residential Property Price Indices
S-VAT	Stock value added tax
Sixth VAT Directive	<i>Sixth Council Directive 77/388 EEC of 17 May 1977</i>
UK	United Kingdom
VAT	Value added tax

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Conference presentations and publications

Conference presentations informing this dissertation

Christine Peacock, 'Using Imputed Values to Tax the Consumption of Owner-Occupied Housing on a Periodic Basis' (paper presented at the Australasian Tax Teachers Association Conference, 2018) published as 'Is there a viable way to tax the consumption of immovable property that is more consistent with the economic objective of the VAT?' (see page xviii).

Christine Peacock, 'How VAT could be imposed on imputed rent' (paper presented at the Queensland Tax Researchers Symposium, 2018) published as 'Shifting from pre-paid to periodic GST on the consumption of residential premises' (see page xix).

Christine Peacock, 'Judicial interpretation regarding the VAT treatment of residential premises: An analysis involving the traditional and modern VAT' (paper presented at the Australasian Tax Teachers Association Symposium, 2020) published as 'What does it take to make a house new?' (see page xviii).

Christine Peacock, 'The unique VAT treatment of consumer-to-consumer supplies of residential premises in China' (paper presented at the International Conference of Chinese Tax and Policy, 2021) (conference paper informed Chapter 7).

Publications informing and included in this dissertation¹

Peacock, Christine, 'Is there a viable way to tax the consumption of immovable property that is more consistent with the economic objective of the VAT?' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336-350 (Chapter 3).

Peacock, Christine, 'How could sales of residential premises between otherwise unregistered homeowners be brought into the VAT base?' (2019) 14(1) *Journal of the Australasian Tax Teachers Association* 151-169 (Chapter 6).

Peacock, Christine, 'What does it take to make a house new?' (2021) 50(1) *Australian Tax Review* 22-42 (Chapter 2).

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Peacock, Christine, 'Including imputed rent in the GST base' (2022) 3(3) *Perspectives on Tax Law and Policy* 15-17 (Chapter 4).

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Note on Style

Where possible, this thesis has followed the Australian Guide to Legal Citation Fourth Edition (AGLC 4), as the author is based in Australia. Minor style, text and formatting changes have been made where appropriate for consistency across the thesis. This includes the following:

- Removing the headings of articles, details of the author and the abstract, and replacing this information with the headings of chapters;
- Changing references to GST or VAT to GST/VAT, except where the GST or VAT system of a particular country is referred to;
- Changing the numbering of headings, along with fonts and spacing of paragraphs;
- Changing the format of quotation marks to be consistent with AGLC 4;
- Replacing references to 'this article' to 'this chapter';
- Replacing references to 'real property' with 'immovable property'; and
- In chapter four removing hyperlinks and replacing these with footnotes.

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Chapter 1: Introduction

1.1 Overview

The purpose of this chapter is to outline the overall thesis. Following this overview, background to this topic is provided (Section 1.2). This is followed by an explanation of the overall structure of the thesis (Section 1.3), research gap (Section 1.4), research questions (Section 1.5), methodology (Section 1.6), and significance of the research (Section 1.7). At the end of this chapter there is a summary (Section 1.8).

By way of context, it should be noted that this is a technical tax law thesis including some empirical analysis, and is not a public economic thesis. In this thesis the Goods and Services Tax (GST) / Value Added Tax (VAT)¹ treatment of supplies of residential premises is considered from an international perspective. Most jurisdictions with a GST/VAT currently take a similar approach to the GST/VAT treatment of supplies of residential premises. In some chapters of this thesis references are made to Australia, as several of the publications included in this thesis have been published in Australian peer-reviewed academic journals and the candidate is based in Australia. The GST/VAT treatment in Canada is referred to in Chapters 2 and 3 as there has been significant litigation in Canada regarding the GST treatment of renovations, and the author was invited by the Canadian Tax Foundation to contribute Chapter 3 to *Perspectives on Tax Law and Policy*. The current GST/VAT treatment of sales of residential premises in most jurisdictions depends on whether they are new or used, but this is not the

¹ VAT is the traditional name for the broad-based consumption tax in jurisdictions including the European Union. Generally, in many jurisdictions that have more recently introduced this type of consumption tax, including Australia, it has been called a GST. Owing to the international importance of this thesis, this form of consumption tax will generally be referred to as GST/VAT.

case in New Zealand. Therefore, the GST treatment of supplies of residential premises in New Zealand is not considered in detail in this thesis.

1.2 Background to the Topic

It has been reported that 170 countries now have a GST or VAT and on average this form of tax accounts for more than 20% of total tax revenue in Organisation for Economic Co-operation and Development (OECD) countries.²

It is widely recognised that the intended outcome of the GST/VAT is that as far as possible all consumption should be taxed. For example, according to the OECD, '[t]he overarching purpose of a VAT is to impose a broad-based tax on final consumption'.³ James has written that a 'pure VAT' should apply in theory to 'the consumption of all goods and services'.⁴ She has observed that taxing a broad base of goods and services is therefore often considered to be an objective of the GST/VAT.⁵ Similarly, Cnossen has written that '[a] good VAT should tax the broadest possible range of goods and services'.⁶ Cnossen has also observed that '[t]he best practice that can be distilled from the literature ... strongly indicates that the consumption base of the VAT should be defined as broadly as possible and that all goods and services should be taxed'.⁷ In a similar way, Ebrill et al have recognised that a key feature of

² OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (OECD Publishing, 2020) 10–12 ('*Consumption Tax Trends 2020*').

³ Ibid 20.

⁴ Kathryn James, *The Rise of the Value-Added Tax* (Cambridge University Press, 2015) 46.

⁵ Ibid 40–1.

⁶ Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) 5(3) *International Tax and Public Finance* 399, 405 ('Global Trends').

⁷ Sijbren Cnossen, Commentary on Ian Crawford, Michael Keen and Stephen Smith, 'Value Added Tax and Excises' in Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James Poterba (eds) for the Institute for Fiscal Studies, *Dimensions of Tax Design: The Mirrlees Review (Chair, Sir James Mirrlees), Vol 1* (Oxford University Press, 2010) 370.

the GST/VAT is that it is broad based,⁸ Lejeune, Daou-Azzi and Powell have written that a ‘preferred model’ is ‘a VAT system that is broad based and levied on goods and services with minimal exemptions’,⁹ and Van Brederode has described the ‘ideal VAT’ as ‘broad based, including all goods and services supplies ... and has no exceptions or exemptions’.¹⁰

However, despite this intended outcome, there are many standard exemptions used in GST/VAT systems, which means that no GST/VAT is payable when there is an exempt supply and no input tax credits are available in relation to anything acquired to make the exempt supply.¹¹ Traditionally the most common exemptions include activities deemed to be in the public interest (such as health care and education)¹² and supplies which are exempt based on the technical difficulty of taxing them (for example, sales of used residential premises and residential leases,¹³ and supplies of financial services).¹⁴ It has been well recognised that exemptions represent derogations from the objective that all consumption is taxed. For

⁸ Liam Ebrill et al, *The Modern VAT* (International Monetary Fund, 2001). This has also been recognised by Thomas: see Alastair Thomas, ‘Reassessing the Regressivity of the VAT’ (OECD Taxation Working Papers No 49, 2020) 5.

⁹ Ine Lejeune, Jeanine Daou-Azzi and Mark Powell, ‘The Balance Has Shifted to Consumption Taxes – Lessons Learned and Best Practices for VAT’ in Michael Lang, Peter Melz and Eleonor Kristoffersson (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009) 60, 77.

¹⁰ Robert F van Brederode, ‘Preface and Acknowledgements’ in Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) xxv.

¹¹ See OECD, *Consumption Tax Trends 2020* (n 2) 45; Robert F van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International, 2009) 127 (*‘Systems of General Sales Taxation’*). In Australia, the term ‘input taxed supply’ is used. However, in other jurisdictions with a GST/VAT input taxed supplies are generally referred to as ‘exempt supplies’. Owing to the international importance of this thesis, the term ‘exempt supplies’ is generally used to denote these types of supplies.

¹² See Sijbren Cnossen, ‘The C-Inefficiency of the EU-VAT and What Can Be Done About It’ (2022) 29(1) *International Tax and Public Finance* 215, 216 (*‘The C-Inefficiency of the EU-VAT’*); Van Brederode, *Systems of General Sales Taxation* (n 11) 128.

¹³ It has been regarded as administratively and politically difficult to tax consumer-to-consumer supplies of residential premises. See James (n 4) 60; Alan A Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988) 56; Robert F van Brederode, ‘Theory and Practice of VAT Treatment of Real Estate’ in Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) 1, 16–19 (*‘Theory and Practice of VAT Treatment of Real Estate’*).

¹⁴ See Rita de la Feria and Herman van Kesteren, ‘Introduction to This Special Issue – VAT Exemptions: Consequences and Design Alternatives’ (2011) 22(5) *International VAT Monitor* 300, 300; Tait (n 13) 80; Van Brederode, *Systems of General Sales Taxation* (n 11) 128.

example, de la Feria and Krever have described the use of exemptions as ‘an anathema to the logic of the VAT’¹⁵ and ‘exceptions to the core principle of VAT as a tax on consumption’.¹⁶

The discussion in this thesis adds to a body of literature where the rationale for the use of standard exemptions from the GST/VAT is being questioned,¹⁷ particularly in the light of problems caused by the use of exemptions, and technological changes.¹⁸ Specifically, it questions whether there is still a valid reason for sales of used residential premises and leases of residential premises to be regarded as exempt from GST/VAT. ‘Residential premises’ are defined in the Australian GST legislation to mean ‘land or a building that: (a) is occupied as a residence or for residential accommodation; or (b) is intended to be occupied, and is capable of being occupied as a residence or for residential accommodation’.¹⁹ In the case of a house or unit, the land and building are typically sold or leased together for the one price, and so both the land and building are regarded as being the residential premises for GST/VAT purposes.²⁰ From a legal perspective buildings are regarded as fixtures that are permanently

¹⁵ Rita de la Feria and Richard Krever, ‘Ending VAT Exemptions: Towards a Post-Modern VAT’ in Rita de la Feria (ed), *VAT Exemptions: Consequences and Design Alternatives* (Wolters Kluwer, 2013) 3, 4. This has also been recognised by several other authors. See Sijbren Cnossen, ‘A Primer on VAT as Perceived by Lawyers, Economists and Accountants’ in Michael Lang, Peter Melz and Eleonor Kristoffersson (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009) 150; Ian Crawford, Michael Keen and Stephen Smith, ‘Value Added Tax and Excises’ in Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James Poterba (eds) for the Institute for Fiscal Studies, *Dimensions of Tax Design: The Mirrlees Review (Chair, Sir James Mirrlees), Vol 1* (Oxford University Press, 2010) 275, 305; Ebrill et al (n 8) 100; European Commission, *Green Paper on the Future of VAT: Towards a Simpler, More Robust and Efficient VAT System*, COM(2010) 695 final, 2010, 10.

¹⁶ de la Feria and Krever (n 15) 4.

¹⁷ Ebrill et al have acknowledged that the rationale for many standard exemptions from the VAT is being questioned: Ebrill et al (n 8) 100.

¹⁸ See, for example, Cnossen, ‘The C-Inefficiency of the EU-VAT’ (n 12); Cristina Enache, ‘VAT Expansion and Labor Tax Cuts’ (Tax Foundation Fiscal Fact No 807, January 2023); European Commission (n 15) 11.

¹⁹ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1 (‘GSTA’). See Section 1.1 for an explanation as to why there is a focus on the Australian GST.

²⁰ What is a residential premises is a complex area and this is not the only definition that could be used. For example, for accounting purposes land and buildings are treated as separate assets and accounted for separately, even in situations where they have been acquired together: Australian Accounting Standards Board, ‘Property, Plant and Equipment’, AASB 116 (Compilation No 2, 31 December 2018) para 58. However, given that the focus of this thesis is on tax law, and GST/VAT specifically, the definition of residential premises in the Australian GST legislation is applied.

attached to land and therefore they are treated as part of immovable property. This has been recognised both in the law of real property,²¹ and in tax law.²²

Currently for simplicity reasons it is assumed that the value of new residential premises at the time of first acquisition from a property developer is equal to the present value of all future consumption of the residential premises. Therefore, the current approach in Australia and in most GST/VAT jurisdictions is that GST/VAT is imposed on the original purchase price of residential premises as a proxy for the discounted present value of all future consumption of the residential premises. No input tax credits are available in relation to the first acquisition of residential premises where they are purchased by unregistered consumers. Later sales of residential premises between otherwise unregistered consumers are generally exempt or outside the scope of GST/VAT.²³ Residential leases are generally exempt to ensure neutrality between homeowners and tenants.²⁴ It is assumed that the GST/VAT borne in relation to the first purchase of the residential premises is theoretically passed on to tenants in the form of higher rent. It has been recognised in the GST/VAT literature that a problem with this approach is that while a physical building generally depreciates over time, the value of land underlying and abutting the buildings generally appreciates over the long term.²⁵ This generally leads to the market value of residential premises increasing over time.

²¹ Karena Vigilanti-Northway, *Understanding Real Property Law* (LexisNexis Butterworths, 2015) 50.

²² See further Satya Poddar, 'Taxation of Housing Under a VAT' (2010) 63(2) *Tax Law Review* 443, 445; Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 13) 12.

²³ Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 13).

²⁴ See, for example, Australian Treasury, *Tax Expenditures Statement 2015* (January 2016) 141; M Stewart, 'Taxation Policy and Housing' in Susan J Smith (ed), *International Encyclopedia of Housing and Home* (Elsevier, 2012) vol 7, 152.

²⁵ See, for example, Wei Cui, 'Learning to Keep the Consumption Tax Broad: Australian and Chinese VAT Design for the Housing Sector' in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011) 369 ('Learning to Keep the Consumption Tax Broad'); Wei Cui, 'Objections to Taxing Resale of Residential Property under a VAT' (2012) 137(7) *Tax Notes* 777, 779 ('Objections to Taxing Resale'); OECD, *Housing Taxation in OECD Countries* (OECD Publishing, 2022) 14; Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015) 409.

It has long been recognised in the tax literature that the theoretical benchmark for a personal expenditure tax measures consumption as income less amounts set aside as savings or for investment.²⁶ Expenditure is recognised as goods are consumed or devalue through usage or the effluxion of time. In lay terms consumption means using something up,²⁷ whereas for tax purposes consumption is any application of income or withdrawals from savings that are not used to create more income or invested in savings. The purchase of an asset is a form of savings. Consumption is recognised as the value of the asset decreases in value.

It is explained in Chapters 3 and 4 that if assets are immediately consumed or depreciate over time, the cost is the present value of their future use, and tax on the initial purchase price will correspond with taxation of all future consumption. However, where the asset does not waste, taxation of the initial purchase price of the asset does not correspond to the present value of future consumption. Where the market value of the asset increases over time, the value of savings rises. These savings are effectively consumption that is deferred to a later period.²⁸ They result in the value of total consumption of the asset also rising. Upfront (prepaid) taxation cannot capture the full value of consumption as the asset rises in value.

The GST/VAT does not and should not tax gains that are associated with investment. Increases in the value of investment represent increases in savings and these are never taxed under the

²⁶ See Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (The University of Chicago Press, 1938) 7. The increase in the consumption value of residential premises is not already captured by rates imposed by some local councils. These rates are a form of property tax that is imposed for a different purpose, to fund the provision of goods and services supplied by local councils. An increase in the value of residential premises does not necessarily lead to an increase in rates payable. Rates are calculated based on determining the rate revenue required and then dividing this across rateable properties, and the value of land generally appreciates due to factors which affect a broader location, such as the building of new amenities.

²⁷ In the Oxford English Dictionary consumption is defined as '[t]he action or fact of destroying or being destroyed; destruction': Oxford English Dictionary (online at 12 February 2023) <<https://www.oed.com/view/Entry/39997?redirectedFrom=Consumption#eid>>.

²⁸ This has been recognised by Graetz: see Michael J Graetz, 'Implementing a Progressive Consumption Tax' (1979) 92(8) *Harvard Law Review* 1575, 1613.

GST/VAT. If shares are purchased for \$200,000 and sold for \$400,000 the gain of \$200,000 is taxed under the income tax. The shares are a pure investment asset. If the \$400,000 from selling the shares is used to purchase a high-end car, the \$400,000 is taxed under the GST/VAT when the car is purchased, as the consumption of assets is taxed under the GST/VAT. If the consumption value of the car appreciates in value and the car is sold for \$800,000, the gain may be taxable under the income tax (if capital gains are included).

Only the services provided from making investments available such as renting assets should be taxable under the GST/VAT. The value of the use of an asset rises if the asset appreciates in value. If the value of a commercial property keeps rising, the rental also rises, and the GST/VAT on the building rises. For example, if a commercial property worth \$1 million is rented for \$100,000 per year, the rent might increase to \$200,000 a year if the property appreciates over time.

This should be the same for residential property where the tenant might also be the landlord. If the owner consumes the value herself by using the property personally instead of renting it to a third party and the value of the residential property increases, then the value of imputed consumption rises. Any gain or loss is taxed separately under the income tax only on realisation. It is suggested in this thesis that whatever value is used as the imputed rate of return, that rate should continue to be applied as the asset rises or falls in value.

The GST/VAT treatment of residential premises is particularly problematic given that residential premises generally have a long life, appreciate over the long term and are of

significant value.²⁹ This has been well recognised in the GST/VAT literature. For example, Cnossen has found that it is likely that unanticipated changes will occur in the value of residential premises and the services they render, and these are not included in the GST/VAT base. He has also noted that increases in the value of exempt property, which reflect the value of the services rendered by the property, are not included in the base, but this would be desirable.³⁰ As the value of the residential premises appreciates the value of savings rises. Therefore, the value of total consumption of the residential premises also increases. Where this is the case the value of total consumption is greater than the value that was taxed at the time of first purchase.³¹

The savings resulting from the appreciation in the value of residential premises do not result from more spending. They are a form of capital accumulation, an unrealised gain that yields an increase in the consumption value of the residential premises, as represented by their market value.³² Theoretically the increased value of consumption should be brought within the GST/VAT base. As a form of consumption tax, the aim of GST/VAT is to tax final consumption.³³ However, as GST/VAT is imposed only on the first sale of the residential

²⁹ Graetz has recognised that there are other goods such as jewellery and works of art which also have components of both consumption and investment, but that '[h]ousing is typically the most expensive and most enduring of consumer durables, and, in a time of rising housing prices, often turns out to be a family's most important investment': *ibid* 1613. Commercial property also appreciates in value over time, but those purchasing or renting commercial property are generally registered for GST/VAT and are therefore entitled to input tax credits.

³⁰ Sijbren Cnossen, 'A Proposal to Improve the VAT Treatment of Housing in the European Union' in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Kluwer Law International, 2013) 225 ('A Proposal to Improve the VAT Treatment of Housing').

³¹ See the following sources for examples of where this has been recognised in the literature: Cnossen, 'A Proposal to Improve the VAT Treatment of Housing' (n 30) 225; Cui, 'Learning to Keep the Consumption Tax Broad' (n 25); de la Feria and Krever (n 15) 27; Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review (Chair, Sir James Mirrlees)*, Vol 2 (Oxford University Press, 2011) 380; Poddar (n 22) 449–53.

³² In 1921 Haig commented on the British practice of excluding gains from appreciation in property values and noted that this was a product of a practical local situation and called it illogical: Robert Murray Haig, 'The Concept of Income – Economic and Legal Aspects' in Robert Murray Haig (ed), *The Federal Income Tax* (Columbia University Press, 1921) 1, 21.

³³ See, for example, Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, 6; OECD, *Consumption Tax Trends 2020* (n 2) 12.

premises no further GST/VAT is collected on the increased value of consumption. This is inconsistent with the GST/VAT policy objective of taxing consumption, as it can lead to a result where there is consumption that is not included within the GST/VAT base. While the GST/VAT paid is theoretically passed on in terms of the price paid by future purchasers, these purchasers have an effective tax burden equal to the present value of the tax at the time of acquisition, and no GST/VAT is imposed in relation to the increased consumption value of the residential premises. The government receives no further tax relating to the consumption of the residential premises.

The purpose of the GST/VAT is to raise revenue, but it is designed to aim to ensure that it is done efficiently and fairly, meaning that as far as possible all consumption should be taxed the same. For example, according to Schenk, Thuronyi and Cui, '[t]he value added tax is intended to tax personal consumption comprehensively, neutrally, and efficiently. The VAT... has proved to be a major source of government revenue'.³⁴ Horizontal equity applies to the GST/VAT so that two persons enjoying the same value of economic consumption should pay the same tax as a matter of fairness. This can be seen in the way that the GST/VAT applies to a broad base.

However, there is a bias in the tax system in favour of home ownership. The current GST/VAT treatment of supplies of residential premises is one aspect of this bias.³⁵ The non-taxation of the general appreciation in the value of residential premises results in consumption which is not taxed. This encourages the purchase of residential premises as opposed to other assets, and the increased demand for residential premises in turn leads to an increase in the price of

³⁴ Schenk, Thuronyi and Cui (n 25) 23.

³⁵ Other examples of where this bias can be seen include the capital gains tax exemption for main residences and negative gearing.

residential premises and the price of residential leases. This results in residential premises being less affordable and greater wealth inequality. The gap between the rich and poor is widened. It is more common for the wealthy to live in expensive houses and for people in this category to experience the greatest amounts of untaxed appreciation. The under taxation of residential premises benefits those most able to pay the greatest amount for residential premises. On the other hand, lower income earners use proportionately more of their income for consumption and are generally less able to allocate money to savings which are not taxed.³⁶

Equity and efficiency are important to tax policy,³⁷ and a focus of tax reform should be about addressing gaps that cause inequality and inefficiency to improve fairness. The discussion in this thesis considers whether the appreciation of residential premises should be brought within the GST/VAT base.

1.3 Structure of the Thesis

This thesis consists of eight interrelated chapters. It is not a standard monograph. It is a thesis with publications following the guidelines of the University of Canterbury.³⁸ It includes a combination of traditional chapters, peer-reviewed publications and a manuscript in preparation for submission. It does not include a separate literature review because the literature review is covered within the discussion in the thesis chapters. In these chapters

³⁶ This has been recognised by de la Feria: see Rita de la Feria, 'EU VAT Rate Structure: Towards Unilateral Convergence?' (Oxford University Centre for Business Taxation Working Paper No WP 13/05, Centre for Business Taxation, 2013) 20.

³⁷ This has been recognised by Murphy and Nagel: see Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2004) 12.

³⁸ University of Canterbury, 'A Guideline to Including Publications within a Doctoral Thesis' (Version 1.4 – updated 3 July, 2022).

there is also a discussion of the methodology used. The main focus of the chapters is explained below.

1.3.1 Chapter 2: Evaluation of the Current GST/VAT Treatment of Supplies of Residential Premises

In Chapter 2 one of the common issues that arises with the current GST/VAT treatment of supplies of residential premises is discussed as an example of an issue that arises with this approach. This discussion in this chapter contributes to the GST/VAT literature as it considers an issue which has been subject to little scholarly discussion. It provides the first comparative analysis of the legal approaches taken to the GST/VAT treatment of supplies of renovated residential premises.³⁹

Some of the main legal issues that have arisen in Australia, Canada and the European Union regarding the GST/VAT treatment of supplies of residential premises that have been substantially renovated are discussed. The legal approaches taken to these issues in these jurisdictions are compared and evaluated against a benchmark goal of creating a new taxing point where a substantial portion of the value of renovated residential premises being transferred by way of sale is new value that was not included at the time the residential premises were first sold. This comparative analysis indicates that the legal approaches that have been taken have sometimes produced outcomes which are inconsistent with the benchmark goal. It also shows that deciding whether work that has been done to residential premises should lead to the residential premises being regarded as new again based on the

³⁹ For example, cases discussed in Chapter 2 include *Erickson v The Queen* [2001] GSTC 19, *Lair v The Queen* [2003] TCC 929 and *Marana Holdings Pty Ltd v Federal Commissioner of Taxation* (2004) 141 FCR 299; 57 ATR 521; [2004] FCAFC 307.

facts of the situation can lead to uncertainty. A statutory solution is offered to provide certainty as to when renovations will lead to the creation of a new taxing point.

1.3.2 Chapter 3: Alternative Approach One: Including Imputed Rent in the GST/VAT Base

The discussion in this thesis then moves on to consider two alternative approaches to the GST/VAT treatment of supplies of residential premises. The first of these approaches, the possibility of including imputed rent in the GST/VAT base, is considered in Chapters 3, 4 and 5. Imputed rent is the theoretical value of the residential services that an owner-occupier receives for living in their home.⁴⁰ No jurisdiction has ever included imputed rent in its GST/VAT base. The discussion in these chapters builds on an earlier recommendation in the United Kingdom Mirrlees Review's *Tax by Design* that imputed rent be included in the GST/VAT base.⁴¹

In Chapter 3 it is discussed that in the past it has generally been regarded as too difficult to include imputed rent in the GST/VAT base, primarily because of concerns about how to value imputed rent⁴² and about how such a proposal would affect those with a low income or no income.⁴³ Two historic examples of imputed rent being included in the income tax base are discussed, along with ways that concerns that have been expressed about the idea of including imputed rent in the GST/VAT base could be addressed.

⁴⁰ See Donald B Marsh, 'The Taxation of Imputed Income' (1943) 58(4) *Political Science Quarterly* 514, 514; Australian Treasury, *Australia's Future Tax System: Consultation Paper* (December 2008) 206.

⁴¹ See Institute for Fiscal Studies (n 31) 384.

⁴² See Sijbren Cnossen, 'VAT Treatment of Immovable Property' in Victor Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, 231, 242 ('VAT Treatment of Immovable Property'); Cnossen, 'Global Trends' (n 6).

⁴³ See Graetz (n 28) 1621.

1.3.3 Chapter 4: Including Imputed Rent in the GST/VAT Base: Further Ideas

In Chapter 4 how imputed rent could be included in the GST/VAT base is elaborated upon. For example, it is suggested that to determine the estimated amount of imputed rent that should be subject to GST/VAT current market values could be increased yearly by an assumed appreciation rate and multiplied by an assumed market rental rate. It is suggested that this alternative approach of including imputed rent in the GST/VAT base might have a downward effect on the price of residential premises and on residential rent and that this could go some way to addressing housing affordability concerns.

1.3.4 Chapter 5: Simulation Showing How Imputed Rent Could Be Calculated

In Chapter 5 a simulation is provided explaining how a homeowner's annual tax liability could be calculated if imputed rent were included in the GST/VAT base. Several policy alternatives regarding the values that could be given to each of these variables are discussed, along with what would happen if the values of these variables were increased or reduced. Ways in which the GST/VAT could be collected periodically are discussed, along with potential implementation issues that could arise from this approach.

1.3.5 Chapter 6: Alternative Approach Two: Including Sales of Residential Premises in the GST/VAT Base

A feature that has been common to much of the literature on the optimal GST/VAT treatment of supplies of residential premises is a call for sales of residential premises between otherwise unregistered homeowners to be included in the GST/VAT base, with deferred input tax credits

available in relation to the initial acquisition.⁴⁴ This is the second alternative approach to be considered in this thesis, and this is considered in Chapters 6 and 7. In Chapter 6 the earlier literature where this approach is recommended is reviewed. Multiple ways are considered as to how GST/VAT could be collected in relation to sales of residential premises by otherwise unregistered homeowners without them having to register for GST/VAT purposes.

In this chapter issues relating to the appropriate quantum of input tax credits that could be available as deferred input tax credits are also considered. However, unlike the authors of the earlier literature recommending this approach, it is suggested in this chapter that if sales of residential premises were included within the GST/VAT base then homeowners should not be entitled to claim input tax credits. Allowing homeowners input tax credits would mean that residential premises would be treated as a pure investment, and it would not fully acknowledge that residential premises have both consumption and investment components.

1.3.6 Chapter 7: China's VAT Treatment of Consumer-to-Consumer (C2C) Supplies of Residential Premises

The only exception to the current general GST/VAT treatment of supplies of residential premises can be found in China, where since 2016 some C2C supplies of residential premises have been subject to VAT.⁴⁵ However, this VAT treatment has not been discussed in detail in

⁴⁴ See Cnossen, 'A Proposal to Improve the VAT Treatment of Housing' (n 30) 227; Committee on Value Added Tax of the American Bar Association Section of Taxation, *Value Added Tax: A Model Statute and Commentary* (Tax Management Education Institute, 1989); Robert F Conrad, 'Value Added Taxation and Real Estate' (World Bank Development Research Department Discussion Paper No DRD224, February 1987) 25; Robert F Conrad, 'The VAT and Real Estate' in Malcolm Gillis, Carl S Shoup and Gerardo P Sicat (eds), *Value Added Taxation in Developing Countries* (The World Bank, 1990) 95, 102; Robert Conrad and Anca Grozav, 'Real Property and VAT' in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 81, 90; Poddar (n 22) 443; Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 13) 16.

⁴⁵ Ministry of Finance, People's Republic of China, Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner, Caishui [2016] No 36 (23 March 2016).

the international VAT literature. In Chapter 7 the VAT treatment of C2C supplies of residential premises in China is considered, and this chapter contains analysis as to whether this VAT treatment provides a model for other GST/VAT jurisdictions to follow.

1.3.7 Chapter 8: Conclusion

Finally, an overview of the research in this thesis and its findings is provided in Chapter 8. In this chapter there is a discussion of the contributions of this thesis to the GST/VAT literature, the limitations of this thesis and a discussion of potential future areas of research relating to the GST/VAT treatment of supplies of residential premises.

1.4 Research Gap

It has generally been considered too difficult to include imputed rent within the GST/VAT base.⁴⁶ However, in 2011 in the United Kingdom report of the Mirrlees Review it was suggested by the Institute for Fiscal Studies that it might be possible to do this.⁴⁷ The discussion in this thesis builds on this finding. Whether including imputed rent in the GST/VAT base would produce a result which would be more consistent with the GST/VAT policy objective of taxing consumption is considered. This discussion adds further insight into how imputed rent could be included in the base. It also considers an alternative approach that has been recommended in the GST/VAT literature of including sales of residential premises in the GST/VAT base and considers how this approach has been taken with respect to some C2C supplies of residential premises in China. The discussion in this thesis provides the most

⁴⁶ See, for example, Cnossen, 'Global Trends' (n 6) 405; Cnossen, 'VAT Treatment of Immovable Property' (n 42); Poddar (n 22) 452; Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 13) 19.

⁴⁷ Institute for Fiscal Studies (n 31).

detailed study in the English-speaking literature of the VAT treatment of C2C supplies of residential premises in China.

1.5 Research Questions

The main research question is:

Is there a way to tax the consumption of residential premises which is more consistent with the GST/VAT policy objective of taxing consumption compared to the current approach?

As mentioned in Section 1.1, the current approach is that sales of new residential premises are taxable, whereas subsequent sales of residential premises and residential leases are exempt from GST/VAT.

The secondary research questions are:

- 1. Are current legal approaches taken to determining whether sales of renovated residential premises are taxable consistent with the benchmark goal of creating a new taxing point where a substantial portion of the value of renovated residential premises being transferred is new value?*
- 2. Would including imputed rent in the GST/VAT base be a viable way to tax the consumption of residential premises? Would this be more consistent with the GST/VAT policy objective of taxing consumption compared to the current approach? How could imputed rent be included in the GST/VAT base?*

3. *How could sales of residential premises between otherwise unregistered homeowners be brought within the GST/VAT base? Would this be more consistent with the GST/VAT policy objective of taxing consumption as compared to the current approach?*
4. *How does the VAT treatment of C2C supplies of residential premises in China operate? Could this approach provide a model that could be adopted in other jurisdictions with a GST/VAT?*

1.6 Overview of Research Methodology

A 'mixed methods' approach is adopted in this thesis.⁴⁸ Most of the data analysed is qualitative, but quantitative data is also analysed.⁴⁹ A variety of approaches are taken to answer the research questions. The main approaches taken are doctrinal research, document analysis, comparative research, a case study approach, and a quantitative approach.

1.6.1 Doctrinal Research

Much of the research in this thesis is doctrinal. For example, some of the research in Chapters 2 and 7, in particular, is doctrinal. This discussion explains aspects of the current GST/VAT treatment of supplies of residential premises in Australia, Canada, and the European Union (Chapter 2), and China (Chapter 7). Hutchinson has defined doctrinal research as 'library-based, focussing on a reading and analysis of the primary and secondary materials'.⁵⁰

⁴⁸ McKerchar has observed that a mixed methodology 'has more than one methodological element': Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters, 2010) 118. Bell, Bryman and Harley have described mixed research methods as 'research that combines qualitative and quantitative research': Emma Bell, Alan Bryman and Bill Harley, *Business Research Methods* (Oxford University Press, 5th ed, 2018) 27.

⁴⁹ According to Creswell and Plano Clark, collecting and analysing qualitative and quantitative data is one of the core characteristics of mixed methods research: John W Creswell and Vicki L Plano Clark, *Designing and Conducting Mixed Methods Research* (Sage Publications, 3rd ed, 2018) 5.

⁵⁰ Terry Hutchinson, *Researching and Writing in Law* (Thomson Reuters, 3rd ed, 2010) 7.

Similarly, McKerchar has observed that '[a]s a methodological approach, doctrinal research is typically based on the "black-letter" (or literal) analysis of formal legal rules and principles',⁵¹ and Dobinson and Johns have observed that a researcher using the doctrinal method 'seeks to collect and then analyse a body of case law, together with any relevant legislation ... This may also include secondary sources such as journal articles or other written commentaries on the case law and legislation'.⁵²

1.6.2 Document Analysis

The discussion in Chapters 3, 4, 6 and 7 involves document analysis. According to Bowen, document analysis involves examining and interpreting documents to gain understanding.⁵³ In Chapters 3 and 4 the current GST/VAT literature relating to including imputed rent in the GST/VAT base is discussed. In Chapter 6 the suggestions of several authors which have recommended bringing sales of residential premises between otherwise unregistered homeowners into the GST/VAT base are discussed and compared.

In Chapter 7 the primary data analysed to review the VAT treatment in China was legal documents published by various government ministries, setting out relevant policies and laws. A bilingual research assistant collected English translations of these legal documents, using the following legal databases: LexisNexis, PKULAW.COM and Wolters Kluwer China Law & Reference. Other legal databases are also available in China, but these three databases were used as they are some of the databases which are most used by Chinese legal scholars.⁵⁴

⁵¹ McKerchar (n 48) 115.

⁵² Ian Dobinson and Francis Johns, 'Legal Research as Qualitative Research' in Mike McConville and Wing Hong Chui (eds), *Research Methods for Law* (Edinburgh University Press, 2nd ed, 2017) 21.

⁵³ Glenn A Bowen, 'Document Analysis as a Qualitative Research Method' (2009) 9(2) *Qualitative Research Journal* 27, 27.

⁵⁴ Westlaw China is also a commonly used legal database, but it is not possible to download English translations from Westlaw China.

It was necessary to consult all three of these legal databases to obtain copies of the relevant materials, as each database contains different materials and not all legal databases allow downloading of all materials in English.

1.6.3 Comparative Research

In Chapter 2 a comparative research methodology is also adopted.⁵⁵ In this chapter the legal approaches taken in Australia, Canada and the European Union to determine whether supplies of renovated residential premises are taxable or exempt are compared. These approaches are evaluated by reference to whether they achieve the benchmark goal of creating a new taxing point where a substantial portion of the value that is being transferred by way of sale is new value that was not included at the time the residential premises were first sold. The VAT system in the European Union is considered as an example of a traditional VAT system, and the legal approaches taken to this issue in Australia and Canada are discussed as examples of jurisdictions with modern GST systems.⁵⁶ Any references in this thesis to countries are used as examples of existing rules. This thesis focuses on technical issues and proposals for reform in line with the goals of a benchmark GST/VAT, not to particular countries.

⁵⁵ See Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International, 2003) 313; Michael Salter and Julie Mason, *Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research* (Pearson Education Limited, 2007) 183.

⁵⁶ Cui refers to the same countries as examples where he mentions the traditional and modern VAT. See Cui, 'Objections to Taxing Resale' (n 25) 779. It is particularly common in the GST/VAT literature for the European Union to be regarded as an example of a traditional VAT system and for the New Zealand GST to be regarded as an example of the modern GST system, given that the New Zealand GST has been regarded as a model of modern GST law. See, for example, Richard Krever, 'Designing and Drafting VAT Laws for Africa' in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 9, 13–19; Andrew Maples and Adrian Sawyer, 'The New Zealand GST and Its Global Impact: 30 Years On' (2017) 23(1) *New Zealand Journal of Taxation Law and Policy* 9, 9; Marianne Steurer, 'VAT and Direct Tax Policy on Exemptions' in Sebastian Pfeiffer and Marlies Ursprung-Steindl (eds), *Global Trends in VAT/GST and Direct Taxes* (Linde Verlag, 2015) 89, 91.

1.6.4 A Case Study Approach

The research in Chapter 7 involves an exploratory case study approach. Bell, Bryman and Harley have described a basic case study as involving ‘the detailed and intensive analysis of a single case’.⁵⁷ Stake has observed that ‘[w]e study a case when it itself is of very special interest’.⁵⁸ The VAT treatment of C2C supplies of residential premises in China has been chosen as a single unit, intrinsic specific case to study, given that there are aspects of this treatment which are different to the GST/VAT treatment of these supplies in every other jurisdiction with a GST/VAT, and in this sense these aspects of the VAT treatment in China are unusual.⁵⁹

1.6.5 Quantitative Research

A quantitative research methodology is adopted in the article which is included in Chapter 5.⁶⁰ Australian Bureau of Statistics (ABS) data is the main source used to provide estimates.⁶¹ In addition, as there is no current ABS data published on rental yields and as the ABS uses data supplied by CoreLogic to compile its statistics for its ‘Residential Property Price Indexes: Eight Capital Cities’ publication,⁶² which is referred to in Chapter 5, the market rental rate used for the purposes of the simulation is based on the national rental yield published by CoreLogic.

⁵⁷ Bell, Bryman and Harley (n 48) 63.

⁵⁸ Robert E Stake, *The Art of Case Study Research* (Sage Publications, 1995) xi.

⁵⁹ Yin confirms that a rationale for a single case can be that the case is unusual: Robert K Yin, *Case Study Research: Design and Methods* (Sage Publications, 5th ed, 2014) 52.

⁶⁰ Christine Peacock, ‘Shifting from Pre-Paid to Periodic GST on the Consumption of Residential Premises’ (2023) 38(2) *Australian Tax Forum* 199-223.

⁶¹ McKerchar has observed that quantitative research involves knowledge claims that are reliable and valid: McKerchar (n 48) 92.

⁶² Australian Bureau of Statistics, *Residential Property Price Indexes: Eight Capital Cities* (Catalogue No 6416.0, 15 March 2022).

1.7 Significance of the Research

Compared to many other forms of taxation, GST/VAT is a relatively young tax that is under-researched.⁶³ Immovable property⁶⁴ is the most frequently consumed asset to appreciate and expenditure on housing services often comprise a large percentage of total consumption of an individual. In this regard, Millar has written that '[i]mmovable property is the most widely held and traded appreciating asset and a purchase of immovable property is more often than not the single most significant acquisition a person will make in his/her lifetime'.⁶⁵ Similarly, Graetz has written that '[h]ousing is typically the most expensive and most enduring of consumer durables, and, in a time of rising housing prices, often turns out to be a family's most important investment'.⁶⁶ The discussion in this thesis provides new insights into ways in which the consumption of residential premises could be included in the GST/VAT base. For example, it provides a simulation showing how the annual GST/VAT liability of a homeowner could be calculated and it is the most comprehensive work in English discussing the unique VAT treatment of C2C supplies of residential premises in China.

⁶³ White has noted that the New Zealand GST, as well as GST and VAT systems generally, have been under-researched: David White, 'Twenty Years of GST: The Best Path Forward' (2007) 13(3) *New Zealand Journal of Taxation Law and Policy* 357, 360–9.

⁶⁴ In tax literature the term 'immovable property' is generally understood to include land, buildings and fixtures, both commercial and residential: Poddar (n 22) 445–56. In several countries, including Australia, 'immovable property' is referred to as 'real property'. Given the international importance of this thesis, 'immovable property' is generally referred to in this thesis by its common name.

⁶⁵ Rebecca Millar, 'VAT and Immovable Property: Full Taxation Models and the Treatment of Capital Gains on Owner-Occupied Residences' in Rita de la Feria (ed), *VAT Exemptions: Consequences and Design Alternatives* (Wolters Kluwer, 2013) 253, 262. See also The Institute for Fiscal Studies, *The Structure and Reform of Direct Taxation: Report of a Committee Chaired by Professor JE Meade* (George Allen & Unwin (Publishers) Ltd, 1978) 54 and Poddar (n 22).

⁶⁶ Graetz (n 29) 1613. Cnossen has recognised that '[i]n most industrial countries, housing services, comprising rents and rental values of owner-occupied dwellings, constitute 15 percent or more of total annual consumption expenditures as computed for national accounts purposes': Cnossen, 'VAT Treatment of Immovable Property' (n 42) 231. Van Brederode has also observed that 'expenditure on housing is significant': Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 13) 26. Similarly, Poddar has written that 'expenditures on housing are perhaps the single largest component of the consumer basket': Poddar (n 22) 443–4.

1.8 Summary

The discussion in this chapter has provided an overview of the thesis by introducing the background to the topic, structure of the thesis, research gap, research questions, methodology, and significance of the research. It has highlighted that a variety of methodological approaches will be used to answer the research questions. New insights will be provided into ways in which the consumption of residential premises could be included in the GST/VAT base.

There will be an emphasis on considering two alternative approaches to the current GST/VAT treatment of supplies of residential premises. The first of these approaches will be the possibility of including imputed rent in the GST/VAT base. The discussion of this approach builds on an earlier finding of the United Kingdom report of the Mirrlees Review that it might be possible to do this and adds further insight into how this could be done. It provides a simulation explaining how a homeowner's annual tax liability could be calculated if imputed rent were included in the GST/VAT base.

The second alternative approach considered is an approach which has been recommended in the GST/VAT literature of including sales of residential premises between otherwise unregistered homeowners in the GST/VAT base. The discussion in this thesis provides the most comprehensive work in English discussing the VAT treatment of C2C supplies of residential premises in China, the only jurisdiction that includes these supplies in the GST/VAT base. Whether the VAT treatment in China could provide a model for other jurisdictions to follow is considered. The two alternative approaches discussed in this thesis are compared

and evaluated to find whether either approach produces a result which is more consistent with the GST/VAT policy objective of taxing consumption compared to the current approach.

In the next chapter one of the common issues that arises with the current GST/VAT treatment of supplies of residential premises will be discussed. This is whether the legal approaches taken to the GST/VAT treatment of supplies of renovated residential premises align to the benchmark goal of creating a new taxing point where a substantial portion of the value of renovated residential premises being transferred by way of sale is new value that has not been included at the time the residential premises were sold. This discussion highlights an issue that arises with the current approach. It provides a comparative analysis of the legal approaches taken to this issue.

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Chapter 2: Evaluation of the current GST/VAT treatment of supplies of residential premises*

2.1 Introduction

It is well recognised in the GST/VAT¹ literature that the intended underlying policy objective is to tax expenditure on private consumption.² For example, Millar has recognised that ‘the objective of a VAT is to tax consumption ... Consumption is measured by reference to *consumption expenditure*’.³ All household consumption expenditure is regarded as part of the theoretical GST/VAT base. However, there would be inherent administrative and compliance limitations in imposing tax on self-supplies of consumption services and on supplies of goods and services between otherwise unregistered consumers. In practice, the GST/VAT does not operate as an expenditure tax.⁴ GST/VAT is collected on a ‘proxy’ for consumption – that is, taxable supplies that are made by registered entities, generally referred to as ‘taxable persons’.

While the GST/VAT is not directly collected from consumers, the effect of the input tax credit mechanism is that the burden of GST/VAT rests on final consumers. Generally, entities that

* This is a modified version of the published article Peacock, Christine, ‘What does it take to make a house new?’ (2021) 50(1) *Australian Tax Review* 22-42.

¹ While VAT was the traditional name for the broad-based consumption tax system implemented in the European Union, countries that have more recently introduced this type of tax, such as New Zealand, Canada and Australia, have called it GST.

² See Richard Krever, “Designing and Drafting VAT Laws for Africa” in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 10; Rebecca Millar, “Echoes of Source and Residence in VAT Jurisdictional Rules” in M Lang, P Melz and E Kristoffersson (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009) 294; James Mirrlees et al, *Tax by Design: The Mirrlees Review* (OUP, 2011) 149; OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020) 12.

³ Millar, n 2, 294 (emphasis in original).

⁴ Graetz distinguishes an expenditure tax from a VAT, stating that a narrowing of the tax base typically accompanies the VAT, while an expenditure tax should relate to an individual’s overall consumption: Michael J Graetz, “Implementing a Progressive Consumption Tax” (1979) 92(8) *Harvard Law Review* 1575, 1578.

carry on taxable activities in the course of a business and meet certain threshold requirements may register for GST/VAT. Once registered, they are entitled to an offset of GST/VAT paid on inputs purchased to produce taxable supplies. This means that no GST/VAT is borne by intermediate registered businesses that are involved in the production chain. The ultimate burden of this multi-stage tax falls on consumers who are unable to register for GST/VAT where they are not otherwise conducting a business activity.

In theory there is an element of investment in durable goods, in the form of consumption that is deferred to later periods.⁵ Consumption does not occur at the time that the durable good is first purchased, but rather as the good is used. The theoretically correct approach would be to treat the purchase of a consumer durable as an investment and allow an immediate deduction for the cost of consumer durables, then tax the flow of consumption over time as the consumer durable depreciates and is used. This would mean that purchasers and renters of consumer durables would be treated equally. However, in practice the date of first purchase of consumer durables is treated as a proxy for the time they are consumed,⁶ and GST/VAT is charged at the time that goods are first purchased from a registered person.⁷ If goods have a durable nature, and are later supplied between unregistered consumers, these later supplies are not included in the GST/VAT base. It is assumed that GST/VAT paid at the time that the durable good is first purchased from a taxable person is a close proxy for the discounted present value of the tax that should have been levied on the future consumption

⁵ See Graetz, n 4, 1613.

⁶ See Robert F Conrad, "Value Added Taxation and Real Property" [1987] *World Bank* 1, 2.

⁷ Cnossen has observed that this is the case irrespective of whether the goods are immediately consumed or embody a 'stock of services' consumed over a period of time: Sijbren Cnossen, "A VAT Primer for Lawyers, Economists, and Accountants" in *The VAT Reader: What a Federal Consumption Tax Would Mean for America* (Tax Analysts, 2011) 23, 38.

services that the durable good provides.⁸ This is not the case where the value of the consumer durable appreciates over time, as in this case the total value of consumption of the durable good would be more than the value that was taxed at the time that the durable good was first purchased.⁹

Residential premises are one of the most commonly held consumer durables where this issue arises. The ideal theoretical GST/VAT treatment of residential premises is like that of other consumer durables. As Krever states:

The theoretical problem raised by immovable property in one sense arises with any capital asset that yields benefit over many years. The acquisition of a long-life asset is an investment, not an asset of consumption. The consumption takes place over the life of the asset as it is used up. The very purest theoretical VAT would rebate the tax paid on the initial acquisition and would instead treat the purchaser as if he or she were renting the asset to him or herself each tax period. In this way, the person who buys a long-life consumer asset (for example, a car or appliance) would be treated exactly the same as the person who put the money in the bank and then rents the asset over a similar period.¹⁰

It would be consistent with the theoretical GST/VAT treatment of residential premises to exclude the initial value of the residential premises from the GST/VAT base, and instead tax the imputed rent from owner-occupied housing. This has been described as ‘the net value of the services rendered by a house to its owner (occupier) for which he would otherwise pay

⁸ See Sijbren Cnossen, “VAT Treatment of Immovable Property” in V Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) 233.

⁹ See Christine Peacock, “Is There a Viable Way to Tax the Consumption of Immovable Property That Is More Consistent with the Economic Objective of the VAT?” (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336, 339.

¹⁰ Krever, n 2, 24.

cash rent to a landlord'.¹¹ Ideally, from an economic perspective, both residential rent as well as imputed rent from owner-occupied residential premises should be included within the theoretical GST/VAT base, as both types of rent involve the supply of housing services that are consumed.¹² This would achieve the correct result from a neutrality perspective. Land should be treated the same as buildings – while land itself may not be consumed, it generates consumption services.¹³ In Australia, imputed rent of owner-occupied dwellings has been included in the Australian Bureau of Statistics measure of final consumption expenditure.¹⁴

However, it has typically been considered too complicated to include imputed rent in the GST/VAT base,¹⁵ as it would be difficult to register otherwise unregistered homeowners, collect GST/VAT from them and calculate the value of imputed rent. For example, Cnossen has argued that:

[T]he registration of all owner-occupiers, as well as the computation of all rental values, would present formidable administrative problems that a VAT should not take on ... Politically, taxing rental values under the VAT would be even harder to accomplish. It would be difficult to explain to owner-occupiers that taxing the rental value of their dwelling under the income tax as well as under the VAT would not constitute double taxation.¹⁶

¹¹ Donald B Marsh, "The Taxation of Imputed Income" (1943) 58 *Political Science Quarterly* 514, 514. See also Peacock, n 9.

¹² Cnossen, n 7, 38.

¹³ See Sijbren Cnossen, "Global Trends and Issues in Value Added Taxation" (1998) 5(3) *International Tax and Public Finance* 399, 405; Cnossen, n 8, 235.

¹⁴ Australian Bureau of Statistics, 5204.0.55.011 *Australian National Accounts: Distribution of Household Income, Consumption and Wealth, 2003-04 to 2011-12* (2014). For this purpose, average rents in various categories (eg urban and rural) are multiplied by the number of owner-occupied residential premises in those categories: Australian Bureau of Statistics, 5216.0 – *Australian National Accounts: Concepts, Sources and Methods* (2000) 14.42.

¹⁵ In fact, 'no country in the OECD taxes or has ever contemplated taxing the imputed rental value of owner-occupied property under the VAT': Cnossen, n 8, 242.

¹⁶ Cnossen, n 8, 231. See also Robert F van Brederode, "Theory and Practice of VAT Treatment of Real Estate" in Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) 1, 19; John F Due, "Some Unresolved Issues in Design and Implementation of Value Added

Further, paying tax on imputed values may be onerous for persons with low cash incomes.¹⁷

Instead, the GST/VAT treatment of residential premises follows the legal approach discussed above. The value of new residential premises when they are sold from a taxable person to the first consumer is generally included in the base.¹⁸ No input tax credits are available in relation to the purchase of new residential premises where they are purchased by otherwise unregistered consumers. Sales of used residential premises between otherwise unregistered consumers and residential leases are generally regarded as either input taxed supplies or outside the scope of GST/VAT.¹⁹ Where there is an input taxed supply, no GST/VAT is payable when the supply is made, and there is no entitlement to input tax credits in relation to anything acquired to make the supply.²⁰

An assumption is made under what is commonly known as the ‘prepaid method’ – that is, the value of the property (and hence consumption from owning it) was captured on the initial supply.²¹ This legal design means that any value added is not included in the tax base. An

Taxes” (1990) 43(4) *National Tax Journal* 383; Satya Poddar, “Taxation of Housing under a VAT” (2009) 63 *Tax Law Review* 443, 452; Cnossen, n 13, 405; Krever, n 2, 24.

¹⁷ See Graetz, n 4, 1621.

¹⁸ For example, in the Australian GST White Paper it was reported that ‘[t]he construction and sale of new homes and repairs and renovations to existing homes, will be subject to GST in the normal manner’: Treasury, *Tax Reform Not a New Tax a New Tax System: The Howard Government’s Plan for a New Tax System* (Australian Government, 1998) 97.

¹⁹ This results in neutrality between owner-occupiers and lessees.

²⁰ The term ‘input taxed supply’, which is most commonly used in Australia, is used throughout this chapter. However, in other jurisdictions, input taxed supplies are generally known as ‘exempt supplies’. Therefore, when discussing the legal approaches taken to this issue in Canada and the European Union, the term ‘exempt supply’ is used.

²¹ The use of the prepaid method has been well documented in the GST/VAT literature; however, the assumption made under this method is questionable as the market value of immovable property may appreciate over time: see, eg, Cnossen, n 13, 405; Wei Cui, “Objections to Taxing Resale of Residential Property under a VAT” (2012) 137 *Tax Notes* 777, 779–790; Rita de la Feria and Richard Krever, “Ending VAT Exemptions: Towards a Post-modern VAT” in Rita de la Feria (ed), *VAT Exemptions: Consequences and Design Alternatives* (Wolters Kluwer, 2013) 25–28; Sijbren Cnossen, “A Proposal to Improve the VAT Treatment of Housing in the European Union” in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Kluwer Law International, 2013) 225; Peacock, n 9, 339–341; Christine Peacock, “Taxing the Consumption of Owner-occupied Residential Property” (2013) 5 *International VAT Monitor* 299, 299–301.

exception to this is that the legislative scheme of the GST/VAT generally allows for the supply of substantially renovated residential premises to be brought back within the GST/VAT base. A supply of substantially renovated residential premises is regarded as equivalent to the supply of new residential premises. If a property requires substantial renovation to be resold, it is expected that most of the value of the residential premises that was included in the GST/VAT base when it was first sold to a homeowner has been consumed. The initial price can be assumed to have anticipated a building life of whatever period of time has occurred prior to renovation. This means that the full value that was taxed by way of the upfront payment on the initial sale of the property has been consumed. If new value is created by way of renovation, the initial tax will not cover the later consumption. The sale of substantially renovated residential premises is intended to replicate the effect of the GST/VAT on the initial sale of property and provide upfront taxation of the present value of the future consumption that has previously never been subject to GST/VAT. This is the benchmark principle and rationale for legal approaches in GST/VAT jurisdictions that seek to regard supplies of substantially renovated residential premises as taxable.

The question of when a renovation transforms used residential premises into new residential premises has been subject to litigation in almost all GST/VAT jurisdictions in which such a distinction is made. This is an important issue given that housing services are so frequently consumed and expenditure on housing often comprises a large percentage of total consumption of an individual.²² There are also implications for whether a property developer or builder is entitled to claim input tax credits for costs relating to the purchase of the property, and work done on it.²³

²² See Poddar, n 16, 443–444; Van Brederode, n 16, 26.

²³ Van Brederode, n 16, 9.

This chapter compares the legal approaches taken in Australia, Canada and the European Union to determine when renovated residential premises cross the line from used to new. It evaluates the outcome of these approaches by reference to the benchmark goal of creating a new taxing point where a substantial portion of the value that is being transferred with respect to the sale of substantially renovated residential premises is new value that was not included at the time it was first sold. GST/VAT is a relatively young tax that has been under researched.²⁴ This chapter contributes to the existing GST/VAT literature by discussing an issue that has been subject to little scholarly discussion.²⁵

The chapter proceeds as follows. Part 2.2 outlines the research methodology. Part 2.3 compares and evaluates the legal approaches that have been taken regarding this issue by reference to the benchmark goal. Part 2.4 provides analysis and policy recommendations. Part 2.5 concludes.

2.2 Research methodology

This chapter adopts a comparative research methodology.²⁶ It compares examples of the legal approaches taken in traditional and modern GST/VAT systems to determine whether

²⁴ For example, the New Zealand GST system is regarded as one of two main international models of GST/VAT design; however, it is under researched: see Mark Keating, "Editorial: Thirty Years On: GST at a Crossroads" (2017) 23(1) *New Zealand Journal of Taxation Law and Policy* 5, 7; David White, "Twenty Years of GST: The Best Path Forward" (2007) 13 *New Zealand Journal of Taxation Law and Policy* 357, 365. Likewise, GST issues in Australia have also been under researched.

²⁵ While there have been some articles published in Australia about the GST treatment of residential premises more generally, the GST treatment of substantial renovations has not been the specific focus of any of these. There has, however, been one article published about when renovation activities may lead to there being an enterprise for GST purposes: Jennifer Batrouney and Angela Lee, "When Is a Renovation One Too Many So As To Become an 'Enterprise' for GST Purposes?" (2014) 14 *AGSTJ* 78. While the article mentions the Canadian definition of 'substantial renovation', it does not involve a detailed comparative analysis of the legal approaches taken to the GST/VAT treatment of supplies of renovated residential premises.

²⁶ Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International, 2003) 313. Michael Salter and Julie Mason, *Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research* (Pearson Education Ltd, 2007) 183.

renovated residential premises are new or used. It also evaluates these approaches by reference to whether they achieve the benchmark goal.²⁷ The VAT system in the European Union is considered as an example of a traditional VAT system,²⁸ and the legal approaches taken to this issue in Australia and Canada are discussed as examples of jurisdictions with modern GST systems.²⁹

2.3 Comparative analysis and evaluation of legal approaches against the benchmark goal

This part first reviews the main laws in Australia, Canada and the European Union that are relevant to whether supplies of renovated residential premises are new or used. This is followed by a discussion of some of the main legal issues that have arisen regarding the GST/VAT treatment of supplies of renovated residential premises in these jurisdictions. The legal approaches to these issues are then compared and evaluated against the benchmark goal.³⁰

²⁷ See Krever, n 2, 13–14.

²⁸ See, eg, Wei Cui, "Objections to Taxing Resale of Residential Property under a VAT" (2012) November *Tax Notes* 777, 779; Krever, n 2; Andrew Maples and Adrian Sawyer, "The New Zealand GST and Its Global Impact: 30 Years On" (2017) 23(1) *New Zealand Journal of Taxation Law and Policy* 9, 9; Marianne Steurer, "VAT and Direct Tax Policy on Exemptions" in Sebastian Pfeiffer and Marlies Ursprung-Steindl (eds), *Global Trends in VAT/GST and Direct Taxes* (Linde Verlag, 2015) 91. The VAT system in the United Kingdom is not considered here, as supplies of new residential buildings are generally GST-free: *Value Added Tax Act 1994* (UK) Sch 8.

²⁹ The New Zealand GST is not considered in detail in this article, as the GST treatment of residential premises in New Zealand does not depend on whether residential premises are new or used. Sales of residential dwellings from registered persons such as property developers or builders to private consumers are taxable in New Zealand. On the other hand, sales of residential dwellings from one consumer to another are regarded as outside the scope of GST.

³⁰ This part follows the approach taken by Van Brederode: Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Wolters Kluwer International, 2011) xxvi.

2.3.1 Australia

Supplies of residential premises³¹ in Australia are input taxed supplies (to the extent that the premises are to be used predominantly for residential accommodation)³² except where the supplies are of commercial residential premises or new residential premises (these latter supplies are taxable when they are supplied by a registered person in the course or furtherance of an enterprise³³). Where new residential premises are supplied to an otherwise unregistered consumer, the consumer will be liable to pay GST in relation to the supply but will not be entitled to input tax credits. GST will either be payable on the gross consideration for the supply or, provided certain conditions are fulfilled, a unique feature of the Australian GST system, known as the margin scheme, may be available. In this circumstance, GST would be payable on 1/11th of the margin between the excess of the consideration for the supply over the consideration for the supplier's acquisition of the real property.³⁴ If the margin scheme is used, input tax credits are not available to the purchaser.³⁵ As purchasers of residential premises are generally not registered for GST, this would be a rare disincentive.³⁶

³¹ Although 'residential premises' are defined in *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1, there has been a history of uncertainty regarding the meaning of this term, and the GST characterisation of supplies of residential premises generally. See, eg, Naomi Kewley, "Eliminating the Impossible – Australian GST, Residential Premises, and the Improbable Solution" (2012) 20 *AGSTJ* 174; Christine Peacock, "What Is an Input-taxed Supply of Used Residential Premises?" (2010) 13(3) *The Tax Specialist* 139; John Tretola, Sylvia Villios and Pasqualina Callea, "GST and Residential Premises – Which Intention Is Relevant?" (2012) 21(1) *Revenue Law Journal* 1; Tony van der Westhuysen, "Just What Is a 'Residence for GST Purposes'?" (2008) 3(1) *Journal of the Australasian Tax Teachers Association* 116; Sylvia Villios, "Australian GST and Residential Property – Uncertainty Abounds" (2010) 21 *International VAT Monitor* 423.

³² See *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ss 40-35, 40-65, 40-70. According to s 40-35, a lease of residential premises (other than commercial residential premises, accommodation in commercial residential premises and commercial accommodation in some circumstances) is input taxed. Treasury has noted that residential leases are input taxed to achieve neutrality between owner-occupiers and investors: Treasury, "Tax Expenditures Statement 2015" (Australian Government, 2016) 141.

³³ In order for a supply to be taxable in Australia the supply must be made by an entity that is registered or required to be registered for GST, in the course or furtherance of an enterprise that it carries on: *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-5. See Batrouney and Lee, n 25.

³⁴ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 75-10.

³⁵ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 75-20.

³⁶ See Christine Peacock, "Changes to the Australian GST Immovable Property 'Margin Scheme'" (2006) 17 *International VAT Monitor* 327, 328.

Section 40-75(1) of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (*GSTA*)

states:

Residential premises are new residential premises if they:

- (a) have not previously been sold as residential premises ... and have not previously been the subject of a long-term lease; or
- (b) have been created through substantial renovations of a building; or
- (c) have been built, or contain a building that has been built, to replace demolished premises on the same land.³⁷

In this way, it would appear that an objective of the *GSTA* is to achieve a new taxing point where a substantial portion of the value being transferred with respect to the sale of substantially renovated residential premises is new value that has not been taxed, and is therefore classified as a new residential premises. In the *GSTA*, 'substantial renovations' of a building are defined as:

renovations in which all, or substantially all, of a building is removed or replaced. However, the renovations need not involve removal or replacement of foundations, external walls, interior supporting walls, floors, roof or staircases.³⁸

There has been no litigation in Australia specifically regarding what is a 'substantial renovation' for GST purposes.³⁹ The Commissioner of Taxation's view on when a sale of real

³⁷ This section was added into the *GSTA* by virtue of the *Taxation Laws Amendment Bill (No 8) 2000* (Cth). Residential premises that have only been used for the purpose of making input taxed supplies will no longer retain their status as 'new' when at least five years has passed since the premises first became residential premises, were last substantially renovated or were last built: *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 40-75(2).

³⁸ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1.

³⁹ See Batrouney and Lee, n 25, 88.

property will be a sale of new residential premises is set out in GSTR 2003/3. This includes guidance on what is considered a substantial renovation. It also includes advice on when a building built to replace demolished premises on the same land will be regarded as new residential premises. This is another way in which the *GSTA* has created a new taxing point – the value of the demolished residential premises is regarded as consumed and the value of the new building has not been taxed.

2.3.2 Canada

The *Excise Tax Act 1985*, RSC 1985, c E-15 (*ETA*) sets out rules relating to Canada's GST, which was introduced 15 years before Australia's GST. There are also five Canadian provinces that have a Harmonised Sales Tax (HST), administered by the Canada Revenue Agency 'together with and essentially on the same base as the federal GST'.⁴⁰

The term 'residential complex' in the *ETA* includes part, or the whole, of a 'building in which one or more residential units are located', and 'a semi-detached house ... residential condominium unit ... and ... residential unit'.⁴¹ Like in Australia, supplies of real property in Canada are generally taxable from the first sale, although sales and leases of used residential complexes are exempt (the terminology used in Canada for an input taxed supply).⁴² Alarie

⁴⁰ Richard M Bird and Michael Smart, "VAT in a Federal System: Lessons from Canada" (2014) 34 *Public Budgeting and Finance* 38, 38.

⁴¹ *Excise Tax Act*, RSC 1985, c E-15, s 123(1).

⁴² *Excise Tax Act*, RSC 1985, c E-15, Sch V Pt 1. Leases of residential complexes are specifically exempt: *Excise Tax Act*, RSC 1985, c E-15, Sch V, Pts 1, 6. A report issued by the Department of Finance Canada indicates that residential leases were made exempt as GST would be 'collected when the developer/builder sells the rental dwelling to the landlord': Department of Finance Canada, "Goods and Services Tax Technical Paper" (August 1989) 18. The Canada Revenue Agency has indicated that in the case of a sale of a condominium complex or strata lot plan, each owner of a unit generally has an undivided interest as tenant-in common in the common areas. The ownership of the common areas is generally not divided on sale, and is supplied as part of the ownership of the residential unit, with the supply of the common areas having the same tax status as the supply of the residential unit: Canada Revenue Agency, "Residential Real Property-sales" (GST/HST Memorandum 19.2.1, February 1998).

and Gendron have explained that 'if the home is being purchased from a party that is not a builder, the purchase price is considered to indirectly include the historical burden of GST/HST and no additional GST/HST is payable'.⁴³ This is because the vendor-homeowner in this situation would not be required to register for GST/HST. A person is not required to register for GST in Canada where the only commercial activity⁴⁴ of the person 'is the making of supplies of real property by way of sale otherwise than in the course of a business'.⁴⁵ A person otherwise unregistered for GST/HST in Canada who purchases residential premises would not be entitled to input tax credits. They would only be liable to pay GST/HST if they purchase new residential premises from a registered business conducting a commercial activity.

The notion of what is a new residential complex in Canada includes a 'substantially renovated' residential complex, as such premises are regarded' as being a close substitute for a newly built residential property'.⁴⁶ A 'substantial renovation of a residential complex' is defined in the *ETA* to mean:

[T]he renovation or alteration of the whole of the building ... to such an extent that all or substantially all of the building or part, as the case may be, other than the foundation, external walls, interior supporting walls, floors, roof, staircases and ... the common areas and other appurtenances, that existed immediately before the renovation or alteration was begun has been removed or replaced if, after completion of the renovation or alteration, the building or part, as the case may be, is, or forms part of, a residential complex.⁴⁷

⁴³ Benjamin Alarie and Pierre-Pascal Gendron, "Canada" in Robert F van Brederode, n 30, 93.

⁴⁴ A 'commercial activity' is defined in *Excise Tax Act*, RSC 1985, c E-15, s 123(1).

⁴⁵ *Excise Tax Act*, RSC 1985, c E-15, s 240(1).

⁴⁶ Alarie and Gendron, n 43, 100.

⁴⁷ *Excise Tax Act*, RSC 1985, c E-15, s 123(1).

Alarie and Gendron have observed that 'the issue of what constitutes a "substantial renovation" has caused considerable controversy in the courts', and that disputes relating to whether a particular renovation is a 'substantial renovation' are one of the top three areas where litigation relating to the GST/HST treatment of real property has been frequent.⁴⁸ One reason for this is that, if a residential complex is substantially renovated, then this may give rise to eligibility for one of two rebates, dependent on the situation.⁴⁹ These are the new housing rebate, and the new residential rental property rebate.

An individual may be eligible for a new housing rebate where they live in new residential premises that the individual:

- built, or engaged someone else to build;
- substantially renovated, or engaged someone else to substantially renovate; or
- purchased from a builder (where the residential premises were purchased in a new or substantially renovated state).⁵⁰

The residential premises must be the individual's primary place of residence, and the fair market value of the residential premises should be below CA\$450,000 (approximately AU\$480,000).⁵¹ The rebate allows for recovery of part of the GST that was paid on the purchase price, or cost of building the new residential premises. The new residential rental

⁴⁸ Alarie and Gendron, n 43, 98.

⁴⁹ There are some differences in how the provinces tax new residential premises: see Bird and Smart, n 40, 43. The discussion of the rebates here relates to the federal GST treatment.

⁵⁰ *Excise Tax Act*, RSC 1985, c E-15, ss 254, 256.

⁵¹ *Excise Tax Act*, RSC 1985, c E-15, ss 254, 256.

property rebate operates in a similar way to the new housing rebate, but it is relevant to new or substantially renovated residential rental property.⁵²

An explicit reason for the introduction of the new residential rental property rebate does not appear in the policy documents. However, it appears it was introduced to provide for consistent treatment among owner-occupiers and renters.⁵³ Three main reasons have been provided for the introduction of the new housing rebate. The first reason relates to affordability concerns. For example, the Department of Finance has noted that the new housing rebate was provided to recognise the importance of homeownership and 'to ensure that the new system does not pose a barrier to affordability of housing'.⁵⁴ Further, it was expected that the GST would increase the cost of new residential premises, which could affect the opportunity of Canadians to own residential premises.⁵⁵ Secondly, Greenbaum has observed that before the introduction of the GST there was concern from the housing industry that the exemption for sales of used residential premises would place them 'at a great economic disadvantage when attempting to sell new homes',⁵⁶ and that the introduction of the new housing rebate was in response to these concerns.⁵⁷ Thirdly, the Tax Court of Canada has explained that Parliament intended to provide this rebate 'not simply to encourage people to modernize their houses and make them more attractive, but to

⁵² See *Excise Tax Act*, RSC 1985, c E-15, s 256; Canada Revenue Agency, *GST/HST New Residential Rental Property Rebate* (No RC4231(E) Rev 16) for further information.

⁵³ M Stewart, "Taxation Policy and Housing" in Susan J Smith (ed), *International Encyclopaedia of Housing and Home* (Elsevier Science, 2012) Vol 7, 152, 162.

⁵⁴ Department of Finance Canada, n 42, 19. It was explained that a restriction on the price of residential premises that are eligible for the rebate would mean that the rebate would be targeted and prevent wealthier Canadians from benefiting from the rebate. See also Van Brederode, n 16, 17.

⁵⁵ Claire FL Young, "Introduction of a Goods and Services Tax: The Canadian Experience" (1991) 8(3) *Australian Tax Forum* 259, 268–269.

⁵⁶ Abe Greenbaum, "The Canadian Goods and Services Tax: A Sign of Things to Come for Australia?" (1992) 20(2) *ABLR* 186, 190.

⁵⁷ Abe Greenbaum, "A Goods and Services Tax for Australia: What Can Be Learned from the Canadian Experience?" (1993) 3(2) *Revenue Law Journal* 152, 160.

reconstruct premises that otherwise would not be available as suitable units for sale and rent – in other words to expand the supply of usable housing'.⁵⁸

2.3.3 *The European Union*

Member States of the European Union are required by *Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax (EU VAT Directive)* (formerly the *Sixth Council Directive 77/388 EEC of 17 May 1977 (Sixth VAT Directive)*) to introduce VAT systems or to harmonise their existing VAT systems to build a common market with characteristics similar to those of a domestic market. Prior to the introduction of a harmonised VAT in the European Union, that different tax systems existed was regarded as a cause of distortion to competition. Therefore, the objective of implementing a harmonised VAT was to eliminate this effect:

[The] common system of VAT should, even if rates and exemptions are not fully harmonised, result in neutrality in competition, such that within the territory of each Member State similar goods and services bear the same tax burden, whatever the length of the production and distribution chain.⁵⁹

In the *Sixth VAT Directive*, the European Communities Commission explained that real property is a means of production, the cost of which should be reflected in the price of goods and services. It reported that the construction and marketing of new buildings should therefore be subject to VAT. The Commission also recognised that real property can be

⁵⁸ *Colosimo v The Queen* [2005] TCC 584, [7].

⁵⁹ *Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax* [2006] OJ L 347, Recital 7 (*EU VAT Directive*), formerly the *Sixth Council Directive 77/388 EEC of 17 May 1977* [1977] OJ L 145.

'products which at the end of an economic cycle are supplied to individuals as consumers'.⁶⁰

It explained that used residential buildings are excluded from the scope of VAT, as they are regarded as having been consumed by virtue of their first occupancy.⁶¹ This approach is consistent with the benchmark goal, as the value of residential premises would be regarded, under the approach in the European Union, as having already been consumed at such time as later sales of the residential premises may take place, providing justification for the need for a new taxing point where substantial value is added.

In Art 9(1) of the *EU VAT Directive*, a 'taxable person' is defined as a person who independently carries out an 'economic activity'.⁶² According to Art 135(1)(j), supplies of a building or parts of a building, and the land on which these stand are exempt from VAT (irrespective of whether they are to be used for residential purposes or not),⁶³ except where these supplies occur 'before first occupation' or a Member State allows a taxable person a right of option for taxation in respect of the supply.⁶⁴ Article 12(1)(a) provides:

Member States may regard as a taxable person anyone who carries out, on an occasional basis ...

- (a) the supply, before first occupation, of a building or parts of a building and of the land on which the building stands;

⁶⁰ European Communities Commission, *Proposal for a Sixth Council Directive on the Harmonization of Member States Concerning Turnover Taxes Common System of Value Added Tax: Uniform Basis of Assessment* (Submitted to the Council by the Commission, Bulletin of the European Communities Supplement 11/73, 29 June 1973) 9.

⁶¹ The Commission also noted that 'the notion of first occupation has been used to determine the moment at which the building leaves the production process and becomes a subject of consumption, that is to say when the building begins to be used by its owner or a tenant': European Communities Commission, n 60, 9. In *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [31], the European Court of Justice noted that the sale of a used building 'does not generate any significant added value'.

⁶² *EU VAT Directive*, n 59, Art 9.

⁶³ *EU VAT Directive*, n 59, Art 135(1)(j). This replaced Art 13B(g) of the *Sixth Council Directive 77/388/EEC of 17 May 1977* [1977] OJ L 145, which was similarly worded.

⁶⁴ *EU VAT Directive*, n 59, Art 137(1)(a). The leasing or letting of immovable property is specifically exempt: Art 135(1)(l).

(b) the supply of building land.⁶⁵

Such a person would be required to charge VAT on the supply. Input tax credits would not be available to the purchaser if they are not registered for VAT.

The discretion given to Member States in Art 12(1)(a) to develop rules to determine when a supply of buildings and the land on which they stand will occur 'before first occupation' has given rise to many different interpretations. This has led to inconsistencies among Member States. On the one hand, some have regarded 'first occupation' as referring to the first use of buildings – for example, it has been noted that in Belgium buildings are considered 'new' until the end of the second year after the date of 'first occupation'.⁶⁶ On the other hand, others have interpreted the term 'first occupation' as referring to when construction begins – for example, it has been noted that in the Czech Republic buildings are no longer considered 'new' three years after construction has begun (irrespective of whether construction has finished).⁶⁷

According to Art 12(2):

Member States may lay down the detailed rules for applying the criterion referred to in paragraph (1)(a) to conversions of buildings [and] may apply criteria other than first occupation, such as the period elapsing between the date of completion of the building and the date of first

⁶⁵ *EU VAT Directive*, n 59, Art 12(1)(a).

⁶⁶ Christian Amand, Gottfried Schellman and Rob Vermeulen, "Immovable Property and VAT – Lessons from Past Experience" (2005) 16 *International VAT Monitor* 325, 326. Further, Van Brederode has noted that in some Member States where buildings have been newly constructed but not occupied the real property has retained its status as new because the buildings have not been regarded as used or occupied yet: Van Brederode, n 16, 10.

⁶⁷ Amand, Schellman and Vermeulen, n 66, 326.

supply, or the period elapsing between the date of first occupation and the date of subsequent supply, provided that those periods do not exceed five years and two years respectively.⁶⁸

Only cases decided by the European Court of Justice are discussed in this chapter. This Court considers questions relating to European Union (EU) law that have been referred to it by the national courts.⁶⁹ One might expect there to be many relevant EU cases, given the number of old buildings in the European Union.⁷⁰ However, in contrast to Canada, there has been a significantly small number. This appears to be because significant discretion is given to Member States to determine when a supply of buildings and the land on which they stand will occur ‘before first occupation’, and to develop rules relating to the VAT treatment of conversions.

2.4 Specific issues regarding whether renovated residential premises are new or used

This section explores four main issues that have arisen regarding whether supplies of renovated residential premises are new or used.

2.4.1. What Is ‘Substantial’?

Consistent with the benchmark goal, it is recognised in the relevant legislation in both Australia and Canada that a substantial renovation may result in there being a new taxing point. The Australian *GSTA* defines ‘substantial renovations’ as ‘renovations in which all, or

⁶⁸ *EU VAT Directive*, n 59, Art 12(2) (previously Art 4(3)).

⁶⁹ See BJM Terra and Julie Kajus, *A Guide to the European VAT Directives* (IBFD, 2019) Vol 1.

⁷⁰ ‘The stock of buildings in the EU is relatively old, with more than 40% of it built before 1960 and 90% before 1990’: Directorate General for Internal Policies, *Boosting Building Renovation: What Potential and Value for Europe?* (European Parliament, October 2016) 11.

substantially all, of a building is removed or replaced'.⁷¹ This is very similar to the definition of 'substantial renovation' in the Canadian *ETA* that the renovation or alteration must be to 'such an extent that all or substantially all of the building ... has been removed or replaced'.⁷² At first glance, both definitions appear consistent with the benchmark goal in that they define a substantial renovation as a situation that would lead to significant value being added that has not previously been included in the GST/VAT base. However, in doing so, it is possible that these definitions have an unnecessarily restrictive effect and preclude some renovations that lead to significant value being added from creating a new taxing point. Examples of how these definitions have been applied are discussed below. It is also worth noting that in Australia, as with Canada, there is no specific part of a building that must be removed or replaced in order for there to be a substantial renovation. In particular, 'the renovations need not involve removal or replacement of foundations, external walls, interior supporting walls, floors, roof or staircases'.⁷³

The Commissioner has indicated in GSTR 2003/3 that '[w]hether renovations are substantial is to be determined in the light of all the facts and circumstances',⁷⁴ and this should be based on considering a building as an entirety, rather than individual rooms in a building.⁷⁵ According to the Commissioner, most rooms in a building must be directly affected in order

⁷¹ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1. This definition is almost identical to the definition of a 'substantially renovated home' in *First Home Owner Grant (New Homes) Act 2000* (NSW) s 4A. In New South Wales, purchasers of substantially renovated homes may qualify for a first homeowners' grant. In *O'Connor v Chief Commissioner of State Revenue (NSW)* [2019] NSWCATAD 260, the New South Wales Civil and Administrative Tribunal found that the applicants had not purchased a substantially renovated home. Only some interior dividing walls, gyprock, and fixtures and fittings were renovated or replaced. Those items did not represent 'all or substantially all of the building'. The Tribunal referred to its earlier decision in *Pandanas Qld Pty Ltd v Chief Commissioner of State Revenue (NSW)* [2017] NSWCATAD 106, where it came to a similar conclusion.

⁷² *Excise Tax Act*, RSC 1985, c E-15, s 123(1). See also Batrouney and Lee, n 25, 88.

⁷³ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1. See also the definition of 'substantial renovation' in *Excise Tax Act*, RSC 1985, c E-15, s 123(1).

⁷⁴ Australian Taxation Office, *Goods and Services Tax Ruling GSTR 2003/3*, [64].

⁷⁵ Australian Taxation Office, n 74, [64].

for there to be a substantial renovation.⁷⁶ An example is provided of significant work that would not be substantial. Although this example involves extending a kitchen, replacing the roof, replacing the floor in all ground floor rooms, and replacing ceilings in most ground floor rooms, the work mainly involves one floor of a two-storey residential premises.⁷⁷ It is explained that:

Although the renovation work is significant we do not consider the renovations to be substantial renovations. The house in its entirety has not been substantially renovated, as a number of rooms have not been affected.⁷⁸

The facts in this situation arguably come close to the borderline of whether renovations are substantial. While there is significant work done to the residential premises that would probably lead to some added value, the Commissioner's finding that the renovations are not substantial is probably consistent with the benchmark goal, as when the residential premises are sold most of the value that is transferred would still relate to the existing residential premises that was already taxed.

An example of where the Commissioner has indicated that a substantial renovation would occur is where an upstairs extension is added to a bungalow, necessitating the replacement of the existing roof and ceilings and some other structural changes to the lower level, as all of the existing rooms would be affected by the renovation.⁷⁹ It is clear that this outcome is

⁷⁶ Australian Taxation Office, n 74, [65].

⁷⁷ Australian Taxation Office, n 74, Example 3.

⁷⁸ Australian Taxation Office, n 74, [106].

⁷⁹ Australian Taxation Office, n 74, Example 5. Another example of a situation involving a substantial renovation can be found in an edited version of Australian Taxation Office, *Private Ruling Authorisation Number 1051241174835* (13 September 2017), which concerned a two-storey residential premises. A lift was installed, the ceiling, walls and roof were replaced, and some of the wiring and plumbing lines were replaced. It was explained that the renovations affected 'the building as a whole and involve the replacement of substantially all of the building'. Based mainly on a comparison of floor plans before and after the renovations, it was found that

consistent with the benchmark goal, as most of the value that would be transferred when the substantially renovated residential premises is sold would not have previously been taxed.

The Commissioner has indicated that there may be a substantial renovation where there is removal or replacement of a substantial part of structural or non-structural components of a building.⁸⁰ Structural work includes altering or replacing foundations, floors, supporting walls and roofs.⁸¹ Non-structural work includes replacing electrical wiring and non-supporting walls, plastering or rendering an entire wall, plumbing and removing or replacing kitchen cupboards and bathroom fixtures.⁸² Reflecting on the benchmark goal, it would seem that both structural and non-structural work could lead to an increase in the value of residential premises. While structural work could be more in the nature of a repair and therefore not lead to significant value being added, it is generally more likely that structural rather than non-structural work would lead to significant value being added to the residential premises. Some of the examples provided of non-structural work appear to involve work that is more in the nature of a repair than an improvement.

What is more important in determining whether a renovation leads to new value being added to the residential premises would seem to be whether the renovation is cosmetic or not. According to the Commissioner, cosmetic changes that will not by themselves amount to a 'substantial renovation' include work that does not impact on the structure of a building but is more 'in the nature of renewing or refreshing what is already there'.⁸³ This includes painting

all the rooms except one on the ground floor, and all rooms on the first floor were affected by either structural or non-structural work. This outcome is consistent with the benchmark goal, as a sale of the substantially renovated residential premises would result in significant new value added to the property.

⁸⁰ Australian Taxation Office, n 74, [69].

⁸¹ Australian Taxation Office, n 74, [70].

⁸² Australian Taxation Office, n 74, [73]–[74].

⁸³ Australian Taxation Office, n 74, [77].

and replacing fittings, curtains and carpets.⁸⁴ A similar approach has been taken by the Tax Court of Canada in *Blades v The Queen*.⁸⁵ The Court in this case indicated that the relevant renovation was not a ‘substantial renovation’, as while there were some structural changes, other changes made to residential premises were cosmetic.⁸⁶ It found that ‘[a]ll or substantially all of the residential premises has not been removed or replaced’.⁸⁷ Except for renovations to the living room, a kitchen and bathroom, renovations to the rest of the residential complex were aesthetic.⁸⁸ If the renovated residential premises were sold, most of the value transferred would relate to the existing residential premises. Therefore, this approach appears consistent with the benchmark goal.

Somewhat similar to the Commissioner’s approach of considering a building as an entirety, the Canada Revenue Agency has indicated that a major renovation where ‘the interior of a house is essentially gutted’⁸⁹ will qualify as a substantial renovation. It has advised that ‘generally, 90% or more of the interior of an existing house is the minimum that has to be removed or replaced to qualify as a substantial renovation’.⁹⁰ Any ‘fair and reasonable method’⁹¹ can be used to determine if the 90% test has been met. For example, it would be

⁸⁴ Australian Taxation Office, n 74, [77]. The Commissioner has provided an example of where a kitchen and bathroom are replaced, but other restoration work, such as replastering or repainting, while affecting most of the rooms of the residential premises, may be cosmetic. In the Commissioner’s view, this would not amount to a substantial renovation: Australian Taxation Office, n 74, Example 6. This would appear to be consistent with the benchmark goal, as when the renovated residential premises are transferred, most of the value that would still relate to the existing residential premises, which has already been taxed.

⁸⁵ *Blades v The Queen* [2012] TCC 227.

⁸⁶ The Court noted that ‘building closets, painting walls, and refinishing the floors’ was cosmetic in nature: *Blades v The Queen* [2012] TCC 227, [14].

⁸⁷ *Blades v The Queen* [2012] TCC 227, [16].

⁸⁸ *Blades v The Queen* [2012] TCC 227, [15]. In the kitchen, a wall was replaced, the pantry was rebuilt, an island was added, and cabinets, tiles and flooring were replaced. To facilitate a 200 square foot addition to the living room, the flooring, ceiling and walls in this room were replaced, and a fireplace was also built.

⁸⁹ Canada Revenue Agency, *GST/HST Information for the Home Construction Industry* (No RC4052(E) Rev 18).

⁹⁰ Canada Revenue Agency, *GST/HST New Housing Rebate* (No RC4028(E) Rev 16) 11. The 90% rule is also mentioned in Canada Revenue Agency, “Substantial Renovations and the GST/HST New Housing Rebate” (GST/HST Technical Information Bulletin No B-092, 2005). Examples are provided of methods to calculate the percentage affected that are reasonable and methods that are not reasonable.

⁹¹ Canada Revenue Agency, *GST/HST New Housing Rebate* (No RC4028(E) Rev 16).

acceptable to compare ‘the square metres of the renovated liveable floor space of the house’, or ‘the square metres of the floor and wall of the areas renovated to the total floor and wall space of the house’.⁹² The Canada Revenue Agency has indicated that only liveable areas should be taken into account in determining if there is a substantial renovation. This includes living areas, but not garages.⁹³

At first glance, the 90% test may appear more determinative than the Commissioner’s approach of deciding if there has been a substantial renovation based on ‘all the facts and circumstances’.⁹⁴ However, application of this test may have an unnecessarily restrictive effect. It could lead to outcomes inconsistent with the benchmark goal where less than 90% of the interior of the residential premises has not been removed or replaced, but significant value has been added that has not previously been included in the GST/VAT base.

In *Lair v The Queen*,⁹⁵ the Tax Court of Canada indicated that applying the 90% test is not always helpful or decisive. The taxpayer appealed a decision to deny their application for the new housing rebate. The respondent argued that 90% of the residential premises had not been renovated. However, the Court found that the renovation was substantial as a reasonable and neutral observer would conclude that the residential complex underwent a substantial renovation:⁹⁶ the existing foundation of the residential premises was raised; a basement was constructed; the first floor of the residential complex was gutted and refinished; the electrical system, plumbing, installation, drywall, and flooring were removed and replaced; a new septic system was installed; the roof and windows were replaced; and a

⁹² Canada Revenue Agency, *GST/HST New Housing Rebate* (No RC4028(E) Rev 16).

⁹³ Canada Revenue Agency, *GST/HST New Housing Rebate* (No RC4028(E) Rev 16).

⁹⁴ Australian Taxation Office, n 74, [60].

⁹⁵ *Lair v The Queen* [2003] TCC 929.

⁹⁶ *Lair v The Queen* [2003] TCC 929, [85].

kitchen extended. The Court noted that in this case it was not of assistance to measure different parts of the residential complex that were renovated and those that were not. It found that:

if a reasonable and neutral observer of the building, before and after construction of the interior and exterior ... can conclude that the degree of renovation and alteration was substantial, the definition of 'substantial renovation' is satisfied.⁹⁷

This outcome appears consistent with the benchmark goal as the value that would be transferred when the renovated residential premises are sold would mainly be new value that has not previously been included in the GST base.

In *Sviros v The Queen*,⁹⁸ the appellants operated a business of performing home improvements. They purchased residential premises for CA\$270,000 (approximately AU\$290,000) and sold it for CA\$470,000 (approximately AU\$500,000). The Court noted that the residential premises were resold after a substantial amount of work was done,⁹⁹ the cost of which was over CA\$105,000 (approximately AU\$110,000). The electrical supply and plumbing were replaced throughout the residential premises, new drywall and flooring were installed, a staircase was replaced, a front veranda was added, and there was an extension of six feet to the back of the second floor. Substantial work was also done to the basement, including the height of the basement being increased, installation of a separate entrance, and creation of a new bathroom.¹⁰⁰ The appellants had been assessed for unpaid GST relating to selling the residential premises. However, the Court found that the evidence did not support

⁹⁷ *Lair v The Queen* [2003] TCC 929, [14].

⁹⁸ *Sviros v The Queen* [2008] GSTC 87.

⁹⁹ *Sviros v The Queen* [2008] GSTC 87, [10].

¹⁰⁰ *Sviros v The Queen* [2008] GSTC 87, [26]–[41].

the finding that there had been a substantial renovation, allowed the appeal and referred the assessment back to the relevant Minister for reassessment. The respondents argued that 97% had been renovated,¹⁰¹ based on there being renovations to all of the 1,378 square feet of the residential premises except 35 square feet underneath an addition at the back.¹⁰² However, the Court noted that it was not possible to determine whether there had been a substantial renovation in this case on the basis of the percentage of areas affected, or the costs of what the appellants did as opposed to work that they did not do, as the evidence did not support a comparative exercise based on costs. It noted that there was no evidence relating to renovations to the ceilings.¹⁰³ The appellants did not replace outside doors, some windows,¹⁰⁴ and the framing of the partition walls.¹⁰⁵ The outcome in this case appears at odds with the benchmark goal, as the facts would suggest that while some work done was of more a remedial nature, other work was substantial.

In *Baby v The Queen*,¹⁰⁶ the taxpayer contended that renovations were made to 90% of the residential premises that was used, and the cost of the renovations amounted to over 90% of the value of the residential premises before the renovation.¹⁰⁷ However, the Tax Court of Canada dismissed the taxpayer's appeal against a decision to deny their application for the new housing rebate, confirming that it is the whole building that must be renovated, and that there is nothing in the definition of substantial renovation 'that suggests Parliament intended to take renovation costs into account'.¹⁰⁸ The Court noted that the taxpayer did not remove

¹⁰¹ *Sviros v The Queen* [2008] GSTC 87, [53].

¹⁰² *Sviros v The Queen* [2008] GSTC 87, [4].

¹⁰³ *Sviros v The Queen* [2008] GSTC 87, [56].

¹⁰⁴ *Sviros v The Queen* [2008] GSTC 87, [58].

¹⁰⁵ *Sviros v The Queen* [2008] GSTC 87, [70].

¹⁰⁶ *Baby v The Queen* [2013] TCC 39.

¹⁰⁷ *Baby v The Queen* [2013] TCC 39, [13].

¹⁰⁸ *Baby v The Queen* [2013] TCC 39, [14].

or replace all or most of the interior of the residential premises as it existed before the renovations. Even though the taxpayer had rewired the residential premises, replaced an outer wall of a kitchen with a solarium, turned a dining room into three smaller rooms, rebuilt the foundation and added a cement floor, the entire second floor of the two-storey residential premises and most of the first floor were untouched. This approach is probably consistent with the benchmark goal, as in this situation if the renovated residential premises were sold most of the value that would be transferred would likely relate to the existing residential premises and would have already been taxed.

2.4.2 Are additions relevant?

The *GSTA* states that “substantial renovations” of a building are renovations in which all, or substantially all, of a building must be removed or replaced’.¹⁰⁹ This is similar to the *ETA*, which states that a ‘substantial renovation’ must involve a ‘renovation or alteration of the whole or part of a building’.¹¹⁰ It appears from these definitions that the legislative policy intent in both Australia and Canada was that a substantial renovation must occur to the existing residential building. Therefore, additions to residential premises are generally not considered in determining whether there has been a substantial renovation. This is the case even though there are often additions added to residential premises as part of the renovation. A concern regarding this approach is that additions could lead to significant value being added to the residential premises that has not already been included in the GST/VAT base. It would appear inconsistent with the benchmark goal for this new value added to not be taxed if the value added is substantial.

¹⁰⁹ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1.

¹¹⁰ *Excise Tax Act*, RSC 1985, c E-15, s 123(1).

In Australia, in GSTR 2003/3 the Commissioner indicated that additions to residential premises are not to be considered in determining whether a residential building has been substantially renovated. However, if it is found that there has been a substantial renovation, then all additions to the residential building will be regarded as part of the new residential premises.¹¹¹ This approach appears consistent with the benchmark goal to the extent that, where there is a substantial renovation, significant value would generally be added so that it may be assumed that, when the renovated residential premises are sold, the value transferred mainly relates to the new value added to the property.

A similar approach has been taken by the Canada Revenue Agency, which stated:

An addition to a house is not considered to be a substantial renovation, as it is the existing house that must be renovated. For example, if a 700 square metre bungalow is being renovated and a 100 square metre addition is added, the 90% test does not consider the addition. However, if the renovation of the 700 square metre bungalow is found to be a substantial renovation, the GST/HST paid on the addition is also eligible for the GST/HST new housing rebate.¹¹²

In *Erickson v The Queen*,¹¹³ the Tax Court of Canada dismissed the appellant's application for a new housing rebate. It found that an addition that doubled the square footage of the residential premises and added a garage and second floor did not lead to eligibility for a rebate. It noted:

¹¹¹ Australian Taxation Office, n 74, [67].

¹¹² Canada Revenue Agency (2005), n 90, 11. A similar example is provided in Canada Revenue Agency, *GST/HST Information for the Home Construction Industry* (No RC4052(E) Rev 18).

¹¹³ *Erickson v The Queen* [2001] GSTC 19.

[A]n addition will not give rise to rebates unless it incorporates (consumes) a pre-existing residential premises to the point where the addition is essentially the new residential premises and the pre-existing residential premises, having ceased to exist as a residential unit is essentially reduced to a relatively minor aspect of that new premises.¹¹⁴

The Court's explanation of when additions will give rise to rebates appears somewhat consistent with the benchmark goal, as it recognises that the addition must be significant for a new taxing point to be created. However, the facts in this case would suggest that the addition was significant, and increased the value of the residential premises substantially, so that when the renovated residential premises is sold a substantial portion of the value transferred would be new value that had not been previously taxed. Applying the test that the Court created in this case for determining whether an addition will give rise to rebates may lead to outcomes that deviate from the benchmark goal.

Later, the Tax Court of Canada in *Goulet v The Queen*¹¹⁵ referred to the above test in *Erickson*, and found that the relevant addition in *Goulet* did not meet this test, as the addition did not incorporate the existing residential premises 'to the point where the addition was essentially the new premises and the existing house was a minor aspect of the total'.¹¹⁶ This was an appeal from a decision of the relevant Minister denying a rebate application. The appellant had renovated the existing residential premises, and demolished a garage to replace it with a two-storey addition and basement. The new addition included living space, a master bedroom and ensuite bathroom.¹¹⁷ The existing residential premises included a kitchen, bedrooms and

¹¹⁴ *Erickson v The Queen* [2001] GSTC 19, [15].

¹¹⁵ *Goulet v The Queen* [2013] TCC 255.

¹¹⁶ *Goulet v The Queen* [2013] TCC 255, [16].

¹¹⁷ *Goulet v The Queen* [2013] TCC 255, [4].

non-ensuite bathroom.¹¹⁸ Changes made to the existing residential premises included a new hallway, raising of the roof and ceilings of the bedrooms, re-insulation, and the addition of a porch.¹¹⁹ The Court found that the existing residential premises still played a major role in the overall residential premises. Although many changes had been made to the existing residential premises, it had not been substantially renovated, as it had not been gutted.¹²⁰ This outcome is arguably inconsistent with the benchmark goal, as while the existing residential premises was not completely removed or replaced, the addition and renovations would result in significant new value being added. The facts of this case do not present a clear-cut situation, however, as there were aspects of the existing residential premises that were not significantly affected by the renovations. If a new taxing point were not created though, it would lead to significant value added due to the addition and renovation not being included in the GST/VAT base. A requirement that residential premises be gutted in order for a substantial renovation to occur would appear at odds with the benchmark goal.

In *Camiré v The Queen*,¹²¹ the Court considered the Canada Revenue Agency's GST/HST Technical Information Bulletin B-092, which states that to 'be considered a newly constructed residential complex, the addition must at least double the size of the habitable area of the existing residence'.¹²² In this case, the addition included a 12 feet by 30 feet extension that included two bedrooms, and a 12 feet by 30 feet patio. The appellant argued that the extension and the patio combined doubled the initial size of the residential premises (which was 24 feet by 30 feet).¹²³ The Court excluded the addition of the patio from its consideration

¹¹⁸ *Goulet v The Queen* [2013] TCC 255, [16].

¹¹⁹ *Goulet v The Queen* [2013] TCC 255, [7]–[10].

¹²⁰ *Goulet v The Queen* [2013] TCC 255, [15].

¹²¹ *Camiré v The Queen* [2008] TCC 255.

¹²² Canada Revenue Agency (2005), n 90.

¹²³ *Camiré v The Queen* [2008] TCC 82, [5].

of whether there was a newly constructed residential complex, as it found that this ‘was not part of what is reasonably necessary to the residential use of the building within the definition of residential complex’.¹²⁴ It found that work done to the pre-existing residential premises was not sufficient enough for it to be regarded as substantially renovated, as ‘the pre-existing portion was not largely removed or replaced’.¹²⁵ The bathroom of the existing residential premises was completely redone, but otherwise changes made to the existing residential premises largely appeared cosmetic. This included replacing flooring and resurfacing kitchen cabinets.¹²⁶ The outcome in this case appears to be consistent with the benchmark goal, as most of the value transferred when this residential premises is sold would relate to the existing residential premises.

2.4.3 New residential premises built to replace demolished premises

Where a demolished building is entirely or substantially replaced by a new residential building, it appears consistent with the benchmark goal that in this situation the new residential building and the underlying land on which it stands should be regarded as a taxable supply of ‘new residential premises’, as there would be significant value added to the property by the new building.

In the *GSTA*, it is stated that residential premises are regarded as new when they have been ‘built, or contain a building that has been built, to replace demolished premises on the same land’.¹²⁷ An example has been provided by the Commissioner of a person who acquires rundown historic residential premises. The original residential premises in this example are

¹²⁴ *Camiré v The Queen* [2008] TCC 82, [9].

¹²⁵ *Camiré v The Queen* [2008] TCC 82, [11].

¹²⁶ *Camiré v The Queen* [2008] TCC 82, [6].

¹²⁷ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 40-75(1)(c).

demolished, apart from a façade, and a new residential building is constructed behind the façade. It is explained that the demolition and construction would create new residential premises for two reasons: first, because there is a substantial renovation, as there is replacement of substantially all of the building; and secondly, because the new residential premises have been built to replace demolished premises on the same land.¹²⁸ This approach appears consistent with the benchmark goal.

In Canada, in *Rehmat v The Queen*,¹²⁹ a real estate business contracted to have residential premises demolished, and then built new residential premises, which it occupied. It claimed input tax credits in relation to GST paid, but did not remit GST on the fair market value of the new residential premises. Consistent with the benchmark goal, the real estate business was reassessed for GST, and an appeal by the business was dismissed. The Court found that there had been a taxable supply, and the business was subject to a self-supply rule in s 191(1) of the *ETA*, as it was a 'builder' that was the first occupier of the residential premises after its construction. This self-supply rule does not apply if the builder of the new residential premises is an individual who occupies the residential premises primarily as their place of residence. In this latter situation, there would be no GST consequences of an individual building residential premises to replace demolished residential premises.¹³⁰ This exception probably exists as in the case of an individual they would not be registered for GST/VAT.

In the European Union, in *Don Bosco Onroerend Goed BV v Staatssecretaris van Financien*¹³¹ the Court of Justice found that the supply of land with partially demolished buildings

¹²⁸ Australian Taxation Office, n 74, Example 10.

¹²⁹ *Rehmat v The Queen* [2000] GSTC 67.

¹³⁰ *Excise Tax Act*, RSC 1985, c E-15, s 191(5).

¹³¹ *Don Bosco Onroerend Goed BV v Staatssecretaris van Financien* (European Court of Justice (Fourth Chamber), C-461/08, 19 November 2009) ECR I-11079.

previously used as a school with boarding facilities was a single taxable supply. The buildings were dilapidated, and the demolition was already in progress at the time of supply.¹³² The Court found that the aim ‘was not to supply the existing building and the land it stands on but land that has not been built on’.¹³³ This outcome appears consistent with the benchmark goal, as what was being supplied was essentially different to the existing building and land that had previously been taxed.

On the other hand, in *JJ Komen en Zonen Beheer Heerhugowaard BV v Staatsecretaris van Financien*¹³⁴ the Court of Justice found that there was an exempt supply where a partially demolished existing building and land were supplied. A company had acquired apartment rights to retail premises in a shopping mall. At the time of acquisition of these rights, partial demolition had already been carried out at the request and for the account of the vendor, with a view to transforming the real property into a new building.¹³⁵ The mall was still in use at the time of the acquisition. It was accessible to the public, and at least one shop was operational.¹³⁶ No construction work to transform it into a new building had been carried out at the time of supply.¹³⁷ What was being supplied was effectively an existing building.

¹³² *Don Bosco Onroerend Goed BV v Staatsecretaris van Financien* (European Court of Justice (Fourth Chamber), C-461/08, 19 November 2009) ECR I-11079, [33].

¹³³ *Don Bosco Onroerend Goed BV v Staatsecretaris van Financien* (European Court of Justice (Fourth Chamber), C-461/08, 19 November 2009) ECR I-11079, [44]. This judgment appears consistent with that of the New South Wales Supreme Court in *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* (2006) 197 FLR 74, [105]; 62 ATR 73; [2006] NSWSC 83, where the Court found that the sale of a development site containing a disused house was a taxable supply as the purchaser ‘intended to demolish the existing buildings’. Concerns have been expressed elsewhere regarding the focus in the *Toyama* judgment on the purchaser’s intention. See, eg, Australian Taxation Office, *Decision Impact Statement: Toyama Pty Ltd v Landmark Building Developments Pty Ltd* (2006); Villios, n 31, 426.

¹³⁴ *JJ Komen en Zonen Beheer Heerhugowaard BV v Staatsecretaris van Financien* (European Court of Justice (Fourth Chamber), C-326/11, 12 July 2012).

¹³⁵ *JJ Komen en Zonen Beheer Heerhugowaard BV v Staatsecretaris van Financien* (European Court of Justice (Fourth Chamber), C-326/11, 12 July 2012) [10].

¹³⁶ *JJ Komen en Zonen Beheer Heerhugowaard BV v Staatsecretaris van Financien* (European Court of Justice (Fourth Chamber), C-326/11, 12 July 2012) [37].

¹³⁷ *JJ Komen en Zonen Beheer Heerhugowaard BV v Staatsecretaris van Financien* (European Court of Justice (Fourth Chamber), C-326/11, 12 July 2012) [38].

2.4.4 *Conversions of commercial property into residential premises*

When commercial property is converted from commercial use into residential premises, GST/VAT relating to any previous business supplies would have been recovered, so it is consistent with the benchmark goal for the first supply of the new residential premises to be taxable, as the 'new residential premises' provide consumption services. The owner of these residential premises is effectively the first owner of what is now 'new residential premises'. In both Australia and Canada, such a conversion of commercial property into residential premises would likely lead to there being a supply of new residential premises. However, in each jurisdiction different reasons have been given for this.

In Australia, the conversion of commercial premises into residential premises is likely to lead to a taxable supply by virtue of the use of the building changing from commercial to residential, rather than because of the building being substantially renovated. As mentioned above, the *GSTA* regards residential premises as being new if they 'have not previously been sold as residential premises ... and have not previously been the subject of a long-term lease'.¹³⁸ The Commissioner has considered a situation involving a warehouse being converted to residential premises and has explained that the building would become new residential premises because they were not previously used as such.¹³⁹ This approach is consistent with the benchmark goal, as explained above. Previous sales of the property would have had a neutral GST effect, as input tax credits would have been available. The first sale of the property as residential premises should be taxed, as the first purchaser of the residential

¹³⁸ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 40-75(1)(a).

¹³⁹ Australian Taxation Office, n 74, [41].

premises should pay GST in relation to the value of the residential premises, given that they provide consumption services to the purchaser.

The facts of *Marana Holdings Pty Ltd v Federal Commissioner of Taxation*¹⁴⁰ also involved a conversion of commercial property into residential premises. The taxpayer through its agent purchased a motel, which they later converted into strata title units. The Court considered whether the sale of one of those units, which was previously used as a motel room and was to be used as residential premises, was the sale of new residential premises.¹⁴¹ The appellants claimed that the sale of the unit was an input taxed supply and not a taxable supply of new residential premises, as when the motel was sold to them it was sold as residential premises.¹⁴² However, the Court found that when the appellants purchased the motel it was not occupied as residential premises or intended to be, or capable of being, so occupied. This meant that the subsequent sale of the strata titled unit was new residential premises when it was sold by the appellants, as the sale of the motel to the appellants (prior to its strata titling) was not the sale of residential premises.¹⁴³ This approach is consistent with the benchmark goal, as the previous sale of the motel to the appellants would be a taxable supply that would have a neutral GST effect (as the appellants would have been entitled to input tax credits).

¹⁴⁰ *Marana Holdings Pty Ltd v Federal Commissioner of Taxation* (2004) 141 FCR 299; 57 ATR 521; [2004] FCAFC 307.

¹⁴¹ *Marana Holdings Pty Ltd v Federal Commissioner of Taxation* (2004) 141 FCR 299, [2]; 57 ATR 521; [2004] FCAFC 307. Van der Westhuysen has noted that ‘it was agreed by the parties that the conversions of the motel units into apartments did not amount to ‘substantial renovations’’: Van der Westhuysen, n 31, 121.

¹⁴² *Marana Holdings Pty Ltd v Federal Commissioner of Taxation* (2004) 55 ATR 161, [14]; [2004] FCA 233.

¹⁴³ *Marana Holdings Pty Ltd v Federal Commissioner of Taxation* (2004) 141 FCR 299, [68]; 57 ATR 521; [2004] FCAFC 307. The Court noted, at [52], that reference in the Explanatory Memorandum to the *A New Tax System (Goods and Services) Tax Bill 1999* (Cth) to a new ‘house’ suggests that the expression ‘residential premises’ is not intended to include a hotel or motel, and that ‘the meaning ‘residence’ dictates the element of permanent or long-term occupation’. For a more detailed analysis of the *Marana* case, see Rebecca Millar and Paul Stacey, “Case Update” (2004) 4 AGSTJ 311; Tretola, Villios and Callea, n 31, 4–6; Van der Westhuysen, n 31, 120–125.

Therefore, the subsequent sale of the strata titled unit would have involved the transfer of value, which should be taxed.

In Canada, s 190(1) of the *ETA* provides that where a person holds a residential complex that was previously used for business or commercial activity, the person will be deemed to have substantially renovated the residential complex.¹⁴⁴ The Canada Revenue Agency has indicated its view that this will be the case regardless of how much, if any, work is done in converting the building.¹⁴⁵ An example is provided of an office building that is converted into apartments, which are then rented for residential purposes. The owner will be regarded as having substantially renovated the complex and made a self-supply of new residential premises. This is consistent with the benchmark goal, as the previous sale of the property for business or commercial use would have had a neutral GST/VAT effect; whereas, when the property is used for residential purposes, the property would provide consumption services on which tax should stick.

The Canada Revenue Agency has also explained that s 190(1) may apply where a building that was used for non-residential purposes is sold to an individual for residential use. In this situation, it would view:

the individual as purchasing a non-residential property and converting it to residential use. The purchaser would then be deemed to have substantially renovated the building, and would be eligible to claim the new housing rebate with respect to the tax paid on the acquisition.¹⁴⁶

¹⁴⁴ *Excise Tax Act*, RSC 1985, c E-15, s 190.

¹⁴⁵ Canada Revenue Agency (2005), n 90.

¹⁴⁶ Canada Revenue Agency (2005), n 90.

This approach would achieve the benchmark goal, as it would mean that the consumption value of the residential premises when it is regarded as 'new' would be included in the GST/VAT base.

The EU case *Kozuba Premium Selection*¹⁴⁷ involved a conversion of a property from residential to commercial use. A company was given a residential building by one of its shareholders. The company then adapted the building for use as a 'show room', used it for this purpose, and then later sold the building to a third party. The cost of converting the residential building to a show room was equivalent to 55% of the initial value of the building. The relevant national law indicated that an 'upgrade' would constitute 'first occupation' of a building 'if the expenditure incurred for the upgrade ... constituted at least 30% of the initial value'.¹⁴⁸

The Court explained that supplies of buildings that have been converted may be taxed 'since a conversion adds value to the building concerned, in the same way as the initial construction does'.¹⁴⁹ While noting that 'conversion' is not defined in the *EU VAT Directive*,¹⁵⁰ it indicated that this term suggests 'the building concerned must have been subject to substantial modifications intended to modify the use or alter considerably the conditions of its occupation'.¹⁵¹ The Court explained that this is consistent with the objective of the *EU VAT Directive* and 'in particular that of taxation of a transaction that seeks to increase the value of the property at issue'.¹⁵² This approach appears consistent with the benchmark goal, particularly given that if the modifications are substantial the value being transferred would likely relate to the value that is added by these modifications. The Court found that the *EU*

¹⁴⁷ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017).

¹⁴⁸ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [9].

¹⁴⁹ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [51].

¹⁵⁰ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [51].

¹⁵¹ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [52].

¹⁵² *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [55].

VAT Directive did not preclude a national law requiring that an upgrade of an existing building would constitute first occupation where the expenditure incurred for the upgrade was at least 30% of the initial value. It observed that the fact that the costs incurred for the upgrade amounted to 55% of the initial value suggested that the modifications could have contributed to altering the conditions of occupation of the building considerably.¹⁵³ However, it left it to the national court to assess the extent to which the upgrade led to substantial modification to the building.¹⁵⁴

2.5 Analysis and policy recommendations

2.5.1 Analysis

While most of the outcomes of the legal approaches discussed appear to be consistent with the benchmark goal, some factors that have been used to determine whether residential premises are new or used appear to deviate from this benchmark. There are similarities in the way that a substantial renovation is defined in the relevant legislation: all or substantially all of a building must be removed or replaced. While this is consistent with the benchmark goal to the extent that it defines a situation where significant value is added so that a new taxing point should be created, it appears unnecessarily restrictive in that it may preclude some renovations that lead to significant value being added. Several factors may be considered in determining whether the definition has been met, which may sometimes lead to outcomes that are inconsistent with the benchmark goal. For example, the application of the 90% test

¹⁵³ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [59].

¹⁵⁴ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017) [58]. The Court of Justice also indicated that the requirement in the relevant national law that first occupation ‘shall mean release for use of buildings ... in performance of taxable activities’ was inconsistent with Art 135(1)(j) as it made this exemption for the supply of buildings after their first occupation subject to a condition that the first occupation occur in the context of a taxable transaction. At [47], the Court indicated that Member States are not permitted to subject Art 135(1)(j) to a condition.

developed by the Canada Revenue Agency could lead to inconsistent outcomes where less than 90% of the interior of the residential premises has not been removed or replaced but significant value is added. The larger the property, the more complex it may be to determine whether there has been a substantial renovation.¹⁵⁵

The distinction between 'new' and 'old' real property is broader in the European Union than it is in Canada and Australia. It relates to all real property, not just residential premises. While in theory the European Union has a policy of trying to harmonise their VAT systems and aims to have a common market without distortions, there are no firm rules regarding what are 'new' or 'used' residential premises. Unlike the situation in Canada and Australia where substantial renovations are defined in the relevant legislation, there are no equivalent definitions in the European Union. Member States can develop their own criterion to interpret what constitutes a taxable supply 'before first occupation', and determine how this applies to a conversion. This leaves room for inconsistent interpretation of these terms among Member States, as well as outcomes that might be inconsistent with the benchmark goal.

In both Australia and Canada, it appears that the legislative policy intent is that, for there to be a substantial renovation, the renovation must occur to the existing residential building. Therefore, additions to residential premises are generally not considered when determining whether there has been a substantial renovation. However, an addition could lead to

¹⁵⁵ For example, in *Seabrook Investments Ltd v The Queen* [2001] GTC 422 the facts involved work done to multiple properties, one of which was a nursing home that had been converted into seven strata titled units and then each sold separately. The Court found that five of the strata units had been substantially renovated, as the roof and main staircase in the building had been removed and replaced, some walls were added and others were removed. Also, kitchens in some of the strata units were placed in new locations, fire insulation, drywall, extra cladding, floor beams and ceiling joists were added. Two of the strata units were newly constructed residential condominiums as the basement was gutted and converted. This outcome appears consistent with the benchmark goal, as significant value seems to have been added.

significant value being added to residential premises that has not already been included in the GST/VAT base. Where this is the case, it would be more consistent with the benchmark goal to create a new taxing point.

Where a new residential building replaces a demolished building, it appears consistent with the benchmark goal that the new building and the underlying land on which it stands should be regarded as a taxable supply of 'new residential premises', as the demolished building has been substantially replaced. What would be transferred when the new residential premises are sold would essentially be new value added to the property because of the construction of the new residential premises. In all three jurisdictions considered in this chapter, the approaches taken to this issue are consistent with the benchmark goal.

When commercial property is converted into residential premises, the supply of the residential premises will generally be regarded as a taxable supply of new residential premises. This appears consistent with the benchmark goal, as GST/VAT relating to any previous business supplies would have been recovered, so the first supply of the new residential premises should be taxable as the new residential premises provide consumption services. There is a difference in the approaches taken in these jurisdictions as to why the converted residential premises are regarded as new. In Australia, the conversion of the building is likely to lead to a taxable supply by virtue of the change in use of the property rather than because of the building being substantially renovated. In Canada, a person owning converted residential premises is deemed by virtue of the *ETA* to have substantially renovated the property. In the European Union, it is left to Member States to develop rules to determine when there has been a taxable supply 'before first occupation' when a building has been converted. The European Court of Justice has explained that supplies of buildings that have

been converted should be taxed, and the term 'conversion' suggests that a building must have been subject to 'substantial modifications intended to modify the use or alter considerably the conditions of its occupation'.

Of the jurisdictions considered, Australia is the only one where there is administrative guidance regarding all four issues considered in this chapter. Australia also has the least number of relevant cases relating to the issues. This may be because GST was introduced in Australia significantly later than in many jurisdictions, including Canada and the European Union. There was therefore potential for policy-makers in Australia to learn from the experiences of other jurisdictions that already had rules about the GST/VAT treatment of supplies of renovated residential premises. This might in part explain the overall similarity in the approaches taken to these issues in Australia and Canada. That there is administrative guidance in Australia on all four issues may also explain the lack of relevant litigation.

2.5.2 Policy recommendations

It is clear that, on the one hand, a very minor repair will not lead to substantial value being added and, on the other hand, the replacement of demolished premises should create a new taxing point. However, there is a continuum between a minor repair and a substantial renovation, with no obvious way to characterise an activity in any particular case. The comparative analysis in this chapter indicates that, while there has been some legislative definitions of key terms and administrative guidance provided in some jurisdictions, these sometimes have an unnecessarily restrictive effect, producing results inconsistent with the benchmark where significant value is excluded from being regarded as creating a new taxing point. The administrative guidance provided has suggested a number of factors that may indicate whether a renovation is substantial. However, deciding the GST/VAT characterisation

based on the facts of each case is an administrative and compliance burden and can lead to inconsistent results for taxpayers in similar situations, as well as litigation. This suggests there is a need for statutory reform.

The current uncertainties relating to the GST/VAT characterisation of repairs and renovations are not unlike the issues that arise in an income tax context regarding whether a change to a building constitutes a deductible repair or a capital improvement. In this regard, Allen has explained how application of two tests often used by Australian courts to characterise repair costs produces results that are not always consistent. She has recommended a 'safe harbour rule' that relies on objective criteria to overcome these uncertainties.¹⁵⁶

Likewise, to provide certainty regarding the GST/VAT characterisation of renovations and additions, a statutory rule is needed that explains when these will lead to the creation of a new taxing point. Like with the statutory rules in Australia relating to capital allowances, the rule for GST/VAT purposes could be based on a cost threshold.¹⁵⁷ This rule could be that, if the cost of the work to the property is 50% or more of its resale value, the residential premises will be regarded as new. If the cost of the work is less than this, the resale of the renovated residential premises will be input taxed or outside the scope of GST/VAT.

It would be consistent with the benchmark goal for the recommended statutory rule to refer to the resale value rather than the initial value. While *Kozuba Premium Selection*¹⁵⁸ involved interpretation of a national rule that indicated an upgrade would constitute 'first occupation' 'if the expenditure incurred for the upgrade ... constituted at least 30% of the initial value', it

¹⁵⁶ See Christina Allen, "From Uncertainty to Objectivity: Reforming Tax Deductions for Repair Costs in Australia" (2020) 35(4) *Australian Tax Forum* 496.

¹⁵⁷ See *Income Tax Assessment Act 1997* (Cth) ss 40-80(2), 40-425, 328-180.

¹⁵⁸ *Kozuba Premium Selection* (European Court of Justice (Second Chamber), C-308/16, 16 November 2017).

is assumed under the benchmark principle that the full value that was taxed by way of the upfront payment on the initial sale of the property has been consumed before the property is renovated. Any value added to the residential premises because of changes made to it affect its resale value, not its initial value. It is therefore the resale value the benchmark rule seeks to tax.

Requiring the cost of the work to the property to be at least 50% or more of its resale value would exclude minor changes that do not add significant value, such as cosmetic changes. It would also mean that when renovated residential premises are sold most of the value bought by the new owner is attributable to value added to the property, which was not subject to GST/VAT on any previous sale. Some of the rules discussed in this chapter, such as the definition of 'substantial renovation' and the 90% test used in Canada, appear to have an unnecessarily restrictive effect, sometimes excluding some situations where significant value appears to be added from creating a new taxing point. A 50% test would likely result in outcomes more consistent with the benchmark goal.

The recommended statutory rule bears resemblance to the 90% test used by the Canada Revenue Agency. As discussed above, it is ambiguous as to when this test will be met as it is unclear when 90% of the interior of the residential premises will be regarded as being removed or replaced. Basing the statutory rule on the cost of the work done to the property would provide more certainty as to when a new taxing point should be created.

2.6 Conclusion

This chapter considered examples of the legal approaches taken in Australia, Canada and the European Union to determine the GST/VAT characterisation of supplies of renovated

residential premises. It compared and evaluated these approaches by reference to whether they are consistent with the benchmark goal.

The analysis indicates that some of these approaches have sometimes had an unnecessarily restrictive effect, producing results inconsistent with the benchmark goal where significant value has been excluded from being regarded as creating a new taxing point. Further, deciding whether work done to a property leads to a new taxing point based on the facts of the situation leads to uncertainty. It is recommended that the solution to these problems could be a statutory rule setting out a cost threshold. If the cost of the work done to residential premises is 50% or more of its resale value, the residential premises should be regarded as new. If the cost of the work is less than this, the sale should be input taxed or outside the scope of GST/VAT.

A limitation of this chapter is that the issues considered are not the only issues that arise in relation to the GST/VAT treatment of supplies of renovated residential premises. A myriad of variations in different facts can arise. This includes variances concerning what parts of an existing residential premises are removed or replaced and what parts are kept unrenovated. While there is scope for further research, it is hoped that this chapter, and particularly the explanation of the benchmark goal, may provide useful insights to policy-makers considering what might be the appropriate GST/VAT treatment relating to the issues considered

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Chapter 3: Alternative approach one: Including imputed rent in the GST/VAT base*

3.1 Introduction

The research question to be answered in this chapter is whether there is a viable way to tax the consumption of immovable property that is more consistent with the economic objective of the GST/VAT (which is to tax the flow of consumption) as compared to the current approach. The current approach to the GST/VAT treatment of immovable property will first be considered in Section 3.2 of this chapter. It will be noted in this section that the design of GST/VAT systems is generally based on an assumption that is known as the ‘prepaid method’. It is assumed that the value of goods at the time that they are first purchased is equal to the total value of the use and enjoyment (consumption) of those goods.¹ Therefore, GST/VAT is generally imposed on the first purchase of goods, and later sales of goods from consumer to consumer are not subject to GST/VAT.

In Section 3.3, the particular challenge posed by the GST/VAT treatment of owner-occupied housing under the prepaid method will be discussed. The general appreciation in the value of immovable property² may result in the value of total consumption of owner-occupied housing

* This is a modified version of the published article Peacock, Christine, ‘Is there a viable way to tax the consumption of immovable property that is more consistent with the economic objective of the VAT?’ (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336-350.

¹ David F Bradford, *Blueprints for Basic Tax Reform* (Tax Analysts, 2nd ed, 1984) 108; Wei Cui, ‘Objections to Taxing Resale of Residential Property under a VAT’ (November 2012) *Tax Notes* 777, 779; and Robert F van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International, 2009) 183.

² The term ‘immovable property’ is generally understood in the tax literature to mean land, buildings and fixtures, both residential and commercial: Satya Poddar, ‘Taxation of Housing Under a VAT’ (2009) 63 *Tax Law Review* 443, 445–6. In Anglo countries, including Australia, immovable property is known as real property. However, owing to the international importance of this chapter, immovable property is referred to by its most common name.

being greater than the value that was taxed at the time of first purchase. This is inconsistent with the economic objective of the GST/VAT, as it may produce a result where there are flows of consumption of owner-occupied housing that are not subject to GST/VAT.

It has been recognised in the GST/VAT literature that the theoretically correct approach for GST/VAT purposes would be to include the imputed rent of a house or apartment in the GST/VAT base.³ Section 3.4 of this chapter will discuss the concept of imputed rent. This is the hypothetical rent that an owner-occupier would pay to him or herself for living in his or her own home.⁴ Imputed rent has been regarded as part of the tax base for income tax purposes in many countries.⁵ However, it has generally been considered that including imputed rent in the GST/VAT base would be too difficult. This has primarily been because of concerns about how to value imputed rent, and concerns as to how such a proposal would affect low-income earners and those who do not earn income. As there is no example of any country including imputed rent within its GST/VAT base, this chapter will consider two historic examples of imputed rent being included within the income tax base (see Section 3.5). These examples will demonstrate some of the problems that have arisen from such an approach. Section 3.6 will then consider whether the concerns that have arisen regarding including imputed rent within the GST/VAT base are still realistic concerns today.

³ See, for example, Robert Albon, 'The Appropriate Tax Treatment of Owner-Occupiers' (1984) 1(4) *Australian Tax Forum* 391, and Rita de la Feria and Richard Krever, 'Ending VAT Exemptions: Towards a Post-Modern VAT' in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Wolters Kluwer, 2013). In relation to the purest theoretical VAT treatment of goods more generally, see Richard Krever, 'Designing and Drafting VAT Laws for Africa' in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 24.

⁴ Marsh provides a similar explanation. See Donald B Marsh, 'The Taxation of Imputed Income' (1943) 58(4) *Political Science Quarterly* 514, 514.

⁵ See Steven C Bourassa and William G Grigsby, 'Income Tax Concessions for Owner-Occupied Housing' (2000) 11(3) *Housing Policy Debate* 521; Paul E Merz, 'Foreign Income Tax Treatment of the Imputed Rental Value of Owner-Occupied Housing: Synopsis and Commentary' (1977) XXX(4) *National Tax Journal* 435; and Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International, 2003).

3.2 VAT treatment under the prepaid method

To answer the research question, this chapter first considers the current approach. Under the prepaid method, GST/VAT is currently imposed on the original purchase price of goods as a measurement of the present value of all future consumption.⁶ Later sales of goods from consumer to consumer are not subject to GST/VAT, although theoretically later consumers pay GST/VAT as future consumption is assumed to be built into the price at which second-hand goods are sold.

The current use of the prepaid method yields an appropriate result where goods provide immediate gratification to a consumer, such as a cup of coffee.⁷ In this case, the value of goods at the time that they are first purchased is the present value of their future use, and the GST/VAT on the initial purchase corresponds with all future consumption. Use of the prepaid method also generally yields an appropriate result where goods are sold partway through their useful lives.⁸ The owner of a washing machine, for example, who sells it for, say, half the purchase price when it is halfway through its life recovers half the GST/VAT that he or she originally paid to the revenue authority. The purchaser of a second-hand washing machine bears an effective burden equal to the present value of the GST/VAT on the remaining consumption that is yielded by the washing machine. The market value of used

⁶ The following sources provide similar explanations: Bradford, above n 1; Sijbren Cnossen, 'VAT Treatment of Immovable Property' in Victor T Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, 233–4; Cui, above n 1, 799; Rebecca Millar, 'Echoes of Source and Residence in VAT Jurisdictional Rules' in Michael Lang, Peter Melz et al (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009); Rebecca Millar, 'VAT and Immovable Property: Full Taxation Models and the Treatment of Capital Gains on Owner-Occupied Residences' in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Wolters Kluwer, 2013) 253; Christine Peacock, 'Taxing the Consumption of Owner-Occupied Residential Property' (2013) 5 *International VAT Monitor* 299, 299; and Van Brederode, above n 1, 183.

⁷ This has been recognised by Van Brederode: Robert F van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' in Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) vol 37, 1.

⁸ Krever has recognised this: Krever, above n 3, 24.

goods such as second-hand washing machines is the GST/VAT-inclusive value. This includes a portion of the GST/VAT paid by the first purchaser.⁹

The purchase of a good is a form of savings, not consumption.¹⁰ Expenditure is recognised as goods waste through usage or the effluxion of time. Cui has recognised this where he has written that '[t]he act of purchase is not itself an act of consumption. Instead, consumption happens when a durable good is used.'¹¹ Many consumer durables are goods that waste in value over time.¹² Therefore, for many consumer durables the GST/VAT on the initial sale price will generally be approximately equal to the present value of all future consumption.

However, where a durable good appreciates, upfront taxation does not correspond to the present value of all future consumption. If the market value of a durable good increases over time, the value of savings will rise, and yield more consumption. Final consumption will therefore be greater than the original present value that was ascribed to the good. Owners who retain appreciating goods therefore bear less GST/VAT than the amount that corresponds with the increased consumption value of the good. This is problematic, as it is inconsistent with the economic objective of the GST/VAT, which is to tax the flow of consumption.¹³ It presents a situation where the legal design of the GST/VAT as a tax on transactions does not achieve this economic objective. For simplicity reasons, expenditure is

⁹ This was earlier recognised in Peacock, above n 6.

¹⁰ Ibid.

¹¹ Cui, above n 1. See also Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015), and Van Brederode, 'Theory and Practice of VAT', above n 7.

¹² Krever, above n 3.

¹³ The economic objective of the VAT is recognised by Millar. See Millar, 'VAT and Immovable Property', above n 6. See also Robert F Conrad, 'Value Added Taxation and Real Estate' (Discussion Paper DRD224, Development Research Department Economics and Research Staff World Bank, February 1987); Alan A Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988) 80; and Van Brederode, 'Theory and Practice of VAT', above n 7.

generally currently used as a proxy for consumption. In effectively describing the operation of the prepaid method, Millar has explained that:

while the objective of a VAT is to tax consumption, in its legal design it is a tax on transactions, in which future consumption is predicted. Consumption is measured by reference to consumption expenditure (the price paid to acquire goods or services for the purpose of consuming them, whether immediately or in the future).¹⁴

Generally, there are time of supply rules that are imposed in countries that have a GST/VAT, which have the effect that GST/VAT is accounted for at the time that ownership of a good is transferred.¹⁵ This will generally be regarded as the time that a transaction takes place. For example, in New Zealand there is a general ‘time of supply’ rule that states that GST should be accounted for at ‘the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier in respect of the supply.’¹⁶ Similarly, in the European Directive (EU) Directive 2006/112 it is written that ‘on each transaction, value added tax ... shall be chargeable’.¹⁷

James has observed that using ‘expenditure on consumption as a proxy for consumption’ is considered best practice design.¹⁸ She has written that it is generally thought ‘necessary to

¹⁴ Millar, ‘Echoes of Source’, above n 6. See also OECD, *Consumption Tax Trends 2016: VAT/GST and Excise Rates, Trends and Policy Issues* (OECD Publishing, 2016).

¹⁵ Millar describes the time of supply rules in more detail: Millar, ‘Echoes of Source’, above n 6.

¹⁶ Goods and Services Tax Act 1985 (NZ) s 9.

¹⁷ European Union Directive 2006/112 Article 1. New Zealand and the EU are mentioned here as the GST/VAT systems in these countries are considered international models of VAT design: John F Due, ‘The New Zealand Goods and Services (Value-Added) Tax – A Model for Other Countries’ (January–February 1988) 36(1) *Canadian Tax Journal* 125; Andrew Maples and Adrian Sawyer, ‘The New Zealand GST and its Global Impact: 30 Years On’ (2017) 23(1) *New Zealand Journal of Taxation Law and Policy* 9, 25; Christine Peacock, ‘Why Simple GST Treatment of Real Property Is Important’ (2010) 13(4) *The Tax Specialist* 216; Adrian Sawyer, ‘GST Reform: Can New Zealand Offer Constructive Guidance to Inform the Australian Debate?’ (Paper presented at the Visiting Professor Seminar Series, QUT Business School, Brisbane, Queensland, Australia, November 2014); and Thuronyi, above n 5, 313.

¹⁸ Kathryn James, *The Rise of the Value-Added Tax* (Cambridge University Press, 2015) 41.

identify some taxable transactions ... such as the supply of a good or service, that triggers the expenditure on consumption and therefore the liability to pay VAT'.¹⁹ According to Ecker, '[c]onsumption itself is not directly observable but what we can hope to observe is ... spending'.²⁰

However, this chapter suggests that it is no longer necessary to identify taxable transactions in order to subject the consumption of immovable property to GST/VAT. This chapter therefore fits within the increasing body of literature where the current general design of GST/VAT systems is being questioned, and where it is being suggested that it is now possible to tax some consumption that has generally not been subject to GST/VAT in the past. In particular, there is an increasing body of literature where the rationale for the use of standard exemptions from the GST/VAT, are being questioned.²¹ This is particularly in light of the experience in GST/VAT jurisdictions with the problems caused by the use of exemptions, such as the often-difficult issue of determining which supplies of goods and services are taxable and which are exempt. Further, as noted by the European Commission, there is a need to review standard exemptions 'in the light of economic and technological changes'.²² The focus of this chapter is on the GST/VAT treatment of residential premises. Currently sales and leases of residential premises are generally regarded as exempt from GST/VAT, or outside the scope of GST/VAT when a vendor is not registered for GST/VAT (see Section 3.3).

¹⁹ Ibid 41–2.

²⁰ Thomas Ecker, *A VAT/GST Model Convention* (IBFD, 2013) 100.

²¹ Liam Ebril et al, *The Modern VAT* (International Monetary Fund, 2001) 100.

²² European Commission, 'Green Paper on the Future of VAT: Towards a Simpler, More Robust and Efficient VAT System' (2010) <http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/consultations/tax/future_vat/com%282010%29695_en.pdf>.

3.3 The problem with the GST/VAT treatment of owner-occupied housing

The particular challenge posed by the GST/VAT treatment of owner-occupied housing under the prepaid method will be discussed in this section, after consideration of the GST/VAT treatment of immovable property more generally. Unlike most consumer durables that depreciate over time, the value of immovable property generally appreciates.²³ Cui has attributed this appreciation to '[u]rbanization, the building of new transportation pathways and amenities, unexpected rises in income in the local population, and so forth'.²⁴ Other factors affecting the general appreciation in the value of immovable property may include population growth, particularly in jurisdictions with immigration.²⁵ Appreciation in the value of immovable property can also arise due to other circumstances relating to the property, such as a change of zoning.²⁶

Van Brederode has noted that other than immovable property 'art, antiques and some other collectibles'²⁷ can also appreciate. To achieve consistency, the GST/VAT treatment of these other durable items that may also experience a change in real values should also be considered. However, this is beyond the scope of this chapter, which focuses on the GST/VAT treatment of immovable property. This is because it is more common for people to purchase immovable property than these other items, as this form of property is considered more of a necessity, and immovable property is the most frequently consumed asset to appreciate. The importance of the GST/VAT treatment of immovable property also lies in the fact that

²³ This has been recognised by Cui: Wei Cui, 'Learning to Keep the Consumption Tax Base Broad: Australian and Chinese VAT Design for the Housing Sector' in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011). See also Cui, 'Objections to Taxing Resale', above n 1, 779.

²⁴ Cui, 'Objections to Taxing Resale', above n 1, 779.

²⁵ This was recognised in Peacock, 'Taxing the Consumption', above n 6, 300.

²⁶ Cui, 'Objections to Taxing Resale', above n 1, 779.

²⁷ Van Brederode, 'Theory and Practice of VAT', above n 7.

expenditure on housing services often comprise a large percentage of an individual's total consumption.²⁸ In this regard, Millar has written that '[i]mmoveable property is the most widely held and traded appreciating asset and a purchase of immovable property is more often than not the single most important acquisition a person will make in his/her lifetime.'²⁹

The general appreciation in the value of immovable property is not so problematic when it comes to supplies of commercial property, as business consumers are entitled to deduct GST/VAT on the purchase or lease of commercial property, as the property is used as an input into the purchaser's production.³⁰ Therefore, there is no GST/VAT net effect for revenue authorities as a result of supplies of commercial property being subject to GST/VAT. The general appreciation in the value of immovable property is also not a problem that affects the GST/VAT treatment of residential rents, as residential rents are generally exempt from GST/VAT.³¹

The GST/VAT treatment of owner-occupied housing is, however, problematic. Under the prepaid method, the first sale of residential premises from a developer to a consumer is subject to GST/VAT. Subsequent sales of residential premises from consumer to consumer are generally regarded as exempt from GST/VAT, or outside the scope of GST/VAT when a

²⁸ Ibid 1.

²⁹ Millar, 'VAT and Immoveable Property', above n 6. See also Institute for Fiscal Studies, *The Structure and Reform of Direct Taxation: Report of a Committee Chaired by Professor J.E. Meade* (George Allen & Unwin, 1978) 54, and Poddar, above n 2.

³⁰ See Krever, above n 3, 24; Ine Lejeune, Jeanine Daou-Azzi and Mark Powell, 'The Balance Has Shifted to Consumption Taxes – Lessons Learned and Best Practices for VAT' in Michael Lang, Peter Melz et al (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009); and Van Brederode, 'Theory and Practice of VAT', above n 7.

³¹ This is so as to achieve tenure neutrality between homeownership and residential rents, as sales of used residential premises are not subject to GST/VAT: Sijbren Cnossen, 'Improving the VAT Treatment of Exempt Immoveable Property in the European Union' (Working Paper 10/19, Oxford University Centre for Business Taxation, 2010) 1; Lejeune, Daou-Azzi and Powell, above n 30; Millar, 'VAT and Immoveable Property', above n 6; and M Stewart, 'Taxation Policy and Housing' (2012) 7 *International Encyclopedia of Housing and Home* 152.

vendor is not registered for GST/VAT.³² In theory, it is assumed that the initial sale price of residential premises will include the present value of all future consumption of the residential premises.³³ However, Cnossen has described the current GST/VAT treatment under the prepaid method as a 'second-best approach' as changes in the value of residential premises are not included in the GST/VAT base.³⁴ Over time, the value of a house or apartment generally rises above the consumer price index. Applying the prepaid method to the GST/VAT treatment of owner-occupied housing may therefore mean that the value of total consumption of owner-occupied housing may be greater than the value that was taxed at the time of first purchase.³⁵ Future purchasers of a used residence will have an effective tax burden equal to the present value of the GST/VAT at the time of acquisition, not the new value of future consumption.

3.4 The concept of 'imputed rent'

It has been recognised in the GST/VAT literature that the theoretically correct approach for GST/VAT purposes would be to include the imputed rent of a house or apartment in the GST/VAT base.³⁶ Marsh has described imputed rent as 'the net value of the services rendered by a house to its owner (occupier) for which he would otherwise pay cash rent to a landlord.'³⁷

³² Van Brederode, 'Theory and Practice of VAT', above n 7.

³³ De la Feria and Krever, above n 3.

³⁴ Sijbren Cnossen, 'A Proposal to Improve the VAT Treatment of Housing in the European Union' in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Wolters Kluwer, 2013) 225; Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) 5(3) *International Tax and Public Finance* 399; and Sijbren Cnossen, 'Is the VAT's Sixth Directive Becoming an Anachronism?' (2003) 43(12) *European Taxation* 434. See also de la Feria and Krever, above n 3.

³⁵ This was recognised in: Cnossen, 'A Proposal to Improve the VAT Treatment', above n 34; Cui, 'Learning to Keep the Consumption Tax Base Broad', above n 23; de la Feria and Krever, above n 3, 453; and Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review* (Oxford University Press, 2011) 380.

³⁶ See, for example, Albon, above n 3, 391, and de la Feria and Krever, above n 3. In relation to the purest theoretical VAT treatment of goods more generally, see Krever, above n 3, 24.

³⁷ Marsh, above n 4, 514.

Imputed rent falls within the broader taxation concept of imputed income, which Marsh has defined as a 'flow of satisfactions from durable goods owned and used by the taxpayer, or from goods and services arising out of the personal exertions of the taxpayer on his own behalf.'³⁸ If imputed rent were included within the GST/VAT base, then it would not be subject to GST/VAT at the time that transactions between parties take place, but instead, a value would be placed on the imputed rent of a home for a specific period, such as a month or year, and this value could be updated as the immovable property appreciates.

Cnossen has observed that subjecting imputed rent to GST/VAT would involve regarding the owner-occupier of a home as making a self-supply of the services in a home to him or herself.³⁹ He has explained that by purchasing a home, an owner would become a producer of housing services. The owner could sell the housing services to a tenant who would act as a consumer of the housing services. A theoretically correct approach would be for the tenant to pay GST/VAT on the rental charge. Alternatively, the owner could put the home to his or her own disposal.⁴⁰ This would be equivalent, Cnossen has argued, to making a self-supply of housing services. He has recommended that GST/VAT should be charged on the consideration for this self-supply.⁴¹ Such an approach would involve widening the GST/VAT base, to include residential rent and imputed rent.

While imputed rent has been regarded as part of the tax base for income tax purposes in many countries including Australia, Austria, Belgium, Denmark, Finland, Germany, Greece, Israel, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden,

³⁸ Ibid.

³⁹ Cnossen, 'Improving the VAT Treatment of Exempt Immovable Property', above n 31, 1.

⁴⁰ Ibid.

⁴¹ Ibid.

Switzerland, Turkey and the United Kingdom,⁴² there is no country that includes or has included imputed rent in its GST/VAT base.⁴³ The next section considers two historic examples of when imputed rent was included within the income tax base. These examples will illustrate some of the problems that have arisen from such an approach.

3.5 Historical examples of imputed rent being subject to income tax

Imputed rent was assessed for income tax purposes at a national level in Australia, from 1915 until 1923.⁴⁴ Where applicable, the income of any person included:

five per centum of the capital value of land and improvements thereon owned and used or used rent free by the taxpayer for the purpose of residence or enjoyment and not for the purpose of profit or gain, less the interest paid on a mortgage of that land.⁴⁵

Simons wrote in particularly positive terms about this experience in 1938 in the course of discussing the ‘comprehensive concept of income’ and ‘income in kind’.⁴⁶ However, it appears that he mistakenly viewed this as a simple system under which imputed rent was calculated on a net basis, without further deductions allowed for depreciation or repairs.⁴⁷ For example, he wrote that ‘[a] conspicuous advantage of this method lies in the avoidance of the depreciation problem – which ... is very inadequately handled under rules of the kind

⁴² See Bourassa and Grigsby, above n 5; Merz, above n 5, 435; New Zealand Treasury, New Zealand Government, *Issues Paper – Tax Review 2001* (2001) 39; and Thuronyi, above n 5.

⁴³ Richard M Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007), and Cnossen, ‘VAT Treatment of Immovable Property’, above n 6.

⁴⁴ South Australia included imputed rent in its income tax base from 1885 until 1930, Victoria from 1895 until 1936, and Queensland from 1920 until 1923: B F Reece, ‘Taxing Imputed Rent: Australian Precedents’ (1975) *Community* 6.

⁴⁵ Income Tax Act 1915 (Cth) s 14(e).

⁴⁶ Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (University of Chicago Press, 1938).

⁴⁷ This is noted in Robert Albon, ‘Housing and Taxation – Commonwealth Issues’ (1990) 7(3) *Australian Tax Forum* 337 and Barry Reece, ‘Simons’ Account of Australian Taxation of Imputed Rental Income’ (1985) 2(2) *Australian Tax Forum* 239.

prescribed in Schedule A of the English law'⁴⁸ (the operation of Schedule A in the United Kingdom will be discussed below). Albon has explained that the Australian system was, however, more complex than this. He has written that, '[f]rom the "five per centum of the capital value", owner-occupiers could deduct for repairs, rates, land taxes and mortgage interest.'⁴⁹

The previous system of including imputed rent in the income tax base in the United Kingdom, which existed from the beginning of its income tax system in 1799 until 1963,⁵⁰ has been cited in the tax literature as an example of the administrative difficulties that can arise in assessing imputed rent for income tax purposes.⁵¹ Income tax was levied on the annual value of the property that was owner-occupied.⁵² The annual value of owner-occupied property was regarded as the amount that it was 'worth to be let by the year'.⁵³ Revaluation of owner-occupied property was to occur every five years.⁵⁴ However, no revaluations took place in the United Kingdom between 1936 and 1963 due to war conditions and post-war difficulties.⁵⁵ Merz has written that, '[t]he fear of significant increases in income tax liability following establishment of realistic values by reassessment was the major factor in the cessation of income tax on this form of income'.⁵⁶

⁴⁸ Simons, above n 46.

⁴⁹ Albon, above n 47, 337. See also Reece, 'Simons' Account', above n 47.

⁵⁰ Kevin Holmes, *The Concept of Income: A Multi-Disciplinary Analysis* (IBFD, 2001).

⁵¹ See Government of Canada, *Report of the Royal Commission on Taxation* (1966) vol 3, 48; Richard Goode, *The Individual Income Tax* (The Brookings Institution, revised ed, 1976) 118; and Merz, above n 5.

⁵² Government of Great Britain, 'Royal Commission on the Taxation of Profits and Income: Final Report: Presented to Parliament by Command of Her Majesty' (Her Majesty's Stationery Office, 1955) 246.

⁵³ *Ibid* para 8.11.

⁵⁴ *Ibid* para 8.12.

⁵⁵ Merz, above n 5, 7.

⁵⁶ *Ibid*.

3.6 Including imputed rent within the GST/VAT base

Following on from the historical experiences of Australia and the United Kingdom in including imputed rent in the income tax base, administrative concerns have also arisen in the more recent theoretical GST/VAT literature that has discussed whether imputed rent could be included in the GST/VAT base (see Section 3.4 above). For example, in 1996 Cnossen wrote that ‘the computation of all rental values, would present formidable administrative problems that a VAT should not take on’.⁵⁷ However, while valuing assets in general may have been problematic historically (for instance, for income tax purposes in the United Kingdom, as discussed above), this does not appear to be the case today. In 2011, Holmes wrote that, from an income tax perspective,

[t]here seems to be little justification for omitting imputed rent from owner occupied housing on the basis of measurement difficulties in a climate of increasingly sophisticated valuation methodology for local authority rating (and other) purposes.⁵⁸

Tax administrations have become more capable over time of administering increasingly more complex tax laws. These administrations have more sophisticated technology now compared to what they have had in the past. Further, real values of residential property are utilised for other taxation purposes (including local council rating) in many jurisdictions and these systems of valuation could potentially be adapted so that they could be used to determine how to value imputed rent.

⁵⁷ Cnossen, ‘VAT Treatment of Immovable Property’, above n 6, 233–4. See also Cnossen, ‘Global Trends and Issues in Value Added Taxation’, above n 34.

⁵⁸ Holmes, above n 50.

In the Australian state of Victoria, a Net Annual value is stated on the Notice of Valuation, Rates and Charges that is issued to property owners by local councils. This Net Annual value is 5 per cent of the capital-improved value, which is the value of the land and any capital improvements, including buildings. For the purpose of including imputed rent within the GST/VAT base, the Net Annual value on this Notice of Valuation could be regarded as the value of imputed rent that would be subject to GST/VAT on an annual basis. However, a potential problem with such an approach is that the values of residential property that are currently utilised for tax purposes are sometimes not revised regularly, and hence become outdated (as happened in the United Kingdom when imputed rent was subject to income tax).

Alternatively, GST/VAT could be charged based on the average market rental in different regions, and these figures could be adjusted over time for inflation, and in accordance with the features of a home. For example, two-bedroom homes could be valued more than one-bedroom homes; and the standard valuation allocated to a home could be adjusted based on the size of the property. However, such a system would be far more complex to administer than the proposal mentioned above relating to regarding the capital-improved value as the value of imputed rent. A potential problem with both of these potential ways to calculate imputed rent is that sometimes the values that are used in valuation systems even in year one do not reflect the actual value of the property, given the broad valuation metric that is used. There would therefore be compliance and administrative costs associated with any system of valuation that may be used to value imputed rent.

Another concern that has been raised in the tax literature is that if the consumption of housing were taxed on an annual basis then people on lower incomes or no income may be at a disadvantage financially. For example, in considering the possibility of an annual tax

levied on housing services, the authors of the Mirrlees Review Report wrote that '[t]here would clearly be a large number of losers from a reform of this kind. The losers would include those, often older people, on low incomes who live in expensive houses.'⁵⁹ Likewise, when discussing the possibility of including imputed rent within the income tax base, Bourassa and Grigsby wrote that,

[t]he tax bears little relationship to capacity to pay, weighing more heavily on lower-income, elderly homeowners ... Substantial exclusions would be required to protect retired homeowners being taxed out of their own homes.⁶⁰

However, older people living in expensive houses are often exercising a choice to enjoy a high-imputed rent rather than cash flow or investing in other assets such as shares. If their imputed rent were subject to GST/VAT, they may not necessarily experience hardship, given their capacity to use the equity in their home (the difference between the value of the property and how much is owed on any mortgage) to obtain a loan that could be used to pay GST/VAT on the imputed rent.

Taxing imputed rent for GST/VAT purposes may, however, have the potential to impact negatively on first homebuyers in particular. This may especially be the case during a time of declining homeownership rates due to inflation in house prices. Perhaps there could be ways to deal with this issue. For example, accompanying social assistance could be considered for those who could genuinely claim that they would be unreasonably disadvantaged (as occurred in New Zealand, when the very comprehensive GST was introduced – in that case to

⁵⁹ Institute for Fiscal Studies, above n 35, 390.

⁶⁰ Bourassa and Grigsby, above n 5, 528.

combat regressivity).⁶¹ The authors of the Mirrlees Review Report have suggested that ‘it would be possible to allow people, in specified circumstances, to roll up liabilities (with interest) either until the property is sold or until death, in order to alleviate cash-flow problems.’⁶² If governments collected the additional revenue from including imputed rent within the GST/VAT base and redistributed some of this, then people disadvantaged by such a proposal could be compensated. For example, in Australia the first homeowner’s grant was introduced to offset the effect of the GST/VAT on homeownership.

3.7 Conclusion

Given that housing is so frequently consumed, the appropriate GST/VAT treatment of immovable property is particularly important. In the past, using expenditure on consumption as a proxy for consumption, as occurs under the prepaid method (discussed in Section 3.2) has been considered best practice design. However, the current GST/VAT treatment of immovable property under the prepaid method produces a result that is inconsistent with the economic objective of the GST/VAT (which is to tax all consumption). Under the prepaid method, the consumption of immovable property is only taxed once, at the time that the property is first sold to a consumer. Therefore, any appreciation in the value of immovable property is not captured within the GST/VAT base. This produces a result where there may be a flow of consumption that is not subject to GST/VAT. The research question that this chapter therefore set out to answer was whether there is a viable way to tax the consumption of immovable property that is more consistent with the economic objective of the GST/VAT.

⁶¹ Jeff Todd, ‘Implementing GST – Information, Education, Co-ordination’ in David White and Richard Krever (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 30.

⁶² Institute for Fiscal Studies, above n 35, 390.

In this chapter, the current GST/VAT treatment of immovable property under the prepaid method was compared to the result that would be achieved if imputed rent were subject to VAT. Including the imputed rent of owner-occupied housing within the GST/VAT base, along with rentals of housing to tenants, would produce a result that is more consistent with the economic objective of the GST/VAT. Subjecting imputed rent to GST/VAT would involve subjecting the consumption of immovable property to GST/VAT on a more regular basis. The value of immovable property that is subject to GST/VAT as part of this process could be updated regularly to reflect its appreciation.

In the GST/VAT literature, the idea of including imputed rent in the GST/VAT base has been considered the theoretically correct approach. However, it has generally been considered that this might result in measurement difficulties in determining the value of imputed rent (as occurred when imputed rent was considered part of the income tax base in the United Kingdom: see Section 3.4). It has also been considered that low-income earners and those with no income would be at a financial disadvantage if they were required to pay GST/VAT on their imputed rent (see Section 3.6).

In considering the measurement difficulties that may arise, it was conceded that there would be compliance and administrative costs associated with any system of valuation that may be used to value imputed rent. However, the availability of sophisticated technology and existing systems of valuing property suggests that these costs would be lower than they may have been in the past. The ability today to achieve an outcome closer to the economic objective of the GST/VAT may outweigh these costs.

In considering the potential financial disadvantage that may be experienced by low income earners and those who do not earn an income, it was suggested that some people who fall

within this category may be able to take out loans to fund the potential GST/VAT liability on imputed rent. It was also suggested that social assistance could be provided to those who may be genuinely disadvantaged. It was concluded that the potential problems that may arise from including imputed rent within the GST/VAT base may not be insurmountable. Referring back to the research question that this chapter set out to answer, including imputed rent in the GST/VAT base may be a viable way to tax the consumption of immovable property that may produce a result that is more consistent with the economic objective of the GST/VAT.

Chapter 4: Including imputed rent in the GST/VAT base: Further ideas*

4.1 How does Canada's GST treat housing?

In this chapter, I explain how Canada's GST system inappropriately under taxes the consumption of owner-occupied housing, and I propose a reform to address this inequity.¹

In general terms, Canada's consumption tax system, like those in other countries, requires builders to charge GST/HST on their taxable sales of housing.² In Canada, this includes new or substantially renovated housing. In some circumstances, when newly constructed housing is purchased³ or rented⁴ to residential tenants, the owner may qualify for a federal or provincial rebate of some of the GST/HST paid upon purchase. Subsequent sales of used housing between consumers are generally exempt.

Housing that was in existence when the GST was introduced in Canada in 1991 generally escapes GST/HST. Residential renters are generally exempt⁵ from GST/HST on their rents; similarly, owner-occupiers are exempt on the notional or imputed rent that they pay to themselves for use of the real estate.

* This is a modified version of the published article Peacock, Christine, 'Including imputed rent in the GST base' (2022) 3(3) *Perspectives on Tax Law and Policy* 15-17.

¹ An earlier version of this reform proposal appeared in Christine Peacock, "Taxing the Consumption of Owner-occupied Residential Property" (2013) 5 *International VAT Monitor* 299, 299-301.

² Government of Canada, 'GST/HST and home construction', *GST/HST* (Web Page) <<https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/gst-hst-businesses/charge-collect-home-construction.html>>.

³ Canada Revenue Agency, *GST/HST New Housing Rebate* (No RC4028(E) Rev 22).

⁴ Canada Revenue Agency, *GST/HST New Residential Rental Property Rebate* (No RC4231(E) Rev. 20).

⁵ Canada Revenue Agency, "Residential Real Property-sales" (GST/HST Memorandum) 19.2.2, February 1998).

4.2 Underlying theory of GST/VAT design

The design of GST and VAT systems, including Canada's GST, is premised on the assumption that the value of goods when they are purchased is a close proxy for the discounted present value of all future consumption services that the goods provide. On this basis, tax is imposed on the initial purchase price, which serves as a proxy for the discounted present value of future consumption; later sales of used goods between consumers are generally exempt from GST/VAT. This method yields an appropriate result when goods are immediately consumed, as is the case for a cup of coffee, and when durable goods, such as home appliances, depreciate over time, even if those goods are sold partway through their useful life.

The GST/VAT on depreciable assets is assumed to be built into the price at which second-hand goods are sold. In theory, an asset owner who sells a durable good for half of its purchase price when it is halfway through its useful life can recover half of the GST/VAT collected on the initial purchase. The purchaser of the second-hand good bears an effective tax burden equal to the present value of GST/VAT on the remaining consumption yielded by the good. The revenue authority is indifferent to the transaction, having already collected GST/VAT on the present value amount of future consumption of the good over its useful life.

These assumptions break down when durable goods appreciate significantly over their life, as is the case with owner-occupied housing in Canada. Here, the initial purchase price of the newly built home will not correspond to the present value of all future consumption. The effect is to leave meaningful amounts of consumption outside the GST/VAT base. This is problematic, given that the objective of GST/VAT is to be a broad-based tax on all final consumption.

4.3 The problem with the GST/VAT treatment of housing

Immovable property is the most common of the durable goods that appreciate over time. Historically, although the building itself may depreciate, the market value of the land underneath and abutting a building generally appreciates, in some markets very significantly. This appreciation is not problematic when it comes to supplies of commercial property because purchasers engaged in a commercial activity are generally entitled to an input tax credit to offset the GST/VAT on the purchase or lease of commercial property. However, this appreciation is problematic when it comes to residential housing.

In 2011, the UK Mirrlees review's *Tax by Design* noted that 'because houses are so long lived, their consumption value may change a great deal over time. Hence, their up-front price may prove to be a bad approximation to the value of consumption services they eventually provide.'⁶ As noted elsewhere in this issue, inflation-adjusted average home prices in Canada have appreciated significantly over the past several decades. Similar growth in the real value of housing has been observed in many other countries. Indeed, according to the OECD, the price of housing has 'grown faster than general inflation across many OECD countries over the last 20 years'⁷. Wei Cui, in a 2012 paper, attributes this general appreciation in housing to '[u]rbanization, the building of new transportation pathways and amenities, unexpected rises in income in the local population, and so forth.'⁸ In Canada, high and increasing levels of immigration and restrictive zoning rules have no doubt also contributed to the upward trend.

⁶ Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review* (Oxford University Press, 2011), 380.

⁷ OECD, *Housing Taxation in OECD Countries* (OECD Tax Policy Studies, 21 July 2022), 14.

⁸ Wei Cui, 'Objections to Taxing Resale of Residential Property under a VAT' (2012) November *Tax Notes* 777, 779.

In jurisdictions with a GST/VAT, the tax is normally paid once, at the time of the initial purchase of newly constructed or substantially renovated housing (albeit a new housing rebate is available in Canada; where applicable, it has the effect of reducing the effective tax rate paid by the first purchaser⁹). Although the initial GST/VAT is implicitly passed on in terms of the price of housing when it is sold from one homeowner to another, no further GST/VAT is imposed in relation to its increased consumption value, and later sales of homes between consumers are generally outside the scope of GST/VAT. Another way in which GST/VAT under taxes consumption is in the exempt treatment of residential rent. As stated in a 1989 GST technical paper, it is assumed that GST/VAT is collected 'when the developer/builder sells the rental dwelling to the landlord'¹⁰; the embedded GST/VAT borne by the landlord (who is generally ineligible for an input tax credit for the GST/VAT included in the purchase price) is, in theory, passed on to tenants in the form of higher rent. This exempt treatment seemingly makes sense from a neutrality perspective, but the problem, again, is that any increase in market rentals is left out of the GST/VAT base. Another problem is that, as noted above, housing that was in existence in 1991 is never subjected to GST.

4.4 A proposed solution

As explained above, the current system—that is, taxing purchases of newly constructed homes—is premised on the assumption that the initial purchase price approximates the present value of future consumption, a premise that is demonstrably false in the case of housing. A more appropriate outcome could be achieved if, instead of taxing new home purchases, the system imposed the periodic taxation of homeowners based on an estimate

⁹ See above n 3.

¹⁰ Department of Finance Canada, "Goods and Services Tax Technical Paper" (August 1989) 18.

of the current market value of housing. The mechanism would be to calculate the notional or imputed rent that homeowners effectively pay to themselves, and to impose GST/VAT annually based on this notional or imputed rent.

Imputed rent is the hypothetical rent that homeowners would charge if the property were leased to a third party. The amount of imputed rent for each year should reflect current market conditions. Imputed rent has been regarded as part of the tax base for income tax purposes in several countries, including Australia, Denmark, Greece, the Netherlands, Switzerland, and the United Kingdom, but no country includes imputed rent in the GST/VAT base. That said, the idea is hardly novel. In 2011, the Mirrlees review recommended that the UK VAT be levied on the consumption of housing services. The report recommended that VAT be applied to the estimated periodic rent. In this regard, it was recommended that housing be revalued at intervals of no more than every five years.¹¹ More recently, in a 2018 article, I recommended that GST/VAT be levied on average market rentals, with figures to be adjusted over time for inflation.¹²

One particular advantage of this proposal is that it would subject older housing, built before the introduction of GST/VAT to this tax, whereas currently older housing stock escapes all consumption taxes. Many jurisdictions now use current market values to calculate real estate property taxes. These databases could be leveraged in order to come up with a workable method of regularly updating the amount of imputed rent on each owner-occupied home. Once established, market values could be increased yearly by an assumed appreciation rate.

¹¹ See above n 6, 380-391.

¹² Christine Peacock, 'Is There a Viable Way to Tax the Consumption of Immovable Property That Is More Consistent with the Economic Objective of the VAT?' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336, 345.

The estimated market price of housing (after considering appreciation) could be multiplied by an assumed market rental rate to determine the estimated amount of imputed rent that would be subject to GST/VAT. The Mirrlees review recommended something similar—specifically, that annual rental values be determined as “about 5% of capital values.” Another alternative would be to base the rental rate on the available data regarding gross rental yield for Canada.¹³

Currently, upfront GST/VAT should in theory be carried forward and reflected in the purchase price of the property when it is subsequently sold. If GST/VAT liability were spread over many years in the form of imputed rent, it is possible that such a measure might have a downward effect on the price of housing. If imputed rent were subject to GST/VAT, then residential rent, too, in the interest of neutrality between home ownership and renting, should be included in the GST/VAT base. Removing upfront GST/VAT on the purchase of housing should in theory lead to a reduction in the price of residential rent. While it is true that renters would become subject to GST/VAT on the rents themselves, enhanced credits could be provided to mitigate the impact on low-income tenants.

Although the imposition of GST/VAT on imputed rent would not likely, on its own, solve the current affordability crisis, it might nonetheless go some way toward addressing this problem by reducing the price of residential premises and residential rent.

Of course, low-income homeowners may find annual payments of GST/VAT on imputed rent difficult, just as they may today find it challenging to pay annual property taxes. One way to address this would be to allow qualifying (low-income) homeowners to defer their GST/VAT

¹³ See ‘Global Property Guide’, *Rental Yields in Canada compared to North America* (Web Page) <<https://www.globalpropertyguide.com/North-America/Canada/rent-yields>>.

liability until their home is sold or until their death. This might operate similarly to Alberta's seniors' property tax deferral program,¹⁴ which in some circumstances enables homeowners to obtain low-interest loans—secured by the homeowner's equity in the home—in order to finance property tax payments. Other variations are possible, such as exempting imputed rent below a stipulated amount, or taxing imputed rent at progressive GST/VAT rates, with the rate being dependent on the property's current market value.

Currently, homeowners are generally unable to register for GST/VAT because they are not regarded as conducting a commercial activity; this is the case whether they occupy their own home or lease it out.

Under the proposed approach, revenue authorities could be informed of the purchase price of each home and could calculate the annual GST/VAT liability of owner-occupiers based on this information. They could notify the homeowner annually of the amount due. Owner-occupiers would continue to be unable to register and would continue to be unable to claim input tax credits for any GST/VAT paid in relation to their consumption of housing. This is appropriate because in this case the homeowner is the final consumer. In contrast, homeowners who lease out their homes would be required to register; they would charge GST/VAT on residential rents payable by tenants and would be entitled to input tax credits for any GST/VAT payable in relation to the leasing of the home.

¹⁴ Alberta.ca, 'Seniors Property Tax Deferral' (Web Page) <<https://www.alberta.ca/seniors-property-tax-deferral-program.aspx>>.

4.5 Conclusion

From a tax policy perspective, an approach more appropriate than the current approach of taxing consumption of housing only once (that is, at the time of first purchase of newly constructed or substantially renovated homes) would be to exempt the initial purchase of the home from GST/VAT and tax the home annually based on assumptions about imputed rent and periodic appreciation. There would be several implementation issues to consider, but these could be addressed. Such a measure could be expected to exert downward pressure on home prices, and to alleviate the tax system's bias in favour of home ownership.

Chapter 5: Simulation showing how imputed rent could be calculated*

5.1 Introduction

Durable goods contain an element of investment in the form of consumption which occurs in later years as the consumer durable is used. Under the theoretical model of GST/VAT, the purchase of a consumer durable should be regarded as an investment, and an immediate deduction for the GST/VAT on the purchase price should be allowed in the form of an input tax credit. Then GST/VAT should be imposed on the flow of consumption over time, as the consumer durable depreciates and is used. Under this approach, a purchaser would be treated as if they were renting the consumer durable to him or herself.

However, what generally happens in practice in jurisdictions with a GST/VAT is that the pre-paid method is applied.¹ Under this method, it is assumed that the value of goods at the time that they are first acquired is equal to the present value of the use and enjoyment (consumption) of the goods.² GST/VAT is charged just once, at the time of first purchase. Sales of second-hand goods between unregistered entities are not subject to GST/VAT (they are outside the scope of GST/VAT)³, although theoretically later consumers pay GST/VAT as

* This is a modified version of the published article: Peacock, Christine, 'Shifting from pre-paid to periodic GST on the consumption of residential premises' (2023) 38(2) *Australian Tax Forum* 199-223.

¹ Liam Ebrill, Michael Keen and Victoria J. Perry, *The Modern VAT* (International Monetary Fund, 2001) 98.

² See Wei Cui, 'Objections to Taxing Resale of Residential Property under a VAT' (2012) 137 *Tax Notes* 777, 779 and James Mirrlees et al, *Tax by Design: The Mirrlees Review* (Oxford University Press, 2011) 379-380. This method is generally applied with respect to sales of residential premises in jurisdictions with a GST or VAT. The only exception to this is in the People's Republic of China, where some consumer-to-consumer sales of residential premises are subject to VAT.

³ The focus of this chapter is on consumer-to consumer supplies. GST/VAT is charged on second-hand sales of goods made by registered enterprises, and registered enterprises can generally claim input tax credits for acquisitions of second-hand goods: *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 66-1.

future consumption is assumed to be built into the price at which second-hand goods are sold. Where consumption of the goods is immediate, or the value of the goods depreciates over time, the correct result is achieved, as the initial purchase price reflects the consumption value of the goods over their useful life.⁴ However, where the value of durable goods appreciates, use of the pre-paid method does not yield the correct result, as the value of savings rises and yields more consumption. Final consumption is therefore greater than the original purchase price of the good.

Immovable property generally appreciates in value over time and is the most common durable good where this issue arises.⁵ The increase in value is not problematic when it comes to supplies of commercial immovable property, because registered entities are entitled to input tax credits for the GST/VAT paid on the purchase or lease, as it will generally be used as an input into the purchaser's production. Therefore, there is no GST/VAT net effect for the tax administration.

The GST/VAT treatment of residential premises,⁶ on the other hand, presents a particular challenge. While the price of residential premises has recently fallen in many parts of Australia

⁴ Cui has explained that for many consumer durables a tax on the purchase price is equal to the total of the present value of tax payments that could be collected in relation to consumption of the goods during future periods and that this can be expressed as the following equation: $V \cdot T = \sum_t [T \cdot c_t / (1+r)^t]$ where t = time period; c_t = the value of the consumption use of the good in period t ; r = rate of discount; T = tax rate applicable to all periods; and V = tax-exclusive purchase price of the durable good.'; Cui (n 2) 779.

⁵ Millar has noted that 'immovable property is the most widely held and traded appreciating asset and a purchase of immovable property is more often than not the single most significant acquisition a person will make in his/her lifetime.': Rebecca Millar, 'VAT and Immovable Property: Full Taxation Models and the Treatment of Capital Gains on Owner-Occupied Residences' in Rita de la Feria (ed), *VAT Exemptions: Consequences and Design Alternatives* (Wolters Kluwer, 2013) 253, 262.

⁶ 'Residential premises' are defined in Australia to mean 'land or a building that: (a) is occupied as a residence or for residential accommodation; or (b) is intended to be occupied, and is capable of being occupied as a residence or for residential accommodation': *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 195-1.

as well as other countries,⁷ over time it generally appreciates. In 2022 the OECD reported that '[h]ouse and rent prices have grown faster than general inflation across many OECD countries over the last 20 years'.⁸ Cui has explained that:

[i]n some historical periods and in some locations, housing values may witness unexpected appreciation or depreciation that had not been fully anticipated or capitalized into purchase prices. ...an important reason is enhanced locational premium. Urbanization, the building of new transportation pathways and amenities, unexpected rises in income in the local population, and so forth may all enhance the value of real property in ways that could not easily be predicted.⁹

In jurisdictions that have a GST or VAT, currently under the pre-paid method the first sale of residential premises from a developer to a consumer is generally subject to GST/VAT. Later sales of residential premises between homeowners are input-taxed¹⁰ or outside the scope of GST/VAT.¹¹ Supplies of residential leases are generally also input-taxed, to ensure neutrality between owner-occupiers and investors.¹²

⁷ See 'Home Value Index shows housing downturn accelerates as more markets follow Sydney and Melbourne into a downswing', *CoreLogic* (Web Page, 1 August 2022) <https://www.corelogic.com.au/news-research/news/2022/home-value-index-shows-housing-downturn-accelerates-as-more-markets-follow-sydney-and-melbourne-into-a-downswing?utm_medium=email&utm_source=newsletter&utm_campaign=20220801_propertypulse>.

⁸ OECD, *Housing Taxation in OECD Countries* (OECD Tax Policy Studies, 21 July 2022) 14.

⁹ Cui (n 2) 779.

¹⁰ Input-taxed supplies are generally known as exempt supplies in other jurisdictions. No GST/VAT is payable when there is an input-taxed supply, and no input tax credits are available in relation to anything acquired to make the input-taxed supply.

¹¹ The sale of residential premises for more than the registration threshold will not lead to a registration requirement for the vendor if the vendor is not in the business of selling residential premises as capital assets are excluded from the registration threshold calculation: *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 188-25.

¹² See, for example, Treasury, 'Tax Expenditures Statement 2015' (Australian Government, 2016) 141 and M Stewart, 'Taxation Policy and Housing' in Susan J. Smith (ed), *International Encyclopedia of Housing and Home* (Elsevier Science, 2012) Vol 7, 152, 162.

Whilst over time the value of residential buildings depreciate, in urban areas in particular, the market value of land underlying residential buildings usually appreciates. As residential premises includes both the building and the land,¹³ overall the value of the consumption of residential premises will often increase over time and be greater than the value of the residential premises at the time it was first purchased from a property developer. Therefore, upfront taxation under the pre-paid method generally does not correspond to the present value of all future consumption. There is consumption which is not included in the GST/VAT base.¹⁴ This is problematic from the perspective that GST/VAT is a tax falling on private consumption.¹⁵

Under the theoretical model, GST/VAT would be imposed on imputed rent. This is the theoretical value of the residential services that an owner-occupier receives for living in their home. It has been described as 'the net value of the services rendered by a house to its owner (and occupier), for which he would otherwise pay cash rent to a landlord.'¹⁶ If imputed rent were included in the GST/VAT base it would involve regarding owner-occupiers as if they were supplying those residential services to themselves as tenants. The first sale of residential premises would not be included in the GST/VAT base and instead a notional value would be placed on an owner-occupier's imputed rent for a specific period such as a year and this would

¹³ See *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 195-1.

¹⁴ The fact that the value of residential premises generally appreciates over time and that this results in there being consumption not included in the GST base has been well recognised in the GST/VAT literature. See, for example, Rita de la Feria and Richard Krever, 'Ending VAT Exemptions: Towards a Post-Modern VAT' in Rita de la Feria (ed), *VAT Exemptions: Consequences and Design Alternatives* (Wolters Kluwer, 2013) 27; James Mirrlees et al (n 2) 380; and Satya Poddar, 'Taxation of Housing Under a VAT' (2009) 63 *Tax Law Review* 443, 449-453.

¹⁵ See, for example, the Australian Government's 'Explanatory Memorandum' to its bill introducing GST in that country – 'GST is a tax on final private consumption in Australia.': Explanatory Memorandum, *A New Tax System (Goods and Services Tax) Bill 1998* (Cth) 6. The tax is based on the value of private consumption, measured as the expenditure incurred to acquire goods and services consumed.

¹⁶ Donald B Marsh, 'The Taxation of Imputed Income' (1943) 58(4) *Political Science Quarterly* 514, 514. For another description see Treasury, Australian Government, *Australia's Future Tax System* (Consultation Paper, December 2008) 206.

be subject to GST/VAT. This would apply to all residential premises, whether they have been purchased from a property developer or not.

Whilst in many jurisdictions imputed rent has been included in the income tax base, generally it has traditionally been regarded as too difficult to include imputed rent within the GST/VAT base for administrative and political reasons.¹⁷ However, more recent literature has suggested that it might be possible to do this.¹⁸ Of course, it would make sense from a neutrality perspective for residential leases from a landlord to a tenant to also be subject to GST/VAT, so no distortions occur in the choice between homeownership and renting.¹⁹ The current approach of charging GST/VAT on sales of commercial immovable property (rather than in connection with the annual use by an owner of that property) should remain, given the neutral effect when these supplies occur between registered entities, and the fact that applying the theoretical model is more administratively burdensome than the current pre-paid approach.

Regarding the state of knowledge relating to taxing the consumption of residential premises in the most theoretically correct way, the 2011 United Kingdom (UK) report of the Mirrlees Review recommended a housing services tax as effectively a tax on the consumption of housing. It proposed levying this tax at a rate lower than the standard rate of VAT in the UK,²⁰

¹⁷ See, for example, Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) 5(3) *International Tax and Public Finance* 399, 405; Sijbren Cnossen, 'VAT Treatment of Immovable Property' in Victor T. Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, 242; Poddar (n 14) 452; and Robert F van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' in Robert F van Brederode, (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) 1, 19.

¹⁸ See, for example, James Mirrlees et al, (n 3) 380 and Christine Peacock, 'Is There a Viable Way to Tax the Consumption of Immovable Property That Is More Consistent with the Economic Objective of the VAT?' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336, 345.

¹⁹ This has been recognised by Van Brederode. See Van Brederode (n 17).

²⁰ VAT is the traditional name used for this type of broad-based consumption tax in jurisdictions including the UK and European Union. Generally, in jurisdictions that have more recently introduced this system of consumption tax, including Australia, it has been called a GST.

at a flat percentage of about 12% on an estimate of the rental value of each property, with annual rental values to be determined as about 5% of capital value, and residential premises to be revalued at least every three to five years.²¹ A later study in 2018 suggested that GST/VAT could be based on the average market rental in different regions, with the figures adjusted over time for inflation and taking into account specified features of residential premises.²²

This chapter will build on these proposals to explore how this could be done using a simulation that will compare the effect of imposing GST/VAT periodically on an estimate of the consumption of residential premises with the current pre-paid system. The calculations used in the simulation will include several independent variables: The estimated appreciation rate, market rental, GST/VAT rate, and present value rate. It will be assumed that residential premises generally appreciate over time, as this reflects common historical experience, but what would happen if negative appreciation were experienced will also be considered. Policy alternatives will be discussed which have not previously been considered in the GST/VAT literature, such as what appreciation rate and present value rate to use in determining a homeowner's tax liability, and whether the market rental rate should be fixed or variable. There is potential for this simulation to be used as a tool to show the amount of GST/VAT that could be due for homeowners to pay on an annual basis, and for it to be adapted to show the impact of changing the variables which are used in the calculations within it.

Australian data is referred to in this chapter. However, the analysis has implications for any jurisdiction where charging periodic GST/VAT in relation to the consumption of residential

²¹ James Mirrlees et al, (n 2) 384-392.

²² Peacock (n 18) 345.

premises is considered. There are opportunities for future research, as data from other jurisdictions could be input into the tool developed for the purposes of discussion. Australian Bureau of Statistics (ABS) data will be the main source used to provide these estimates, providing reliability and validity.²³ All of the ABS data used is freely available as part of the ABS publication 'Residential Property Price Indexes: Eight Capital Cities'.²⁴ In addition, as there is no current ABS data published on rental yields and as the ABS uses data supplied by CoreLogic to compile statistics for its 'Residential Property Price Indexes: Eight Capital Cities' publication, it is appropriate to base the market rental rate for the purposes of the simulation on the national rental yield published by CoreLogic in its December 2021 Quarterly Rental Review. Permission was received from CoreLogic to use this data. CoreLogic is the largest property data and analytics company in the world. It publishes rental yields for different states and capital cities of Australia, and for houses and units for each quarter. Both the ABS and CoreLogic data used in this chapter is current to December 2021.

The structure of this chapter will be as follows: The independent variables used in the simulation will be discussed. This will be followed by an explanation of the simulation. The effect of changing these variables will then be considered. This will be followed by analysis, and a discussion of the limitations and contribution of this chapter, and a conclusion.

²³ McKerchar has observed that quantitative research involves knowledge claims that are reliable and valid: Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters, 2010) 92.

²⁴ 'Residential Property Price Indexes: Eight Capital Cities', *Australian Bureau of Statistics* (Web Page, 15 March 2022).

5.2 The variables

5.2.1 Value of residential premises

ABS data suggests that there were 10.76 million residential premises in Australia in December 2021, and 10.6 million residential premises in December 2020.²⁵ The mean value of residential premises averaged for these four quarters is \$851,900. For the purposes of the simulation below, residential premises will be valued at \$774,455 ($\$851,900 \times 10/11$).

5.2.1 Appreciation

Whilst it has been recognised in the previous GST/VAT literature that the value of immovable property generally appreciates, there are no previous studies suggesting what appreciation rate should be used. It is assumed for the purposes of the simulation that residential premises may appreciate over time at an annual rate of 5.52%. This rate is based on historic, annualised trends in the percentage change in the Residential Property Price Indices (RPPI) of the weighted average of the eight capital cities.²⁶ The RPPI measures the price change in residential premises.²⁷ The ABS has published RPPI and the weighted average of the RPPI for Australia's eight capital cities. The RPPI which are currently available date from September 2003, so there is an 18.25-year period from September 2003 until December 2021.

²⁵ Ibid Table 6.

²⁶ Ibid Table 1.

²⁷ Ibid Methodology.

The formula that was used to calculate how these historic RPPI have appreciated over time is:

$$C = I \times (1 + x)^P$$

Where C = Current RPPI (for December 2021)

I = Initial RPPI (for September 2003)

x = Annualised percentage change in RPPI

p = Period in years (18.25)

This formula can be transposed to derive the formula for the annualised percentage change in RPPI (where the other variables are known) as follows:

$$\frac{C}{I} = (1 + x)^P \quad \therefore$$

$$1 + x = \sqrt[P]{C/I} \quad \therefore$$

$$x = \sqrt[P]{C/I} - 1$$

Applied to the ABS dataset, this indicates that the annualised percentage change in RPPI, using the data relating to the weighted average of the eight capital cities is 5.52% ($\sqrt[18.25]{183.9/69.0} - 1$), whilst there was variance in the annualised percentage change in RPPI in the different cities (for example, 5.12% in Perth and 7.02% in Hobart). See Table 5.1.

Table 5.1: Annualised percentage change in RPPI

City	Annualised percentage change in RPPI
Sydney	5.29%
Melbourne	6.32%
Brisbane	5.30%
Adelaide	5.18%
Perth	5.12%
Hobart	7.02%
Darwin	5.14%
Canberra	5.24%
Weighted average of 8 capital cities	5.52%

5.2.3 Market rental

The calculations in the simulation below are based on the homeowner paying GST/VAT on a theoretical market rental, irrespective of whether the homeowner lives in the residential premises or rents it out (it assumes GST/VAT is charged on an estimate of the annual consumption of residential premises irrespective of its use). Other studies have suggested that GST/VAT be charged periodically based on a rental value. The UK report of the Mirrlees Review recommended a tax 'on an estimate of the rental value of each property, with annual rental values to be determined as about 5% of capital value'.²⁸ A later study suggested that GST/VAT be charged based on the average market rental for different regions.²⁹ This chapter will consider other policy alternatives for the market rental value, but for the purposes of the simulation a market rental rate of 3.22% is assumed. Data published by CoreLogic indicates that whilst there is a wide variance in the rental yields relating to different areas of Australia,

²⁸ Mirrlees et al (n 2) 384-391.

²⁹ Peacock (n 18) 345.

the gross national rental yield was 3.22% in December 2021.³⁰ Section 5.3 examines the effects of using different rental yields.

5.2.4 GST/VAT rate

A GST/VAT rate of 10% is used in this simulation, as this is the current GST/VAT rate in Australia (Australia currently only has one standard GST/VAT rate). Other policy alternatives for the GST/VAT rate are considered later in this chapter.

5.2.5 Present value

Previous studies have not considered the fact that if GST/VAT were charged periodically in relation to the consumption of residential premises, it would be necessary to calculate the present value of accumulated GST/VAT payments, as \$1 paid in year 10 is not the same as \$1 paid 10 years earlier. The Governor of the Reserve Bank of Australia and the Treasurer of Australia have agreed that the appropriate target rate for inflation purposes in Australia is between 2 to 3 percent on average over time.³¹ Recently, like in many other countries,³² Australia has experienced high inflation, with increased costs of goods in the post-COVID environment and concerns about oil prices because of the war in Ukraine. The rate of inflation

³⁰ CoreLogic, *Quarterly Rental Review: Australia* (Report, April 2022).

³¹ 'Inflation Target', *Reserve Bank of Australia* (Web Page) <www.rba.gov.au/inflation/inflation-target.html>.

³² See, for example, David J. Lynch, 'Prices are rising all over the world, and leaders see no quick fix', *The Washington Post* (online, 23 January 2022) <<https://www.washingtonpost.com/business/2022/01/23/inflation-global-prices-biden/>>; Gayle Markovitz and Natalie Marchant, 'Why is inflation so high and will it stay that way? An economist explains', *World Economic Forum* (online, 12 May 2022) <<https://www.weforum.org/agenda/2022/05/inflation-rising-economist-explains/#:~:text=The%20rise%20in%20inflation%20is,and%20the%20war%20in%20Ukraine.&text=Inflation%20is%20on%20the%20increase,the%20Russian%20invasion%20of%20Ukraine>> and Eshe Nelson, 'Globally, inflation is surging amid persistent pandemic disruptions and war in Ukraine.', *The New York Times* (online, 12 April 2022) <<https://www.nytimes.com/2022/04/12/business/global-inflation.html>>.

in Australia jumped to 5.1% in the March 2022 quarter³³ and 6.1% in the June 2022 quarter.³⁴ However, inflation in Australia since 1992 has averaged 2.4% per annum.³⁵ Therefore a present value rate of 2.4% is used for the purposes of the calculations in the simulation below, and in Section 4.5 the effect of increasing or reducing the present value rate is explained.

5.3 Simulation

Table 5.2 below provides an example of how GST/VAT could be calculated based on an estimate of the value of residential premises on an annual basis. Using the variables discussed above, in the year of purchase:

- The value of residential premises is assumed to be \$774,455 ($851,900 \times 10/11$), as GST would not be paid upfront but would be paid each year instead.
- The value of consumption in the first year of ownership is regarded as equal to the market rental of 3.22% x \$774,455 value of residential premises (excluding GST/VAT) = \$24,937.
- Initially, the GST/VAT liability would therefore be the market rental of \$24,937 x 10% GST/VAT = \$2,493.70.

It is assumed that in the first year of purchase, the residential premises is purchased at the start of the year and is used for 12 months. In practice, residential premises may be purchased

³³ Philip Lowe, 'Today's Monetary Policy Decision', *Reserve Bank of Australia* (Web Page 3 May 2022) <<https://www.rba.gov.au/speeches/2022/sp-gov-2022-05-03.html>>.

³⁴ 'Measures of Consumer Price Inflation', *Reserve Bank of Australia* (Web Page, 26 October 2022) <<https://www.rba.gov.au/inflation/measures-cpi.html>>.

³⁵ The average of the percentage change from the corresponding quarter of the previous year for each quarter between September 1992 and March 2022 is 2.4 percent: 'Consumer Price Index, Australia', *Australian Bureau of Statistics* (Web Page, 26 October 2022) (see Table 1 and 2, Column S).

at different points in time during the year, and it may be appropriate to pro rata the GST/VAT payable in relation to the first year of ownership.

In later years, it is then assumed that:

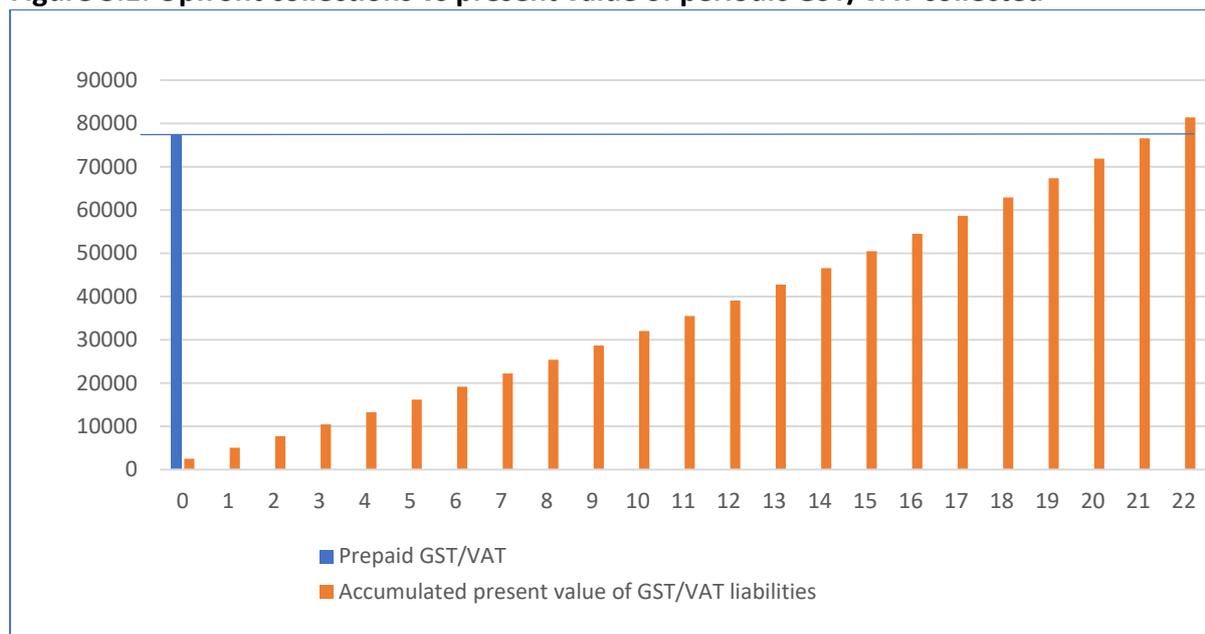
- the value of the residential premises would rise by the annual appreciation rate of 5.52%. Therefore, the value of the residential premises for the previous year is multiplied by $(1 + 0.0552)$ to determine the new value of the residential premises.
- The value of consumption would rise since the residential premises would be worth more over time. The value of residential premises in the current year multiplied by 3.22% market rental would be the value of consumption.
- The GST/VAT liability would be the value of consumption multiplied by 10%.
- The present value of the future GST/VAT payments in year X is calculated as the GST/VAT liability for year X divided by $(1+0.024)^X$.
- The accumulated present value of future GST/VAT liabilities to year Y is the sum of all GST/VAT liabilities to year Y.

Table 5.2: Simulation for hypothetical residential premises originally purchased for \$851,900 (including GST/VAT)

How many years the property has been owned	Underlying value of residential premises at start of year	Consumption during the year	GST payable	Present value of GST payable	Accumulated present value of GST liabilities
0	\$774,455	\$24,937	\$2,494	\$2,494	\$2,494
1	\$817,204	\$26,314	\$2,631	\$2,570	\$5,063
2	\$862,314	\$27,767	\$2,777	\$2,648	\$7,711
3	\$909,914	\$29,299	\$2,930	\$2,729	\$10,440
4	\$960,141	\$30,917	\$3,092	\$2,812	\$13,252
5	\$1,013,141	\$32,623	\$3,262	\$2,898	\$16,150
6	\$1,069,066	\$34,424	\$3,442	\$2,986	\$19,135
7	\$1,128,079	\$36,324	\$3,632	\$3,077	\$22,212
8	\$1,190,349	\$38,329	\$3,833	\$3,171	\$25,383
9	\$1,256,056	\$40,445	\$4,045	\$3,267	\$28,650
10	\$1,325,390	\$42,678	\$4,268	\$3,367	\$32,016
11	\$1,398,552	\$45,033	\$4,503	\$3,469	\$35,486
12	\$1,475,752	\$47,519	\$4,752	\$3,575	\$39,061
13	\$1,557,213	\$50,142	\$5,014	\$3,684	\$42,744
14	\$1,643,171	\$52,910	\$5,291	\$3,796	\$46,541
15	\$1,733,875	\$55,831	\$5,583	\$3,912	\$50,452
16	\$1,829,584	\$58,913	\$5,891	\$4,031	\$54,483
17	\$1,930,577	\$62,165	\$6,216	\$4,154	\$58,637
18	\$2,037,145	\$65,596	\$6,560	\$4,280	\$62,917
19	\$2,149,596	\$69,217	\$6,922	\$4,411	\$67,328
20	\$2,268,253	\$73,038	\$7,304	\$4,545	\$71,873
21	\$2,393,461	\$77,069	\$7,707	\$4,684	\$76,557
22	\$2,525,580	\$81,324	\$8,132	\$4,826	\$81,383

Table 5.2 indicates that based on the variables discussed above, it would take 21.2 years for the present value of GST/VAT collected under the theoretical model to exceed the GST/VAT that would be collected under the current pre-paid approach (\$77,445). There would be an additional cost for homeowners and additional revenue for the government after 21.2 years.

The figure below compares the GST/VAT collected under the two approaches.

Figure 5.1: Upfront collections vs present value of periodic GST/VAT collected

5.4 What happens if the values of the variables are changed?

In the section below we will discuss several policy alternatives regarding the values that could be given to the variables used in the simulation, and what would happen if these values were increased or reduced. These policy alternatives demonstrate the usefulness of this simulation as a tool, and how it can be adapted to reflect different values that might be given to the variables, perhaps to reflect changing economic circumstances or for use in different areas (such as different states of Australia). Whilst different policy alternatives are discussed, what value to give to each of these variables is a political decision, which might be informed by the economic circumstances of any jurisdiction where the application of this tool is considered.

5.4.1 Value of residential premises

The value of residential premises which have similar features such as size or number of bedrooms may vary because of various factors such as location and nearby amenities. Based on available ABS data, other possibilities of values that could be used as the initial value of

the residential premises for the purpose of the simulation could be the mean price of residential premises in different states,³⁶ or the median price of established house transfers (unstratified) in different cities or regional areas. If the tool were used in practice, the actual initial value of the residential premises should be used for the purpose of calculating the periodic GST/VAT liability in relation to owner-occupied residential premises. Changing the initial value of residential premises from \$851,900 to a different value would not affect the number of years it takes to achieve equivalence in the GST/VAT collected using the pre-paid method and the theoretical model.³⁷ For example, if residential premises were purchased for \$800,000 or \$900,000, it would still take the same number of years for the accumulated present value of GST/VAT liabilities to be equivalent to the GST/VAT collected under the pre-paid method.

5.4.2 Appreciation

As mentioned earlier, this is the first study that provides discussion of policy alternatives regarding the appropriate appreciation rate to use to calculate a homeowner's tax liability. A constant appreciation rate of 5.52% was used for the purpose of the simulation. It was explained in Section 2.2 that this rate is based on historic, annualised trends in the percentage change in the RPPI of the weighted average of the eight capital cities in Australia. The rate was calculated based on 18.25 years of available data.

What appreciation rate to use to calculate annual GST/VAT liability is a political decision. The same method used to calculate the 5.52% appreciation rate could be used to determine a rate to use as the appreciation rate for residential premises in different cities and states or

³⁶ 'Residential Property Price Indexes: Eight Capital Cities' (n 24), Table 6, Columns AC to AJ.

³⁷ 'Residential Property Price Indexes: Eight Capital Cities' (n 24), Tables 4 and 5.

for different types of residential premises. If a constant rate of appreciation is used, it may be suitable to evaluate whether this rate should be revised once every few years.

Another alternative method of estimating the appreciation in residential premises would be to use a variable appreciation rate based on historic data, perhaps from the previous year. However, whilst this might more accurately reflect historic appreciation, a variable rate would lead to less certainty for homeowners about how much GST/VAT they can expect to pay in the future. The table below indicates variable rates each year, using the percentage change in RPPI from the corresponding quarter of the previous year for the weighted average of the eight capital cities, starting at the September 2004 quarter (the first available data³⁸), and then taking this RPPI for the September quarter of each of the following years (September 2004- 2.3, September 2005- 2.1, September 2006- 8.7, etc.). From year 19, the assumed appreciation rate of 5.52% is used, as only 18.25 years of historic data is available. Similar assumptions are made as were made in the simulation above, i.e.:

- the value of residential premises each year rises by the annual appreciation rate; and
- the value of residential premises in the current year multiplied by 3.22% market rental is the consumption during the year.

If we look at years 8 to 10 in Table 5.3, we see an example of how the change in variable appreciation rates effects the GST/VAT payable:

- In year 8, the appreciation rate is -2.7%. Therefore, consumption during the year is reduced and GST/VAT is still payable, but at a reduced amount.

³⁸ The ABS has RPPI dating back to September 2003, so it is possible to derive an average compound rate for each year since that date. However, the annual change in RPPI can only be given from September 2004, as the ABS have a completed year of data from that quarter.

- In year 9, there is 0% appreciation. Therefore, consumption during the year and GST/VAT payable are unchanged from the previous year. GST/VAT is still payable but has not increased from the previous year.
- In year 10, the appreciation rate is 8.1%. Therefore, consumption during the year and GST/VAT payable increases by the same percentage.

Table 5.3: Example using varying appreciation rates

How many years the property has been owned	Underlying value of residential premises at the start of year	Appreciation rate	Consumption during the year	GST payable	Present value of GST liabilities	Accumulated present value of GST liabilities
0	\$774,455		\$24,937	\$2,494	\$2,494	\$2,494
1	\$792,267	2.30%	\$25,511	\$2,551	\$2,490	\$4,984
2	\$808,905	2.10%	\$26,047	\$2,605	\$2,481	\$7,465
3	\$879,279	8.70%	\$28,313	\$2,831	\$2,632	\$10,097
4	\$976,879	11.10%	\$31,456	\$3,146	\$2,854	\$12,951
5	\$986,648	1.00%	\$31,770	\$3,177	\$2,814	\$15,765
6	\$1,053,740	6.80%	\$33,930	\$3,393	\$2,933	\$18,698
7	\$1,154,899	9.60%	\$37,188	\$3,719	\$3,137	\$21,835
8	\$1,123,717	-2.70%	\$36,184	\$3,618	\$2,979	\$24,814
9	\$1,123,717	0.00%	\$36,184	\$3,618	\$2,908	\$27,722
10	\$1,214,738	8.10%	\$39,115	\$3,911	\$3,068	\$30,790
11	\$1,321,635	8.80%	\$42,557	\$4,256	\$3,258	\$34,048
12	\$1,463,050	10.70%	\$47,110	\$4,711	\$3,520	\$37,567
13	\$1,514,257	3.50%	\$48,759	\$4,876	\$3,556	\$41,123
14	\$1,639,940	8.30%	\$52,806	\$5,281	\$3,758	\$44,881
15	\$1,608,781	-1.90%	\$51,803	\$5,180	\$3,598	\$48,480
16	\$1,549,256	-3.70%	\$49,886	\$4,989	\$3,382	\$51,862
17	\$1,618,973	4.50%	\$52,131	\$5,213	\$3,449	\$55,311
18	\$1,970,290	21.70%	\$63,443	\$6,344	\$4,097	\$59,408
19	\$2,079,050	5.52%	\$66,945	\$6,695	\$4,220	\$63,628
20	\$2,193,813	5.52%	\$70,641	\$7,064	\$4,346	\$67,973
21	\$2,314,912	5.52%	\$74,540	\$7,454	\$4,475	\$72,449
22	\$2,442,695	5.52%	\$78,655	\$7,865	\$4,609	\$77,058
23	\$2,577,532	5.52%	\$82,997	\$8,300	\$4,747	\$81,805

Another alternative could be to base the appreciation rate on property valuations used for the purposes of apportioning the council rates payable in relation to each individual property. These are usually revalued regularly. Whilst this would more accurately reflect the actual appreciation in an individual property, it would be more administratively burdensome to calculate this at an individual property level.

Whatever method is used to estimate the appreciation rate, if the rate used is more than 5.52%, it would take less time to reach equivalence in the GST/VAT collected under the pre-paid and theoretical models. If the appreciation rate is less than 5.52%, it would take longer to achieve equivalence. For example, if an appreciation rate of 6.52% were used, equivalence would be achieved in 19.5 years, whereas if a 3.52% rate were used equivalence would be achieved in 25.9 years.

5.4.3 Market rental

As mentioned earlier, there has only been very limited discussion in the GST/VAT literature of possible policy alternatives regarding the market rental rate to be used to determine a homeowner's tax liability. The market rental rate used for the purpose of the above simulation is assumed to be a constant 3.22%. Using the data published by CoreLogic, different market rental rates could be determined based on whether the residential premises are in a capital city (and which capital city) or in a regional area, and based on whether the residential premises are a house or unit.³⁹ It is likely to be suitable to use the same constant market rental rate for a period of years. Residential premises are a long-term investment, and, in that sense, it is appropriate to treat them as a long-term bond.

An alternative approach which has not previously been considered in the literature would be to use a standard presumed rate of return as the market rental rate for a particular period. Historically, there have been several countries, including Australia, where imputed rent for income tax purposes has been calculated based on a presumed rental value.⁴⁰ Currently in

³⁹ See, for example, CoreLogic, *Quarterly Rental Review: Australia* (n 30).

⁴⁰ Paul E Merz, 'Foreign Income Tax Treatment of the Imputed Rental Value of Owner-Occupied Housing: Synopsis and Commentary' (1977) XXX(4) *National Tax Journal* 435, 436-437.

the Netherlands, owner-occupied residential premises are taxed based on the deemed rental value of the residential premises if there is a mortgage. Leasehold charges and mortgage loan interest are deductible.⁴¹ The deemed rental value is determined based on the market value of the residential premises. It is calculated at low progressive rates which vary between 0% and 2.35% on any excess. If there is no mortgage, or the interest on the mortgage that is paid is less than the deemed income, then the deemed income is regarded as zero. Where immovable property is rented out or is a second home, the owner of the immovable property is taxed based on a weighted notional yield. This yield increases as the value of the immovable property increases, and it varies between 1.898% and 5.69%.

There may be situations where using a presumed rate of return to calculate the market rental rate may be perceived as less fair than basing the market rental rate on historic rates of return. Calculating a presumed rate of return based on assumptions about the rate of return that could be gained if the net value of assets were saved or invested does not recognise that different types of saving and investment have different risk profiles and therefore different returns. For example, investing in shares is generally considered to carry a higher risk than investing in immovable property, and so an investor would expect a higher rate of return for investing in shares. What market rental rate to use and how to calculate this rate is a political decision. Different jurisdictions considering imposing GST/VAT on a periodic basis in relation to the consumption of residential premises may choose different approaches. If the market rental rate were increased above 3.22%, it would take less time to achieve equivalence between the GST/VAT collected using the pre-paid method and the theoretical model. If it were reduced, it would take more time. For example, if a market rental rate of 4.22% were

⁴¹ Marnix Veldhuijzen, 'Netherlands - Individual Taxation' in IBFD (ed), *Country Tax Guides* (IBFD, 2021), 1, 26-27.

used, it would take 17.1 years to achieve equivalence. If a market rental rate of 2.22% were used, it would take 27.8 years. The table below indicates what happens when the market rental rate increases or reduces:

Table 5.4: Effect of increasing or reducing the market rental rate on years taken to achieve equivalence

Market rental	2%	3%	4%	5%	6%	7%	8%	9%	10%
Years to equivalence	29.8	22.4	17.9	14.9	12.7	11.0	9.7	8.7	7.9

5.4.4 GST/VAT rate

It has been recognised in the GST/VAT literature that differential GST/VAT rates may be used to lessen the regressive effect of the GST/VAT,⁴² and encourage people to consume certain goods and services.⁴³ However, in most jurisdictions differential rates have not been considered regarding the GST/VAT treatment of residential premises.⁴⁴ An estimate of the value of consumption of residential premises could be taxed at a reduced rate, significantly less than the standard GST/VAT rate, in recognition of the importance placed by society on

⁴² See Sijbren Cnossen, 'What Rate Structure for a Value-Added Tax?' (1982) 35(2) *National Tax Journal* 205, 205 and Rita de la Feria, 'EU VAT rate structure: towards unilateral convergence?' (Working Paper No 13/05, Centre for Business Taxation, 2013) 20.

⁴³ Chemi Gotlibovski and Nir Yaacobi, 'Israel Economic Review' (2018) 16(2) *Israel Economic Review* 97, 98.

⁴⁴ China is the only country in the world where some consumer-to-consumer supplies of residential premises are subject to VAT. Where this is the case, these supplies are subject to a reduced rate of VAT which is lower than the rate of VAT which is usually payable in relation to other supplies of real property: See 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No. 36, 23 May 2016, Annex I, art 15(2) and Annex 2 art 9(6) and 国家税务总局关于发布《纳税人转让不动产增值税征收管理暂行办法》的公告 [Announcement of the State Administration of Taxation on Issuing the Interim Measures for the Administration of Collection of Value-Added Tax on the Transfer of Immovable Properties by Taxpayers] (People's Republic of China) State Administration of Taxation, No. 14, 31 March 2016, art 5.

home ownership.⁴⁵ This could soften the blow of including residential premises within the GST/VAT base and result in more political acceptance of the idea of including the consumption of residential premises within the GST/VAT base. It would involve having a multi-rate GST/VAT system, more characteristic of the European VAT,⁴⁶ and less characteristic of more modern single-rate GST/VAT systems (for example, Australia and New Zealand). A reduced rate of GST/VAT would mean it would take longer to achieve equivalence.

Generally, having differential GST/VAT rates is regarded as less administratively simple than applying one standard rate. It can result in interpretational issues,⁴⁷ as well as administrative reporting complexities for registered entities who make different supplies at different rates, audit costs for tax administrations, and costs in issuing assessments where the wrong rate is applied, and in dealing with objections and appeals. In fact, Zu has observed that '[a] single rate and broad base remain one of the key design norms of a good VAT.'⁴⁸ The borderline between residential and commercial residential premises has been a contentious area,⁴⁹ and differential GST/VAT rates for supplies of different types of immovable property could lead to

⁴⁵ Poddar has recognised that 'home ownership is viewed in many jurisdictions as an important policy objective and is encouraged through fiscal instruments': Poddar (n 14) 444. See also Fiona Martin, 'The Case for Specific Exemptions from the Goods and Services Tax: What Should We Do about Food, Health and Housing?' (2020) 18(1) *eJournal of Tax Research* 99, 117.

⁴⁶ See Stefan Bach et al, 'Value Added Tax- VAT Gap, Reduced VAT Rates and Their Impact on Compliance Costs for Businesses and on Consumers' (Briefing Paper, European Parliamentary Research Service, July 2021), 27 for a summary of the VAT rates used in the European Union.

⁴⁷ Zu has noted that '[a]ny concession that carves out particular supplies for concessional treatment... creates a legal distinction that raises a host of definitional and interpretative problems including boundary issues between the various types of supplies and the problem of multi-element supplies': Yige Zu, 'Reforming VAT Concessions: A Tax Expenditure Analysis' (2017) 4 *British Tax Review* 418, 428.

⁴⁸ *Ibid* 422.

⁴⁹ There have been several cases in Australia regarding this issue. See, for example *Karmel & Co Pty Ltd as Trustee for Urbanski Property Trust* [2004] AATA 481 (dual occupancy rental was not a boarding house), *South Steyne Hotel Pty Ltd v Commissioner of Taxation* [2009] FCAFC 155 (leases of apartments in a hotel were input-taxed residential premises), *Wynnum Holdings No. 1 Pty Ltd and Ors and Commissioner of Taxation* [2012] AATA 616 (a retirement village was not taxable commercial real property), *ECC Southbank Pty Ltd as trustee for Nest Southbank Unit Trust v Commissioner of Taxation* [2012] FCA 795 (supply of shared and studio apartments was a supply of taxable commercial residential premises). The distinction between supplies of commercial residential premises and residential premises is not the focus of this chapter. There is scope for further research in this area.

more litigation in this area. There have also been questions raised in the GST/VAT literature about whether differential GST/VAT rates significantly lessen the regressive effect of the GST/VAT. Whilst reduced rates of GST/VAT can be particularly beneficial to low-income groups, they subsidise consumption for all persons.⁵⁰

5.4.5 Present value

In computing present values in the simulation discussed earlier, the discount rate used was 2.4%, based on historic inflation. An alternative would be to base the discount rate on government bond yields, which approximate the cost of money to the government of money that it borrows. In Australia, the average long-term bond yield for the last 10 years has been 2.5%.⁵¹

If the present value rate increased above 2.4%, it would take longer to achieve equivalence in the GST/VAT collected using the pre-paid method and the theoretical model. If it reduced, it would take less time. For example, if a present value rate of 1.4% is used, equivalence is achieved in 19.5 years. If a present value rate of 3.4% is used, equivalence is achieved in 23.3 years.

5.5 Analysis, limitations, and contribution

It is well recognised that the current approach in most jurisdictions of regarding supplies of used residential premises as input-taxed is problematic, as any appreciation in the value of residential premises is excluded from the tax base. Whilst it has been acknowledged that

⁵⁰ This has been recognised by Zu. See above Zu (n 47) 435.

⁵¹ This figure was calculated based on the minimum and maximum yields for 10-year Government bonds in Australia over the last 10 years. See 'Australia 10 Years Bond – Historical Data', *World Government Bonds* (Web Page) <<http://www.worldgovernmentbonds.com/bond-historical-data/australia/10-years/>>.

imputed rent could be brought within the GST/VAT base, there has been little discussion in the past of what this would look like. This chapter provides the first simulation showing how GST/VAT could be calculated on a periodic basis in relation to the consumption of residential premises. It illustrates the potential for the GST/VAT base to be broadened⁵² so that the added value of consumption resulting from the general appreciation in residential premises is also included in the base. For the first 21.2 years, GST/VAT collected would be the same in present value terms to what would be collected if the pre-paid system were retained for the same period, assuming no change in the values of the variables used in the simulation. Under the alternative approach, more consumption would be taxed from year 22.

Whilst only Australian statistics have been referred to, data from other jurisdictions could be input into the tool discussed. The RPPI was used in this chapter to estimate the appreciation in residential premises, and it is commonly used in many other jurisdictions.⁵³ A larger comparative study showing the effect of using this tool to calculate periodic GST/VAT in different jurisdictions could be the focus of future research.

The discussion regarding policy alternatives as to the values to be given to the variables used in the simulation provides a significant addition to the GST/VAT literature. Whilst what value to give to each of these variables is a political decision, and different values may be appropriate in different jurisdictions, this discussion may be helpful to policy makers considering shifting from a pre-paid to a periodic approach. The effect of changing the values of the variables used in calculating the periodic GST/VAT has been considered.

⁵² It has commonly been recognised that it is preferable to have a broad-based GST with minimal exemptions. For example, Cnossen has argued that '[a] 'good' VAT should tax the broadest possible range of goods and services.': Cnossen, 'Global Trends and Issues in Value Added Taxation' (n 17) 405.

⁵³ There are RPPI compilers in more than 80 countries See International Monetary Fund, *Residential Property Price Index RPPI Practical Compilation Guide 2020* (Report, 2020) 6

Surrogate numbers were used for the appreciation and market rental rates. This has been done with administrative feasibility in mind. It is possible in an age of big data to calculate appreciation rates for residential premises in different states or cities, or even on an individual basis, and for market rental rates to be calculated based on which city the residential premises are in or based on whether they are in a regional area. However, this would add a layer of administrative complexity, and there could be appeals if the variables were calculated on an individual basis. Surrogate numbers are often used in mass tax systems.⁵⁴ For example, the value of an interest-free or low-interest loan will vary for each taxpayer depending on the security of their income sources and the assets they hold that could be used as security for a full-rate loan. However, for the purpose of calculating the taxable value of a loan fringe benefit, in a compromise between the purest theoretical rule and one that is administratively feasible, a statutory interest rate is used.⁵⁵ Tax law is filled with pragmatic solutions of this sort and using surrogate numbers to calculate the appreciation rate and market rental rate is consistent with this approach.

If GST/VAT were imposed on an estimate of the value of consumption of residential premises on a periodic basis, the upfront cost of purchasing residential premises would reduce. It is expected that this would be the case not just for new residential premises, but all residential premises. Currently whilst GST/VAT is only paid in relation to the first purchase it is presumably carried forward in the price regarding subsequent sales and in the amount of residential rent charged. Under the alternative approach, the impact of the GST/VAT liability would be spread over more years. It is possible that this would have a downward effect on

⁵⁴ See John Prebble, 'Income Taxation: A Structure Built on Sand' (2002) 24(3) *Sydney Law Review* 301, 302-304 for a discussion of how surrogate numbers were used historically for tax purposes in England.

⁵⁵ *Fringe Benefits Tax Assessment Act 1986* (Cth) s18.

the price of residential premises and on leases. Implementing GST/VAT on a periodic basis in relation to the consumption of residential premises could go some way to addressing housing affordability concerns which are currently experienced in many jurisdictions.⁵⁶ Some homeowners might prefer the annual payments if they do not have the cash to pay for the upfront GST/VAT under the pre-paid method because the borrowing cost will generally be a much higher interest rate than the government's borrowing rate.⁵⁷

However, just like with upfront GST/VAT, paying this tax in relation to the periodic consumption of residential premises could be difficult for those earning low or no income, who may have little disposable cash. For example, it was recognised in a report of the Mirrlees Review that such a reform would adversely affect 'older people, on low incomes who live in expensive houses.'⁵⁸ Mechanisms could be introduced to address these concerns. For example, the GST/VAT liability could be deferred.⁵⁹ This could involve the government

⁵⁶ See, for example, Richard Eccleston et al, *Pathways to housing tax reform* (AHRUI Final Report No 301), July 2018; George Galster and Kwan Ok Lee, 'Introduction to the special issue of the Global crisis in housing affordability' (2021) 25(1) *International Journal of Urban Sciences* 1, 1-6; House of Representatives Standing Committee on Tax and Revenue, Parliament of the Commonwealth of Australia, *The Australian Dream: Inquiry into housing affordability and supply in Australia* (Report, March 2022) and Tax Working Group, *Future of Tax: Interim Report* (Report, 20 September 2018), 6.

⁵⁷ In a similar way it is expected that many first home buyers in New South Wales will opt in to a First Home Buyer Choice scheme to be implemented from January 2023. Provided eligibility criteria are met, homebuyers purchasing residential premises for up to \$1.5 million will have a choice whether to pay upfront stamp duty or annual property tax payments based on the value of the land when purchased, with tax rates indexed each year. It is anticipated that this will assist many first home buyers to get into the housing market quicker. Over the first few years until 2025-26 implementation of the new scheme is expected to result in a total revenue reduction of \$663.6 million. A property tax calculator and stamp duty calculator will be available, and property tax assessments will be issued annually to home buyers that opt into the scheme: NSW Government, 'Opening Doors for More First Home Buyers' (Media Release, 21 June 2022). See also NSW Government, *NSW Budget 2022-23 No. 01 Budget Statement* (Budget Paper) 4-11. There has been speculation that other state governments may feel 'competitive pressure' to make similar changes to their state taxes: Rachel Clun, 'Stamp duty move puts pressure on other states', *The Sydney Morning Herald* (online, 13 June 2022) > <https://www.smh.com.au/politics/federal/stamp-duty-move-puts-pressure-on-other-states-20220613-p5ataj.html>.

⁵⁸ James Mirrlees et al (n 2) 390.

⁵⁹ Boadway, Chamberlain and Emmerson have made similar recommendations with regard to deferring liability for inheritance tax in some circumstances: Robin Boadway, Emma Chamberlain and Carl Emmerson, 'Taxation of Wealth and Wealth Transfers' in Stuart Adam et al (ed), *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, 2010) 737, 799-802.

offering reverse mortgages to homeowners, secured by the value of residential premises, and repayable when they are later sold or after the death of the homeowner.⁶⁰ Loans could be made available for people experiencing temporary unemployment, to enable them to continue to pay the periodic GST/VAT owing. Repayment rates could increase as future potential income increases. Such a scheme could potentially operate in a similar way to the current Higher Education Loan Program (HELP) in Australia, according to which loans are available to eligible tertiary students with rates of repayment increasing as income increases.⁶¹ An important policy decision would be whether to factor in the time value of money in any interest or penalties charged. Both with respect to reverse mortgages and other loans, consideration could be given to the merit of offering these at low interest rates or at no interest. Accompanying social assistance could be provided to those who can claim that they would be particularly disadvantaged by periodic GST/VAT payments. Other measures that could be considered include regarding the imputed rent relating to residential premises purchased up to a certain value as exempt from GST/VAT or taxing the consumption of residential premises at progressive GST/VAT rates, dependent on the purchase price.

Another implementation issue would be how to collect the GST/VAT on a periodic basis. Currently owners of residential premises are generally unable to register for GST/VAT, as they are not regarded as conducting an enterprise and as meeting the registration turnover

⁶⁰ A similar suggestion was made by James Mirrlees et al who suggested in relation to their proposed housing services tax that 'it would be possible to allow people, in specified circumstances, to roll up liabilities (with interest) either until the property is sold or until death, in order to alleviate cash-flow problems.': James Mirrlees et al (n 3) 390.

⁶¹ Information about HELP repayment is available here: 'Study and training loan repayment thresholds and rates', *Australian Taxation Office* (Web Page, 14 July 2022) <<https://www.ato.gov.au/Rates/HELP,-TSL-and-SFSS-repayment-thresholds-and-rates/>>.

threshold requirements.⁶² A possible way of implementing a periodic GST/VAT in relation to the consumption of residential premises by homeowners would be to introduce rules so that this be paid periodically directly to the tax administration by homeowners, without them being required to register for GST/VAT. In this situation, homeowners should not be required to submit GST/VAT returns or comply with any of the other administrative obligations of a registered entity.

In Australia there was previously concern regarding non-compliance by property developers with a vendor's obligation to remit GST/VAT relating to supplies of new residential premises in their next Business Activity Statement. As a form of phoenixing, property developers would collect GST/VAT from the purchaser and claim input tax credits in relation to their construction costs, but then dissolve their business and never remit the GST/VAT to the tax administration. The way in which this concern has been addressed is the introduction of a requirement for the purchaser to remit the GST/VAT payable directly to the tax administration. Liability has been transferred from the vendor to the purchaser to ensure collection.⁶³ This sort of non-compliance would not be a concern in shifting to a periodic GST/VAT, because in effect it is the purchaser who is liable for the GST/VAT and if they miss a payment their property can be seized. This is consistent with the current rule transferring liability to the buyer. It would involve a redraft of the current rule leaving the person who acquires the property liable for GST/VAT.⁶⁴

⁶² Generally, in most jurisdictions with a GST/VAT, registered entities are required to carry on some form of commercial or economic activity and are only required to register for GST if a registration threshold is met. See David Williams, 'Value-Added Tax' in Victor Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) 164, at 197-198.

⁶³ See Explanatory Memorandum, Treasury Laws Amendment (2018 Measures No. 1) Bill 2018 (Cth) 47-48.

⁶⁴ See Tax Administration Act 1953 (Cth) s14-250 of sch 1.

Given the complexity of calculating a homeowner's tax liability, and to simplify compliance, the tax administration should be informed of the initial price of the residential premises and calculate the homeowner's tax liability annually, informing the homeowner by way of a notice of the amount of GST/VAT due.⁶⁵ To address potential concerns within the tax administration regarding GST/VAT recovery, these notices could reflect the GST/VAT owing for the next year. In a similar way to how pay as you go (PAYG) instalments operate in Australia and how provisional tax operates in New Zealand, homeowners could be required to pay this liability in quarterly instalments. As homeowners would not be registered for GST/VAT, they would not be entitled to input tax credits in relation to tax that they pay concerning their consumption of residential premises. This is the correct outcome as it reflects that the homeowner consumes the housing services that the residential premises produce and should be liable for the burden of the GST/VAT.

When homeowners lease residential premises to tenants, they should be required to register for GST/VAT, independent of whether they would otherwise meet the registration turnover threshold,⁶⁶ as they would effectively be conducting an enterprise. They should charge GST/VAT on leases.⁶⁷ Homeowners should be entitled to input tax credits relating to any GST/VAT paid on inputs. This should include the GST/VAT payable in relation to their ownership of the residential premises, as well as any GST/VAT paid in relation to repairs and

⁶⁵ In a similar way, the Australian Taxation Office estimates the amount of tax that taxpayers with business and or investment income should pay and requires this estimate to be paid in regular 'Pay as you go instalments: See 'PAYG instalments', *Australian Taxation Office (Web Page, 9 March 2022)* <<https://www.ato.gov.au/Business/PAYG-instalments/>>.

⁶⁶ In Australia and several other jurisdictions, taxi operators are required to register for GST notwithstanding that they may not otherwise be required to register: See *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 144-1.

⁶⁷ Where the lease is facilitated through agents, for example, real estate agents or online platforms such as Airbnb, the agent or online platform should be regarded as a GST/VAT agent, and the homeowner should remain responsible for remitting the GST/VAT payable to the tax administration.

maintenance and renovation costs. The net amount of GST/VAT should be remitted to the tax administration, perhaps on a quarterly basis.

Alternatively, in a similar way to how PAYG instalments operate in relation to taxpayers with investment income in Australia, the tax administration could calculate an estimate of the amount of GST/VAT due. The lessor could be required to pay this estimate quarterly, and there could be a reconciliation of this amount with the actual GST/VAT received by the lessor at the end of the year. At this time the lessor could also have an opportunity to claim input tax credits.⁶⁸ Accounting for the GST/VAT implications of a lease would be an extra administrative burden for homeowners, which could lead to an uptake in the use of professionals to assist with these obligations.

In relation to collecting the GST/VAT payable by homeowners and lessors, there would need to be an enforcement process in place.⁶⁹ In Australia, the GST payable could be regarded as a tax liability that is due and payable and the usual debt recovery process available to the Commissioner of Taxation could apply.⁷⁰ Interest and penalties could be imposed in relation to late payment,⁷¹ except in cases of serious financial hardship. It is recommended that GST/VAT be payable to the tax administration quarterly, but in cases of hardship payment plans could be made available.

Residential premises should be revalued where there is any event that leads to a significant change in their market value. One such situation would be where there are substantial renovations which lead to an increase in the value of consumption of the residential

⁶⁸ See 'PAYG instalments', *Australian Taxation Office* (Web Page, 9 March 2022) <<https://www.ato.gov.au/business/payg-instalments/>>.

⁶⁹ *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s162-5.

⁷⁰ See *Tax Administration Act 1953* (Cth), s 255-5 of sch 1.

⁷¹ In Australia this should include the general interest charge. See *Tax Administration Act 1953* (Cth), Part IIA.

premises.⁷² Another situation would be where the residential premises are rebuilt after an unexpected event such as a fire or flood. The initial value of residential premises at the start of a particular year for the purposes of calculating periodic GST liability should reflect the revaluation. This revaluation should also impact on the amount of rent (and GST/VAT) charged to lessees.

Under the current pre-paid approach homeowners prepay GST/VAT that they cannot recover. If they live in the residential premises or they are vacant, they are left with the burden of the GST/VAT. If they lease out the residential premises, they pass on the cost of the GST/VAT paid in the lease charged to lessees. If the alternative approach were implemented, the politically easiest transition rule would be to exempt all existing homeowners and only apply the alternative approach to residential premises purchased after the commencement date. Furthermore, existing leases should be input-taxed after the commencement of the alternative approach is implemented, until there is a sale of residential premises. After that, if the new homeowner leases out the residential premises, they should be entitled to input tax credits for the periodic GST/VAT that they would pay as a homeowner, and the lease payments charged should be taxable.

It is often the case that new tax systems are introduced during times of crises. As governments respond to the global COVID-19 crises, with its resultant economic impact on disposable incomes and revenue collection, this would be an ideal time to consider shifting to a periodic GST/VAT relating to the consumption of residential premises. It would involve looking beyond

⁷² Under the current pre-paid approach, it is assumed that most of the value of the residential premises that was taxed when it was first sold has been consumed. The supply of substantially renovated residential premises is regarded as creating a new taxing point and is treated as a supply of new residential premises. See Christine Peacock, 'What Does It Take to Make a House New?' (2021) 50(1) *Australian Tax Review* 22, 24-25.

short-term election periods to what is best for a country long-term. Shifting to a periodic GST/VAT on the consumption of residential premises may go some way towards addressing housing affordability concerns. It may have a downward effect on the price of residential premises and leases. In the short-term a reduction in revenue would be expected as GST/VAT would no longer be collected on the upfront purchase of residential premises. Over the longer-term shifting to a periodic approach would lead to more revenue collection as appreciation would no longer be left out of the GST/VAT base.

It is estimated that there are 171,628 new residential premises built per year, as there were 10,761,900 residential premises in Australia in December 2021, and there were 9,002,700 residential premises in September 2011 (the first quarter when data was available):⁷³

$$\frac{10,761,900 - 9,002,700}{41 \text{ quarters}} = 42,907$$

$$42,907 \times 4 \text{ quarters} = 171,628$$

Assuming that the mean value of residential premises in Australia is \$774,455 excluding GST/VAT (see Section 5.2.1), it is assumed that under the current approach about \$11.96 billion GST revenue is collected in relation to sales of new residential premises each year:

$$\$774,455 \times 171,628 \times 9\%$$

The 10% GST rate in Australia has been discounted slightly in the above calculation, as a significant number of sales of new residential premises take place via the margin scheme which allows for GST to be calculated on a concessional basis.⁷⁴ Since 1 July 2018, where the

⁷³ Residential Property Price Indexes, Eight Capital Cities' (n 24), Table 6, cells AT52 and AT11.

⁷⁴ See *A New Tax System (Goods and Services Tax) Act 1999* (Cth), Div 75.

margin scheme is applied GST is withheld by the purchaser at a rate of 7% based on the contract price of the property.⁷⁵ The percentage of sales of new residential premises in Australia which are subject to the margin scheme is unknown. Therefore a 'blended' rate of 9% was used in the above calculation.

If there were no transitional rule, and GST/VAT were collected periodically in relation to imputed and actual rent from the first day of implementation of the alternative approach, GST/VAT collected would double:

$$\$774,455 \times 3.22\% \text{ market rental} = \$24,937$$

$$\$24,937 \times 10\% \text{ GST} = \$2,493.75 \text{ GST/VAT payable}$$

$$\$2,493.75 \times 10,761,900 \text{ residential premises} = \$26.84 \text{ billion}$$

Assuming that the alternative approach is only applied to residential premises purchased after the commencement date, it would take approximately 9 years for revenue collected under the alternative approach to exceed revenue collected under the current approach. This is based on the following assumptions:

- The average of the total number of residential premises sold per quarter is 120,700.⁷⁶ Therefore it is assumed that 481,080 residential premises are sold per year. It is assumed that the number of residential premises that would be subject to the alternative approach would grow by 481,080 per year.

⁷⁵ *Taxation Administration Act 1953* (Cth), Schedule 1, s14-250.

⁷⁶ Residential Property Price Indexes, Eight Capital Cities' (n 24), Table 4. This was calculated as the total of Columns AF to BI, and then averaged.

- In year 1 it is assumed that the mean value of residential premises is \$744,445, and in other years it is assumed that the mean value of residential premises would grow by the annual appreciation rate of 5.52% per year.
- GST/VAT on imputed rent is calculated as the mean value of residential premises x 3.22% market rent/10
- The present value of the future GST/VAT payments in year X is calculated as the GST/VAT liability for year X divided by $(1+0.024)^X$.

Table 5.5: GST/VAT collected under the alternative approach, applying the transitional rule

Year	Number of residential premises subject to annual GST/VAT	Mean value of residential premises	GST/VAT on Imputed rent	Total GST/VAT revenue (\$bn)	Present value (\$bn)
1	481,080	\$774,455	\$2,493.75	1.20	1.20
2	962,160	\$817,205	\$2,631.40	2.53	2.47
3	1,443,240	\$862,315	\$2,776.65	4.01	3.82
4	1,924,320	\$909,914	\$2,929.92	5.64	5.25
5	2,405,400	\$960,142	\$3,091.66	7.44	6.76
6	2,886,480	\$1,013,141	\$3,262.32	9.42	8.36
7	3,367,560	\$1,069,067	\$3,442.40	11.59	10.05
8	3,848,640	\$1,128,079	\$3,632.42	13.98	11.84
9	4,329,720	\$1,190,349	\$3,832.92	16.60	13.73
10	4,810,800	\$1,256,057	\$4,044.50	19.46	15.72
11	5,291,880	\$1,325,391	\$4,267.76	22.58	17.82

Ways in which the immediate budgetary shortfall could be funded might include adjustments to the transitional rule. For example, it is estimated that approximately 66% of residential premises have never been subject to GST as they were built before GST was introduced in Australia.⁷⁷ If these were immediately subject to the alternative approach at the date of implementation, this would raise approximately \$17.64 billion in revenue in year one. Using the number of new residential premises per quarter calculated above (42,907), we can estimate the number of residential premises at 1 July 2000 (when GST was introduced in Australia). Between the GST implementation date of 1 July 2000 and September 2011, the first quarter in which data for total residential premises in Australia were available, there are 11.25 years or 45 quarters. Therefore:

⁷⁷ This percentage might be lower than this, as some of these residential premises may have been brought within the GST base by virtue of having been substantially renovated. See n 72.

42,907 x 45 = 1,930,815 residential premises subject to GST

9,002,700 residential premises in Sept 2011 – 1,930,815 = 7,071,871 residential
premises at 1 July 2000

7,071,871 /10,761,900 residential premises in Dec 2021 = 66%

\$26.84 billion x 66% = \$17.64 billion

There would, however, be political challenges involved in adjusting the proposed transitional rule. While the focus of this chapter has been on the GST/VAT treatment of residential premises, implementation of this alternative approach should be considered as part of wider reform of the tax system which might also have the effect of reducing the overall expected short-term revenue shortfall. This might include reform of the income tax system, and other adjustments to broaden the GST/VAT base, such as including financial services within the base.⁷⁸ This would be consistent with recognition in the tax literature that GST/VAT should have a broad base,⁷⁹ and that consumption is a particularly efficient tax base.⁸⁰

⁷⁸ MacIntyre has explained that the traditional rationale for exempting financial services is the inability to determine the 'value add' component, but that the increasing use of artificial intelligence may mean that determining the value add may be less problematic in the future: Amrit MacIntyre, 'Financial Supplies after 20 Years' (2020) 18(1) *eJournal of Tax Research* 147, 166. According to Treasury estimates, if the input taxed treatment of financial services were removed this would result in \$3.7 billion of revenue in 2023-24. The removal of the input taxed treatment would not likely 'materially impact the demand for these services': Treasury, 'Tax benchmarks and variations statement' (Australian Government, 2021), 157.

⁷⁹ See, for example, Sijbren Cnossen, 'Commentary by Sijbren Cnossen' in Stuart Adam et al (ed), *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, 2010), 370; Cnossen, 'Global Trends and Issues in Value Added Taxation' (n 17) 405; Ebril et al (n 1) 3; Ine Lejeune, Jeanine Daou-Azzi and Mark Powell, 'The Balance Has Shifted to Consumption Taxes - Lessons Learned and Best Practices for VAT' in Michael Lang and Peter Melz et al (ed), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009), 77; Alastair Thomas, 'Reassessing the Regressivity of the VAT' (Working Paper No 49, OECD, 2020), 5 and Robert F van Brederode, 'Preface and Acknowledgements' in Robert van Brederode (ed), *Immovable Property Under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011), xxv.

⁸⁰ See, for example, Treasury, Australian Government, *Australia's Future Tax System: Report to the Treasurer: Part One Overview* (December 2009), 50. In comparison, some forms of revenue also relied on by states and territories have been recognised as highly inefficient. For example, stamp duties and insurance levies. See pwc, *Where next for Australia's Future Tax System? How Our Tax System Can Help Reboot Prosperity for Australia* (June 2020), 14.

Of course, there would be political challenges to overcome in implementing this alternative approach. At one time, Australian owner-occupiers were subject to income tax on the imputed income they enjoyed from exploiting the market value benefit of their own property,⁸¹ but there has been no serious consideration of reinstating the measure since its removal almost 100 years ago. Since that time, homeownership has been subject to concessional income tax treatment, most notably the full exemption from capital gains taxation of gains on the disposal of owner-occupied housing. Owner-occupied homes have also been exempt from land tax. Most homeowners in Australia, apart from those who have acquired new residential premises after 2000 have never experienced paying GST on residential premises either because the premises they acquired were built before the introduction of GST or they acquired a supply of used residential premises.

In short, Australians are accustomed to concessional tax treatment of housing, and it would be difficult for any government to garner public support for an annual tax on the consumption of residential premises, particularly if potential taxpayers did not realise the change might result in a reduction in the price of residential premises and leases. However, the removal of a current tax, such as stamp duty on transfers of residential premises, may make this

⁸¹ See Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (University of Chicago Press, 1938), 117; Robert Albon, 'Housing and Taxation - Commonwealth Issues' (1990) 7(3) *Australian Tax Forum* 337, 340 and Barry Reece, 'Simons' Account of Australian Taxation of Imputed Rental Income' (1985) 2(2) *Australian Tax Forum* 239, 239-242.

alternative approach more acceptable to homeowners.⁸² Some states and territories are moving in this direction.⁸³

5.6 Conclusion

This chapter has explored an alternative to the current general approach to the GST/VAT treatment of residential premises which is taken in most jurisdictions with a GST or VAT. The problem with the current approach is that any appreciation in the value of residential premises is excluded from the tax base. This chapter illustrates the potential for the GST/VAT base to be broadened so that the added value of consumption resulting from the general appreciation in residential premises is also included in the base. It provides the first simulation showing how tax could be calculated on a periodic basis in relation to the consumption of residential premises. Based on the values of the independent variables used for the purposes of discussion, it would take just over 21.2 years for GST/VAT collected under the alternative approach to exceed the GST/VAT that would be collected under the current pre-paid approach. Use of the alternative approach would likely have a positive effect on housing affordability, as the equivalent of the GST/VAT that is currently paid when purchasing residential premises would be spread over 21.2 years. More revenue would be generated under this approach as the GST/VAT base would be broadened to include the consumption value of all residential premises.

⁸² This would be consistent with recommendations that stamp duty be abolished. See, for example, Treasury, Australian Government, *Australia's Future Tax System: Final Report* (2 May 2010) Recommendation 51 and Productivity Commission, Australian Government, *Shifting the Dial: 5 Year Productivity Review* (Inquiry Report No. 84, 2017) Recommendation 4.8. Stamp duty has been considered inefficient and inequitable. See, for example, Treasury, Australian Government, *Australia's Future Tax System: Report to the Treasurer: Part One Overview* (December 2019), 48-49.

⁸³ The ACT is phasing out stamp duty, and in New South Wales first homeowners will have a choice to pay land tax instead of stamp duty. See (n 57).

Whilst Australian data has been used for the purposes of discussion, data from other jurisdictions could be input into the tool developed for the purposes of illustrating this simulation. Several policy alternatives have been considered in discussing different values that could be given to the variables used in this simulation. Many of these policy alternatives have not previously been considered in the GST/VAT literature. The effect of changing the values of these variables on the years taken to achieve equivalence has been considered, to provide a fuller discussion of how an estimate of the consumption of residential premises could be taxed periodically. Discussion has also been provided regarding ideas about how the GST/VAT could be collected periodically, and possible implementation issues.

Chapter 6: Alternative approach two: Including sales of residential premises in the GST/VAT base*

6.1 Introduction

Under the theoretical model of GST/VAT,¹ a purchaser of goods would be entitled to claim input tax credits in relation to GST/VAT paid when acquiring those goods.² GST/VAT would then be imposed on the annual value of goods as they depreciate and are used. However, to simplify matters, under what is known as the prepaid method, GST/VAT is imposed just once, when goods are originally purchased. GST/VAT on the original purchase is regarded as a measurement of the present value of GST/VAT payable on all future consumption.³ Second-hand sales of goods by unregistered vendors are not subject to GST/VAT, although, theoretically, later consumers pay GST/VAT, as future consumption is assumed to be built into the price at which second-hand goods are sold. Pomp and Oldman have provided the following example:

Assume that ... A bought a stereo for \$1,000 cash, paying a 10 percent sales tax of \$100. This year A sells the used stereo to B for \$550. ... The stereo's tax inclusive cost to A was \$1,100 ... A sold it for half of the tax inclusive cost ($\$550 = \frac{1}{2} \times \$1,100$). The \$550 that A received on the

* This is a modified version of the published article Peacock, Christine, 'How could sales of residential premises between otherwise unregistered homeowners be brought into the VAT base?' (2019) 14(1) *Journal of the Australasian Tax Teachers Association* 151-169.

¹ The term GST/VAT is used throughout this chapter to denote the broad based consumption tax system, as it is in other chapters of this thesis.

² See Richard Krever, 'Designing and Drafting VAT Laws for Africa' in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 24.

³ Christine Peacock, 'Is There a Viable Way to Tax the Consumption of Immovable Property That Is More Consistent with the Economic Objective of the VAT?' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336, 338.

resale can be viewed as consisting of two parts: \$500, half the \$1,000 tax exclusive cost of the stereo ($\$500 = \frac{1}{2} \times \$1,000$) and \$50, half of the sales tax paid on its purchase ($\$50 = \frac{1}{2} \times 100$).⁴

Use of the prepaid method generally produces the correct result for most goods.⁵ However, the problem with this approach when it comes to the GST/VAT treatment of residential premises is that upfront taxation generally does not correspond with the present value of all future consumption. While the value of residential buildings depreciates over time as the buildings waste, the value of residential land underlying the buildings generally rises over the longer term.⁶ Any appreciation in the value of residential land, an element in the value of an owner-occupier's consumption, is not captured within the GST/VAT base.⁷

Peacock has noted that '[i]t has been recognised in the VAT literature that the theoretically correct approach for VAT purposes would be to include the imputed rent of a house or apartment in the VAT base'.⁸ Imputed rent is the residential services that an owner-occupier receives for living in their home.⁹ Including imputed rent in the GST/VAT base would involve treating an owner-occupier as if they were supplying those services to themselves.¹⁰ GST/VAT would not be charged on the first sale of the residential premises, but instead a value would

⁴ Richard D Pomp and Oliver Oldman, 'A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins' (1990) 43(4) *National Tax Journal* 427, 427–8. This example relates to the application of retail sales tax in the US. Van Brederode has also explained that the resale price of a used good includes a fraction of the tax-inclusive price made by the first consumer. See Robert F van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International, 2009) 169.

⁵ See Peacock (n 3) 338–9.

⁶ This is recognised in Wei Cui, 'Learning to Keep the Consumption Tax Base Broad: Australian and Chinese VAT Design for the Housing Sector' in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011) 369. See also Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015) 409.

⁷ In the Mirrlees Review report, it was recognised that the consumption value of housing 'may change a great deal over time. Hence, their up-front price may prove to be a bad approximation to the value of consumption services they eventually provide': Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review* (Oxford University Press, 2011) 380.

⁸ Peacock (n 3) 337.

⁹ Donald B Marsh, 'The Taxation of Imputed Income' (1943) 58(4) *Political Science Quarterly* 514, 514.

¹⁰ Sijbren Cnossen, 'Improving the VAT Treatment of Exempt Immovable Property in the European Union' (Working Paper No 10/19, Oxford University Centre for Business Taxation, 2010) 1.

be placed on those services for a specific period, such as a year, and this value could be updated as the immovable property appreciates. However, it has been recognised in the GST/VAT literature that including imputed rent in the GST/VAT base would involve administrative and political challenges.¹¹

A feature common to much of the literature on the optimal GST/VAT treatment of residential premises envisages an alternative approach of bringing sales of residential premises between otherwise unregistered homeowners into the GST/VAT base, with deferred input tax credits for the initial acquisition.¹² The key research question that this chapter seeks to answer is: ‘How could sales of residential premises between otherwise unregistered homeowners be brought into the VAT base?’ This chapter will first review the earlier literature recommending this approach (Section 6.2), before suggesting multiple ways in which GST/VAT could be collected on each sale of residential premises (Section 6.3), and considering issues relating to the appropriate quantum of input tax credits that should be available as deferred input tax credits (Section 6.4). It then questions whether homeowners should be able to claim deferred input tax credits (Section 6.5), before coming to a conclusion (Section 6.6).

¹¹ See Sijbren Cnossen, ‘A Proposal to Improve the VAT Treatment of Housing in the European Union’ in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Wolters Kluwer, 2013) 225, 227; Sijbren Cnossen, ‘Global Trends and Issues in Value Added Taxation’ (1998) 5(3) *International Tax and Public Finance* 399, 405; Sijbren Cnossen, ‘Three VAT Studies’ (CPB Special Publication No 90, CPB Netherlands Bureau for Economic Policy Analysis, December 2010); Sijbren Cnossen, ‘VAT Treatment of Immovable Property’ in Victor T Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, 235–6; Robert F Conrad, ‘The VAT and Real Estate’ in Malcolm Gillis, Carl S Shoup and Gerardo P Sicat (eds), *Value Added Taxation in Developing Countries* (World Bank, 1990) 102; Robert F Conrad, ‘Value Added Taxation and Real Estate’ (Discussion Paper No DRD224, Development Research Department, World Bank, February 1987) 25; Rita de la Feria and Richard Krever, ‘Ending VAT Exemptions: Towards a Post-Modern VAT’ in de la Feria (ed) (n 11) 28; Krever (n 2) 24; Peacock (n 3) 337–8.

¹² Cnossen has proposed a tax on sales of residential premises between unregistered homeowners, to be applied on the difference between the selling price and purchase price of residential premises, and levied on the vendor at the time of sale: See Cnossen, ‘Three VAT Studies’ (n 11) 71–3. The application of this proposal would involve different considerations to the other proposals considered in this chapter, which involve VAT being imposed on the purchaser of residential premises at the time of purchase, and the homeowner later being entitled to a deferred input tax credit when they sell the residential premises. Therefore, Cnossen’s proposal is not considered in this chapter.

6.2 Summary of alternative proposals

First suggested by Conrad in his 1987 stock value added tax (or 'S-VAT') proposal, the idea of bringing sales of residential premises between otherwise unregistered homeowners into the GST/VAT base was restated in a modified form by Conrad and Grozav in 2008. Later variations include Poddar (2009), *Value Added Tax: A Model Statute and Commentary* (1989) ('Model Statute'), Van Brederode (2011), and Clossen (2013).¹³

Conrad's proposed alternative of the S-VAT was one of the earliest proposals recommending that all sales of residential premises be included in the GST/VAT base.¹⁴ He acknowledged that, in theory, a GST/VAT should tax flows of consumption, and that this would imply that GST/VAT should operate as a tax on 'consumption' rather than on 'transactions'.¹⁵ However, he suggested that there is 'no feasible way for the government to determine the value of these periodic rentals other than via some arbitrary rule'.¹⁶ Instead, Conrad proposed that GST/VAT should be payable on all sales of immovable property (including sales of residential premises), and that homeowners would receive the GST/VAT that they earlier paid on the purchase of their residential premises as a refund if they later sell the residential premises.¹⁷

The S-VAT was later modified by Conrad and Grozav's real estate VAT.¹⁸ These authors also

¹³ See Satya Poddar, 'Taxation of Housing under a VAT' (2009) 63 *Tax Law Review* 443; Committee on Value Added Tax of the American Bar Association Section of Taxation, *Value Added Tax: A Model Statute and Commentary* (Tax Management Education Institute, 1989) ('Model Statute'); Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) vol 37, 1; Clossen, 'A Proposal to Improve the VAT Treatment of Housing in the European Union' (n 11).

¹⁴ See Conrad, 'Value Added Taxation and Real Estate' (n 11); Conrad, 'The VAT and Real Estate' (n 11).

¹⁵ Conrad, 'Value Added Taxation and Real Estate' (n 11) 1.

¹⁶ *Ibid* 25.

¹⁷ *Ibid* 11–12.

¹⁸ Conrad and Grozav acknowledged that the real estate VAT is a modification of the S-VAT proposal: Robert Conrad and Anca Grozav, 'Real Property and VAT' in Krever (ed) (n 2) 90.

proposed that all sales of residential premises should be taxable,¹⁹ and that homeowners should be entitled to claim input tax credits in relation to the purchase of residential premises if they later sell.²⁰

Later, Poddar investigated three possible alternative GST/VAT treatments of immovable property that could be considered if the US were to adopt a federal GST/VAT. One of these options (Option A) was similar to the approach advocated previously, under which the resale of residential premises would be taxable, and a homeowner would have a right to claim input tax credits relating to the purchase of residential premises at the time of resale.²¹ Poddar wrote:

Conceptually, this option is the most comprehensive. It addresses the two gaps in taxation of housing consumption ... It extends the scope of VAT to the consumption of existing stock of housing, as well as to any unanticipated future increases in the rental value of new housing units.²²

The Model Statute, published by the Committee on Value Added Tax of the American Bar Association, included a similar proposal that casual sales by sellers who are not registered for GST/VAT should be taxable, if the consideration that the seller receives exceeds a prescribed statutory threshold.²³ This proposal provided for a deferred credit of the GST/VAT paid when

¹⁹ Conrad and Grozav noted that '[t]he fact that sales of real property would be taxed implies that all leases would also be taxed under the proposal; an action that would ensure neutrality between the uses of real property': *ibid.*

²⁰ *Ibid* 93.

²¹ Poddar (n 13) 453–8. This option (Option A) will be considered in this chapter, whereas Poddar's Option B and Option C will not be considered in detail. Poddar's Option B was very similar to Option A, except residential rent would not be taxable under Option B, whereas it would be under Option A. Option B therefore would not achieve neutrality between homeowners and lessees. Option C involves regarding sales and leases of residential premises as exempt from VAT, and so it is not relevant to this chapter.

²² *Ibid* 456.

²³ See Model Statute (n 13) ss 4003(a)(3A) and 4005(a).

the residential premises were acquired, which would become available at the time that the residential premises are sold.²⁴ The following example was provided of how this would work (it assumes a GST/VAT rate of 10 per cent):

Assume Consumer A purchased her home for \$100,000 plus \$10,000 VAT. She later sold her home for \$120,000. Assuming the sale is taxable ... Consumer A charges \$12,000 VAT on the sale to Consumer B and claims a \$10,000 credit ... she remits the net \$2,000 to the government.²⁵

Similarly, Van Brederode has proposed that homeowners should pay GST/VAT on all purchases of residential premises. Under this proposal, homeowners would be assumed to use their residential premises for consumption purposes until they sell. At this point, a 'fiscal metamorphosis' would occur, and homeowners would then be regarded as registered for GST/VAT, and able to claim input tax credits relating to the initial purchase of the residential premises.²⁶

6.3 How would the collection of GST/VAT occur?

Currently, an entity must be registered for GST/VAT in order to make taxable supplies and receive input tax credits relating to the GST/VAT paid on acquisitions in the course of its business. Generally, in order for an entity to be eligible to register for GST/VAT, a business activity must be carried on, and aggregate taxable supplies made by that entity must exceed

²⁴ See Model Statute (n 13) s 4019.

²⁵ Ibid 76–7.

²⁶ Robert F van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' in Van Brederode (ed), *Immovable Property under VAT* (n 13) 16.

the registration threshold.²⁷ Registered entities must comply with various administrative obligations.²⁸ For instance, they are generally required to charge GST/VAT on the market value of their supplies, and are entitled to claim input tax credits on the GST/VAT that they pay in relation to any acquisitions that they make in the course of their business. They also must submit regular GST/VAT returns, and collect the GST/VAT owing relating to sales of their taxable supplies, and remit this GST/VAT to the tax administration, less any GST/VAT claimable back as an input tax credit.²⁹

GST/VAT is not imposed on supplies made in the course of an activity that is regarded as personal.³⁰ For this reason, homeowners who purchase residential premises to live in those premises are generally regarded as not eligible to register for GST/VAT.³¹ Living in residential premises is not generally regarded as satisfying the requirement that there is a business activity being carried on. At first glance, a clear administrative argument against charging

²⁷ Williams has explained that ‘the law imposing the VAT usually makes it clear that only economic activities are within the scope of the tax. How this is defined varies among laws. Some laws require that the supply be made as part of economic activity, or the business activities of the supplier, or in the course or furtherance of a business carried on by the supplier. Others refer to supplies made by the taxable person acting as such, that is, acting in the capacity as a taxable person making taxable supplies’: David Williams, ‘Value-Added Tax’ in Thuronyi (ed) (n 11) 164, 198. In the European Union, an entity must carry on an ‘economic activity’: Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International, 2003) 313. In New Zealand, an activity must be carried on ‘continuously or regularly’: *Goods and Services Tax Act 1985* (NZ) s 6(1)(a). Regarding the registration threshold that generally applies, see Williams (n 27) 171–81 and 60–4.

²⁸ Terminology used to describe entities that are registered for GST is different in different countries. In Australia, entities registered for GST are generally referred to as registered entities. In New Zealand, the *Goods and Services Tax Act 1985* imposes obligations on ‘a registered person’: *Goods and Services Tax Act 1985* (NZ) s 8(1). In the European Union, home of VAT, a registered entity is known as a ‘taxable person’: *Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax* [2006] OJ L 347/1, art 9 (‘EU Directive’). Interestingly, a registered entity is also known as a ‘taxable person’ in Singapore (*Goods and Services Tax Act 2005* (Singapore) s 2(1)). This is likely to be because of the influence of the UK VAT system on drafters of the Singaporean GST legislation, the UK also being a country where the ‘taxable person’ terminology is used: *Value Added Tax Act 1994* (UK) s 3(1). The terminology used in the UK presumably comes from the EU Directive (n 28).

²⁹ Sijbren Cnossen, ‘A Primer on VAT as Perceived by Lawyers, Economists and Accountants’ in Michael Lang et al (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (International Bureau of Fiscal Documentation, 2009) 138.

³⁰ Williams (n 27) 197.

³¹ This has been recognised by Cui (n 6) 369; Schenk, Thuronyi and Cui (n 6) 409.

GST/VAT on all sales of residential premises is that this would place an increased administrative burden on homeowners. One would think that, for sales of residential premises to come within the GST/VAT base, the GST/VAT registration rules would need to be changed in order to elevate homeowners to the status of a registered entity. In this regard, Van Brederode has suggested that it would not be 'practically nor politically feasible to register all individuals who sell residential property and charge them with collecting tax from other private individuals'.³² However, three possible ways in which GST/VAT collection could occur without homeowners having to register for GST/VAT will be outlined below.

The first possible option is that an intermediary could collect GST/VAT on behalf of homeowners. For example, Conrad and Grozav have proposed that all sales of residential premises should be taxable, and homeowners should be entitled to input tax credits in relation to the purchase of residential premises if they later sell. To facilitate this, they have proposed that a 'closing agent, solicitor or tax official would collect and credit the GST/VAT. Thus, GST/VAT collection would not be dependent on whether the person is really a taxpayer in any traditional VAT sense of the term.'³³ Similarly, Van Brederode has noted that sales of residential premises:

are generally mediated by legal professionals ... involved in title verification and the disbursement of moneys. In most jurisdictions they are already responsible for the collection

³² Van Brederode, *Systems of General Sales Taxation* (n 4) 190.

³³ Conrad and Grozav (n 18) 92. It is worth noting that some of the early proposals to include all sales of residential premises in the GST/VAT base did not detail how GST/VAT would be collected when sales of residential premises occur between homeowners who would not otherwise be registered for GST/VAT. Poddar, for example, recommended that the resale of owner-occupied housing be included in the GST/VAT base, but did not address how the GST/VAT on resale would be collected: Poddar (n 13). Likewise, the Model Statute proposed that casual sales above a threshold be regarded as taxable, but did not address how the GST/VAT on such sales would be collected: Model Statute (n 13). As part of his S-VAT proposal, Conrad proposed that GST/VAT should be payable on all sales of immovable property, but '[c]onsumers would not be VAT taxpayers and they would never need to file any type of return': Conrad, 'Value Added Taxation and Real Estate' (n 11) 15. Conrad and Grozav's proposal builds upon this idea.

of transactional taxes, such as transfer or conveyance taxes. It makes practical sense to also charge these mediators with withholding of VAT due as regards a sale of real estate on behalf of the seller.³⁴

Van Brederode's view is probably influenced by his experience working in the US. In Australia, homeowners can use either lawyers or conveyancers to assist in property transfers. For example, in the Australian State of Victoria, whilst some homeowners use lawyers to assist in transfers of residential premises, licenced conveyancers can perform tasks that include the transfer of title to the immovable property and the payment of stamp duty that is generally owed on the purchase of immovable property.³⁵ Whoever handles the transfer of residential property, whether it be a lawyer or conveyancer, may therefore be highly suited to collect GST/VAT owing on the purchase of residential premises from the purchaser, and remit this GST/VAT to the tax administration.

Alternatively, there may be some jurisdictions where it might be more suitable for the collection of GST/VAT from the purchaser to occur not through an individual intermediary such as a conveyancer, but through an agency responsible for the transfer of title. This is the second possible way in which GST/VAT could be collected from the purchaser. In jurisdictions with subnational governments, it might be appropriate for this to be done at a state or provincial level, perhaps in a similar way to how stamp duty may be collected.³⁶ There are several countries where stamp duty is levied, including Australia, Hong Kong, Singapore and

³⁴ Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

³⁵ 'Conveyancing work' is defined in the *Conveyances Act 2006* (Vic) s 4. Regarding the payment of stamp duty, see William DM Cannon, 'Fundamental Principles of Stamp Duty' (1996) 19(1) *UNSW Law Journal* 1, 2. Originating from England, stamp duty is described by Cannon as 'one of the most important sources of revenue collection for the States and Territories of Australia': at 1.

³⁶ For a detailed history of how the Australian states previously collected income taxes, see Peter Mellor, 'Origins of the Judicial Concept of Income in Australia' (2010) 25 *Australian Tax Forum* 339, 344–54.

South Africa.³⁷ However, it should be noted that in recent times there have been tax reviews that have recommended the abolition of stamp duty.³⁸

The experience of some agencies in collecting tax revenue relating to when motor vehicles are sold also indicates that it is possible for agencies to perform a revenue collection role. For example, in the US and Canada, payment of sales tax owing on the purchase of used motor vehicles is a precondition to registration, and is regarded as a simple process. In this regard, Van Brederode has written that consumer-to-consumer resales of durable goods:

that require registration, such as automobiles, motorcycles, boats and campers, are taxed in the majority of states for the single reason that this is a simple matter from an administrative perspective. Payment of sales tax is a precondition for registration, and payment can be made in many states upon registration with the Department of Motor Vehicles.³⁹

As Van Brederode has noted, similar rules exist in the European Union regarding cross-border sales of new means of transport, such as motor vehicles,⁴⁰ to a purchaser in another Member State when they are transported to the other Member State.⁴¹ The example he has provided is of a Belgian consumer ('C1') who purchases a motor vehicle in a private capacity, and pays

³⁷ Jonathan Barrett, 'Property Taxes as a Policy Response to Foreign Investment as a Perceived Cause of Housing Unaffordability' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 1, 10. Regarding the transfer duty payable in South Africa, see Enid Slack, 'Property Taxation in Australia' in Richard M Bird and Enid Slack (eds), *International Handbook of Land and Property Taxation* (Edward Elgar, 2004) 203.

³⁸ See, for example, Treasury, Australian Government, *Australia's Future Tax System: Final Report* (2 May 2010) Recommendation 51; Institute for Fiscal Studies (n 7) 403; Productivity Commission, Australian Government, *Shifting the Dial: 5 Year Productivity Review* (Inquiry Report No 84, 2017) Recommendation 4.8. The frequency of recommendations to abolish stamp duty might be increased if all sales of residential premises were subject to VAT.

³⁹ See Robert F van Brederode, 'A Normative Evaluation of Consumption Tax Design: The Treatment of the Sales of Goods under VAT in the European Union and Sales Tax in the United States' (2009) 62(4) *The Tax Lawyer* 1055, 1071–2. See also Pomp and Oldman (n 4) 427. In Canada, provincial sales tax may apply when a motor vehicle that was bought through a private sale is registered: 'GST/HST and Motor Vehicles', *Government of Canada* (Web Page, 15 April 2019) <<https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/gst-hst-businesses/charge-collect-specific-situations/motor-vehicles.html>>.

⁴⁰ See EU Directive (n 28) arts 2.2(a) and (b).

⁴¹ Van Brederode, 'A Normative Evaluation of Consumption Tax Design' (n 39) 1070–1.

VAT on the purchase price but does not have a right to claim input tax credits. He purchases the motor vehicle for EUR25,000, plus EUR5,000 in VAT. He later sells the car to his nephew ('C2') in Germany for EUR20,000. The sale of the motor vehicle to C2 means that C1 is regarded as a registered entity.⁴² However, because the sale involves a cross-border, intracommunity transaction, Van Brederode explains that it is zero-rated in Belgium. C2 then pays GST/VAT in Germany on the purchase price, and C1 is entitled to input tax credits for part of the GST/VAT paid on the original purchase price.⁴³

A third possible way to collect GST/VAT on all sales of residential premises might be to leverage off the system, introduced in Australia in 2018, of generally requiring the recipient of a sale or long-term lease by a registered entity of new residential premises or potential residential land to pay the GST payable on that supply directly to the Australian Taxation Office ('ATO').⁴⁴ Under this system, the vendor is then entitled to an input tax credit of the amount of GST paid by the purchaser.⁴⁵ These rules could be expanded to require all purchasers of residential premises to pay the GST payable on such supplies directly to the ATO.

⁴² Ibid 1071. See also EU Directive art 9.2.

⁴³ Van Brederode, 'A Normative Evaluation of Consumption Tax Design' (n 39). See also EU Directive art 172.

⁴⁴ ATO, *Purchaser's Obligation to Pay an Amount for GST on Taxable Supplies of Certain Real Property* (LCR 2018/4, 1 July 2018) paras 2, 3, 4 and 15. Australia's former Treasurer Scott Morrison explained that these rules were designed to prevent tax evasion by property developers who may dissolve their business before the GST owing would otherwise become payable: Australian Government, Treasury Laws Amendment (2019 Measures No 1) Bill 2019 Second Reading, House of Representatives, 27 February 2018 (Scott Morrison, Treasurer).

⁴⁵ ATO, *Purchaser's Obligation to Pay an Amount for GST* (n 44) para 4. Similarly, in Australia, precedent for one-off liabilities on people not otherwise registered for tax purposes exists in the capital gains tax ('CGT') rules. A CGT withholding requirement is generally imposed on purchasers of Australian immovable property, with a market value of AUD750,000, or more where the sale is made by a vendor who is deemed a foreign resident. In this situation, the purchaser must pay 12.5 per cent of the purchase price to the ATO as a foreign resident capital gains withholding payment. The foreign resident can then claim a credit for this amount once they have lodged an Australian tax return for the relevant year: 'Capital Gains Withholding — A Guide for Conveyancers', ATO, *Australian Government* (Web Page, 11 December 2017) <<https://www.ato.gov.au/general/capital-gains-tax/in-detail/calculating-a-capital-gain-or-loss/capital-gains-withholding---a-guide-for-conveyancers>>.

6.4 *Assuming sales of residential premises are included within the GST/VAT base, what is the appropriate quantum of input tax credits that should be available to homeowners?*

Generally, entities that are registered for GST/VAT purposes are eligible to claim input tax credits for the GST/VAT that they pay in relation to purchasing taxable inputs, in order to supply taxable outputs. For example, a commercial business that purchases, renovates, then sells buildings would be entitled to claim input tax credits in relation to the GST/VAT that is paid on the purchase of the buildings, and any inputs into their renovation. This results in no net GST/VAT effect to the commercial business, but some administrative burden in terms of the business having to comply with GST/VAT requirements (see Section 6.3).

As the GST/VAT is a consumption tax, and the burden of the GST/VAT rests on the consumer, a consumer purchasing residential premises for a non-commercial purpose is currently not entitled to claim input tax credits in connection with any GST/VAT that they pay relating to the purchase or maintenance of the premises. The authors of the alternative proposals reviewed in Section 6.2 all propose, however, that if all residential premises are included within the GST/VAT base, deferred input tax credits relating to the GST/VAT paid in connection with purchasing the residential premises should be available when they are sold.⁴⁶

The proposed deferred input tax credits give rise to questions about whether input tax credits relating to construction costs, alterations and renovations should be claimable. In this regard, Poddar proposed that the quantum of input tax credits claimable should include 'any

⁴⁶ Conrad, 'Value Added Taxation and Real Estate' (n 11) 11–12; Conrad and Grozav (n 18) 91; Poddar (n 13) 254 (regarding Option A); Model Statute (n 13) s 4019; Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

improvements to the home ... other than repairs and maintenance'.⁴⁷ This appears logical, as improvements increase the value of residential premises, and under the alternative proposals, the GST/VAT payable relates to this value.

The authors of the alternative proposals appear to use the purchase price as a proxy for the consumption value of residential premises. Applying this logic, it would be consistent with the alternative proposals for deferred input tax credits relating to the GST/VAT chargeable on construction costs of building residential premises to be claimable, as these costs are not unlike the costs of purchasing residential premises that have already been built.

According to Poddar's proposal, input tax credits relating to maintenance costs, including repairs, should not be deductible.⁴⁸ Following the logic of the alternative proposals, this appears to be the correct GST/VAT treatment, as presumably, maintenance costs incurred would not result in any increase in the market value of residential premises when another homeowner next purchases them. If residential premises suffered wear and tear, but maintenance costs were not incurred to address this issue, the value of the residential premises might depreciate in recognition of the use and consumption of the residential premises.⁴⁹ If maintenance costs were incurred that merely maintained the value of the residential premises, there would be no additional value of consumption to apply GST/VAT to, and no corresponding input tax credits to provide to the homeowner.⁵⁰

⁴⁷ Poddar (n 13) 454. Millar has also noted that '[p]rovided ... the improvements form part of the value of the property when resold ... they ought to be creditable because they are taxed as part of the price of the on-going sale': Rebecca Millar, 'VAT and Immovable Property: Full Taxation Models and the Treatment of Capital Gains on Owner-Occupied Residences' in de la Feria (ed) (n 11) 253, 277.

⁴⁸ Poddar (n 13) 454.

⁴⁹ When discussing the VAT treatment of residential premises, Poddar has recognised that 'any decrease in value is presumed to be attributable to its use or consumption': Poddar (n 13) 455.

⁵⁰ In Australia, the costs of repairs to a home owned by an investor are deductible against assessable income: ATO, *Income Tax: Deductions for Repairs* (TR 97/23, 3 December 1997). However, different considerations apply

It would be important to clearly distinguish between repairs and improvements, as input tax credits should only be available when homeowners incur GST/VAT on the cost of improvements (as it is only improvements, and not repairs, that increase the value of residential premises). Differentiating between deductible repairs and capital improvements for income tax purposes in Australia requires examining the ordinary meaning of these terms, as no legislative definition of what is a 'repair' appears in the income tax legislation.⁵¹ Whilst the ATO has produced a ruling providing guidance on this issue in the context of revenue versus capital expenses,⁵² there has been no consideration of this distinction for GST purposes, as GST law does not normally distinguish between capital and revenue expenditures. Whether there is a repair or an improvement in terms of law is a question of fact and degree.⁵³

One factor in the context of revenue or capital expenses, which has been considered important in making this distinction by courts in the UK, Australia and New Zealand, is whether the entirety of an asset or just a part of the asset is changed. If the entirety is changed, there is more likely to be a capital improvement. If only a part of the asset is changed, this is more likely to be a deductible repair.⁵⁴ However, what will constitute a change to an entirety is not clear.⁵⁵ To promote clarity and consistency, perhaps tax legislation,

in determining whether a homeowner (who would be regarded as a registered entity under the alternative proposals) should be entitled to claim input tax credits for repair costs.

⁵¹ *Income Tax Assessment Act 1997* (Cth) s 23-10.

⁵² ATO, *Income Tax: Deductions for Repairs* (n 50).

⁵³ This appears to be the case also in New Zealand and the UK.

⁵⁴ The distinction between an entirety and subsidiary was discussed in *Lurcott v Wakeley and Wheeler* [1911] 1 KB 905.

⁵⁵ For example, in *Elite Investments Ltd v Davstone (Holdings) Ltd* [1980] 1 QB EGLR, the cost of replacing an entire room was found to be a repair, whereas replacement of an entire aluminium cladding of commercial premises in *Credit Suisse v Beegas Nominees* [1994] EGLR 76 was found to be an improvement. Whilst these are cases from the UK, they have often been referred to in Australia and New Zealand in determining whether changes made to an asset are repairs or improvements.

regulations or even tax administration rulings could be adopted to differentiate repairs and improvements by reference to the relative cost of the expense of making a change to residential premises compared to the value of the relevant residential premises. For ease of simplicity, a proxy that could be used for the value of residential premises is its net annual value, which is determined on an annual basis for local tax purposes (see Section 6.6). The higher the cost of the expense in proportion to its value, the more likely the cost would be regarded as an improvement rather than a repair.

GST/VAT is generally payable in relation to fees charged to acquire property, such as lawyer's fees and conveyancing costs paid in relation to the transfer of title of residential premises, provided that the services are supplied by registered entities, as these are taxable professional services. Input tax credits should be available to homeowners when they incur lawyer's fees or conveyancing costs in connection to the transfer of title of residential premises, as following the logic of the alternative proposals would involve treating the homeowner as a registered entity. Further, incurring lawyer's fees or conveyancing costs would relate to the homeowner's consumption of the residential premises.

It has been highlighted by Van Brederode that, where input tax credits are claimable, such as in relation to renovations, 'private individuals would need to keep and maintain records in order to be able to exercise their right of deduction at the time of closing'.⁵⁶ On face value, it might seem that this would be likely to result in a large extra administrative burden for homeowners. Tax administrations tend to only require taxpayers to keep general records

⁵⁶ Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

relating to their tax affairs for a certain number of years. In Australia, for example, taxpayers must keep general tax records for five years.⁵⁷

However, the requirement to keep records for the purpose of claiming input tax credits would not be dissimilar to requirements imposed for capital gains tax ('CGT') purposes. For example, in Australia, a taxpayer's main residence is usually exempt from CGT, but records should still be kept (either in hard copy or electronic format)⁵⁸ by homeowners, in case this exemption no longer applies at some point in the future (this might be the case if a homeowner later uses their home to produce income). For CGT purposes, records should be kept of the purchase and sale contract and all expenses relating to the purchase and sale, as well as of all costs of owning the residential premises, and capital expenditures on improvements.⁵⁹

If homeowners do not want the burden of keeping records, they could simply not claim input tax credits.⁶⁰ Alternatively, a type of presumptive input tax credit entitlement system could be introduced (or any existing one in operation could be adapted) for the purpose of claiming input tax credits. Zu has explained that:

⁵⁷ 'Keeping Your Tax Records', ATO, Australian Government (Web Page, 3 January 2019)

<<https://www.ato.gov.au/individuals/income-and-deductions/in-detail/keeping-your-tax-records>>.

⁵⁸ ATO, *Income Tax: Record Keeping and Access — Electronic Records* (TR 2018/2, 14 February 2018). Generally, for Australian taxation purposes, records can be retained in hard copy or electronically.

⁵⁹ 'Keeping Records for Real Estate', ATO, Australian Government (Web Page, 30 March 2019) <<https://www.ato.gov.au/General/Capital-gains-tax/Your-home-and-other-real-estate/Keeping-records-for-real-estate/#Recordsforyourhome>>.

⁶⁰ Homeowners may opt to not claim input tax credits in relation to minor alterations, for example, but they would probably want to claim input tax credits relating to the purchase price and any major alterations. In Australia, homeowners owning homes for investment purposes would usually already keep records of these costs for CGT purposes. Owners of premises owned for residential purposes are generally eligible to claim the main residence exemption: *Income Tax Assessment Act 1997* (Cth) sub-div 118-B.

[p]resumptive input tax entitlement regimes seek to simplify the calculation of VAT liability by removing the need to record ... input tax on all acquisitions and instead allowing qualifying persons to substitute a single presumptive input tax entitlement.⁶¹

A schedule of amounts claimable under such a regime could be introduced, including items such as a fixed amount for an addition of a balcony, addition of a bedroom, and so on. If homeowners desire to claim more than the fixed amount, they would need to keep records. Obviously, a disadvantage with such a regime would be its inaccuracy. Homeowners would often claim more or less than the GST/VAT that they paid in connection with the improvements. This problem would need to be weighed against the cost of complexity if input tax credits were allowed in connection with the cost of improvements but such a presumptive regime was not introduced.

In some of the proposals considered in Section 6.2, it is envisaged that the claiming of input tax credits be facilitated through the GST/VAT paid in relation to the purchase of the residential premises being recorded on its title. For example, Conrad and Grozav proposed that 'VAT would be recorded as part of the closing documents'.⁶² Similarly, Van Brederode has suggested that a deferred input tax credit claim could be verified if the VAT paid on purchase was registered 'in the real estate registers that most jurisdictions require either at the local or regional level'.⁶³

⁶¹ Yige Zu, 'VAT/GST Thresholds and Small Businesses: Where To Draw the Line?' (2018) 66(2) *Canadian Tax Journal* 309, 339. Zu explains how these regimes sometimes apply in the case of small businesses.

⁶² Conrad and Grozav (n 18) 90. Earlier, Conrad had similarly proposed that 'when the real estate is sold, the title search (or deed) should contain prior first payment of the tax': Conrad, 'Value Added Taxation and Real Estate' (n 11) 16.

⁶³ Van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

The Torrens title system of land transfer and registration used in a number of jurisdictions, particularly in Commonwealth jurisdictions including Australia, New Zealand, and some Canadian provinces, could be adapted so that GST/VAT paid on the purchase of residential premises is recorded on the title documents evidencing their ownership.⁶⁴ This might be possible, particularly in Australia where GST revenue is collected by the government and distributed to the states and territories as part of Australia's formal system of horizontal fiscal equalisation. In this situation, the states and territories might be interested in keeping records of such information. However, it should be noted that the equity of which states and territories receive which amounts of GST revenue has been an ongoing, contentious issue.⁶⁵

Regarding the quantum of input tax credit claimable, Conrad and Grozav have recommended that:

inflation adjustments are necessary to adjust the VAT paid at the time of purchase to a current credit at the time of sale. This difficulty can be reduced to some degree by using one cumulative inflation index (presumably the GDP deflator) and publishing the value of that index annually.⁶⁶

Making adjustments for inflation appears logical, as \$1 paid today is not the same as \$1 paid in five years' time. However, this would add an extra layer of complexity, especially given that the rate of inflation generally tends to change from time to time. Perhaps there are lessons to learn from the Australian experience with indexing the cost base to take into account the inflationary effect for CGT purposes. As a result of the Ralph Report recommendations, the

⁶⁴ For example, in the Australian State of Victoria, according to the *Transfer of Land Act 1958* (Vic) s 27(1), '[t]he Registrar must keep a Register of land which is under the operation of the Act'.

⁶⁵ See, for example, Productivity Commission, Australian Government, *Horizontal Fiscal Equalisation* (Inquiry Report No 88, 2018).

⁶⁶ Conrad and Grozav (n 18) 94.

income tax law in Australia was amended so that it is not possible to index the cost base of CGT assets acquired from 21 September 1999.⁶⁷ Instead, a system of discounting the capital gain was introduced.⁶⁸ Calculating the discount capital gain is regarded as a simpler step than indexing the cost base for CGT purposes. However, a cost of this system is its inequity. As high-income persons are more able to afford residential premises, they are more likely to take advantage of the ability to discount the capital gain than low-income earners.⁶⁹ This inequity could be replicated if the alternative proposals were implemented and homeowners were allowed to claim deferred input tax credits, as it is more likely that such a system would benefit higher-income than lower-income persons.

6.5 *Should homeowners be entitled to claim deferred input tax credits?*

In Section 6.3, a discussion was provided of issues relating to the quantum of input tax credits claimable and how these could be claimed, assuming that homeowners are entitled to claim deferred input tax credits in relation to their purchase of residential premises. However, it will be suggested in this section that if sales of residential premises are included within the GST/VAT base, then homeowners should not be entitled to claim input tax credits. The following example will be used to demonstrate why this is the case. Assuming a 10 per cent GST/VAT rate, a homeowner might purchase residential premises for AUD1 million, pay AUD100,000 GST/VAT and sell the residential premises 10 years later for AUD2 million. If this

⁶⁷ See *Income Tax Assessment Act 1997* (Cth) divs 114 and 115; John Ralph, Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable* (Treasury, Australian Government, 1999) Recommendation 18.1(b) ('Ralph Report').

⁶⁸ Ralph Report (n 67) Recommendation 8.2(a).

⁶⁹ By virtue of *Income Tax Assessment Act 1997* (Cth) sub-div 118-B, the effect of the main residence exemption is that homeowners generally do not pay CGT when they sell residential premises that they have regarded as their main residence. Therefore, in the context of residential premises, discounting the capital gain generally only applies to individual investors, trusts and complying superannuation funds who have held residential premises for at least 12 months.

homeowner were entitled to the full AUD100,000 GST/VAT paid as input tax credits, the neutral net GST/VAT result would not reflect that the homeowner has effectively consumed some of the residential premises over the 10-year period. If the residential premises were a pure investment, then the correct result would be achieved.⁷⁰ However, residential premises have both an investment and a consumption component.⁷¹

It is possible to estimate the value of the consumption benefits that flow from the ownership of residential premises. For this purpose, we assume that homeowners live in the residential premises that they own. The accommodation services that the residential premises theoretically provide to the homeowner have a value that can be measured on a regular basis. For example, the accommodation services provided by residential premises in the Australian State of Victoria could be determined to be the net annual value (or imputed rent). This is calculated to be 5 per cent of the capital-improved value, which is determined on 1 January each year for rating purposes.

As the capital-improved value is determined on an annual basis, it is possible for it to appreciate or depreciate in the following year.⁷² GST/VAT could be applied to the net annual value. Using such an approach, homeowners should not be charged GST/VAT upfront on their purchase, as they would pay GST/VAT on an annual basis. They should also not be entitled to

⁷⁰ Conrad and Grozav have recognised that, consistent with VAT being a consumption tax, '[i]nvestment (savings) are not taxed ... Stocks, bonds and other financial instruments are explicitly exempt from VAT taxation': Conrad and Grozav (n 18) 85–6.

⁷¹ Several studies have also recognised that residential premises may have both a consumption and investment component: see Robert F Conrad, 'Commentary' (2009) 63 *Tax Law Review* 471, 473; Conrad and Grozav (n 18) 91; Millar (n 47) 260; Schenk, Thuronyi and Cui (n 6) 409.

⁷² Whilst the capital-improved value can fluctuate from year to year, on average over time the value of residential premises in metropolitan cities generally increases. For example, the per annum compound annual increase in the price of residential premises in Melbourne over a 14-year period, calculated using data published by the Australian Bureau of Statistics, is 1.067 per cent: 60.7 (Residential Property Price Index for September 2003 Quarter) $\times (1 + x)^{14} = 150.4$ (Residential Property Price Index for September 2017 Quarter), where x is 6.7 per cent.

input tax credits, as homeowners would have paid the amount of GST/VAT relating to the consumption component of the residential premises. GST/VAT could be collected on an annual basis through an agency, as mentioned in Section 6.3. In Australia, it might be appropriate for the GST/VAT to be collected on a state basis. The State Revenue Offices may be appropriate agencies to collect this revenue, as they hold information on all owners of residential premises, including the purchase price of residential premises, and information for land tax purposes (this tax applies when people own more than one property).

6.6 Conclusion

Whilst it is possible from an administrative perspective for all sales of residential premises to be brought within the GST/VAT base, and there are multiple ways in which GST/VAT on these sales can be collected, this would give rise to housing affordability concerns. Homeowners would be faced with having to pay GST/VAT on purchases of used residential premises, an area of the property market currently not subject to GST/VAT. The price of used residential premises would be likely to rise if they were included within the GST/VAT base, as the price of residential premises appreciates.

A potential increase in the price of used residential premises as a result of sales of all residential premises being included within the GST/VAT base might be somewhat offset, however, by potential purchasers becoming less interested in purchasing used residential premises. Further, allowing homeowners the ability to claim input tax credits, as per the recommendations in the GST/VAT literature (see Section 6.2), would help to 'sweeten the deal' for homeowners, as the availability of input tax credits might ultimately give rise to a neutral net GST/VAT result for the homeowner. For example, if Homeowner One purchased

residential premises for AUD1 million, and sold those residential premises 10 years later to Homeowner Two for AUD2 million, assuming a 10 per cent GST/VAT rate, Homeowner One would pay AUD100,000 GST/VAT when they purchase the residential premises, but then receive AUD100,000 back as input tax credits 10 years later.

However, the relevant recommendations summarised do not take into account the fact that residential premises have both a consumption and an investment component. Allowing the homeowner full input tax credits would be to treat the residential premises as a pure investment, as there would be no net GST/VAT effect of a homeowner paying GST/VAT on the purchase of residential premises and then later receiving this GST/VAT as a deferred input tax credit. The only significant change that would result from implementation of the relevant recommendations is added administrative complexity regarding the collection of GST/VAT on residential premises, and also particularly regarding the administration of input tax credit claims available to homeowners. The fact that homeowners enjoy accommodation in residential premises and that this accommodation has a value that can be measured on a regular basis would not be considered. A better approach would be for homeowners to not be eligible to claim input tax credits, and a more appropriate result would be achieved, from a consumption tax perspective, if the value of residential premises were included in the GST/VAT base on a yearly basis.

Including sales of used residential premises within the GST/VAT base would result in a new revenue stream for the government. Using the details included in the above example, the government would collect AUD100,000 from Homeowner One's purchase, and AUD200,000 from Homeowner Two's purchase. If the proposals discussed in Section 6.2 were implemented, these amounts collected would later be returned to homeowners as input tax

credits when they later sell the residential premises. However, the amount of GST/VAT revenue that the government would gain each time residential premises are sold would generally increase as the value of residential premises appreciate. The amount of GST/VAT revenue raised by the government from including used residential premises in the GST/VAT base would be greater if homeowners were not eligible to claim input tax credits. As an approximation, using results reported by the Australian Bureau of Statistics for Melbourne in the December 2018 quarter, this would result in the government raising an extra AUD627 million from sales of used residential premises in that region for that quarter (assuming homeowners are not eligible to claim input tax credits).⁷³

⁷³ '6416.0 — Residential Property Price Indexes: Eight Capital Cities, Dec 2018', *Australian Bureau of Statistics* (Web Page, 19 March 2019) Tables 4 and 5 <<https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6416.0Dec%202018?OpenDocument>>. The relevant calculations are as follows: Median price of established house transfers (Unstratified): Melbourne (AUD706,000) x Number of established house transfers: Melbourne (8,887) = AUD6,274,222,000 x 10% GST/VAT = AUD627,422,200 GST/VAT revenue.

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Chapter 7: China's VAT Treatment of Consumer-to-Consumer (C2C)

Supplies of Residential Premises*

7.1 Introduction

The model GST/VAT is a broad-based consumption tax applying generally to goods and services acquired in market transactions.¹ However, in most jurisdictions that have a GST/VAT C2C supplies of residential premises² are generally excluded from GST/VAT. The main reason for this is that it has been regarded as administratively and politically difficult to tax C2C supplies of residential premises.³ For simplicity reasons, in many jurisdictions the first sale of residential premises is generally subject to GST/VAT and future sales of residential premises between otherwise unregistered consumers as well as residential leases are considered 'out of scope' supplies not subject to GST/VAT.

The exclusion of C2C supplies of residential premises from GST/VAT distorts investment and consumption decisions and drives up the price of residential premises. There is a clear bias in

* This chapter is in preparation to be submitted to a journal for publication.

¹ See, for example, Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) 5(3) *International Tax and Public Finance* 399, 403; Kathryn James, *The Rise of the Value-Added Tax* (Cambridge University Press, 2015) 40–1; Ine Lejeune, 'Designing VAT/GST Law to Be Effective and Efficient: A Global Benchmarking of VAT/GST Systems' in Thomas Ecker, Michael Lang and Ine Lejeune (eds), *The Future of Indirect Taxation: Recent Trends in VAT and GST Systems around the World* (Kluwer Law International, 2012) 723; OECD, *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (2020) 20 ('*Consumption Tax Trends 2020*'); Robert F van Brederode, 'Preface and Acknowledgements' in Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) xxv.

² In taxation policies in China, there is usually no distinction made between terms such as 'house' and 'apartment'. Instead, the terms 'house' and 'housing unit' are generally both used to refer to a wider category of housing which could include a house, apartment, or villa (generally, most people in China live in apartments). For the purposes of this chapter, the term 'residential premises' is used to denote this wider concept of housing that the relevant taxation policies in China refer to.

³ See, eg, James (n 1) 60; Alan A Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988) 56; Robert F van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' in Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) 1, 16–19 ('Theory and Practice of VAT Treatment of Real Estate').

the tax systems of many countries in favour of home ownership as supplies of residential premises are often treated preferentially.⁴ The treatment of C2C supplies of residential premises as outside the scope of GST/VAT is one aspect of this bias. It encourages the purchase of residential premises as opposed to other assets, as it means that any appreciation in the value of residential premises is kept outside of the GST/VAT base.⁵ Increased demand for residential premises in turn leads to an increase in their price. This leads to residential premises being less affordable and greater inequality.

For most individuals, residential premises are one of their largest items of consumption expenditure. In metropolitan areas at least the value of residential premises generally increases over time, and there are significant concerns in many jurisdictions regarding their affordability. Internationally there have been recommendations in the GST/VAT literature for all supplies of residential premises to be subject to GST/VAT.⁶ There is also a need for extra

⁴ Poddar has noted that ‘home ownership is viewed in many jurisdictions as an important policy objective and is encouraged through fiscal instruments’: Satya Poddar, ‘Taxation of Housing Under a VAT’ (2010) 63(2) *Tax Law Review* 443, 444. For a list of tax concessions that encourage home ownership in Australia see Fiona Martin, ‘The Case for Specific Exemptions from the Goods and Services Tax: What Should We Do about Food, Health and Housing?’ (2020) 18(1) *eJournal of Tax Research* 99, 117. Regarding the ‘home ownership’ bias in income tax systems, see Francesco Figari, Alari Paulus, Holly Sutherland, Panos Tsakloglou, Gerlinde Verbist and Francesca Zantomio, ‘Removing Homeownership Bias in Taxation: The Distributional Effects of Including Net Imputed Rent in Taxable Income’ (2017) 38(4) *Fiscal Studies* 525.

⁵ It has been recognised in the GST/VAT literature that residential premises generally appreciate in value over time: See, for example, Wei Cui, ‘Learning to Keep the Consumption Tax Broad: Australian and Chinese VAT Design for the Housing Sector’ in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011) 369 (‘Learning to Keep the Consumption Tax Broad’); Wei Cui, ‘Objections to Taxing Resale of Residential Property under a VAT’ (2012) 137(7) *Tax Notes* 777, 779 (‘Objections to Taxing Resale’); OECD, *Housing Taxation in OECD Countries* (OECD Publishing, 2022) 14; Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015) 409.

⁶ See, e.g., Committee on Value Added Tax of the American Bar Association Section of Taxation, *Value Added Tax: A Model Statute and Commentary* (Tax Management Education Institute, 1989) 76–7; Robert F Conrad, ‘The VAT and Real Estate’ in Malcolm Gillis, Carl S Shoup and Gerardo P Sicat (eds), *Value Added Taxation in Developing Countries* (World Bank, 1990) 95, 98–102; Robert Conrad and Anca Grozav, ‘Real Property and VAT’ in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 81, 90; Poddar (n 4) 469–70; Van Brederode, ‘Theory and Practice of VAT Treatment of Real Estate’ (n 3) 16.

revenue in response to increased government expenditure because of the global Covid-19 crises.⁷

The only country exception to the current general GST/VAT treatment of residential premises can be found in China, where since 2016 some C2C supplies of residential premises have been subject to VAT.⁸ The unique VAT treatment in China has not been discussed in detail in the international VAT literature.⁹ This is the first manuscript in English where the focus is specifically on discussing how the VAT applies to some of these supplies in China. It will explore whether this VAT treatment provides a model for the rest of the world to follow.

Wolfers has noted an increased influence of the BIC countries (Brazil, India, and China) on global indirect tax developments and that measures adopted in these countries 'may be a more reliable signpost to the future'.¹⁰ This study of the VAT treatment of C2C supplies of residential premises in China may provide policy-makers with ideas for how these supplies could be included in the GST/VAT base in other countries, providing an additional source of

⁷ The need for governments to secure new tax revenue to fund expanding social welfare programs and medical services has been recognised by Sadiq and Krever: Kerrie Sadiq and Richard Krever, 'Does Tax Policy Fit in the Portfolio of COVID-19 Responses?' (2021) 33(2) *Pacific Accounting Review* 212. Cui has recognised that the 'revenue potential of taxing residential resale... is great': Cui, 'Objections to Taxing Resale' (n 5) 778.

⁸ 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No 36, 23 March 2016.

⁹ There have been other publications where the Business Tax to VAT reform in China has been discussed more generally. See, eg, Wei Cui, 'China's Business-Tax-to-VAT Reform: An Interim Assessment' [2014] (5) *British Tax Review* 617, 620–1; Jianjun Li and Xuan Wang, 'Does VAT Have Higher Tax Compliance than a Turnover Tax? Evidence from China' (2020) 27(2) *International Tax and Public Finance* 280, 283–4; Shirley (Yinghua) Shen and Richard Krever, 'China's VAT Reform: Experiences and Lessons Learned' (2017) 28(2) *International VAT Monitor* 147, 147–9 ('China's VAT Reform'); Zhiyuan Wang, Jagdeep Singh-Ladhar and Howard Davey, 'Business Tax to Value-Added Tax Reform in China' (2019) 31(4) *Pacific Accounting Review* 602; Hao Zhong, 'The Choice of China's Business Tax to Value Added Tax Reform: The Traditional VAT Model or the Modern GST Model?' (MCom in Accounting Thesis, University of Canterbury, 2016) ('The Choice of China's Business Tax to Value Added Tax Reform'). There have also been publications where the focus has been on other aspects of the VAT in China. For example, Shen and Krever have noted that the VAT system in China is 'very unique due to the broad application of VAT to financial services and immovable property and their related services', but did not discuss the VAT treatment of immovable property in detail: Shen and Krever, 'China's VAT Reform' (n 9) 147.

¹⁰ Lachlan Wolfers, 'Five Years of Rapid VAT Evolution: How Have Predictions Held Up?' (2020) 30(Supp 7) *International Tax Review* 91.

revenue.¹¹ It may also provide ideas for how this treatment could be adapted and applied more generally in considering how other C2C supplies may be brought within the GST/VAT base.¹²

The focus in this chapter will be on relevant urban policies, as these affect most of the population in China.¹³ The VAT treatment of C2C supplies of residential premises in China will be discussed in Section 7.2, followed by analysis in Section 7.3 regarding the relevance of this approach as a model for other jurisdictions with a GST/VAT.¹⁴

7.2 The VAT Treatment of C2C Supplies of Residential Premises in China

7.2.1 The Former Dual Business Tax-VAT System

The application of VAT to C2C supplies of residential premises in China is a consequence of the incorporation in 2016 of a previously separate tax, the Business Tax (BT) into the VAT. The original version of the VAT was adopted in 1984 when income taxes and VAT were introduced to replace profit appropriations from state-owned enterprises, after a shift away from

¹¹ Likewise, Shen and Krever have anticipated that revenue authorities around the world would take an interest in the VAT system in China, with relevant reforms in China ‘potentially encouraging reconsideration of the optimal VAT treatment of financial supplies and immovable property elsewhere’: Shen and Krever, ‘China’s VAT Reform’ (n 9) 147.

¹² This is particularly important given that the growth of the use of digital platforms and online marketplaces facilitating trade between consumers has given rise to questions about whether GST/VAT should apply to some of these supplies, and if so, how could this be done. The OECD has recognised that C2C supplies are becoming more common and are being facilitated by e-commerce. See OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015) 56.

¹³ In China, different legal, economic, and social systems apply to rural and urban populations. See Kam Wing Chan and Yanning Wei, ‘Two Systems in One Country: The Origin, Functions and Mechanisms of the Rural-Urban Dual System in China’ (2019) 60(4) *Eurasian Geography and Economics* 422, 423.

¹⁴ The focus of this chapter is the VAT treatment of C2C supplies of residential premises in China. It does not consider other taxes which might apply to the supply of residential premises. A list of taxes which are levied on property in China appears in OECD, *Making Property Tax Reform Happen in China: A Review of Property Tax Design and Reform Experiences in OECD Countries* (OECD Publishing, 2021) 29. Since 2011 there have been separate limited property taxes in Shanghai and Chongqing, levied at low rates. These taxes appear to have had little impact on revenue collection and property prices. In October 2021 the Standing Committee of the National People’s Congress authorised the rollout of a pilot property tax in some regions.

socialist principles towards a quasi-market economy and private ownership of businesses.¹⁵ The preliminary versions of the taxes proved inadequate for the government's revenue needs and the system was entirely overhauled in 1994 when, in the course of a compromise arrangement between the central and provincial governments, separate taxes were levied on supplies of goods and supplies of services, with the VAT limited to supplies of goods and a BT applicable to supplies of services. Supplies of immovable property, including the transfer of new and used residential premises, along with supplies of services and intangible property were included in the BT base, which was assigned to the provincial governments. Several different rates applied to different types of services.¹⁶

The inclusion of supplies of immovable property in the BT system rather than in the VAT was consistent with the legal status of immovable property in China. All land in China is state owned.¹⁷ Land use rights can be granted for up to 70 years for residential purposes, and can

¹⁵ Li Na, Jonathan Teoh and Richard Krever, 'VAT Reform in China Reaches a Critical Turning Point' (2016) 82(4) *Tax Notes International* 387, 387; Li Jin and Richard Krever, 'Globalization and Modernization as Drivers for Tax Reform in the Socialist Market Economy' (2010) 11(2) *Comparative Tax Law and Culture* 687, 689–92; Yan Xu and Richard Krever, 'Applying VAT to Financial Services in China: Opportunities for China and Lessons for the World?' (2016) 45(1) *Australian Tax Review* 38, 38.

¹⁶ See Dongsheng Jin and Weifu Jin, 'On the Development Strategy of China's Value-Added Tax (VAT) Reform' (2013) 3 *Journal of China Tax and Policy* 226, 231–2; Zhong, 'The Choice of China's Business Tax to Value Added Tax Reform' (n 9); Yan Xu, 'China's Turnover Taxation in the Pre-VAT Period: 1949-83' (2012) 1(2) *World Journal of VAT/GST Law* 149, 155. Earlier forms of BT had existed in China. See Lorenzo Riccardi and Giorgio Riccardi, *China VAT Regulations and Reforms* (Springer, 2020) 34–6.

¹⁷ Singapore is another country with a high percentage of state-owned properties, but in Singapore the sale and lease of residential properties is exempt from GST: Inland Revenue Authority of Singapore, *GST: Guide for Property Owners and Property Holding Companies* (IRAS e-Tax Guide, Inland Revenue Authority of Singapore, 8 January 2021) para 2.1.

be transferred, leased, or mortgaged.¹⁸ These land use rights were regarded as intangibles under the BT, whilst the rental of immovable property was taxed as a service.¹⁹

Though it raised considerable revenue for the provinces, the BT proved to be a very distorting and economically inefficient tax. Unlike the VAT, which had a mechanism to relieve businesses from VAT included in the price of acquisitions through a credit mechanism, the BT applied in a cascading manner, with tax imposed on tax in the case of business-to-business supplies.²⁰

In 2011, a program was announced to replace the BT with VAT to eliminate this cascading effect, broaden the VAT base, improve the efficiency of tax collection, as well as improve the international competitiveness of the country and stimulate the growth of the services sector.²¹ It has also been suggested that a driver for this reform was fiscal concerns. The services economy was growing significantly. Most of the BT revenue was allocated to provincial governments, whilst most of the VAT revenue was received by the central government.²² The replacement of BT with VAT was rolled out to target supplies in different cities and involving specific industries. In 2016 this process was complete, and the BT was fully replaced by VAT. China's VAT system has been described as amongst the broadest based

¹⁸ KPMG, 'China's New VAT Rates & Rules – Real Estate & Construction Industry Impacts', *China Tax Alert, Issue 12* (March 2016) ('China's New VAT Rates & Rules'); Lachlan Wolfers and Curtis Ng, 'VAT Reform in China: Impact on Construction and Real Estate' (2013) 24(1) *International Tax Review* 22, 22. State-owned land cannot be privately owned: Civil Code of the People's Republic of China, Art 242.

¹⁹ See Wei Cui, 'Business Tax: China's Quasi-VAT' (2009) 20(4) *International VAT Monitor* 291, 292 ('China's Quasi-VAT'); Cui, 'Learning to Keep the Consumption Tax Broad' (n 5) 372. Cui provides a more thorough explanation of the former BT treatment of immovable property, and changes to this treatment over time: 'Learning to Keep the Consumption Tax Broad' (n 5) 372–5.

²⁰ See Cui, 'China's Quasi-VAT' (n 19) 291; Li and Wang (n 9) 283; Yan Xu, 'A Historical Account of Taxes on Goods and Services in the Transition to Post-Socialist China' in Peter Harris and Dominic de Cogan (eds), *Studies in the History of Tax Law, Vol 7* (Hart Publishing, 2015) 393, 395.

²¹ Shen and Krever (n 9) 147–8.

²² See Li and Wang (n 9) 283; Yang Ping and Jin Wanjun, 'Ideas on the Perfection of China's Value Added Tax System' (2000) 11(3) *International VAT Monitor* 106, 108; Riccardi and Riccardi (n 16) 37; Shen and Krever (n 9). It is worth noting that in China the VAT base is also adopted for other tax related social policies. For example, the tax base of the Education Surcharge mirrors the VAT, but the original aim for levying this Education Surcharge was to add to consolidated revenue, to fund a national nine-year free education program.

systems in the world.²³ Included within the VAT base are supplies which have generally been regarded as exempt in most other jurisdictions with a GST/VAT, including supplies of financial and insurance services and some C2C supplies of residential premises.²⁴

7.2.2 *The Former BT Treatment*

There are broad similarities between the former BT treatment of C2C supplies of residential premises and the current VAT treatment of these supplies. After the privatisation of the housing market in China in the 1990s and a recession triggered by the Asian financial crisis in 1997, the government had a policy of encouraging the purchase of residential premises. Cui has observed that individuals who purchased ‘ordinary residential premises’ and lived in these for more than one year could sell them ‘without paying BT’.²⁵

A policy objective in China has been to encourage the consumption of ‘ordinary’ residential premises which have been described as ‘medium and small sized ordinary commodity housing at medium and low prices’.²⁶ The concept of ‘ordinary residential premises’ is also relevant to the current VAT treatment (see Section 7.2.3). Supplies of this type of residential premises are generally treated preferentially for the purposes of various tax regimes.²⁷ According to

²³ KPMG, *China: VAT Essentials Guide 2021* (2021) 6 (*‘China: VAT Essentials Guide’*).

²⁴ Shen and Krever (n 9). The VAT treatment in China of financial and insurance services has been discussed elsewhere in the VAT literature. See, eg, Na Li and Richard Krever, ‘Loan Intermediary Services: China’ in Robert F van Brederode and Richard Krever (eds), *VAT and Financial Services: Comparative Law and Economic Perspectives* (Springer, 2017) 109; Yan Xu and Richard Krever, ‘VAT Compliance Burdens in the OECD and China’ [2021] (3) *British Tax Review* 328 (*‘VAT Compliance Burdens’*).

²⁵ Cui, ‘Learning to Keep the Consumption Tax Broad’ (n 5) 373.

²⁶ 国办发[2006]37号国务院办公厅转发建设部等部门关于调整住房供应结构稳定住房价格意见的通知 [Circular of the General Office of the State Council on Distributing the Opinions of the Departments Including the Ministry of Construction on Adjusting the Housing Supply Structure and Stabilising the Housing Price] (People’s Republic of China) General Office of the State Council, No 37, 24 May 2006.

²⁷ This preferential tax treatment of supplies of ordinary residential premises is not just a focus of the former BT regime and current VAT regime. For example, purchasers of ordinary residential premises are taxed at preferential rates for deed tax purposes in some circumstances. See 财税[2010]94号财政部、国家税务总局、住房和城乡建设部关于调整房地产交易环节契税个人所得税优惠政策的通知 [Notice of the Ministry of

Cui the concept of 'ordinary' residential premises 'was intended to capture the type of apartments that average purchasers of urban housing could buy'.²⁸ Most people in China live in 'ordinary' residential premises. As a matter of practice, an individual purchasing residential premises will know whether they are 'ordinary' based on records which regional Housing Bureaus retain of data recorded about residential premises when they are first built. The exact details of what is an 'ordinary residential premises', referred to as a 'standard', vary in different regions and change over time.

By 2005, the real estate market in China had become attractive to speculative investors, and the price of residential premises had increased dramatically.²⁹ The State Council recognised that 'the scale of real estate investment is too large and ... the price is in excessive growth'.³⁰ The government was concerned that investment in residential premises would have an upward effect on their price. Whilst the purchase of ordinary residential premises was to be encouraged, speculative investment was to be discouraged.³¹

If an individual sold residential premises less than two years after purchasing them, they would be subject to BT, whereas if the residential premises were held for two years or more, the sale of the residential premises would be exempt from BT if they were 'ordinary'

Finance, the State Administration of Taxation and the Ministry of Housing and Urban-Rural Development on Adjusting the Preferential Policies on Deed Tax and Individual Income Tax during Real Estate Transactions] (People's Republic of China), Ministry of Finance, State Administration of Taxation and Ministry of Housing and Urban-Rural Development, No 94, 29 September 2010, l.

²⁸ Cui, 'Learning to Keep the Consumption Tax Broad' (n 5) 374.

²⁹ This has been recognised by Cui: *ibid* 374.

³⁰ 国办发[2005]26号国务院办公厅转发建设部等部门关于做好稳定住房价格工作意见的通知 [Circular of the General Office of the State Council on Forwarding the Opinion of Such Departments as the Ministry of Construction on Doing a Good Job of Stabilising House Prices] (People's Republic of China) General Office of the State Council, No 26, 9 May 2005. In China, the State Council is the main executive organ of Government: Riccardi and Riccardi (n 16) 2.

³¹ The long-term owner occupation of ordinary residential premises is also encouraged by the exempt treatment of C2C supplies of ordinary residential premises under the current VAT (see Section 7.2.3) and by other taxation policies relating to residential premises. Despite policies aimed at discouraging property speculation in China, the price of residential premises continues to grow significantly.

residential premises, or subject to BT on the margin between the sales price and the purchase price if they were not ordinary residential premises.³² The letting of residential premises was subject to a 1.5% BT rate.³³ At the time leading up to immovable property being included in the VAT base, it was speculated that any policies resulting in the sale or letting of residential premises being exempt from VAT where BT currently applied would result in an erosion of the tax base and might 'stimulate demand and prices which the government is currently seeking to contain'.³⁴

7.2.3 *The Current VAT Treatment*

Currently individuals are generally required to charge VAT in China when they supply goods, services, intangible assets, or immovable property.³⁵ They are not required to be conducting a business activity to do this.³⁶ This is a unique feature of the VAT system in China. In other jurisdictions with a GST/VAT, an individual is generally not able or required to register for GST/VAT unless he or she is conducting a business activity. GST/VAT is generally collected

³² 国办发[2005]26号国务院办公厅转发建设部等部门关于做好稳定住房价格工作意见的通知 [Circular of the General Office of the State Council on Forwarding the Opinion of Such Departments as the Ministry of Construction on Doing a Good Job of Stabilising House Prices] (People's Republic of China) General Office of the State Council, No 26, 9 May 2005 (n 30) III; 财税[2015]39号关于调整个人住房转让营业税政策的通知 [Circular on Adjusting Policies on Business Tax on Transfer of Housing by Individuals Transfers of Houses] (People's Republic of China) State Administration of Taxation and Ministry of Finance, No 39, 30 March 2015, I.

³³ 财税[2008]24号财政部、国家税务总局关于廉租住房经济适用住房和住房租赁有关税收政策的通知 [Notice of the Ministry of Finance and State Administration of Taxation on Tax Policies on Low-rent Housing, Economically Affordable Housing and Lease of Housing] (People's Republic of China) Ministry of Finance, No 24, 3 March 2008, II(3).

³⁴ Wolfers and Ng (n 18).

³⁵ 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No 36, 23 March 2016 (n 8) Annex 1, Art 1; 中华人民共和国国务院令 第691号国务院关于废止《中华人民共和国营业税暂行条例》和修改《中华人民共和国增值税暂行条例》的决定 [Decision of the State Council on Abolishing the Interim Regulations of the People's Republic of China on Business Tax and Amending the Interim Value-Added Tax Regulations of the People's Republic of China] (People's Republic of China) State Council of the People's Republic of China, No 691, 19 Nov 2017, I.

³⁶ Wei Cui and Alan Wu, 'China' in Thomas Ecker, Michael Lang and Ine Lejeune (eds), *The Future of Indirect Taxation: Recent Trends in VAT and GST Systems around the World* (Kluwer Law International, 2012) 159, 165.

through businesses that are registered for GST/VAT which are usually entitled to a credit for any GST/VAT that they have paid in relation to their acquisitions. Final consumers are not entitled to these credits as they are not eligible to register for GST/VAT, meaning that they bear the full burden of the GST/VAT.³⁷ In China, this burden also rests with individuals, as they are not entitled to these credits. However, whether a person is required to charge VAT is not dependent on whether a business activity is conducted.

Generally, where a vendor supplies immovable property VAT is payable at the rate of 11%.³⁸ With respect to supplies of residential premises, this rate applies to the first sale of these residential premises from a business to a consumer.³⁹ Where residential premises are sold by individuals less than two years after purchase, the sales are subject to a 5% VAT rate. KPMG has noted that this is 'to encourage longer-term holdings in real estate assets, and to discourage market speculation'.⁴⁰ Where residential premises are held by individuals for two years or more and then sold, these sales are generally exempt from VAT. However, special rules apply regarding residential premises that are in Beijing, Shanghai, Guangzhou and Shenzhen. In these cities, sales of ordinary residential premises that have been held for two years or more are exempt whereas sales of non-ordinary residential premises that have been

³⁷ This is noted by Knotzer and Pfeiffer: Christian Knotzer and Sebastian Pfeiffer, 'Exemptions in VAT: A Theoretical Overview of Traditional and Modern VAT Systems' in Robert F van Brederode (ed), *Virtues and Fallacies of VAT: An Evaluation after 50 Years* (Kluwer Law International, 2021) 104, 129.

³⁸ 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No 36, 23 March 2016 (n 8) Annex I, Art 15(2).

³⁹ 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No 36, 23 March 2016 (n 8) Annex I, Art 15(2).

⁴⁰ KPMG, 'China's New VAT Rates & Rules' (n 18).

held for two years or more are subject to a 5% VAT rate on the difference between the sales price and the purchase price.⁴¹

As mentioned in Section 7.2.2, most people in China live in ‘ordinary’ residential premises. The exact details of what is an ‘ordinary residential premises’ vary in different regions and change over time. Residential premises that are not ‘ordinary’ residential premises are regarded as ‘non-ordinary’ residential premises.

The application of differentiated tax treatments dependent on the location of the residential premises is an approach which is consistent with the State Council’s policy in 2005 to control the price of real estate (see Section 7.2.2). In this policy it was outlined that to address the problem of property speculation differentiated treatments could be used and ‘suiting measures to local conditions’.⁴²

The VAT treatment of residential leases varies based on the circumstances. A 5% VAT rate generally applies to landlords leasing immovable property.⁴³ However, a 1.5% reduced VAT rate applies to individuals leasing residential premises.⁴⁴ The policy behind this tax treatment

⁴¹ 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No 36, 23 March 2016 (n 8), Annex 3, Article V.

⁴² See 国办发[2005]26号国务院办公厅转发建设部等部门关于做好稳定住房价格工作意见的通知 [Circular of the General Office of the State Council on Forwarding the Opinion of Such Departments as the Ministry of Construction on Doing a Good Job of Stabilising House Prices] (People’s Republic of China) General Office of the State Council, No 26, 9 May 2005 (n 30).

⁴³ 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No 36, 23 March 2016 (n 8), Appendix II, s9(5).

⁴⁴ 财政部、国家税务总局关于全面推开营业税改征增值税试点的通知 [Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Change from Business Tax to Value-Added Tax in an All-round Manner] (People's Republic of China) Ministry of Finance, No 36, 23 March 2016 (n 8) Appendix II s9(6)); 国家税务总局公告2016年第16号 [Announcement of the State Administration of Taxation on Issuing

appears to be to encourage investment in and supply of residential premises.⁴⁵ Where an individual collects rental income in a lump sum (typically 12 months in advance), and the monthly rental income after it has been evenly apportioned does not exceed CNY 100,000, the rental income received is exempt from VAT.⁴⁶

7.3 Analysis

The VAT treatment in China of C2C supplies of residential premises indicates that it is possible to include these types of supply in the GST/VAT base, providing a result more consistent with the GST/VAT policy objective of taxing consumption. Regarding C2C sales of non-ordinary residential premises in Beijing, Shanghai, Guangzhou and Shenzhen, only including the difference between the sales price and purchase price in the VAT base appears to be the correct treatment from a consumption tax perspective. Only the subsequent value added to residential premises (appreciation) should be subject to VAT. The previous value has already been subject to taxation.

A potential difficulty for policy-makers considering the possibility of using this approach as a model is that China is the only jurisdiction in the world where individuals supplying residential

the Interim Measures for the Administration of Collection of Value-Added Tax on Taxpayers' Provision of Immovable Property Operating Lease Services] (People's Republic of China) State Administration of Taxation, No 16, 1 May 2016, Art 4(2). In addition, residential premises leased by an individual are subject to the real estate tax at the rate of 4%: 财税[2008]24号财政部、国家税务总局关于廉租住房经济适用住房和住房租赁有关税收政策的通知 [Notice of the Ministry of Finance and State Administration of Taxation on Tax Policies on Low-rent Housing, Economically Affordable Housing and Lease of Housing] (People's Republic of China) Ministry of Finance, No 24, 3 March 2008 (n 33) II(3).

⁴⁵ See 国办发[2005]26号国务院办公厅转发建设部等部门关于做好稳定住房价格工作意见的通知 [Circular of the General Office of the State Council on Forwarding the Opinion of Such Departments as the Ministry of Construction on Doing a Good Job of Stabilising House Prices] (People's Republic of China) General Office of the State Council, No 26, 9 May 2005 (n 30) 5.

⁴⁶ 国家税务总局公告2019年第4号国家税务总局关于小规模纳税人免征增值税政策有关征管问题的公告 [Announcement of the State Administration of Taxation on Issues Concerning the Administration of Tax Collection under the Policy of Exempting Small-Scale Taxpayers from Value Added Tax] (People's Republic of China), State Administration of Taxation, No 4, 19 January 2019, IV.

premises but not conducting a business can register for GST/VAT purposes. In other jurisdictions, an entity can generally only register for GST/VAT if they are conducting a business activity.⁴⁷ There are other ways in which GST/VAT could be collected in relation to C2C supplies of residential premises in other jurisdictions without an individual having to register for GST/VAT. For example, GST/VAT could be collected through a lawyer or conveyancer at the time of transfer of the residential premises, or a government agency responsible for the property transfer, or by requiring the purchaser to pay GST/VAT directly to the tax administration.⁴⁸ It is likely that it would be possible in some jurisdictions for the tax administration's records to be linked to existing records of land transfer.⁴⁹ The tax administration could send a notice to individuals with the GST/VAT that is due after the transfer of land is recorded in a land transfer system. As tax administrations in some jurisdictions have moved to prefilling some areas of GST/VAT returns, or plan to move towards prefilling these, this could also occur in relation to C2C supplies of residential premises.⁵⁰

China has a different political system to some other jurisdictions where it might be more difficult for a government to gain political acceptance of the idea of including C2C supplies of residential premises in the GST/VAT base, and concerns may be expressed about the effect of this on housing affordability. Convincing voters that GST/VAT should be charged on C2C

⁴⁷ This has been recognised by Schenk et al: Schenk, Thuronyi and Cui (n 5) 445–6.

⁴⁸ These are suggestions that were made in Chapter 4.

⁴⁹ For example, the Torrens title system of land transfer and registration is used in several jurisdictions including Australia, New Zealand, and some Canadian provinces, and in some jurisdictions information is kept about the purchase of residential premises for stamp duty purposes. In New Zealand, people transferring property are generally required to provide tax information using a land transfer tax statement. This information is collected by a government department responsible for collecting information about properties which acts on behalf of the tax administration. It is used to ensure that property tax obligations are met: 'Land Transfer Tax Statements', *Land Information New Zealand (Web Page)* <<https://www.linz.govt.nz/land/land-registration/prepare-and-submit-your-dealing/land-transfer-tax-statements>> (accessed 26 February 2022).

⁵⁰ OECD, *Supporting the Digitalisation of Developing Country Tax Administrations* (OECD, 2021) 127.

supplies of residential premises is likely to be the biggest obstacle against including these supplies in the GST/VAT base in other jurisdictions, and policy-makers should consider the effect of this on particularly disadvantaged members of the community such as first homeowners and those on lower incomes. For first homeowners, GST/VAT may be seen as a barrier to entry into the property market. Grants could be offered to people meeting eligibility criteria to counteract the fact that it can be hard for people within this group to break into the homeownership market.⁵¹ How to take the concerns of low income earners and those who do not have an income into account would be more complex, as people in this category, such as retirees, may live in expensive properties.⁵² Reverse mortgages could be made available, repayable when the residential premises are later sold or after the death of the homeowner. Also, a threshold could be introduced, and GST/VAT could only apply to C2C supplies of residential premises above this threshold. This would obviously give rise to some complexity in administration and lower tax revenue being collected than would be the case if all C2C supplies of residential premises were subject to GST/VAT.

In China there are broad similarities between the current VAT treatment and former BT treatment of C2C supplies of residential premises. Other jurisdictions do not have a history of previously taxing C2C supplies of residential premises for GST/VAT purposes. However, other forms of tax, such as stamp duty and capital gains tax sometimes apply in relation to some C2C sales of residential premises.

⁵¹ For example, a First Homeowner Grant scheme was introduced at the time that GST was introduced in Australia to compensate for the increased costs of purchasing residential premises.

⁵² This was recognised in the Mirrlees Review report: Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review (Sir James Mirrlees, Chair), Vol 2* (Oxford University Press, 2011) 390.

Some aspects of the policy rationale for the VAT treatment in China may not necessarily be relevant to specifically adopt in other jurisdictions. For example, the differentiated tax treatment dependent on whether residential premises are held for less than or more than two years indicates what can be done if property speculation is a concern, and it is an example of how the Chinese government uses taxation policy to attempt to influence real estate prices. However, it may not necessarily be specifically relevant in some other jurisdictions, where residential premises may generally often be held for much longer periods of time.⁵³ The differentiating tax treatment dependent on where residential premises are located shows what can be done to encourage or discourage property investment in different regions, but it may not necessarily be relevant to policy-makers in some jurisdictions where a more uniform GST/VAT treatment already exists across the jurisdiction. Nevertheless, these details may still be of broad interest to policy-makers given that they show how GST/VAT systems can be used to encourage or discourage property investment.

It is unclear what compliance issues there are in China relating to the VAT treatment of C2C supplies of residential premises, but this could be an area for future research. Individual vendors and landlords may not be motivated to report VAT in relation to sales and leases of residential premises as they are not entitled to claim credits for VAT that they have paid in relation to purchases.⁵⁴ There may be specific ways in which individuals try to avoid paying VAT in relation to supplies of residential premises in China, for example through arranging to

⁵³ In other jurisdictions, whilst residential premises generally often appreciate over time in metropolitan areas at least, there may not be as significant a level of appreciation within such a short time.

⁵⁴ The study by Li and Wang found that the reform in China that was announced in 2011 to include within the VAT all supplies previously subject to BT had a significant effect on business-to-business companies but not business-to-consumer companies. Businesses had an incentive to report costs to claim credits for VAT paid whereas consumers not entitled to these credits had no incentive to do the same: Li and Wang (n 9) 282.

lease residential premises privately and not reporting these supplies.⁵⁵ Also individuals might lease property that they might claim is 'residential', but which may also be used for 'commercial' purposes (therefore a higher VAT rate should apply). It is unclear to what extent tax administrations focus on investigating individuals supplying residential premises. Perhaps more emphasis is placed on investigating business activities. If C2C supplies were included in the GST/VAT base in other jurisdictions, the cost of compliance for many individuals would increase significantly. However, GST/VAT in relation to the sale of residential premises would only need to be reported once and would not give rise to a continued obligation to regularly report GST/VAT.

Krever has recognised that '[t]he acquisition of a long-life asset is an investment, not an act of consumption. The consumption takes place over the life of the asset as it is used up. The very purest theoretical VAT would rebate the tax paid on the initial acquisition'.⁵⁶ Applying a reduced rate of VAT regarding some C2C supplies of residential premises in China may be seen as a proxy for allowing some, but not all, input tax credits, recognising the dual nature of the investment and consumption components of residential premises. It may also be seen as a way of recognising that the first business-to-consumer sale of residential premises at the standard rate of VAT is not recoverable by the homeowner. As with all private sales of secondhand goods, it can be assumed that the initial value of the residential premises is captured in the price of all future sales. Including C2C sales of residential premises in the VAT base is a way of taxing the additional value added to the original price of the residential

⁵⁵ See Eva Huang and Xi Nan, 'Transaction-Based Tax Evasion in the Cross-Border Digital Economy: The Case of Daigou Activities on Social Media Platforms' (2020) 26(3) *New Zealand Journal of Taxation Law and Policy* 269 for a description of how hidden activities that cannot be easily detected by tax administrations can be facilitated through WeChat.

⁵⁶ Richard Krever, 'Designing and Drafting VAT Laws for Africa' in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 9, 24.

premises through appreciation. It is possible that the reduced rate of VAT is a proxy for taxing this additional value at the standard rate and allowing input tax credits, again considering the dual investment and consumption components of residential premises.

The fact that China taxes some C2C supplies of residential premises at a reduced VAT rate when compared to supplies of commercial premises might be relevant to policy-makers in other jurisdictions considering including these supplies in the GST/VAT base. Applying a reduced rate to C2C supplies of residential premises in other jurisdictions could also result in more political acceptance of this idea than might otherwise be the case. This would involve having a GST/VAT system with multiple tax rates, more characteristic of the traditional European VAT system which has many exemptions,⁵⁷ and less characteristic of GST systems which have been more recently introduced and which typically have fewer supplies of goods and services that are exempt like the GST systems in New Zealand, Singapore and Australia.⁵⁸ There has been a long history of multiple tax rates being used in China.⁵⁹ The current VAT rates are 0%, 3%, 5%, 6%, 9% and 13%.⁶⁰ This is a greater number of rates than used in most

⁵⁷ Krever has noted that 'one of the preferred sources of VAT inspiration for many Chinese scholars and sometimes Chinese government officials is the older European model of VAT'. He has suggested that this is odd given that the European Union VAT system is often considered as a poor model for other jurisdictions to follow given its multi-rate structure and large number of exemptions that are costly to administer and complex: Richard Krever, 'Understanding Chinese VAT Law: Lessons from Abroad' in Xiaoqiang Yang (ed), *Chinese VAT Law: Reform and Justice* (China Taxation Publishing House, 2008) 19.

⁵⁸ New Zealand is regarded as having the purest GST system in the world, with a single GST rate and few exemptions, and has been considered a model for countries outside the European Union, including Australia. However, Zhong noted in 2016 that there had been more research conducted in China regarding the European Union VAT system as compared to the New Zealand GST system: Zhong (n 9). The GST system in Singapore is also particularly pure, with few exemptions, and it follows the New Zealand GST model: See Andrew Maples and Adrian Sawyer, 'The New Zealand GST and Its Global Impact: 30 Years On' (2017) 23(1) *New Zealand Journal of Taxation Law and Policy* 9, 24-25.

⁵⁹ Li has observed that '[t]he Chinese industrial and commercial tax system has always been multiple-rated': Jinyan Li, 'People's Republic of China: Value Added Tax' (1998) 42 *Bulletin for International Taxation* 17, 19. She has noted that goods and services 'considered essential to people's life and to the national economy' have typically been taxed at preferential rates; whereas non-essential goods and services were generally taxed at higher rates: Jinyan Li, 'Focus on... The People's Republic of China' (1991) 2 *International VAT Monitor* 8, 8-9.

⁶⁰ KPMG, *China: VAT Essentials Guide* (n 23).

countries that are members of the Organisation for Economic Co-operation and Development (OECD), particularly those outside the European Union.⁶¹

Reduced rates of GST/VAT are sometimes used to attempt to address concerns that the burden of the GST/VAT falls more heavily on low income earners and promote the consumption of goods which are considered to be of particular public benefit.⁶² However, whilst consumers are often supportive of the idea of using reduced rates as they understand this to result in there being less GST/VAT to pay, the use of reduced rates is not completely effective in achieving objectives relating to fairness as higher income earners also benefit from reduced GST/VAT rates.⁶³ Furthermore, the use of different GST/VAT rates for different types of supplies results in the GST/VAT system being less simple to administer, enforce and comply with. It is well recognised that different GST/VAT treatment of different supplies leads to arguments about the proper treatment of items lying close to the borderline between two different GST/VAT treatments. Once reduced GST/VAT rates are introduced it can also lead to lobbying for other supplies of goods and services to be subject to these rates.⁶⁴ The costs and benefits of applying a reduced rate to the supply of residential premises as opposed to the standard GST/VAT rate need to be weighed against the costs, benefits, and potential effectiveness of other ways to compensate particularly disadvantaged groups in society, if this is a policy goal of a jurisdiction interested in following this model.

⁶¹ Xu and Krever, 'VAT Compliance Burdens' (n 24) 334–5.

⁶² See Stefan Bach et al, *Value Added Tax – VAT Gap, Reduced VAT Rates and Their Impact on Compliance Costs for Businesses and on Consumers: Briefing Paper* (European Parliamentary Research Service, July 2021) 51; Sijbren Cnossen, 'What Rate Structure for a Value-Added Tax?' (1982) 35(2) *National Tax Journal* 205, 207–9; OECD, *Consumption Tax Trends 2020* (n 1) para 2.2; Yige Zu, 'Reforming VAT Concessions: A Tax Expenditure Analysis' [2017] (4) *British Tax Review* 418, 422.

⁶³ This has also been noted by Lejeune. See Ine Lejeune, 'The EU VAT Experience: What Are the Lessons?' in Tax Analysts, *The VAT Reader: What a Federal Consumption Tax Would Mean for America* (Tax Analysts, 2011) 271, 276.

⁶⁴ Cnossen (n 62) 209–11.

The magnitude of the costs and benefits with respect to using multiple VAT rates in China is not clear and could be the subject of future research.⁶⁵ If other jurisdictions taxed C2C supplies of residential premises at a reduced rate for GST/VAT purposes, the costs and benefits would likely vary. Any auditing in China of whether individuals are correctly claiming to live in ordinary or non-ordinary residential premises would be likely to be simple to administer, as records indicating the correct classification for each residential premises are retained by regional Housing Bureaus. This is unlikely to be an issue in other jurisdictions, as residential premises are not categorised into such sub-categories.

7.4 Conclusion

Consideration of the VAT treatment in China of C2C supplies of residential premises is timely given there may be a strong case for broadening the GST/VAT base in other jurisdictions during the economic recovery from Covid-19. Whilst including these supplies of residential premises within the GST/VAT base was once considered in the international GST/VAT literature to be practically difficult, this would appear to no longer be the case in many jurisdictions. Taxing C2C supplies of residential premises would be more consistent with the GST/VAT policy objective of taxing consumption. The discussion in this chapter adds to calls in the GST/VAT literature for a review of the typically exempt treatment of certain supplies.⁶⁶ It provides discussion of a model for policy-makers to consider using and adapting in other jurisdictions.

⁶⁵ However, it seems that it is generally difficult to obtain quantitative estimates of the costs and benefits of using multiple rates. For example, Bach et al have noted this with respect to VAT in the European Union and have commented that using different VAT rates leads to complexity and increased costs of compliance: Bach et al (n 62) 19.

⁶⁶ See, eg, European Commission, *Green Paper on the Future of VAT: Towards a Simpler, More Robust and Efficient VAT System*, COM(2010) 695 final, 2010, 10–11.

There are some unique aspects of the VAT treatment of C2C supplies of residential premises in China. There is a history of taxing these supplies and a driving concern expressed in political policies regarding curbing speculative investment and its effect on property prices. In many other jurisdictions, there is not the same history of taxing these supplies for consumption tax purposes. Furthermore, the differentiated tax treatments in China dependent on whether residential premises are held for two years or more may not be directly applicable to the situation in other jurisdictions where residential premises are often held for much longer periods of time. Whilst the differentiated tax treatments dependent on where residential premises are located shows how tax policy can be used to encourage or discourage property investment in specific regions, it may not be relevant in other GST/VAT jurisdictions where more uniform GST/VAT treatment generally exists.

Despite the VAT system in China having some unique aspects which may not necessarily be relevant to other jurisdictions, the discussion in this chapter has nevertheless highlighted key issues for policy-makers to consider. It shows that including C2C supplies of residential premises in the GST/VAT base is not just a theoretical possibility. If these supplies were taxable for GST/VAT purposes in another jurisdiction, there would need to be a way for GST/VAT to be collected on the supply of residential premises. This would not necessarily have to be through individual vendors collecting GST/VAT directly, as is done in China. In fact, this is not necessarily advisable, given that GST/VAT registration leads to a significant administrative burden. Alternatives might include GST/VAT being collected by intermediaries like lawyers or property conveyancers or by a government department responsible for the transfer of title to the property.

The fact that China taxes some C2C supplies of residential premises at a reduced rate may be particularly interesting to policy-makers considering including these supplies within the GST/VAT base. However, for more modern GST/VAT jurisdictions it might involve a move away from a single rate GST/VAT system to a multi-rate system more commonly seen in older VAT systems, like the European Union VAT system. Whilst the use of multiple tax rates is generally considered not advisable for jurisdictions outside the European Union, this might be regarded as one thing that could be done to soften the blow of including residential premises within the GST/VAT base.

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Chapter 8: Conclusion

8.1 Introduction

The purpose of this final chapter is to provide an overview of the research (Section 8.2), summarise its findings (Section 8.3), outline its contributions (Section 8.4), note its limitations (Section 8.5), discuss areas for future research (Section 8.6), as well as provide concluding comments (Section 8.7).

8.2 Overview of the Research

There has been recognition in the GST/VAT literature that residential premises generally appreciate over the long term, and that a problem with the current approach to the GST/VAT treatment of residential premises is any appreciation in their value results in consumption that is not included in the GST/VAT base. The main research question that this thesis set out to answer was:

Is there a way to tax the consumption of residential premises which is more consistent with the GST/VAT policy objective of taxing consumption compared to the current approach?

The secondary research questions included questions about whether including imputed rent in the GST/VAT base or including sales of residential premises between otherwise unregistered homeowners in this base would be more consistent with the GST/VAT policy objective of taxing consumption compared to the current approach (see Section 5.1).

8.3 Summary of the Research Findings

This section provides a summary of the main findings of this study in relation to the research questions.

8.3.1 The Main Research Question

In Chapter 2 the focus was on an issue with the current approach: The need for legal rules relating to when the renovation of residential premises will lead to the creation of a new taxing point. The focus in Chapters 3, 4 and 5 was on whether including imputed rent in the GST/VAT base would be a viable way to tax the consumption of residential premises which would be more consistent with the GST/VAT policy objective of taxing consumption. Recommendations were also made as to how imputed rent could be included in the base. In Chapters 6 and 7 the focus was on how sales of residential premises between otherwise unregistered homeowners could be brought within the GST/VAT base and whether this would be more consistent with the GST/VAT policy objective compared to the current approach. The ways in which this thesis has answered each of the secondary research questions are discussed below.

8.3.2 Renovated Residential Premises

One of the common issues that arises with the current GST/VAT treatment of supplies of residential premises is when a renovation of residential premises should lead to the supply of those residential premises being regarded as a supply of new residential premises. If a property requires substantial renovation, then it is expected that most of the value of the residential premises that was included in the GST/VAT base upon its initial acquisition has been consumed and that the tax imposed at the time of the initial acquisition will not cover

the later consumption of the new value created by way of the renovation. Treating the sale of substantially renovated residential premises as a taxable supply provides for upfront taxation of the present value of future consumption that was not previously taxed. This gives rise to the need for legal approaches to determine when a renovation leads to significant value being added. Current legal approaches taken to determine when a renovation should lead to a new taxing point being created were considered in Chapter 2. The secondary research question addressed was: Are current legal approaches taken to determining whether sales of renovated residential premises are taxable consistent with the benchmark goal of creating a new taxing point where a substantial portion of the value of renovated residential premises being transferred is new value?

The analysis in Chapter 2 involved comparing and evaluating examples of the legal approaches taken in Australia, Canada, and the European Union to determine when the renovation of residential premises leads to a new taxing point by reference to the benchmark goal. A key finding was that some of these legal approaches sometimes have a restrictive effect and produce outcomes which are inconsistent with the benchmark. Also, there are uncertainties as to when a new taxing point should be created.

8.3.3 Imputed Rent

The second set of secondary research questions considered in this thesis related to the possibility of including imputed rent in the GST/VAT base. Whether including imputed rent in the base would be a viable way to tax the consumption of owner-occupied residential premises and whether this would be more consistent with the policy objective of taxing consumption compared to the current approach were questions considered in Chapter 3. The way in which the current approach is inconsistent with this objective was discussed. It was

explained that the value of residential premises generally appreciates over the long term, and this results in consumption which is left out of the GST/VAT base. The concept of what is imputed rent was also discussed. As no country has ever included imputed rent in its GST/VAT base, this chapter considered two historic examples of imputed rent being included within the income tax base. This discussion highlighted some of the issues that have arisen from this approach, for example the valuation difficulties that arose in the United Kingdom.

Some of the main concerns that have been raised in the GST/VAT literature about the theoretical possibility of including imputed rent in the GST/VAT base were also considered in Chapter 3. One of these is about valuation, specifically the computation of rental values. However, it was concluded that valuing assets no longer appears to be an issue today. Another concern that was considered is the potential financial disadvantage that may be experienced by people on lower incomes or no income. It was considered that there may be ways to address this issue. It was concluded that including imputed rent in the GST/VAT base may be a viable way to tax the consumption of residential premises which might produce a result more consistent with the policy objective of taxing consumption.

The focus of Chapter 4 was on addressing the secondary research question of how could imputed rent be included in the GST/VAT base. How imputed rent could be calculated was discussed. It was suggested that one possible way to do this might be to use databases of current market values held in many jurisdictions for property tax purposes. The market values could be increased yearly by an assumed appreciation rate, and the estimated market price of residential premises could then be multiplied by an assumed market rental rate to determine the estimated imputed rent. In this chapter it was proposed that tax administrations calculate the annual GST/VAT liability of owner-occupiers and notify them of

the annual amount due. If imputed rent were included in the GST/VAT base residential rent should also be included in this base, as when residential premises are rented they are still consumed (albeit by tenants).

In Chapter 4 it was explained that if imputed rent were included in the GST/VAT base this might have a downward effect on the price of residential premises and the price of residential rent. This may go some way to addressing housing affordability issues, and the tax system's bias in favour of homeownership. As in Chapter 3, possible ways were considered to address the potential financial difficulties that may be experienced by low-income earners.

The secondary research question of how could imputed rent be included in the GST/VAT base was also addressed in Chapter 5. This chapter involved a simulation explaining how a homeowner's annual tax liability could be calculated if imputed rent were included in the GST/VAT base. A unique combination of independent variables was used. Several policy alternatives were considered regarding the values that could be given to each of the independent variables, and what would happen if the values of the variables used in this simulation were increased or reduced. For example, it was shown what would happen if there was positive or negative appreciation. Based on the values of the variables considered, it was found that it would take 21.2 years for the present value of GST/VAT collected if imputed rent and actual rent were included in the GST/VAT base to exceed the GST/VAT that is collected under the current approach. More consumption would be taxed from year 22.

It is expected that over the long-term landlords would be likely to rent the residential premises out for an amount which covers all their normal expenses, including imputed rent. Therefore, landlords would generally remit net GST/VAT to the tax administration. It is

possible that for short periods of time landlords may be in a refund situation. This may be the case where they claim input tax credits for repairs and renovations.

In discussing possible ways to collect GST/VAT and potential implementation issues relating to including imputed rent in the GST/VAT base, the discussion in Chapter 5 built on earlier discussions in Chapters 3 and 4. Possible transitional rules that could be implemented if the current approach were replaced with the alternative approach of including imputed rent in the base were considered. If the alternative approach were only applied to residential premises purchased after the commencement of this approach and all existing leases were exempt until there is a sale of residential premises after the commencement date, the possible downward effect on the price of residential premises would gradually occur as residential premises are sold.

It was suggested that while over the long term a shift to this alternative approach would lead to more revenue collection, in the short term there would be a reduction in revenue collected. Possible ways in which this shortfall could be funded were considered. It was acknowledged that there would be political challenges to overcome in implementing this alternative approach. The fact that homeowners are accustomed to concessional tax treatment of residential premises means it would be difficult to garner public support for including imputed rent in the GST/VAT base. However, it was suggested that the removal of a current tax, such as stamp duty on transfers of residential premises (in jurisdictions that have it), may be a way to make this alternative approach more acceptable to homeowners. Extra revenue generated from including imputed rent in the GST/VAT base might help fund the removal of an existing tax, depending on how GST/VAT revenues are distributed.

Of course, as stamp duty operates differently to how an annual tax on imputed rent would operate, not everyone would see including imputed rent in the GST/VAT base as more palatable than a stamp duty on transfers. GST/VAT and stamp duty are not directly comparable. The objectives of the two taxes are different. In Australia, the cost of stamp duty relating to the transfer of residential premises is generally less than the total amount of imputed rent that could be collected in relation to those residential premises over time. However, the point made in Chapter 5 is that the removal of a current tax, such as stamp duty on transfers of residential premises, might make including imputed rent in the GST/VAT base more acceptable to homeowners.

8.3.4 Including Sales of Residential Premises between Otherwise Unregistered Consumers in the GST/VAT Base

The following secondary research questions were addressed in Chapter 6: How could residential premises between otherwise unregistered homeowners be brought within the GST/VAT base and would this achieve a closer alignment to the GST/VAT policy objective of taxing consumption compared to the current approach? Earlier literature was reviewed which recommended that sales of residential premises between otherwise unregistered homeowners be brought within the GST/VAT base with deferred input tax credits for the initial acquisition.

The discussion in this chapter built on these earlier recommendations by providing further insight into how the collection of GST/VAT could occur if this approach were implemented. Three possible ways were considered as to how GST/VAT collection could occur without homeowners having to register for GST/VAT. These were: (1) collection and remittance through an intermediary acting on behalf of homeowners; (2) collection and remittance

through an agency responsible for the transfer of title; and (3) requiring the purchaser to pay the GST/VAT payable on the supply directly to the tax administration.

The authors of the proposals reviewed in this chapter all proposed that, if C2C sales of residential premises were included in the GST/VAT base, deferred input tax credits relating to the GST/VAT paid in connection with purchasing the residential premises should be available to homeowners when the residential premises are sold. Therefore issues relating to the appropriate quantum of input tax credits that should be available were considered in this chapter. It was found that it would be consistent with these proposals for input tax credits to also be available in relation to GST/VAT paid in relation to construction costs and improvements. Perhaps making input tax credits available to homeowners might be a way to make the idea of including C2C sales of residential premises in the GST/VAT base more palatable to homeowners. However, unlike the authors of the earlier proposals, it was considered in this chapter that homeowners should not be entitled to claim deferred input tax credits. The neutral net GST/VAT result that would be achieved if a homeowner were entitled to input tax credits would not reflect the fact that part of the value of the residential premises have been consumed. Allowing homeowners full input tax credits would mean that the residential premises would be regarded as a pure investment.

8.3.5 China's VAT Treatment of Consumer-to-Consumer Supplies of Residential Premises

The only exception to the current general GST/VAT treatment of residential premises can be found in China, where since 2016 some C2C supplies of residential premises have been subject to VAT. In Chapter 7 the secondary research questions of how this VAT treatment operates and whether this approach provides a model that could be adopted in other jurisdictions were considered. A key finding of this chapter was that including these supplies in the GST/VAT

base is no longer just a theoretical possibility. The VAT treatment in China indicates that it is possible to include these supplies in the GST/VAT base and that this would provide a result more consistent with the GST/VAT policy objective of taxing consumption. More of the consumption value of residential premises would be included in the base.

There are some unique aspects of the VAT treatment of these supplies in China that may not be relevant to adopt in other jurisdictions. For example, the differentiated tax treatment dependent on where residential premises are located shows how tax policy can be used to encourage or discourage property investment in specific regions. However, it may not be relevant in other GST/VAT jurisdictions where more uniform GST/VAT treatment generally exists. Nevertheless, these details may still be of broad interest to policy-makers given that they show how GST/VAT systems can be used to encourage or discourage property investment.

Despite the VAT system in China having some unique aspects, some key issues that may be of interest to policy-makers in other jurisdictions were highlighted. It was suggested that the VAT treatment of these supplies in China provides a model for policy-makers in other jurisdictions to consider using and adapting. If C2C supplies of residential premises were taxable, there would need to be a way for GST/VAT to be collected. This would not necessarily have to be through individual vendors collecting GST/VAT directly, as is done in China. Alternatives might involve the suggestions discussed in Chapter 6.

The fact that China taxes C2C supplies of residential premises at a reduced rate may be particularly interesting to policy-makers in other jurisdictions. Subjecting C2C supplies of this type to a reduced rate could be used as a proxy for allowing homeowners some, but not all, input tax credits, recognising the dual investment and consumption components of

residential premises. It could also be a way of capturing the additional value added to the original purchase price of residential premises because of appreciation. For more modern GST/VAT jurisdictions that often have single rate GST/VAT systems, adopting such an approach might involve a move away from a single rate to a multi-rate system more commonly seen in older VAT systems. However, it might be regarded as one thing that could be done to soften the blow of including these supplies in the base, and it might make this idea somewhat more attractive to voters. However, the use of multiple tax rates is generally not considered advisable as this makes the GST/VAT less simple to administer and enforce, and it can lead to tax avoidance issues. It can also result in lobbying for other supplies of goods and services to be subject to reduced GST/VAT rates.

In other jurisdictions apart from China, convincing voters that GST/VAT should be charged on C2C supplies of residential premises would be likely to be the biggest obstacle against including these supplies in the GST/VAT base. Policy-makers should also consider the effect that this would have on particularly disadvantaged members of the community, such as first homeowners and those on lower incomes. In this chapter it was discussed that there may be ways to address the concerns of these segments of society.

8.4 Contributions of the Research

The research in this thesis adds to calls in the GST/VAT literature for a review of the traditionally exempt treatment of certain supplies. The major contribution of this thesis is it provides new insights into ways in which the consumption of residential premises could be included in the GST/VAT base. It illustrates the potential for the GST/VAT base to be broadened so that the added value of consumption resulting from the general appreciation

in residential premises is also included in the base. Consideration of how to include more of the value of consumption in the GST/VAT base is timely given there may be a strong case for broadening the GST/VAT base during the economic recovery from Covid-19. This research has built on earlier recognition in the GST/VAT literature that the general appreciation in the value of residential premises over the long term leads to consumption that is not included in the GST/VAT base. The research in Chapter 2 has contributed to the GST/VAT literature by discussing an issue that has been subject to little scholarly discussion. This is the most detailed comparative analysis of the legal approaches taken to the GST/VAT treatment of sales of renovated residential premises. The rest of the thesis has provided new insights into ways in which the consumption of residential premises could be included in the base.

The focus of the discussion in Chapters 3, 4 and 5 was on including imputed rent in the GST/VAT base. This discussion built on earlier findings of the United Kingdom report of the Mirrlees Review that it might be possible to do this. It added further insight into how this could be done and ideas of ways in which potential concerns regarding such an approach and implementation issues could be addressed. While it has been acknowledged in the GST/VAT literature that imputed rent could be brought within the base, there has been little discussion in the past of what this would look like.

The discussion in Chapter 5 was particularly innovative. It compared the effect of imposing GST/VAT periodically on an estimate of the consumption of residential premises with the current prepaid system. This chapter contains the first simulation showing how GST/VAT could be calculated on a periodic basis in relation to the consumption of residential premises. Data from other jurisdictions could be input into this simulation. There is potential for this

simulation to be used as a tool to show the amount of GST/VAT that could be due for homeowners to pay on an annual basis.

The discussion of the policy alternatives regarding the values that could be given to the variables used in the simulation demonstrated the usefulness of this simulation as a tool, and how it could be adapted to reflect different values that might be given to the variables, perhaps to reflect changing economic circumstances or for use in different regions. This discussion may be helpful to policy-makers considering shifting from the current approach to an alternative approach of including imputed rent in the GST/VAT base. If this approach were adopted, it is expected that this could result in a downward effect on the price of residential premises and on residential rent, and that this might go some way to addressing housing affordability concerns.

Unlike the authors of earlier proposals in the GST/VAT literature that have recommended that deferred input tax credits should be available if C2C sales of residential premises were brought within the GST/VAT base, it was considered in Chapter 6 that input tax credits should not be available to homeowners in relation to the initial purchase. Allowing homeowners input tax credits would not recognise that some of the value of the residential premises has been consumed. It would erroneously regard residential premises as a pure investment.

The idea of including C2C sales of residential premises in the GST/VAT base was further considered in Chapter 7. This chapter contains the most comprehensive work in English discussing the unique VAT treatment of C2C supplies of residential premises in China. The discussion in this chapter shows that including these supplies in the GST/VAT base is not just a theoretical possibility. The unique VAT treatment of these supplies in China may be considered a model by policy-makers to consider using and adapting in other jurisdictions.

There are some aspects of this VAT treatment which could be adapted and applied in other GST/VAT jurisdictions. For example, suggestions were made in Chapter 7 regarding how GST/VAT could be collected in relation to C2C supplies. Also it was noted that the fact that China taxes some C2C supplies of residential premises at a reduced rate may be particularly interesting to policy-makers. It would be a way to recognise the dual investment and consumption component of residential premises, capture the additional value added to the original purchase price of residential premises because of appreciation, and soften the blow of including these supplies in the base. Including these supplies in the GST/VAT base could provide an extra source of revenue and be a way to include the appreciation of residential premises in the GST/VAT base. The GST/VAT treatment of C2C supplies of residential premises in China could also be considered more generally by policy makers in considering how other C2C supplies may be brought within the GST/VAT base.

It was discussed that China subjects some C2C supplies of residential premises to a reduced rate of VAT, and that this might be a way of recognising that residential premises have both an investment and consumption component. Policy-makers in other GST/VAT jurisdictions might consider subjecting these supplies to a reduced rate as a proxy for allowing homeowners some, but not all input tax credits. However, it was discussed in Chapter 7 that the use of reduced rates would add a level of complexity to the administration of the GST/VAT.

8.5 *Limitations of the Research*

Notwithstanding the potential contributions of this research, it also has some limitations which should be considered when interpreting the findings. While this thesis provides

proposals for addressing the technical impediments that must be addressed in the adoption of a solution to the fragmented taxation of residential premises, the principal challenge is not technical. It is the political challenge of taxing homeowners who have not previously been fully subject to taxation on the consumption of residential premises. However, this thesis has not considered geo-political and political economy issues. These are important issues but are beyond the scope of this thesis. The focus has been on technical tax law issues relating to the GST/VAT treatment of residential premises. Consequentially, technical rules that would achieve the stated policy aim of including the value of the consumption of residential premises in the GST/VAT base have been considered.

The greatest challenge which stands in the way of both alternative proposals being implemented is the challenge of convincing voters. In many jurisdictions, residential premises are subject to concessional tax treatment. Furthermore, while including imputed rent in the GST/VAT base may result in a downward effect on the price of residential premises, this would be difficult to explain to voters. Also, it might be challenging for homeowners and tenants to understand that residential premises are consumed and that the alternative approaches considered in this thesis are more consistent with the GST/VAT policy objective of taxing consumption.

Strong political will would be required in order for these alternatives to be considered by politicians. The discussion in this thesis considered some ways to make these alternatives more palatable. This includes the potential of using reduced rates, transitional rules, and measures to address the concerns of first homeowners and those on lower incomes.

While the focus of this thesis has been on the GST/VAT treatment of supplies of residential premises, it would be best to consider the implementation of these alternative approaches

within the context of wider reform of the tax system. As mentioned in Chapter 5, this might possibly include the removal of stamp duty regarding purchases of residential premises, other measures to broaden the GST/VAT base, and reform of the income tax system. Some of these potential changes might make the implementation of these alternative approaches more acceptable to homeowners. Furthermore, changes to the transfer system might also be considered to address ability to pay concerns relating to those on a low income or no income and first homeowners. However, deeper consideration of the tax mix is outside the scope of this thesis.

The discussion in Chapter 2 only considered some of the main issues that arise in relation to the GST/VAT treatment of sales of renovated residential premises, not all such issues. There are variations in the facts that arise in different cases, not all of which have been considered in this chapter, and in the parts of existing residential premises that are removed or replaced as part of renovations.

Regarding the discussion in Chapter 7, while there are many legal databases available in China, some are not available to be accessed from IP addresses in foreign jurisdictions, and not all outside universities have subscriptions to these databases. It can be challenging to search some of these databases without a good command of Mandarin. The researcher was dependent on a bilingual research assistant to collect relevant information from legal databases. The extent to which this could be done was limited by available funds. Emphasis was placed on collecting English translations of legal and policy documents issued by government ministries. There may be relevant secondary sources published in Mandarin which were not collected, and the data might not be complete. As with any document

analysis, there may be some biased selectivity.¹ It was unclear from the data collected what the revenue impacts, administration costs and tax compliance issues regarding the GST/VAT treatment of C2C supplies of residential premises in China are.

8.6 Areas for Future Research

The focus of this thesis is the tax law issue of how consumption of residential premises can be taxed in a neutral fashion. It does not deal with policy issues such as the perceived social advantages of home ownership and the use of tax expenditures to support home acquisition. These could be interesting areas for future research.

The discussion in Chapter 2 considered examples of the legal approaches taken to the GST/VAT treatment of sales of renovated residential premises in the European Union, as an example of a traditional VAT system, and Australia and Canada, as examples of more modern GST systems. The research could be further expanded to the legal approaches taken in other countries.

In Chapter 5, data published by the ABS and CoreLogic was used for the purpose of discussing the simulation. Data from the ATO may also provide scope for future work. This might involve modelling with perhaps other assumptions also being made. Further modelling could be done regarding the costs of such an approach. Data from other jurisdictions could be input into the simulation developed in Chapter 5 which could be used as a tool to demonstrate the effect of shifting from the current approach to including imputed rent in the GST/VAT base. A larger

¹ Biased selectivity is discussed by Yin: see Robert K Yin, *Case Study Research: Design and Methods* (Sage Publications, 5th ed, 2014) 106.

comparative study showing the effect of using this simulation to calculate periodic GST/VAT in different jurisdictions could be the focus of future research.

It is possible that including imputed rent in the GST/VAT base could be confused with annual assessment of council rates and other taxes collected in relation to the ownership of property such as land tax and stamp duty (if applicable). This could lead to a perception of double taxation. A design that removes some of this confusion could be the focus of future research. This might involve reviewing the tax-mix in Australia. The point was made in Chapter 5 that the appreciation rate used for the purposes of calculating imputed rent could be based on property valuations used for the purposes of calculating council rates. As this would mirror current practices this may be more politically acceptable, and the administrative burden of the two processes may be shared.

The potential replacement of more inefficient taxes with GST/VAT could be considered. As mentioned in Chapter 5, this might involve the removal of a current tax, such as stamp duty on transfers of residential premises. This may be a good outcome from a tax reform perspective, given that stamp duty is an inefficient tax,² whereas a broad-based GST/VAT system is considered efficient as distortion in consumption decisions is minimised. Alternatively, the removal of land tax where it applies in relation to residential premises could be considered to make including imputed rent in the GST/VAT base more politically acceptable. This would mean that homeowners would not pay both land tax and GST/VAT

² See Australian Treasury, *Australia's Future Tax System: Report to the Treasurer: Part Two – Detailed Analysis – Volume 1* (December 2009), 247 and Productivity Commission, Australian Government, *Shifting the Dial: 5 Year Productivity Review* (Inquiry Report No. 84, 2017), 149.

annually in relation to residential premises. The increase in revenue generated if imputed rent were subject to GST/VAT could help fund the removal of existing taxes.

Modelling could be done of the costs of including imputed rent in the GST/VAT base. This could involve modelling or explaining by case study the possible impact of including imputed rent in the GST/VAT base on taxpayers in different financial positions. This could include those who are asset rich but income poor, such as retirees. It could also involve modelling regarding the effect of those on a low income or no income rolling up liabilities, and further research into how this might work.

Regarding Chapter 7, the revenue impacts, administration costs and tax compliance issues regarding the GST/VAT treatment of C2C supplies of residential premises in China could be an area for future research. A field trip to China and interviews of GST/VAT experts in China was not possible during the period of this research, but it may be an appropriate method to investigate these issues in the future.

8.7 Concluding Comments

The discussion in this thesis has considered two alternative approaches to the current GST/VAT treatment of residential premises. It was found that both approaches would be more consistent with the GST/VAT policy objective of taxing consumption compared to the current approach, as they would both result in more consumption being included in the GST/VAT base. How each approach could work was considered, along with possible implementation issues. It was acknowledged that there would be political challenges to overcome in implementing either of these approaches, but from a tax policy perspective implementation of these approaches is feasible.

The preferred approach would be to include imputed rent in the GST/VAT base, as implementation of this approach would best reflect taxation of the value of consumption used by the current homeowner. If sales of residential premises are included in the GST/VAT base, input tax credits should not be allowed in relation to the initial purchase, as to do so would be to regard residential premises as a pure investment. Only the difference between the sales price and purchase price of C2C sales of residential premises should be subject to GST/VAT. This represents value added which has not previously been subject to GST/VAT. A reduced rate might be considered as a proxy for allowing some, but not all, input tax credits, recognising that residential premises have both investment and consumption components. It might also make this idea more attractive to voters. However, a reduced GST/VAT rate would mean that the GST/VAT treatment of C2C supplies of residential premises would be less simple to administer and enforce.

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Taxation Laws Amendment Bill (No 8) 2000 (Cth)

University of Canterbury, 'A Guideline to Including Publications within a Doctoral Thesis' (Version 1.4 – updated 3 July, 2022)

Appendices

Appendix 1: E-mail correspondence regarding permission to include an article published in the Australian Tax Review

RE: Seeking permission to include articles in PhD

Permissions, TLRANZ <TLRANZ.Permissions@thomsonreuters.com>

Thu 12/01/2023 3:30 PM

To:

Christine Peacock <christine.peacock@pg.canterbury.ac.nz>

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Good afternoon Christine,

Thank you for your email. As requested, permission is granted to reproduce your article as a Word document instead.

We are also happy to grant permission to reproduce our correspondence in the appendices to your thesis.

Kind regards,

Jennifer

Jennifer Brock
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From: Permissions, TLRANZ <TLRANZ.Permissions@thomsonreuters.com>
Sent: Friday, 30 September 2022 3:44 PM
To: Christine Peacock <christine.peacock@pg.canterbury.ac.nz>
Subject: RE: Seeking permission to include articles in PhD

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Kind regards,

Jennifer

Jennifer Brock
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Appendix 2: E-mail correspondence regarding permission to include articles published in the Journal of the Australasian Tax Teachers Association

From: Dale Pinto <Dale.Pinto@cbs.curtin.edu.au>

Sent: Friday, 30 September 2022 6:39 PM

To: Christine Peacock <christine.peacock@pg.canterbury.ac.nz>

Subject: Re: Seeking permission to include articles in PhD

Dear Christine

Great to hear from you and congratulations on finalising your PhD.

I can confirm permission to include the articles, subject to attributing the original source to the Journal of the Australasian Tax Teachers Association (JATTA).

Hope that helps - all the very best.

Regards

Professor Dale Pinto

Chair, Academic Board

Professor of Taxation Law

Discipline Lead, Taxation Law

Curtin Law School

Faculty of Business and Law

Tel | +61 8 9266 7034

Fax | +61 8 9266 3222

Mobile | 0419 929 985

Email | Dale.Pinto@cbs.curtin.edu.au Web | <https://businesslaw.curtin.edu.au>



CRICOS Provider Code 00301J (WA)

Appendix 3: E-mail correspondence regarding permission to include an article published in Perspectives on Tax Law and Policy

From: Christine Escalante <CEscalante@ctf.ca>
Sent: Friday, 13 January 2023 3:34 AM
To: Christine Peacock <c.peacock@federation.edu.au>
Subject: RE: Perspectives on Tax Law & Policy -- author agreement

Dear Christine,

Thank you for following up.

Based on the licence agreement, for any subsequent use of your article you need only acknowledge the original publication by the Foundation by crediting it somewhere in your thesis in the following manner: "First published by the Canadian Tax Foundation in (2022) 3:3 *Perspectives on Tax Law & Policy*."

Hope that helps!

Best,

Chris

Appendix 4: E-mail correspondence regarding permission to include article published in Australian Tax Forum

From: Bus Australian Tax Forum

To: Christine Peacock; Michael Walpole

Subject: RE: Seeking permission to include paper in PhD

Date: Friday, 27 January 2023 10:06:41 PM

Attachments: image001.png

image002.png

image003.png

image004.png

Dear Christine,

The Editor is happy for you to use as a chapter (making whatever structural and descriptive changes necessary to incorporate it in a thesis) the version currently under review or the previous version – it's up to you. The very final version won't be ready by next month as it is presently under final review by the reviewer. Assuming all goes well, it will be slated for publication in the June issue, meaning that the final version will only be ready in late May/early June as the print draft must first be prepared before it goes to the copyeditor. The paper can be referred to as: Peacock, Christine, 'Shifting from pre-paid to periodic GST on the consumption of residential premises' (2023) 38(2) Australian Tax Forum (forthcoming) (Chapter five).

I hope we have answered all your queries but do let us know if we've missed anything.

Kind regards,

Nikki

Appendix 5: E-mail correspondence regarding permission to include CoreLogic data

From: CoreLogic

To: Christine Peacock

Subject: [CoreLogic] Re: Seeking permission to use information in academic paper

Date: Tuesday, 6 April 2021 1:59:50 PM

##- Please type your reply above this line -##

Your request (481440) has been updated. To add additional comments, reply to this email.

Kathleen Joy Loquinario (CoreLogic Property Research)

6 Apr 2021, 1:29 pm ACST

Hi Christine ,

Thank you for contacting CoreLogic.

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If you have any questions, call our friendly customer care team on 1300 734 318.

Kind Regards,

Kind Regards,

Kathleen Joy Loquinario

CoreLogic

Direct 1300 734 318

Website | Facebook | Twitter | LinkedIn | YouTube

Christine Peacock

5 Apr 2021, 10:12 am ACST

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Dear CoreLogic,

I am attaching a letter explaining that I am seeking permission to use two figures published in a CoreLogic Quarterly Review Report in an academic paper.

I would appreciate if you could please respond whether you agree to this request, and if so the wording of an appropriate acknowledgement. Please also let me know if you have any questions about this request.

Yours sincerely,

Christine Peacock

Law Lecturer

Federation Business School

Federation University Australia

Building 901, Level 2 | Berwick Campus

Berwick VIC 3806

T +61 3 5327 6164 |

c.peacock@federation.edu.au

Publications:

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https://www.researchgate.net/profile/Christine_Peacock

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