

[www.sinclairthomas.com](http://www.sinclairthomas.com)

Level 27, 101 Collins Street  
Melbourne VIC 3000  
Telephone +61 3 9639 3425  
Facsimile +61 3 9653 9307  
Email [melbourne@sinclairthomas.com](mailto:melbourne@sinclairthomas.com)

Level 31, Aurora Place  
88 Phillip Street, Sydney NSW 2000  
Telephone +61 2 8211 2777  
Facsimile +61 2 8211 0555  
Email [sydney@sinclairthomas.com](mailto:sydney@sinclairthomas.com)

Sinclair Thomas Pty Limited  
Australia & New Zealand  
ABN 93 118 990 873

## **Submission to the Joint Committee of Public Accounts and Audit**

### ***Inquiry into a range of taxation issues in Australia.***

### ***Tony Ferguson Weightloss Centre v ATO***

6 MARCH 2007

## EXECUTIVE SUMMARY

The following submission outlines an ATO inconsistency in applying tax rules relating to GST. The case can be summarised as follows:

- The ATO has determined that meal replacement shakes, a product of Tony Ferguson Weightloss Centre must have GST. At the same time the ATO has given a private ruling to an identical competitor product granting it GST-free status.
- There are also a number of other situations in the tourism, financial services and banking industries, where the ATO administered a change of interpretation on a prospective basis.
- The ATO has further complicated this matter by their decision to pursue retrospective GST payments to be applied along the supply chain of the meal replacement shake.
- The supply chain involves a range of companies that include the manufacturer, pharmacists, and major health care companies.
- Inconsistency is seen as the most fundamental cause of inequity in the ATO's operations. The evidence suggests inconsistent practices affect all taxpayer segments, including large and small businesses.
- Accordingly, we submit that the GST-free treatment by our client of its shake sachets was reasonable and that it is unreasonable to award private and inconsistent rulings on identical products within an industry.
- Stopping the pursuit of retrospective GST payments is a key priority as well as ensuring tax payers are treated equitably.

On this basis we believe this case is relevant to the Joint Committee on Public Accounts and Audit as it clearly falls within the terms of reference of the *Inquiry into a range of taxation issues in Australia*.

This is an important matter as it has become a costly exercise, resulting in an unnecessary administrative burden on the companies involved as well as tying up the time of ATO staff.

Tony Ferguson and representatives of the companies along the supply chain would welcome the opportunity to appear before the Committee to outline these concerns directly.

## BACKGROUND

We act on behalf of Tony Ferguson Weightloss Centre who sells the Tony Ferguson Meal Replacement Shake Sachets.

On 19 September 2006 the Australian Taxation Office (ATO), published a preliminary view that meal replacement sachets are considered to be “*ingredients for beverages for human consumption*” pursuant to subsection 38-4(1)(d) of *A New Tax System (Goods and Services Tax) Act 1999* (“the GST Act”).

The ATO took the view that the meal replacement products are not GST-free pursuant to subsection 38-3(1)(d) as the meal replacement products do not satisfy item 13 of Schedule 2, i.e. “*beverages and ingredients for beverages of a kind marketed principally as food for infants or invalids*”. Hence, the ATO’s view is that the meal replacement products are not food and should be treated as taxable for GST purposes.

The ATO have provided a private ruling to an identical meal replacement shake product called Optifast (a product of Novartis Consumer Health Australasia Pty Ltd) granting GST-free status. There are also examples of other similar rulings, which demonstrate inconsistent application of the tax rules.

## INTRODUCTION

Inconsistent application of the tax rules by the ATO has been an issue for some time. A March 2000 Senate Economics Committee Report, *Operations of the ATO*, included a section in inconsistency by the ATO. The report said:

*“The Ombudsman’s evidence to the inquiry identified inconsistent treatment and practices as central concerns.<sup>5</sup> In particular, the Ombudsman’s investigation of complaints reveals wide disparities in treatment, including markedly disproportionate approaches by ATO officers in relation to tax penalties and debt collection.”<sup>1</sup>*

The inconsistent ruling by the ATO with respect to Tony Ferguson Weightloss Centre also affects other companies along the supply chain. These include Symbion Health Limited, Jalco Pty Limited, members of the Pharmacy Guild of Australia and Terry White Chemists.

The ATO are also determined to pursue retrospective GST payments to be applied along the supply chain. This will be extremely costly and administratively difficult to calculate exactly how much each entity potential owes.

**The inconsistency lies in the fact that the ATO has given a private ruling to a competitor product, called Optifast, granting it GST-free status, despite it being identical in terms of preparation and labeling.**

This is an example of the inconsistent application of the rules by the ATO and therefore should be part of the Committee’s *Inquiry into a range of taxation issues in Australia* under Part A of the terms of reference.

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<sup>1</sup> 9 March 2000 Senate Economics Committee Report, *Operations of the ATO*

Whilst the technical issue of whether these products are GST free or taxable is of significant importance our immediate concerns are:

- The inconsistent application of the GST rules to identical products.
- Retrospective application of the ATO's decision.
- Ensuring there is a level playing field across the sector to avoid indiscriminate application of the rules.

The decision by the ATO has resulted in a costly exercise, not only to the entities involved but also to customers who have been left confused as to why they have to pay GST.

### **GST free status**

The basis on which the 'Formulated Meal Replacement Shake Sachets' have been deemed to incur GST is that the ATO has determined that the meal replacement formula is a drink and not a food on the basis that it can be made with cold water or milk. However, the 'Formulated Meal Replacement Soup', which is made with hot or cold water is considered a food and is GST-free.

The shake sachets clearly fall within the broad definition of food set out in the Food Standards Australia New Zealand Act 1991.

Other similar products such as Milo are considered a food but are GST-free. This is despite the fact that Milo can be made with milk or water. Baby formula is also GST-free even though it can be made with milk or water.

Under Schedule 2 of the GST Act if the meal replacements were marketed as a "flavoured mild powder" they would be GST free.

At the risk of raising the 'cooked chicken v frozen chicken' debate, it seems absurd that merely amending the labeling could change the GST-free status of this product.

### **Inconsistent application of the GST rules by the ATO**

The GST rules are being applied in an indiscriminate manner since other identical and similar products are considered GST free by the ATO. There have been a number of private rulings for similar products granting GST free status. We are aware that these products are exactly the same in their nature and composition.

On the basis of the private rulings issued it is both inconsistent and unjust that the ATO could arrive at a retrospective decision and argue that it has not revised its interpretation in respect of the classification of weight loss shakes.

In the food and grocery industry, the ATO has granted a unique concession to the supply chain where goods are recorded on the EANnet, by reference to the barcode. We understand that the concession operates such that once a new product is recorded on the EANnet, the ATO has five days to review and revise, where necessary, the GST classification of the product.

If the ATO challenges the classification at a later stage, any change will apply on a prospective basis for the entire supply chain. In this instance, where retailers, such as pharmacists, have not been able to access the EANnet when determining the classification of weight loss products we consider that any attempt to challenge classification retrospectively would represent an unwarranted bias.

The GST rules are being applied in an indiscriminate manner since other similar products are GST free. As well as stopping the pursuit of retrospective GST payments by the ATO, Tony Ferguson is seeking an equitable and common sense approach that is applied across the industry so as to establish a level playing field.

### **ATO Classification of Weightloss Products**

The ATO's position appears to be driven by a rather superficial/simplistic perception that, as the shake sachet contents are commonly consumed by adding them to water and drinking, the resulting product (which is like a milkshake), the shake sachets' contents are an ingredient for a beverage.

The ATO has not considered the role played by these products in an obese person's dietary regime, nor to the fact that they are not consumed for the purposes for which beverages are consumed.

One would expect that a product prepared and consumed by an obese person (even if the resulting product is in a liquid form) in substitution for a GST-free meal that would be prepared and consumed by a person who is not on a weight reducing dietary regime, would similarly be GST-free.

### **Private ruling that the market leader's product is GST-free**

Inconsistently and unfairness is created with the ATO seeking to retrospectively apply GST to meal replacement shake products marketed by our client, and similar products marketed by others, is that the ATO has issued a GST-free ruling on *Optifast VLCD*, a competitor product marketed by Novartis Consumer Health Australasia Pty Ltd. Novartis was also the recipient of a GST-free ruling from the ATO in respect of its predecessor product, *Modifast*.

*Optifast VLCD* enjoys a significant share of the market in which our client operates and it is unfair for the ATO to treat the Tony Ferguson meal replacement sachets (and the similar products of others) differently to *Optifast VLCD*.

It would be a case of the ATO having applied a different tax treatment to competitor products of taxpayers operating in the same industry. The GST-free ruling for *Optifast VLCD* would have brought about a market place distortion if the other players had not adopted the same GST-free treatment of their products in a very competitive market.

In addition to the Tony Ferguson product, the other similar products to *Optifast VLCD* referred to above are:

- *Success formulated meal replacement marketed by Success Foods Pty Ltd: and*
- *Kicstart VCLD formulated meal replacement marketed by Pharmacy Health Solutions Pty Ltd.*

These four products together enjoy the major part of the market for meal replacement products of the relevant kind sold through pharmacies.

### *Similarities between Optifast VLCD and Tony Ferguson meal replacement shake sachets*

While we do not propose to comment on the similarities between the *Success* and *Kicstart* products with *Optifast VLCD*, we do make the comparison between *Optifast VLCD* and our client's meal replacement shake sachets.

Both *Optifast VLCD* and the Tony Ferguson meal replacement shake products are:

- formulated meal replacement products;
- for use in very low calorie diet (VLCD) programs;
- only sold through pharmacies;
- recommended to be taken under the care of a health care professional;
- sold in a powdered form marketed in sachets;
- marketed as a "milkshake" or "shake";
- added to 200mls of water in a shaker by the consumer;
- taken by the consumer in the form of a shake;
- interchangeable in the dietary regime with the other products in range, such as soups.

There is no discernible difference between *Optifast VLCD* and our client's meal replacement shake sachets.

### **Conclusion**

On behalf of Tony Ferguson Weightloss Centre we submit that given the private ruling by the ATO to grant a competitor product GST-free status when it is identical is an example of inconsistent applications of the Australian tax rules.

On the basis of the number of private rulings issued to suppliers since the introduction of GST supporting a GST-free classification, which are more specific than the general statements within the ATO's GST Food Guide, we find it inconsistent and inequitable that the ATO could arrive at a retrospective decision and argue that it has not revised its interpretation in respect of the classification of weight loss shakes.

Given the evidence illustrating the existence of these conflicting rulings, and the issuing an industry fact sheet, it is clear that the ATO is changing its interpretation on the GST classification of such products. The ATO has done nothing to remove the inconsistent application of the rules in relation to this product.

A retrospective decision by the ATO would mean our members will bear an unduly onerous administrative and cost burden on all the entities along the supply chain.

### **Recommendation**

Given the clear inconsistent and inequitable application of the GST rules to Tony Ferguson Weightloss Centre, the Joint Committee of Public Accounts and Audit should recommend the ATO:

1. Apply the GST rules in relation to Tony Ferguson meal replacement shake sachets in a consistent and fair manner.
2. Reverse its decision in relation to Tony Ferguson meal replacement shake sachets.
3. Stop its pursuit of retrospective GST payments.