



FINAL REPORT

The economic impacts of changing arrangements for the importation of low value products

Levying GST and import processing charges on low value imports

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Contents

Glossary	v
Introduction	1
1 Levying low value tangible imports with GST	4
2 Implementation challenges	10
GST registration of non-resident suppliers	10
Assessing compliance and collecting unpaid GST liabilities	11
Complexity of the GST Act	16
3 Low value imports	18
Australia's low value imports	18
Composition of Australia's low value imports	20
Future growth in low value imports	23
4 Economic impacts of levying low value imports with GST	28
Removing the preferential tax treatment	28
GST compliance costs	33
Impacts on consumers	36
GST revenue collected	38
Economic impacts	38
5 Sensitivity analysis of the GST modelling	41
6 Import processing charges	44
Principles guiding cost recovery charges	44
Costs associated with import processing	45
Devising import processing charges	45
Levying SAC imports with IPC	49
7 Findings	50
Concluding comments	53
BOXES, CHARTS AND TABLES	
1.1 Levying GST on digital downloads	5
1.2 NRS process to determine GST liability for imported goods of less than A\$1000, based on the digital model	7
3.1 Monthly online retail expenditure	19
3.2 Expenditure with domestic and international online retailers	19

3.3	Composition of low value imports	21
3.4	GST status of low value consignments destined for households	22
3.5	Non-resident suppliers exceeding the A\$75 000 turnover threshold	23
3.6	Year-on-year growth in online spending with international retailers	24
3.7	Monthly low value consignments brought into Australia by CAPEC members	25
3.8	Year-on-year growth in forecasts of low value consignments	25
3.9	Projection of average consignment value (FOB)	26
4.1	Welfare losses from preferential treatment of low value imports	29
4.2	Economic efficiency losses for varying demand responses	30
4.3	Consignment numbers and the exchange rate	31
4.4	Consignment numbers and the exchange rate (monthly changes)	32
4.5	Factors driving decision to purchase online	33
4.6	GST compliance costs	36
4.7	Impacts on consumers	37
4.8	Changes to consumer welfare from levying GST on low value imports	38
4.9	Additional GST collected on low value imports by CAPEC members	38
4.10	Economic efficiency losses under the GST free and GST liable scenarios	39
4.11	Share of consignment value accounted for by intermediaries	40
4.12	Economic impacts across all low value imports	40
5.1	Sensitivity analysis	41
5.2	Changing the elasticity of demand	42
5.3	Changing GST compliance costs	42
5.4	Changing growth in average consignment value	43
5.5	Changing rate of foreign supplier compliance	43
6.1	Indicative cost recovery IPC in 2014-15	47

Glossary

ACBPS	Australian Customs and Border Protection Service (now known as DIBP)
ABF	Australian Border Force
CAGR	compound annual growth rate
CAPEC	Conference of Asia Pacific Express Carriers, comprises representatives of DHL, FedEx, TNT and UPS.
CIF	cost-insurance-freight value of imports, given by the FOB value plus the cost of insurance and freight to Australia.
DAP	consignments delivered under delivered at place terms, which sees the seller being responsible for paying carriage up to the point of destination, with the buyer being responsible for meeting border clearance costs and duties/taxes.
DAWR	(federal) Department of Agriculture and Water Resources
DIBP	(federal) Department of Immigration and Border Protection, encompassing the ABF.
Digital model	the application of GST to digital products as introduced by the <i>Tax Laws Amendment (GST Treatment of Cross-border Transactions) Bill 2015</i> .
EU	European Union
FID	full import declaration, imports of FOB value greater than A\$1000 (high value imports) are required to complete a full import declaration on entry to Australia.
FOB	free-on-board value of imports, essentially price of imports at the foreign sea/air port excluding international transportation and insurance costs.
INCOTERM	Pre-defined international contract/sale terms and conditions published by the International Chamber of Commerce.
Intangible supplies	a supply other than goods or real property, including the supply of digital products, such as streaming, downloading of movies, music, apps, games, e-books and services including consultancy and professional services.

Intermediaries	entities that transport supplies into Australia including the express carriers (CAPEC and non-CAPEC members) and (air and sea) international mail.
IPC	import processing charge, comprising border clearance charges levied by DIBP and biosecurity charges levied by DAWR.
ITC	income tax credit, which is equal to the amount of GST paid. An ITC is only available where acquisitions are made solely for a creditable purpose and the supply is made to a GST registered entity.
GST	Goods and Services Tax
Low value imports	goods and services imported into Australia with an FOB value of A\$1000 or less .
LDP	landed-duty-paid value of imports, given by the CIF value plus any import processing charges, import duties and taxes.
LVT	Low Value Threshold, specifies the FOB value of imports at or below which the import is exempt from import processing charges, import duties and taxes.
NORSI	NAB Online Retail Sales Index
NRS	non-resident supplier
Platform	based on the definition of platform in the digital exposure draft, a platform is a service operated by electronic communication (including a website, internet portal, gateway, store or marketplace) where the service allows entities to make supplies available to end users. Services that create awareness (for example, advertising) or provide communications medium (for example, the internet) or payment and processing services alone do not satisfy the requirement of a platform. Reference to 'platform' in this document refer to the operator of a platform.
Platform operator	the operator of a platform that (may) allow multiple entities to make supplies through the platform to consumers.
Reverse charge	for acquisitions not solely related to a creditable purpose (e.g. carrying on the enterprise), the GST liability is shifted to the recipient who is to assess and pay the tax liability to the ATO for the portion of the acquisition where an ITC would not have been available.
SAC	self assessed clearance, imports with a FOB value A\$1000 or less (low value imports) are required to complete a self assessed clearance import declaration on entry to Australia.
Tangible supplies	the supply of merchandise goods.

Taxable import	goods imported to Australia that are not exempt under Schedule 4 to the <i>Customs Tariff Act 1995</i> where GST is calculated on VoTI. Currently, goods with an FOB value of equal to or less than A\$1000 are one of the exemptions under Schedule 4.
Taxable supply	goods and services eligible for GST. Under the government's proposed changes, digital products and low value imports will be eligible for GST (except where they are otherwise exempt under Schedule 4 of the <i>Customs Tariff Act 1995</i>).
VoTI	value of taxable importation, given by the sum of the customs value (FOB), transport and insurance, and wine equalisation tax if applicable.

Introduction

The Australian Government has announced significant changes to the way in which low value imports will be treated. As of 1 July 2017, low value imports will be subject to Goods and Services Tax (GST), with the government also considering levying low value imports with import processing charges (IPCs).

In light of these significant changes to the treatment of low value imports, the Conference of Asia Pacific Express Carriers (CAPEC) has commissioned the CIE to:

- consider the strengths and weaknesses of the proposed model for collecting GST from low value imports
- test and verify key assumptions about the proposed GST collection model with a broad section of stakeholders, including consumer groups, business groups, intermediaries, and international online retailers as to the merits of the idea and what can be done in practice
- undertake economic analysis of the implications of levying GST on low value imports
- consider the options for recovering import related border processing and biosecurity charges from low value imports
- report on findings as to the impacts of proposed changes to the treatment of low value imports and the extent to which these changes have positive or negative impacts for Australian households and the wider economy.

The findings of the analysis will enable stakeholders to engage in a constructive and informed dialogue with policy makers.

The CIE would like to thank those stakeholders that contributed data, information and their views and opinions to the analysis. This includes the American and British Chambers of Commerce, Choice, DIBP, eBay, National Australia Bank and Quantum, and CAPEC members.

Background to this report

Levying low value imports with Goods and Services Tax

Since late 2010, Australian retailers have been increasing their calls for the Australian Government to remove the preferential tax treatment granted to low value imports, and in so doing moving to ensure a level playing field between Australian and overseas retailers. The call to tax low value imports the same as products sold by Australian retailers has coincided with moves by the Australian Government to widen the tax base and improve revenue collection.

Previous reports into the treatment of low value imports have arrived at similar conclusions regarding the cost effectiveness of levying low value imports with GST as an at-the-border charge. Despite there being an ‘in principle’ case to treat low value imports the same way as all goods sold locally...

- ...the Productivity Commission found in 2011 that abolishing the Low Value Threshold would generate additional GST revenue of around \$480 million (and import duties of \$135 million) at a collection cost of well over \$2 billion borne by businesses, consumers and government.¹ It considered that the low value threshold should not be lowered until it was cost effective to do so
- ...the Low Value Parcel Processing Taskforce found in 2012 that the costs of taxation collection would outweigh the revenue collected.² This review also found that there would be net economic costs from removing the threshold.

These earlier studies assumed that GST would be collected as an at-the-border charge. Subsequent to these studies, the Australian Government has sought to find ways to reduce the costs of collection. For example, levying the GST on international retailers via a point-of-sale charge rather than an at-the-border charge.

Following GST related discussions with state and territory Treasures in August 2015, the (then) Commonwealth Treasurer Joe Hockey reported:

...the [state and territory] treasurers agreed to apply the GST to offshore sales into the Australian market. This is a significant initiative. From the 1 July 2017, the GST will be applied to all products and services sold by vendors overseas into Australia. This will deliver competitive neutrality for Australian businesses, it will ensure that there is fair and equal treatment of all goods and services, so that if goods and services in Australia were to have the GST applied by companies in Australia, then the same would apply overseas. (Hon Joe Hockey, 21 August 2015)³

This announcement follows on from the release of the exposure draft on Budget night 2015 to apply GST to foreign sales of intangible (that is, digital) goods to Australian consumers. The policy recognises a shift towards online consumption, consistent with the findings of the OECD/G20 Base Erosion and Profit Shifting Project *Addressing the Tax Challenges of the Digital Economy*.

It is understood that the Australian Government will extend the GST on intangibles (dubbed the ‘Netflix tax’ in the media) to tangible products. While no draft legislation has been released, Treasury has indicated that the model will be based on that proposed for the digital market. This would suggest that:

- a non-resident platform or supplier with a turnover of greater than A\$75 000 in Australia would be required to collect and remit GST liabilities to the Australian Government

¹ Productivity Commission 2011, *Economic structure and performance of the Australian retail industry*, Inquiry Report, Figure 7.1 and surrounding text.

² Low Value Parcel Processing Taskforce 2012, *Final Report*, July, pages 7–10 and 10–11.

³ See <http://jbh.ministers.treasury.gov.au/transcript/175-2015/>, accessed 20 October 2015.

- goods and services of A\$1000 or less in value purchased by private consumers (households) from a non-resident platform/supplier with a turnover of greater than A\$75 000 in Australia would no longer be GST exempt
- transactions related to carrying on a business would continue to be GST exempt.

Levying import processing charges on low value imports

The Department of Immigration and Border Protection has undertaken a review of its fees and charging arrangements, with a view to begin levying IPCs on low value shipments.⁴ Currently, low value imports enter Australia IPC free, with import related border processing and biosecurity charges being met by high value imports (those greater than A\$1000 in value). The current arrangements therefore see high value imports cross subsidising low value imports with respect to IPCs. DIPB has put forward a preferred approach for levying low value imports with an IPC, although has not reported what the IPC charge will be nor estimated compliance costs. The latter is particularly important in the context of the Australian Government commitment to reduce red tape imposed on businesses and households by A\$1 billion per year.⁵

⁴ Australian Customs and Border Protection Service and Department of Agriculture 2014, *Joint Border Fees Review —Position Paper low value goods*, November 2014.

⁵ Australian Government, Cutting red tape, <https://cuttingredtape.gov.au/>, accessed 16 October 2015.

1 *Levying low value tangible imports with GST*

The Australian Government's announcement in August 2015 to extend GST to low value imports comes off the back of an international effort to combat cross border tax evasion and the recent work in the European Union to tax digital supplies.

The complexity and cost associated to apply GST to low value imports has been examined in a number of studies over the last five years.⁶ The Productivity Commission's *Economic Structure and Performance of the Australian Retail Industry Inquiry* (2011) concluded:

There are strong in-principle grounds for the low value threshold (LVT) exemption for GST and duty on imported goods to be lowered significantly, to promote tax neutrality with domestic sales. However, the Government should not proceed to lower the LVT unless it can be demonstrated that it is cost effective to do so. The cost of raising the additional revenue should be at least broadly comparable to the cost of raising other taxes, and ideally the efficiency gains from reducing the non-neutrality should outweigh the additional costs of revenue collection. (Productivity Commission, 2011)⁷

As previously noted, the Productivity Commission found that GST collection costs would far and away exceed the collected tax revenue (by a factor of around 3.25 to 1). The Productivity Commission's finding was premised on the basis of GST being collected via an at-the-border charge.

GST currently applies to taxable supplies as 1/11th of the sale price. The retail sector contends that, in the case of low value imports, they are at a competitive disadvantage as these imports are exempt from GST whereas domestic sales (for private consumption) of the same product would generally be subject to GST.^{8, 9}

No legislation has been released since the government's announcement to apply GST to low value imports, although Treasury have indicated that the model for the application of

⁶ Allen Consulting Group (2011) submission to Productivity Commission on behalf of eBay; Low Value Parcel Processing Taskforce (2012), National Retail Association (2012) by Ernst & Young, Parliamentary Library Report (2014).

⁷ Productivity Commission 2011, *Economic structure and performance of the Australian retail industry*, Inquiry Report, Recommendation 7.1, page 214.

⁸ See the National Retail Association submission to the National Commission of Audit *Protecting the Integrity of the GST System*, page 3; submission to the Review of small Business Tax Impediments *A level Playing Field for Australian Retail*, page 3, response to Treasury release of Tax Laws Amendment (Tax Integrity: GST and Digital Products) Bill, see <http://www.anra.com.au/LiteratureRetrieve.aspx?ID=146951>, accessed 20 January 2016.

⁹ Sellers registered for GST will charge GST on their supplies. Sellers must be registered for, and pay GST if their turnover in Australia is greater than or equal to A\$75 000. Sellers can choose to be registered for GST if their turnover is less than the registration threshold.

GST to digital downloads would be extended to low value imports. This would treat low value imports as *taxable supplies* rather than taxable imports and create competitive neutrality between domestic and foreign suppliers selling goods in Australia.¹⁰ The key features of the digital download GST model are summarised in box 1.1.

1.1 Levying GST on digital downloads

GST will be remitted and paid by non-resident suppliers of goods and services under a vendor collect model where:

- the supplier is a non-resident *businesses or platform* with a turnover of greater than or equal to A\$75 000 in Australia
 - ... to shift the GST liability to the platform, the platform must control one of these elements: has involvement in authorising billing; authorising delivery of the supply; or sets the terms and conditions under which the supply is made
 - ... suppliers may be eligible for limited registration, which would reduce their reporting requirements (compared to full registration), but making them income tax credit ineligible
- the imported items would be less than or equal to A\$1000 in (free on board) value, and treated as a taxable supply, not a taxable importation. The item is to be acquired by an Australian consumer (Australian consumer relates to Australian residence, *and* not being registered for GST, *or* registered for GST, but the acquisition not related to carrying on an enterprise)
- business to business transactions will be exempt
- supplies made for dual purpose private and business use will be reverse charged so that the recipient is to assess their GST liability and make the GST payment to the Australian Tax Office.

Source: Tax Laws Amendment (GST Treatment of Cross Border Transactions) Bill 2015 Exposure Draft Explanatory Material, pages 8–30.

Applying the digital model to tangible products would see the non-resident supplier responsible for collecting and remitting GST to the Australian Tax Office (ATO) for supplies equal to or less than A\$1000. Importantly, this approach would also see:

- no change in the import low value threshold, and hence no import duties on imports valued equal or less than A\$1000
- no change in the border clearance process nor border processing/clearance charges (imports equal to or less than A\$1000 currently enter Australia free of charge).

The proposed approach would place the direct GST regulatory and compliance burden on non-resident suppliers, and to a lesser extent consumers (see further below). If non-resident suppliers experience GST related cost imposts, then it is anticipated that such cost increases will be passed onto Australian consumers.

In contrast to the GST on importation approach, the GST on supply approach should see no impact at the border, no need for delivery agents to change existing processes, and no

¹⁰ References to Australia refer to the indirect tax zone.

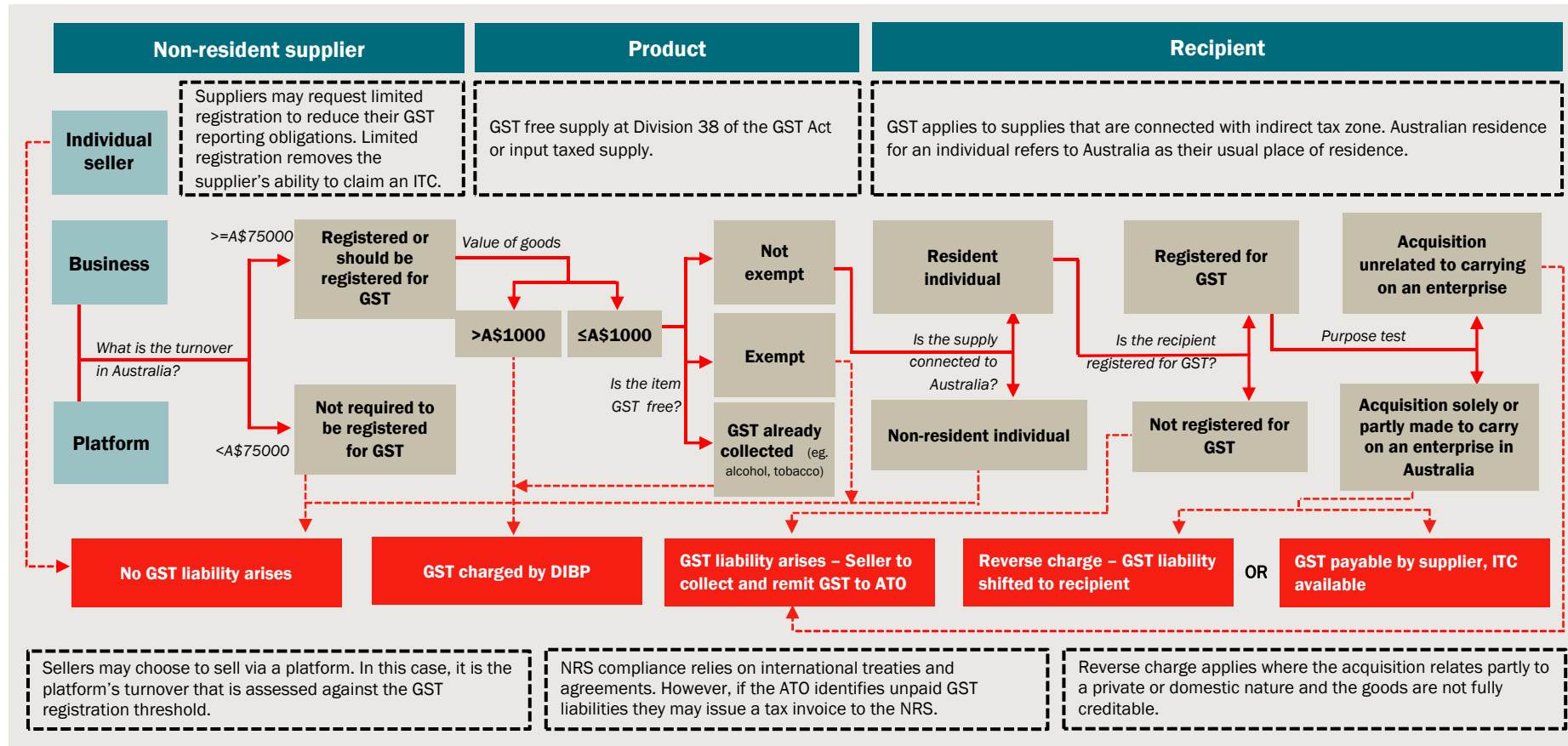
change in the time it takes for consumers to receive their purchase allowing the flow of legitimate trade across the border.

The application of GST to the digital economy is consistent with Action item 1 in the OECD /G20 Base Erosion and Profit Shifting Project *Addressing the Tax Challenges of the Digital Economy*.¹¹ The Australian Government considers that the application of GST to digital products will reduce the risk of GST revenue base erosion due to the growth in online consumption.

Chart 1.2 applies the digital model and current GST legislation to low value imports. As can be seen, there are impacts at the non-resident supplier, product and purchaser levels.

¹¹ OECD/G20 2015 *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report* http://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en, accessed 18 January 2016.

1.2 NRS process to determine GST liability for imported goods of less than A\$1000, based on the digital model



Note: References to 'Australia' relate to the indirect tax zone. ITC refers to an income tax credit. The GST Act refers to A New Tax System (Good and Services Tax) Act 1999. It is unclear whether the ITC and reverse charge provisions will work in unison or if the reverse charge provisions will replace the ITC system for businesses that acquire taxable supplies from non-resident entities to carry on their enterprise.
 Data source: CIE, Treasury 2015 Tax Laws Amendment (GST Treatment of cross-border transactions) Bill 2015 Exposure Draft Explanatory Material, A New Tax System (Good and Services Tax) Act 1999

Non-resident supplier

GST, import duties, border clearance and biosecurity charges, luxury car tax and the wine equalisation tax is collected by DIBP on taxable importations (that is, those above A\$1000 in FOB value) arriving in Australia via an intermediary. DIBP also conducts risk assessed checks of goods declared to be less than or equal to A\$1000 in value to ensure that they are declared correctly and no taxation is payable (low value alcohol and tobacco imports are taxed). In some cases, a tax invoice is issued to the importer for unpaid taxes where a declaration is found to be incorrect or tax liable. The proposed policy will have no impact on the current role of DIBP, although will require NRSs to conduct a similar task by assessing and collecting GST liabilities for payment to the ATO for goods under the low value threshold. This will place an administrative burden on non-resident suppliers who would otherwise be disconnected with the Australian tax system.

The draft digital legislation requires NRS or platforms with a projected turnover of A\$75 000¹² in Australia to collect and remit GST to the ATO on the digital goods acquired by the Australian consumer. NRSs will have a monthly obligation to forecast their Australian sales (considering exchange rates) for the following 12 months, and register when they believe they may exceed the threshold.

Product

For equity, the same GST exemptions (Division 38 of the GST Act) that currently apply to taxable imports and supplies would need to apply to low value goods. This would require the NRS or platform to know if the good they are selling is GST exempt. This implies that non-resident business owners will need to know the GST Act and platforms will need to request the relevant information from their sellers.

Greater clarity is required around the GST base — whether GST is payable on the FOB value or the landed duty paid (LDP) value, and if commissions or other fees charged by the supplier during the transaction are included.¹³ For comparability to the treatment of Australian suppliers, GST would need to be levied on the price of the good delivered to the Australian consumer.

Recipient

The draft digital legislation requires that NRSs take reasonable steps to determine if the good or service is going to an *Australian consumer*.¹⁴ The explanatory material acknowledges that a non-resident supplier can do little beyond rely on the information

¹² The proposed GST registration threshold for non-resident suppliers is consistent with the threshold that applies to resident sellers.

¹³ Note that as the Low Value Threshold is not changing, low value imports will continue to enter Australia free of import duty and border clearance charges. Hence for all intents and purposes, the landed duty paid price is essentially the CIF price, which is the FOB value plus the cost of delivery.

¹⁴ Tax Laws Amendment (GST Treatment of Cross Border Transactions) Bill 2015 Exposure Draft Explanatory Material, p 15.

supplied by the consumer, however the supplier must ensure that they collect sufficient information to make an informed decision about the recipient.

The test for an *Australian consumer* relates to the recipient's residency status, their GST registration status and the purpose of the purchase. The recipient must be an Australian resident (but not solely because they are a resident of one of Australia's external territories) and must not be registered for GST, or if registered for GST, the purchase must not be in the course of carrying on an enterprise. The consumption is also to be in Australia (the explanatory material for the digital goods illustrates how an Australian resident that purchased hairdressing services in a foreign jurisdiction would not give rise to a taxable supply for GST).¹⁵

Consumers who purchase goods online through their business account would not be liable for GST as the amount will either be reverse charged, or GST exempt. To ensure that GST is only paid on goods for domestic or private consumption, the consumer will need to make declarations to that effect for each purpose. We understand that the need to identify GST liable products and Australian consumer status for buyers would require a change to accounting and online sales systems for the business or the platform.

Obligation on non-resident suppliers

The NRS model would impose a number of requirements on foreign suppliers:

- 1 to (continually) assess whether they need to register for GST, and if so, register (limited or full)
- 2 to identify taxable liable sales (on both the product and consumer side)
- 3 to collect GST on taxable sales
- 4 to report on and pay GST monies to the ATO based on their sales to Australian consumers (suppliers would need to meet the timings stipulated by the Australian Government)
- 5 to establish mechanisms to refund GST monies where the taxable sale was cancelled and/or a refund is processed, and to prevent double taxation if a product is returned to the NRS (under warranty) for repair.

The NRS model will therefore clearly impose implementation and ongoing costs on foreign suppliers.

¹⁵ Tax Laws Amendment (GST Treatment of Cross Border Transactions) Bill 2015 Exposure Draft Explanatory Material p19–20.

2 *Implementation challenges*

There appears to be a number of challenges associated with enforcing compliance with the NRS model. These are discussed below.

GST registration of non-resident suppliers

There is little incentive for non-resident suppliers to be conversant with the Australian GST law and comply. The complexity of the law and the associated costs to foreign firms to implement systems to charge, collect and remit the GST to the ATO (even if they were to pass the costs on to consumers) reduces the simplicity that is associated with selling online.

Enforcement of registration

Analysis of CAPEC express carrier (consignment) data for an average one week period found 1100 unique NRSs would be required to register for GST.¹⁶ Realistically, the total number of individual foreign suppliers required to register would be much higher as this figure does not include international mail data (which accounts for approximately 50 per cent of low value imports) and non-CAPEC express carriers.¹⁷

It is difficult to gauge how all of these suppliers would be aware of and understand their GST obligations, particularly when policy makers promote a ‘hands-off’ approach to the Department of Immigration and Border Protection (DIBP) checking tax compliance.

Large businesses and platforms may register due to social pressure and the value associated with the perception of being a ‘good corporate citizen’. However, this is unlikely to be the case with smaller businesses. Based on data provided by some CAPEC members, it is estimated that 40 per cent of purchases are conducted through platforms, and it can be expected that these businesses would agree to collect GST on sales to Australia.

¹⁶ Based on analysis conducted by the CIE using data provided by CAPEC. Sellers who should be registered supply goods to Australia and have an estimated annual turnover in Australia of at least A\$75 000. The one week period was an average trading period in June 2015. See chapter 3 for further information.

¹⁷ The 50 per cent figure is based on 2009-10 data for international mail as it is the most recent data publicly available. See CIE (2011), *The GST threshold for low value products: Economic impacts*, report prepared for the Conference of Asia Pacific Express Carriers, tables 2.1 and 2.4.

Application of GST to platforms

Individuals, small businesses and large businesses can sell via the same platform. Applying the GST liability to the platform implies that all sales via the platform to Australia would attract GST (that is, unless the supply is exempt under Division 38 of the GST Act).¹⁸ This means that all sellers, including individuals and sellers with a business turnover in Australia less than the A\$75 000 threshold will have GST applied to their products. If those suppliers had been resident suppliers and selling goods in Australia, they would not be liable for GST. Hence such NRSs will suffer an unwarranted competitive disadvantage.

Consultation with industry highlighted how platforms can be structured differently to online businesses. Some platforms are a marketplace, where the platform acts as an intermediary between the buyer and the seller (for example, Ebay) and others have their own shopfront, selling and warehousing their own products (for example, Amazon). The CIE met with industry to discuss how the policy could be implemented. Applying tax to the platform may require the platform to change their established business model and conduct a system redesign. The system would need to identify GST liable, low value goods, whether GST is collected by DIBP (as for alcohol and tobacco products), if the recipient is an Australian consumer, and if purchased through an enterprise, the purpose of the purchase. For returned products (that is, refunds) or where the product was not supplied, the system would need a GST refund mechanism. A mechanism would also be needed to avoid the double GST taxation of low value goods that are returned to the NRS for repair under warranty (with the supply being levied with GST when first purchased, and then potentially again on entry to Australia after being repaired). The cost to develop and implement new systems would be passed onto consumers or result in a reduction of the non-resident supplier's profit margin if they chose to absorb the cost.

Assessing compliance and collecting unpaid GST liabilities

Legal complications

Under the territoriality principle, Australia has the legislative jurisdiction to impose GST on non-resident suppliers, however, Australia has no jurisdiction over enforcement.¹⁹ While Australia is a signatory of the *Convention on Mutual Administrative Assistance in Tax Matters* (the Convention), this does not provide the Australian Government with the power to make direct contact with a non-resident supplier and/or issue a tax invoice for unpaid GST. Doing so would breach sovereignty. If the non-resident enterprise was located in a state that is a signatory to the Convention, the Australian Government may attempt tax recovery through the court system of that country.²⁰ This route would be a

¹⁸ The ATO's website contains a broad list of exemptions, see [https://www.ato.gov.au/Business/GST/When-to-charge-GST-\(and-when-not-to\)/GST-free-sales/](https://www.ato.gov.au/Business/GST/When-to-charge-GST-(and-when-not-to)/GST-free-sales/), accessed 27 November 2015.

¹⁹ Boccabella, D & Bain, K (2015), *Removal of the GST low value threshold: analysis of main design options and enforcement issues* Australia Tax Law Bulletin p172–176.

²⁰ *Ibid.*

complex procedure and could only be considered in extreme cases as both governments need to be willing to commit resources to collect the revenue, and where the administrative burden on the other country would need to be in proportion to the claim/benefit to Australia.

Adding to the enforcement challenge is the fact that some of Australia's trade partners have multiple layers of government, each responsible for the collection of different taxes. In the United States for example, it is state governments that are responsible (where applicable) for the collection of sales tax (the GST equivalent) and not the federal Internal Revenue Service. While the Convention allows for an exchange of information, and the recovery of foreign tax claims, these jurisdictional differences provide a layer of complexity as the United States (federal) government has no jurisdiction over sales tax. Hence the Australian Government may need to work through individual American states to enforce compliance.

Identification of eligible entities

To identify NRSs that need to register for (and therefore collect) GST, the ATO would first need to identify unique foreign suppliers and sum their sales to Australia. Consignment data provided by intermediaries to the DIBP may provide an avenue to identify eligible non-resident suppliers, although this will be a resource consuming activity. In 2014-15 CAPEC members alone brought into Australia 8.8 million low value consignments. The number of unique NRSs will likely run into the tens of thousands. The non-resident supplier identification exercise will be complicated by factors such as parent/subsidiary relationships and who the supplier is reported as, the level of detail that intermediaries go to in identifying the supplier, down to simple things such as misspelling of the supplier's name. Furthermore, and depending on how 'turnover' is defined, there may also be a need to include high value import records (Full Import Declaration consignments) in the record checking, as a NRS may make sales to Australia under both the low and high value categories.

If the definition of turnover excludes sales of GST exempt products (as is the case for Australian suppliers), then there will also be a need for the ATO to take into account the products sold (and potentially how used) to assess GST liability status. The consignment records, as submitted to DIBP, do not go into the required level of detail to make this assessment.

The quality of the available data and the diversity of NRSs will make the ATO's task of identifying GST eligible foreign suppliers challenging.

Compliance costs

In the (former) Treasurer's communique of 31 August 2015, Treasurer Hockey noted that the administration costs would be relatively low under a NRS registration model as goods would not be stopped at the border.²¹

²¹ The Hon Joe Hockey, 21 August 2015, *Statement: Council on Federal Financial Relations Tax Reform Workshop*, media release.

While goods are not stopped, there is an implied cost imposed on the ATO to reconcile data received from DIBP and that received from NRSs. This additional task of the ATO would come at a cost of more staff, or a shift in staffing priorities. Furthermore, as previously noted, there will clearly be a compliance cost imposed on NRSs. The willingness of NRSs to incur an implementation and potential ongoing cost (for the systems alone) in return for no financial benefit for their business is likely to be very low. The Australian Government having no meaningful enforcement mechanism further reduces the likelihood that NRSs will comply.

Reconciliation between NRS reports and import data

To assess compliance with foreign suppliers²² meeting their GST obligations, the ATO only has data collected by DIBP with which to reconcile GST reporting by NRSs. There are however some limitations with the reported data which limits how it can be used.

- Consignment records provided to DIBP are the FOB value of imports, rather than the LDP value of imports, the latter the base for GST.²³ Hence the ATO will not be able to directly observe the value needed to assess the GST base nor derive the GST to be remitted.
- The data collected by DIBP does not contain sufficient product detail to ensure the correct assessment of GST liability by the ATO.

The *Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015* made a number of minor amendments in addition to the proposed digital changes, including the introduction of an alternative method to calculate transport and insurance costs for GST registered importers. The amendments aim to reduce compliance costs for GST registered importers by allowing them to use a percentage of the customs (FOB) value of the imported good as the proxy to calculate the VoTI.²⁴ The FOB value, plus the estimated cost for transport and insurance (calculated using the proxy), could be applied to low value goods to estimate the CIF value. In deriving the percentage mark-up, account would need to be taken of:

- consignment weight and/or volume
- the country (or city) of origin, and delivery point in Australia
- different freight rates across express carriers, international post and sea carriers etc
- freight discounts offered to large volume users.

Applying a derived mark-up will unlikely be adequate to cover the diversity in freight costs. At best, the percentage mark-up of the (reported to DIBP) FOB value of imports to arrive at the CIF value could be used by the ATO to determine whether a NRS should be

²² This refers to foreign suppliers that are not currently registered for GST. Foreign suppliers who are currently registered for GST are subject to the same GST reporting as a domestic suppliers.

²³ Note that as the low value threshold is not changing, the land-duty-paid value will in most cases be identical to the cost-insurance-freight value.

²⁴ Tax Laws Amendment (GST Treatment of Cross Border Transactions) Bill 2015 Exposure Draft Explanatory Material, reference 2.167, page 68.

further investigated/audited by the ATO. But whether the ATO has the ability to check (and enforce) GST compliance is questionable, as discussed above.

International experience

The international movement to apply consumption tax to cross border digital services has been adopted in the European Union, Norway, Switzerland, South Africa and South Korea; with likely implementation in the United States, Japan and New Zealand. The models are relatively consistent for business to consumer sales — the offshore supplier is to register for VAT or GST in the country to where they export, charge the tax to the consumer at the rate applicable in the country of consumption, and then pay the tax to the appropriate revenue authority. The process is relatively new therefore the success is yet to be determined, but the digital services market would appear to be simpler than the market for goods:

- digital sales are ‘like’ goods/similar transactions compared to sales of goods which may be taxed differently depending on the type of good and the type of purchaser
- there would likely be a significantly smaller number of NRSs supplying digital products
- NRSs would not need to report insurance and transportation costs due to no intermediary being involved in product delivery.

The (Australian) draft legislation to collect GST on digital products appears to be based on the European Union (EU) system to collect VAT on digital supplies.²⁵ The EU VAT system requires all sellers (EU and non-EU) to apply VAT to sales of digital products to EU consumers. The VAT (charged by the seller, who may be a platform) is applied at the rate in the consumer’s country. These processes would place a high administrative burden on businesses for digital products as they are responsible for:

- 1 charging, collecting, reporting and paying VAT in each country where they have a business presence to the local revenue authority or
- 2 charging, collecting, reporting and paying VAT through the VAT mini one stop shop (VAT MOSS).²⁶

The system in the EU is unique as the single EU market enables data sharing and provides enhanced legal powers across member states. The VAT MOSS system is available to any VAT registered business in the EU, or any non-EU business that has

²⁵ The collection of VAT on tangible goods occurs through a customs process similar to the Australian process for goods above A\$1 000. Where imports from non-EU countries arrive for consumption in the EU, VAT and duty is payable if the value of the import is above a threshold. Thresholds and VAT rates are different for each EU Member State. A list of VAT rates (for tangible goods) by country can be found at http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf, accessed 19 January 2016.

²⁶ There are two types of VAT MOSS schemes — Union VAT MOSS for businesses based in the EU and non-union VAT MOSS for businesses based outside the EU. See the flow chart at the UK HM Revenue and Customs website for further details at https://whitehall-admin.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/415931/VAT_MOSS_Flow_chart_FSB_edit_V1_0.pdf, accessed 19 January 2016.

registered with a country in the EU. The system allows a seller to report all of their sales within the EU in the same place, providing access to the correct VAT rates and exchange rates. The collaborative electronic system provides a compliance mechanism for EU member states to ensure that the correct VAT is collected from registered businesses.

The revenue authority in each member state conducts compliance on registered businesses and non-compliance can result in a VAT MOSS penalty or a fine from the EU member state where the VAT was due.²⁷ The additional legal powers provide cross border audit capability:

If you're registered for VAT MOSS, the tax authority of the member state where you make digital sales to consumers has the legal right to audit your VAT MOSS Return... Normally the tax authority of your home member state will co-ordinate any audit request and contact you about this. (HM Revenue and Customs 2016 *Compliance: audit and penalties*)²⁸

There is no difference in the application of VAT on digital goods for non-EU based businesses exporting to consumers of EU member states to that of EU businesses selling to the same consumers. The policy for digital products has been in place for only 12 months, therefore it hard to gauge how successful the EU has been in ensuring all businesses are registered and whether they are reporting and paying VAT as required. The Australian Government and the EU will face similar compliance issues — the inability to know the exact value of digital goods sold to EU consumers by NRSs and the inability to force non-compliant businesses to pay their tax obligations where they have no jurisdiction. Where an enterprise registers for VAT or GST, the government may have a greater chance of obtaining records, but where the enterprise fails to register, the government will have limited oversight of the business's sales to consumers.

It has not been commonplace to adopt the digital model for cross border *tangible* goods. The existing process of taxing importations as they move across borders has been maintained.

The concern over processing costs at borders is common across jurisdictions with some nations moving to increase the threshold. The United States, for example, introduced the *Low Value Shipment Regulatory Modernization Act of 2015 Bill* to amend the *Tariff Act 1930* to increase the de minimis threshold, and has recently announced an increase in the de minimis threshold from US\$200 to US\$800 for 2016, with annual adjustments thereafter for inflation.²⁹ If the Australian Low Value Threshold had been indexed with inflation since it was first introduced in June 1985, it would be around A\$2800 in December 2015.³⁰

²⁷ HM Revenue and Customs website <https://www.gov.uk/guidance/register-and-use-the-vat-mini-one-stop-shop>, accessed 20 January 2016.

²⁸ *Ibid.*

²⁹ See the American Congress website <https://www.congress.gov/bill/114th-congress/house-bill/978>, accessed 21 January 2016.

³⁰ In real terms, what A\$1000 would buy in June 1985 would be equivalent to what A\$358 would buy in December 2015.

The OECD and G20 however continue to look at models to (efficiently) apply GST/VAT to low value goods. The Transitional Standard 4.13 of the General Annex to the (Revised) Kyoto Convention³¹ recognises that:

...the collection and payment of duties and taxes should not be required for negligible amounts of revenue that incur costly paperwork, both for the Customs administration and the importer/exporter. (World Customs Organization)³²

The proposed NRS taxation model effectively shifts the cost of collecting tax liabilities from the Australian Government to the non-resident suppliers. The EU Commission has discussed the taxation of low value goods, and proposes that the natural next step would be the introduction of a broader one stop shop for all EU business to consumer supplies of goods and services.

The Commission services believe that the successful introduction of the MOSS is crucial for delivering the necessary buy-in by Member States for the broader One Stop Shop. (EU Commission)³³

The ability to use a common system to report, assess liability and collect the tax appears to be the mechanism that the EU considers necessary for successful policy implementation. This information sharing is not yet something that is available to Australia.

Complexity of the GST Act

The complexity of the GST legislation may provide a significant obstacle for NRSs (there are over 230 exemption codes³⁴) as the time cost imposed on the seller to carve out exemptions may be too high.

The NRS would need to understand the exemptions within the act, classify their goods accordingly and continuously monitor changes made to the GST legislation. The exclusion of basic food or inclusion of clothing into a GST base calculation is relatively straight forward, however the exemption for some products is dependent on the purpose of the purchase.

Dental supplies, for example, are generally GST free when the supplies are provided to a patient where a Medicare benefit is payable. However, GST would be applied to dental

³¹ The International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention) entered into force in 1974 and the revised version in 2006. The Kyoto Convention establishes governing principles for international trade and efficient customs procedures.

³² See <http://www.wcoomd.org/en/topics/wco-implementing-the-wto-atf/atf/~media/WCO/Public/Global/PDF/Topics/WTO%20ATF/dev/RKC%20Guidelines%20Ch4.ashx>, accessed 19 January 2016.

³³ European Commission Expert Group on Taxation of the Digital Economy (2014), Working Paper on VAT issues, p3, at http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/2014-03-13_vat_ecommerce.pdf, accessed 21 January 2016.

³⁴ Department of Immigration and Border Protection website <https://www.border.gov.au/Busi/Carg/CMR-/GST-Exemption-Codes>, accessed 15 January 2016.

supplies where no Medicare benefit is payable (for example, the importation was for cosmetic purposes). The 'purpose' of the purchase is determined by the consumer and it is unrealistic for foreign businesses to know the purpose of the purchase. If platforms or businesses implement the GST across all sales to simplify the process, a competitive disadvantage would apply to those NRSs selling products that should be GST exempt, and consumers would face increased costs.

Furthermore, where a customer purchases GST free and GST inclusive goods in a single transaction, the reporting and GST calculation is further complicated for the supplier and DIBP. It is anticipated that any change to the current system will require systems changes for DIBP and the ATO to provide enhanced data capture and audit capability.

3 *Low value imports*

During 2014-15 Australia's merchandise imports were valued at A\$270 billion.³⁵ To enter Australia, imported consignments must meet a number of biosecurity, border processing, import duty, taxation and other fees/charges requirements.

For those imports with a value of A\$1000 or less (FOB value), the Low Value Threshold (LVT) exempts most of these imports from GST, import duties, biosecurity and border processing fees and charges, and the need to complete a full import declaration (FID).³⁶ This streamlined approach to treating (low value) imports facilitates trade and may support cost effective collection of taxation. The LVT exemption also sees low value imports being delivered to Australian households and businesses at a lower cost than otherwise.

Australia's low value imports

Low value imports are growing rapidly and are accounting for an ever increasing share of Australian retail expenditure. The growth in low value imports reflects substantial growth in online shopping by Australians. The National Australia Bank (NAB) estimated domestic and international online shopping by Australians to be valued at A\$17.3 billion in 2014-15, and based on observed trends and seasonality, CIE estimates that online spending would have been around A\$9.5 billion in 2010-11.³⁷ These figures suggest that online retailing in Australia is growing at the average rate of 16.3 per cent per annum. In contrast, expenditure at traditional bricks and mortar retailers grew at 3 per cent per annum over the same period. It can be seen from chart 3.1 that domestic and international online retailing is estimated to have accounted for 4 per cent of retail expenditure in Jan 2011, versus over 7 per cent as at August 2015. It should also be noted, as is shown below, that the majority of Australia's online retail expenditure is domestically orientated and not international.

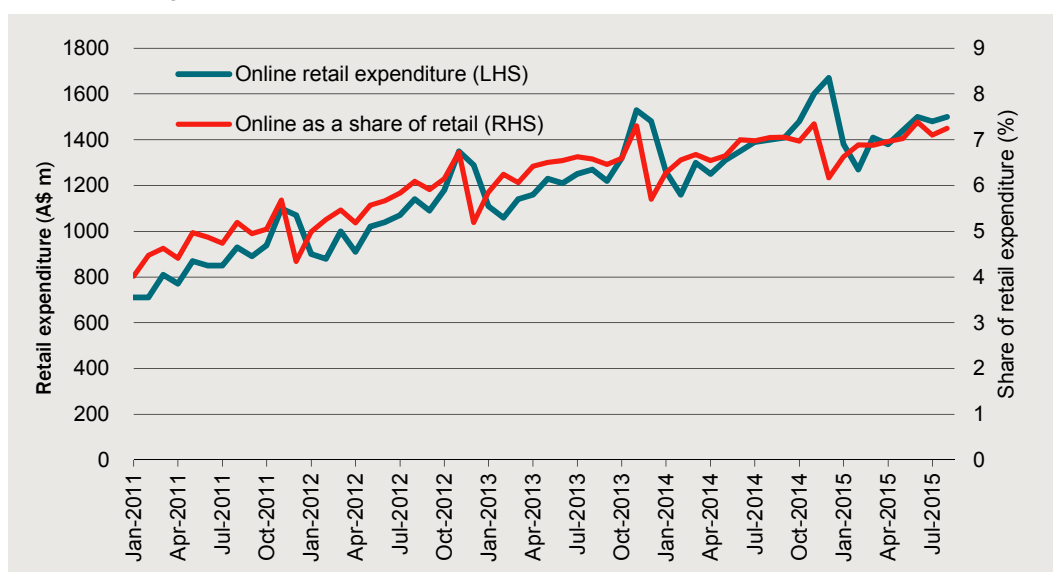
Online retailing comprises purchases from both Australian (domestic) and international retailers. Figures from the NAB Online Retail Sales Index (NORSI) suggest that since 2010-11 expenditure with domestic online retailers has grown at the average annual rate of 17 per cent, versus 14.4 per cent in the case of international online retailers.

³⁵ Department of Foreign Affairs and Trade 2015, *Monthly trade data — August 2015*, <http://dfat.gov.au/about-us/publications/trade-investment/Pages/monthly-trade-data.aspx>, table 2, accessed 19 October 2015.

³⁶ For alcohol and tobacco imports, the full range of taxes and fees/charges apply.

³⁷ National Australia Bank 2015, *NAB Online Retail Sales Index (NORSI)*, data underlying NORSI prepared and provided by Qantium. NORSI is based on up to 2 million non-cash transactions by NAB customers per day, scaled up to replicate the broad Australian economy.

3.1 Monthly online retail expenditure

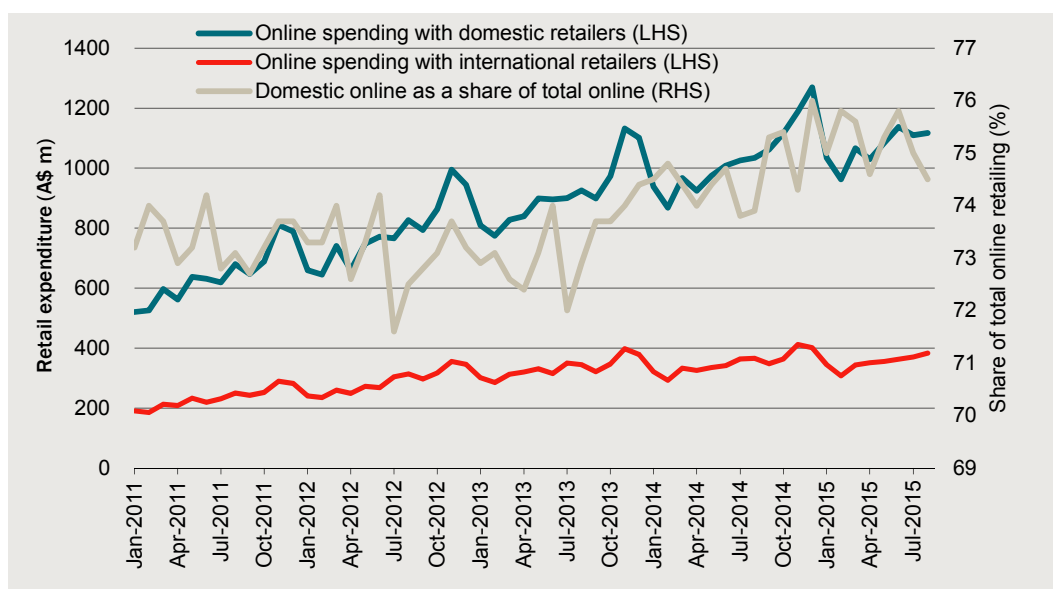


Note: Online sales include purchases of both tangible and intangible products.

Data source: ABS 8501.0, NORSI and CIE.

As can be seen in chart 3.2, the faster growing domestic online retailing sees domestic retailers accounting for a growing share of online retailing. Domestic online retail comprised approximately 75 per cent of total online retail spending in August 2015.

3.2 Expenditure with domestic and international online retailers



Note: Online sales include purchases of both tangible and intangible products.

Data source: ABS 8501.0, NORSI and CIE.

Composition of Australia's low value imports

During 2014-15 CAPEC members transported into Australia 8.8 million low value consignments. The revenue raised and economic impacts of levying low value imports with GST will be influenced by:

- the number of consignments
- the share of those consignments destined for households
- the (average) value of consignments going to households
- the GST liability status of those consignments.

Low value consignments brought into Australia by CAPEC members over a 'representative' one week period (spanning 14–20 June 2015) have been analysed to provide insight into the above areas.

Average consignment value

The dataset(s) provided by CAPEC members yielded a sample of nearly 129 000 low value consignments. These consignments were then allocated to either a business or household recipient based on consignee name (some CAPEC members also identified whether the recipient was a business or individual).

Table 3.3 shows the allocation (share) of consignments by number and value for these consignments. Also shown is the average value of consignments.

As can be seen, households accounted for 65 per cent of low value consignment, with 78 per cent of these consignments being under A\$300. Business use of low value imports is similarly skewed towards the lower valued imports (73 per cent of consignments destined for businesses had a value under A\$300).

As GST is intended to be collected from only business to consumer transactions (see chapter 1), then 65 per cent of low value consignments, accounting for 63 per cent of import value, would attract GST (assuming all such products were GST liable).³⁸

³⁸ Certain goods/services (such as medical equipment) may not be liable for GST, and NRSs will only have to levy GST if their turnover in Australia is greater than A\$75 000 (see chapter 1). These figures also ignore any demand response to now higher priced imports.

3.3 Composition of low value imports

Value range	Number of consignments			Value of consignments			Average consignment value		
	Hhold	Bus.	Total	Hhold	Bus.	Total	Hhold	Bus.	Total
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	A\$	A\$	A\$
\$0-100	30	17	47	7	2	9	45.18	27.06	38.60
\$101-200	14	5	20	10	4	14	143.07	144.54	143.47
\$201-300	7	3	10	8	4	12	244.40	246.33	245.00
\$301-400	4	2	6	7	3	10	346.98	348.27	347.41
\$401-500	3	2	4	6	3	9	446.75	447.94	447.18
\$501-600	2	1	3	6	4	9	548.16	547.05	547.73
\$601-700	2	1	3	5	4	9	648.49	651.10	649.58
\$701-800	1	1	2	5	4	9	749.37	751.40	750.25
\$801-900	1	1	2	5	4	9	848.39	848.81	848.59
\$901-1000	1	1	2	5	5	10	943.82	948.52	946.36
Total	65	35	100	63	37	100	197.88	220.17	205.65

Note: It should be noted that the average consignment values reported in table 3.3 are FOB values. This is the value reported by intermediaries to DIBP. However, GST is to be levied on the landed duty paid value of consignments, which in absence of changes to the Low Value Threshold, is essentially the CIF value. The difference between the FOB and CIF values is the cost of insuring (if up taken) and transporting the product to Australia.

Source: CAPEC members and CIE analysis.

GST liability

A sub-sample of nearly 14 800 consignments was randomly taken from the CAPEC dataset(s) and analysed for the GST liability status of those consignments. Consignments were classified, as best as possible, as being one of:

- GST exempt (basic food products and medical/dental related products and equipment)
- GST already paid (alcohol and tobacco products are levied with GST even though they are below the LVT)
- GST liable (all other products).

Table 3.4 reports the findings of the analysis. Note that given the complicated nature of Australia's GST, the Australian Taxation Office would need to provide guidance as to whether low value imports would attract GST. Hence figures reported in table 3.4 should be treated with the appropriate caution. Overall, it is estimated that 99.5 per cent of consignments (by value) would be liable for GST.

3.4 GST status of low value consignments destined for households

Value range	Number of consignments			Value of consignments		
	GST liable	GST exempt	GST paid	GST liable	GST exempt	GST paid
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
\$0–100	99.3	0.6	0.1	99.3	0.6	0.1
\$101–200	99.1	0.8	0.1	99.1	0.8	0.0
\$201–300	99.9	0.1	0.0	99.8	0.2	0.0
\$301–400	99.7	0.3	0.0	99.7	0.3	0.0
\$401–500	98.6	1.4	0.0	98.6	1.4	0.0
\$501–600	100.0	0.0	0.0	100.0	0.0	0.0
\$601–700	100.0	0.0	0.0	100.0	0.0	0.0
\$701–800	98.7	0.8	0.5	98.7	0.8	0.5
\$801–900	100.0	0.0	0.0	100.0	0.0	0.0
\$901–1000	100.0	0.0	0.0	100.0	0.0	0.0
Total	99.4	0.6	0.1	99.5	0.4	0.1

Source: CAPEC members and CIE analysis.

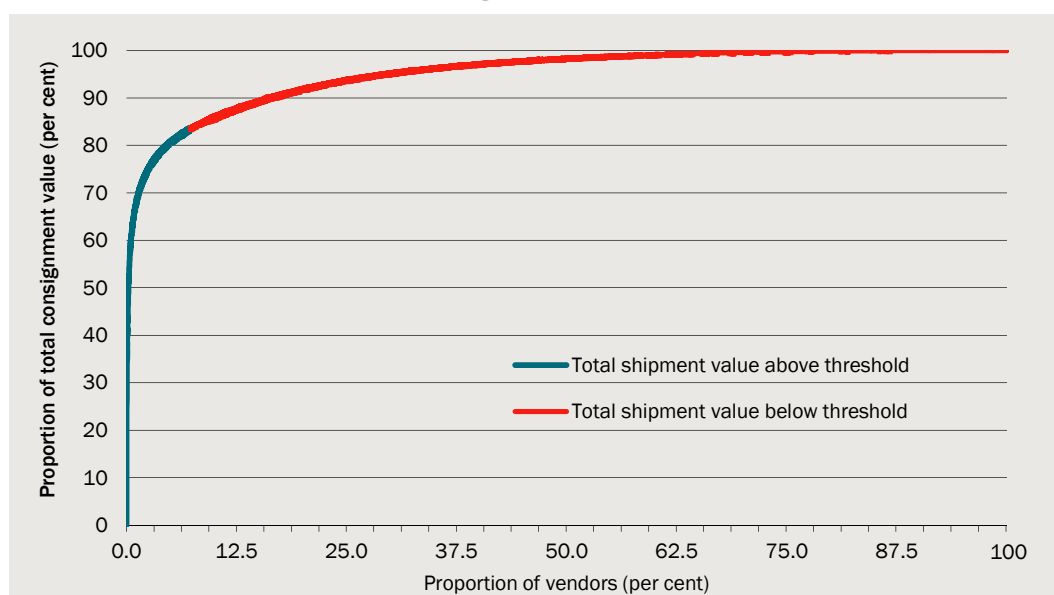
Number of GST liable non-resident suppliers

Only those NRSs with an annual turnover of at least A\$75 000 in Australia will be required to levy their products with GST (assuming products are not GST exempt). Drawing on the CAPEC datasets(s), the annual Australian turnover of foreign NRSs has been estimated.³⁹ For the one week period in June 2015, it is estimated that there were 1100 unique NRSs who would exceed the A\$75 000 turnover threshold, and therefore be required to levy their products with GST. As can be seen from chart 3.5, these suppliers accounted for around 83 per cent of the value of low value imports.

The estimate of 83 per cent of NRSs requiring to register for GST is based on the value of imports entering Australia under the self assessed clearance (SAC) route. The 83 per cent figure assumes that shipments with a value over A\$1000, which require a FID to be completed and thus have GST charged upon entry to Australia, are not included in the determination of whether turnover exceeds \$75 000. It is unclear at this stage of the development of the NRS model whether turnover is assessed on only low value consignments (SACs) or both low and higher value consignments (SACs and FIDs). If FIDs are included, then 83 per cent will likely underestimate the proportion of total consignment value that is covered by NRSs with over A\$75 000 turnover.

³⁹ The amount of consignments sent during the one-week period was adjusted by a seasonal factor (produced by the X-12-ARIMA deseasonalisation model) representing the ratio of consignments in June to the number of consignments annually. By making this adjustment, estimates of the total number of consignments and value of those consignments are known for each consignor. Approximately 1100 of those consignors had estimated annual consignments exceeding A\$75 000 in value.

3.5 Non-resident suppliers exceeding the A\$75 000 turnover threshold



Data source: CAPEC members and CIE analysis.

Future growth in low value imports

The Australian Government intends to start applying GST to tangible low value imports on 1 July 2017.⁴⁰ Quantifying the GST raised and wider economic impacts will necessitate forecasting the number and value of consignments over the post 1 July 2017 period.

In research conducted for the National Retail Association in 2012, Ernst and Young surveyed a number of projections of online retail sales growth, finding compound annual growth rates of between 7.6 and 20.4 per cent.⁴¹ Ernst and Young's own analysis forecasted a growth rate of 23.9 per cent per annum.⁴²

While such growth rates were predicted in 2012 and earlier, more recent data supports lower growth in online sales. It can be seen from chart 3.6 that over the January 2011 to August 2015 period, the year-on-year growth in international online sales trended downwards, which may be associated with market saturation, the weaker value of the Australian dollar, the influx of international retail stores into Australia⁴³, or other factors. Growth rates of 10 per cent or lower seem to be more likely in the future.

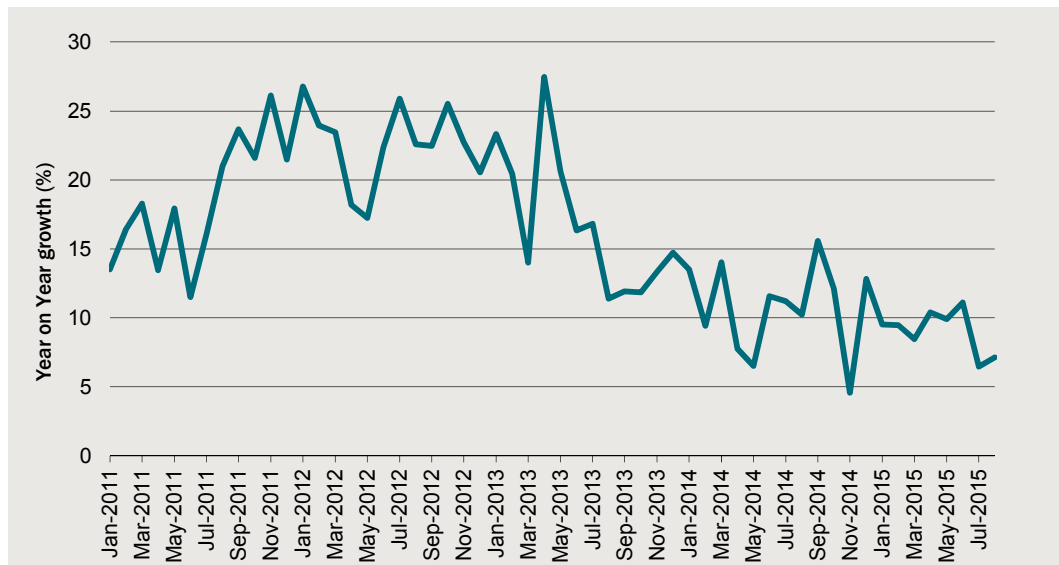
⁴⁰ This is also the start date for GST on intangible products (under the digital model).

⁴¹ Ernst and Young, 2012, *The threshold question: Economic impact of the low value threshold on the retail industry*, p.13, available at [http://www.ey.com/Publication/vwLUAssetsPI/NRA_Economic_Impact_Report/\\$FILE/NRA%20_Economic_Impact_Report.pdf](http://www.ey.com/Publication/vwLUAssetsPI/NRA_Economic_Impact_Report/$FILE/NRA%20_Economic_Impact_Report.pdf), accessed 30th November 2015.

⁴² *Ibid*, p.20.

⁴³ See <http://www.news.com.au/finance/business/retail/big-shops-planning-aussie-invasion/news-story/dcf448f13fb404f9f0c23f66667c4ddb>, accessed 11 February 2016.

3.6 Year-on-year growth in online spending with international retailers



Data source: NORSI.

Measures of online retail sales include both tangible and intangible goods, and are measures of the total value of sales rather than merely the volume of sales. In the following section we present forecasts of the volume of low value consignments and projections of the value of consignments. Forecasts of the volume and (average) value of low value consignments should be distinguished from forecasts of total online sales.

Forecasting low value imports

Forecasts of the number and total value of low value consignments brought into Australia by CAPEC members over the period from July 2015 to June 2020 have been produced.

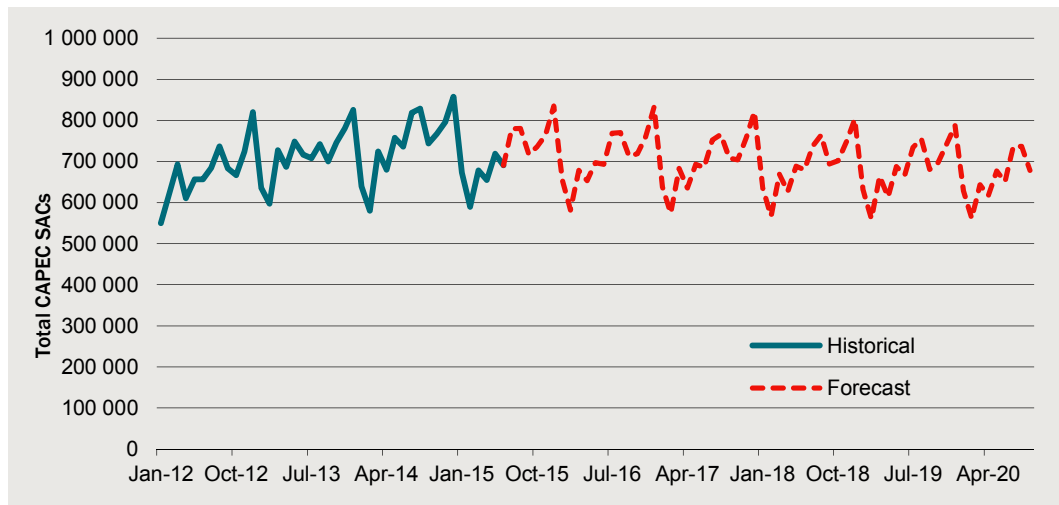
Volume of low value imports

Forecasts of the number/volume of consignments have been produced using the X-12-ARIMA deseasonalisation model, which is developed and used by the US Census Bureau.⁴⁴ This model is suitable for the analysis of data exhibiting seasonality, such as is present in the time series of consignment volumes. Forecasts produced under this method do not rely on relationships between consignment volumes and economic variables such as GDP. Rather, these forecasts are based only on historical patterns in consignments.

Chart 3.7 presents historical and forecast low value consignment monthly volumes. The volume of consignments is forecast to fall slightly over the forecast horizon while replicating the pattern of seasonality evident in the historical data.

⁴⁴ The X-12-ARIMA deseasonalisation program was developed by the US Census Bureau (<https://www.census.gov/srd/www/x13as/glossary.html>), and is the basis of/similar to methods used by statistical agencies such as the ABS (<http://www.abs.gov.au/websitedbs/d3310114.nsf/4a256353001af3ed4b2562bb00121564/c890aa8e65957397ca256ce10018c9d8!OpenDocument>). Further information on this method can be found at <https://www.census.gov/srd/www/x13as/papers4newusers.html>.

3.7 Monthly low value consignments brought into Australia by CAPEC members

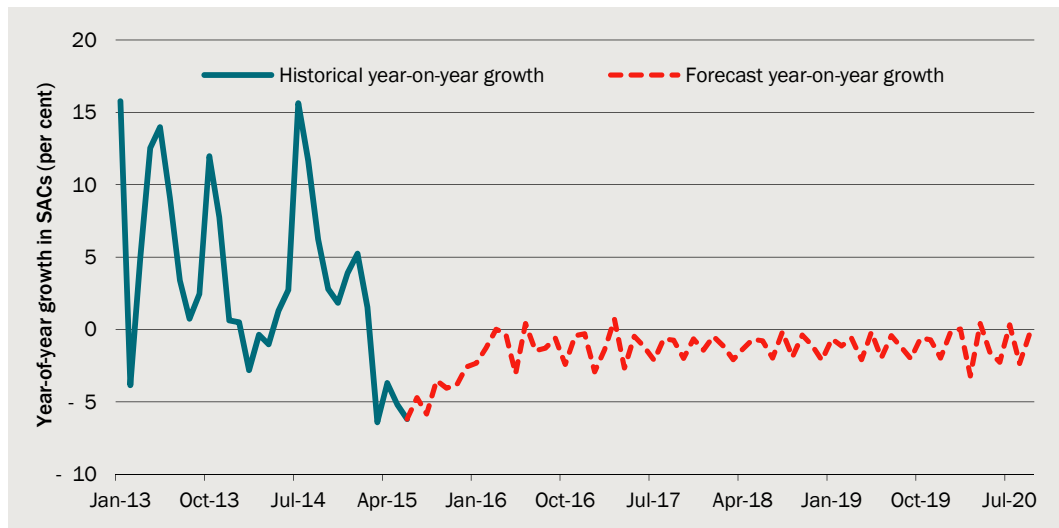


Note: Forecasts of low value consignment volumes are produced using the X-12-ARIMA deseasonalisation model.

Data source: CIE based on CAPEC consignment figures from January 2012 to June 2015.

Chart 3.8 presents the historical and forecast year-on-year growth, derived from the time series presented in chart 3.7. Negative growth in the months preceding July 2015 (the first forecast month) may partially account for the negative trend predicted by the model.

3.8 Year-on-year growth in forecasts of low value consignments



Note: Year-on-year growth is the percentage difference between monthly consignments in a given month and monthly consignments in the same month of the previous year.

Data source: CIE forecasts.

Average value of low value imports

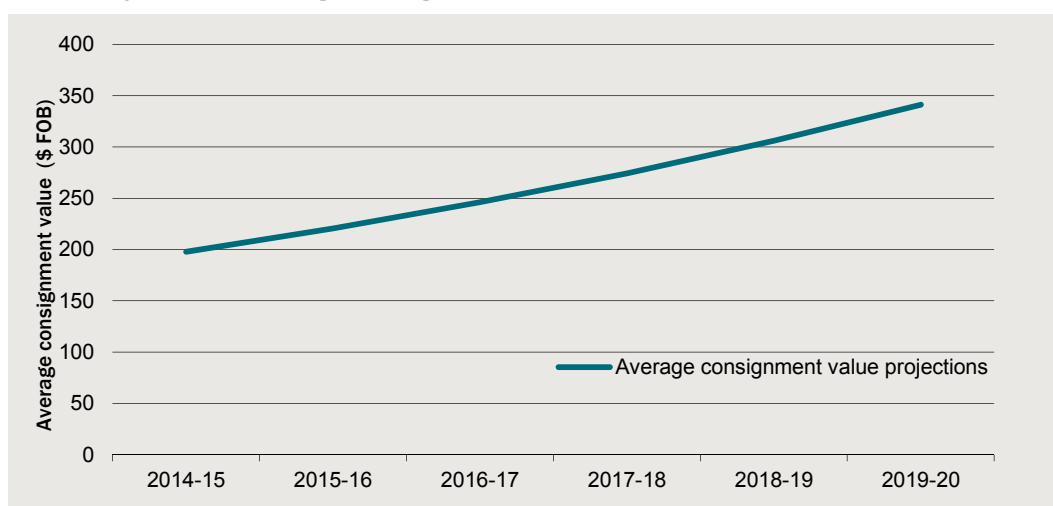
Extensive historical time series data of the average or total value of low value imports is not available. Thus, we are not able to use econometric models to produce forecasts of the value of low value imports. Instead of using an econometric modelling, we simply project the average value of low value consignments with a fixed 11.5 per cent compound annual growth rate (CAGR).

This projected increase is consistent with the following observations.

- Time series data including consignment value was made available by one CAPEC carrier. This data exhibited a growth rate in average consignment value of 11.5 per cent over the period 2011–2015.
- In the analysis completed by the CIE in 2011, the 2009-10 average consignment value implied by the total value and volume of consignments across all CAPEC carriers was A\$118.40.⁴⁵ Comparing this average consignment value to the value estimated in this report (see table 3.3) of A\$205.65 implies a CAGR of 11.7 per cent.

Forecasts of average consignment value are presented in chart 3.9. As part of a sensitivity analysis in this report, the growth rates used to project average consignment value are varied.

3.9 Projection of average consignment value (FOB)



Data source: CIE.

Shipping costs mark-up

In order to project the value of low value consignments, it is necessary to estimate the mark-up between the FOB value of an import and the CIF value. This mark-up will account for shipping and insurance.

One approach to estimating this amount is to use average weight data by country of origin and by carrier, which has been produced from the dataset of shipments provided by CAPEC members. Using this data together with the standard prices for each carrier, an estimate of the CIF mark-up by weight of the package and country of origin can be produced. However, the standard prices for each carrier are very different from the prices commonly paid for low value items, which may be purchased from a platform. Platforms commonly have arrangements with a carrier whereby imports are shipped at a discounted price. Data on these discounts is not available.

⁴⁵ See CIE (2011), *The GST threshold for low value products: Economic impacts*, report prepared for the Conference of Asia Pacific Express Carriers, table 2.1.

The standard shipping prices would be a substantial overestimation of the discounted shipping price actually paid for goods of low value. If the standard prices were used as estimates of the CIF mark-up, the CIF mark-up for goods of value under \$100 would generally exceed 100 per cent.⁴⁶ Given that purchases of goods from platforms rarely involve shipping costs greater than the value of the good itself, it is clear that using this estimate is inappropriate.

Instead, the CIF mark-up has been estimated as 15 per cent for all low value consignments. In the absence of data indicating average discounts or average prices paid for low value consignments, this approach likely produces a more accurate estimate of the mark-up than using the standard prices.

⁴⁶ An examination of the shipping prices for certain carriers indicates prices greater than A\$100 for shipments from the US of goods greater than 1kg in weight. The average weight of consignments with value between A\$0–100 is greater than 1kg, implying that for goods of value under A\$100, the standard shipping price exceeds the value of the good.

4 *Economic impacts of levying low value imports with GST*

Under the current arrangements, low valued imports receive preferential treatment by virtue of not attracting GST. Compared to products sold through local retailers, the low value imports will be cheaper (all other factors aside). This competitive advantage could be expected to see consumption of low value imports being higher than is economically efficient. The lack of competitive neutrality between low value imports and goods sold by local retailers, which attract GST, is cited as the reason why the Australian Government is moving to apply GST to all goods sold by foreign supplies in Australia.

Applying GST to low value imports will trade-off:

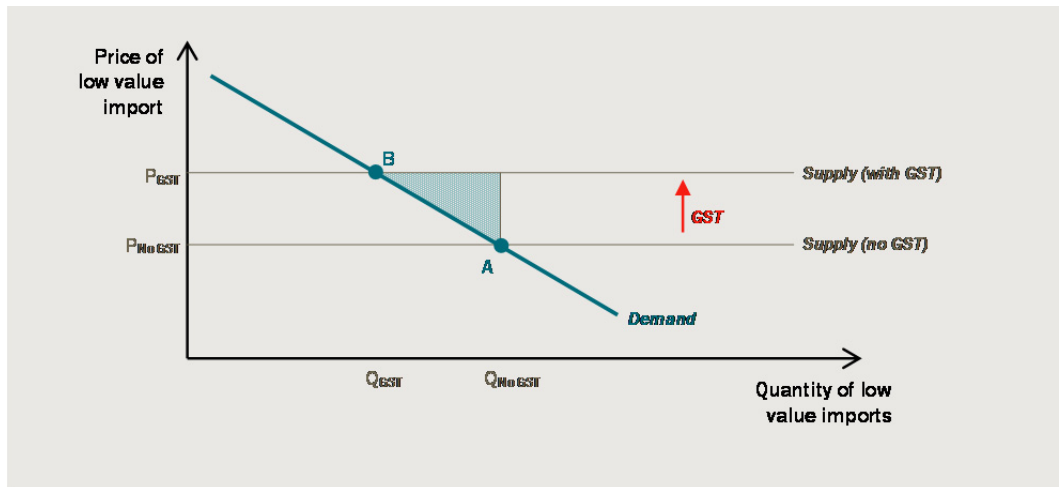
- gains in economic efficiency arising from removing the preferential tax treatment of low value imports
- losses in economic efficiency from imposing GST compliance costs on NRSs.

Each of these areas of economic impact are quantified below, as are the impacts on households and GST revenue collected.

Removing the preferential tax treatment

The preferential treatment afforded low value imports is akin to a subsidy (but without the revenue transfer) — low value imports are cheaper than what they should be. The economic inefficiency, and welfare losses, that arise from this reflect consumer behaviour. Chart 4.1 provides a stylised (partial equilibrium) representation of the welfare loss arising from low value imports not attracting GST. As can be seen, the GST exemption sees low value imports being cheaper ($P_{\text{No GST}}$ is lower than P_{GST}), and the quantity of low value imports being consumed is higher ($Q_{\text{No GST}}$ exceeds Q_{GST}). The economically efficient market outcome would be point B, but the observed market outcome is point A. Point A is economically inefficient as the cost of supplying the marginal good (supply costs are given by the Supply with GST curve) exceeds consumer willingness to pay for that good (willingness to pay is given by the demand curve). The loss in economic efficiency is given by the (teal) shaded area.

4.1 Welfare losses from preferential treatment of low value imports



Data source: CIE.

The loss in economic efficiency shown in chart 4.1, termed a dead weight loss (DWL), can be calculated as:

$$DWL = \frac{1}{2} \times \Delta P \times \Delta Q$$

where ΔP is the change in price as a result of applying differential GST treatment to low value and other goods (approximately 8.3 per cent times the price considering only the GST⁴⁷) and ΔQ is the associated change in quantity.

Australia is typically viewed as a small open economy with respect to international markets, with little ability to influence the price of the goods it is importing. This assumption means Australia would face a very elastic (horizontal) supply curve for low value imports.⁴⁸

To put the scale of the economic inefficiency losses into perspective, it is helpful to express the losses as a share of the value of all low value imports (VI):

$$VI = P \times Q$$

$$\frac{DWL}{VI} = \frac{\Delta P \times \Delta Q}{2 \times P \times Q} = \frac{8.3\% \times P \times \Delta Q}{2 \times P \times Q} = \frac{4.15\% \times \Delta Q}{Q}$$

Noting that the elasticity of demand (ϵ^D) is given as below, and for a perfectly elastic supply the price change is 8.3 per cent:

⁴⁷ While the GST rate is 10 per cent, it is estimated that 83 per cent of NRSs would exceed the GST registration threshold of A\$75 000 turnover in Australia and therefore need to apply GST, with 99.5 per cent of products being GST liable. Hence 10 per cent (GST) * 83 per cent (NRSs liable) * 99.5 per cent (GST liable products) sees an effective GST rate for all low value imports of around 8.3 per cent. This assumes all NRSs comply with the requirement to collect and remit GST (where applicable).

⁴⁸ Note that relaxing the small open economy assumption would increase the economic efficiency losses to Australia as some of the reduction in the tax would be captured by foreign suppliers.

$$\varepsilon^D = \frac{\Delta Q/Q}{\Delta P/P} = \frac{\Delta Q/Q}{8.3\%}, \text{ hence } \Delta Q/Q = \varepsilon^D \times 8.3\%$$

Substituting the above into the previous equation leads to:

$$\frac{DWL}{VI} = 4.15\% \times 8.3\% \times \varepsilon^D = 0.34\% \times \varepsilon^D$$

That is, the deadweight loss is a very small share of the value of low value imports, and likely to be substantially less than the rate of GST (unless the elasticity of demand is around 30⁴⁹).

The estimated dead weight losses over 2014-15 to 2019-20 arising from the differential GST treatment of low value imports for a range of demand elasticities is shown in table 4.2.

For very high demand elasticities (5 to 10), the losses in economic efficiency are in the order of 1.7 to 3.4 per cent of the value of goods imported. In 2014-15, such high elasticities would equate to economic efficiency losses of \$22 to \$45 million. Over time, as the value of low value imports (transported into Australia by CAPEC members) increases, so too do the economic efficiency losses.

4.2 Economic efficiency losses for varying demand responses

Demand elasticity	Economic efficiency loss as a share of the value of imports	Economic efficiency losses					
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	Per cent	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
0.0	0.0	0	0	0	0	0	0
-0.5	0.2	2	2	3	3	3	4
-1.0	0.3	4	5	5	6	6	7
-2.0	0.7	9	10	11	12	13	14
-3.0	1.0	13	14	16	18	19	21
-4.0	1.4	18	19	21	23	26	29
-5.0	1.7	22	24	27	29	32	36
-10.0	3.4	45	48	53	59	65	71

Note: Economic efficiency losses are based on observed low value imports via CAPEC members of \$1.31 billion (landed duty paid value) in 2014-15, and forecast values of \$1.41 billion in 2015-16, \$1.56 billion in 2016-17, \$1.72 billion in 2017-18, \$1.90 billion in 2018-19, and \$2.09 billion in 2019-20.

Source: CIE.

Elasticity of demand

The responsiveness of demand to the price of low value imports has not been tested. However, we can get an idea of the elasticity of demand through looking at how the

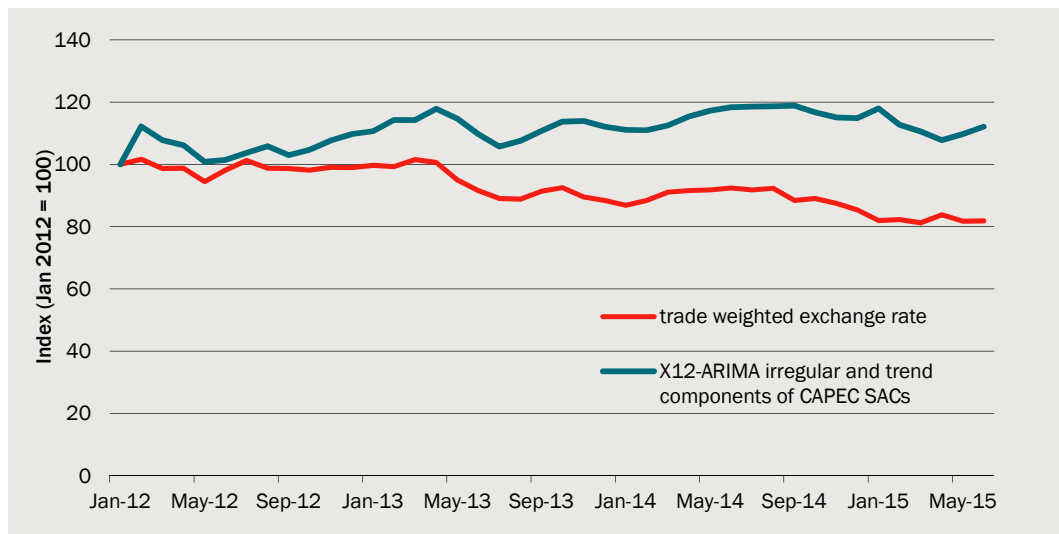
⁴⁹ A demand elasticity of 30 would mean a 1 per cent reduction in price would be associated with a 30 per cent increase in quantity purchased.

quantum of low value imports changes in response to exchange rate movements. An appreciation of the exchange rate means that products purchased on overseas websites would be immediately cheaper in Australian dollar terms, and, if demand were elastic, we could expect the volume of low value consignments to increase.⁵⁰

CAPEC members have provided data on the number of low value consignments on a monthly basis over the January 2012 to June 2015 period. Using the X12-ARIMA deseasonalisation process used by the US Census Bureau,⁵¹ the time series data of low value consignment volumes can be deseasonalised. That means that the resulting series will exclude seasonal variation, such as that associated with greater consignment volumes before Christmas. This will allow for the demand response to price changes because of exchange rate fluctuations to be examined more clearly.

Chart 4.3 shows an index of a deseasonalised series of the volume of SAC consignments and a trade-weighted exchange rate index (with January 2012 used as the base month). Consignment numbers and the exchange rate exhibit co-movement yet have different trends. Other variables may affect the volume of consignments, such as price changes due to factors other than the exchange rate.

4.3 Consignment numbers and the exchange rate



⁵⁰ Note that a changing exchange rate will also change the number of low value consignments even if there were no change in demand. For example, if A\$1 buys US\$0.90, then a US\$1000 purchase would be a high value consignment and subject to a Full Import Declaration (as the Australian dollar value of that purchase is A\$1111). However, at an exchange rate of A\$1 buys US\$1, that same purchase would be classified as a low value import (as the Australian dollar value of that purchase is A\$1000). Hence even if there were no change in demand, the number of low value consignments would be higher (and FID consignments lower) due to the appreciation. It has not been possible to separate this effect of changes in the exchange rate from the behavioural response to exchange rate changes.

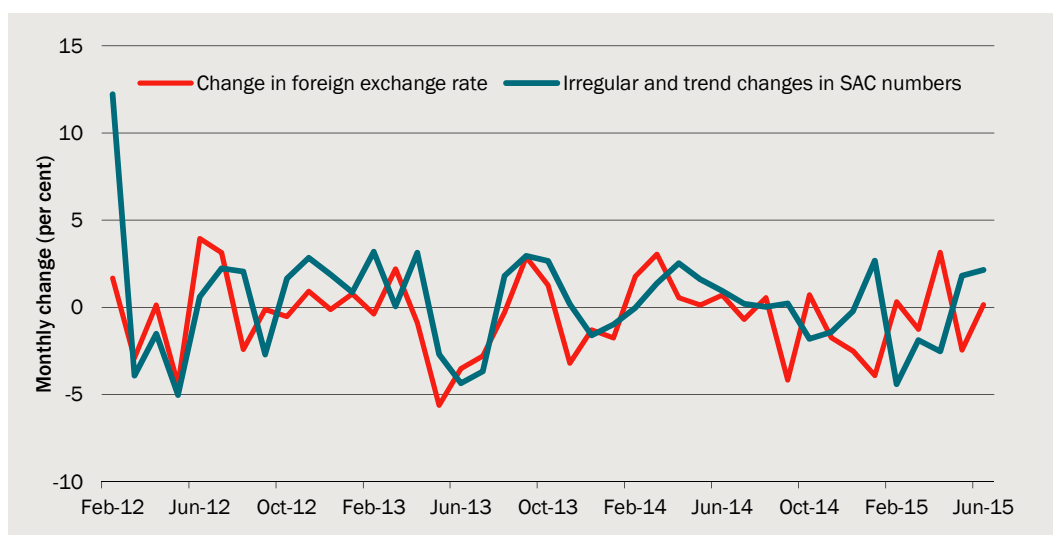
⁵¹ The X-12-ARIMA deseasonalisation program was developed by the US Census Bureau (see <https://www.census.gov/srd/www/x13as/glossary.html>), and is the basis of/similar to methods used by statistical agencies such as the ABS (see <http://www.abs.gov.au/websitedbs/d3310114.nsf/4a256353001af3ed4b2562bb00121564/c890aa8e65957397ca256ce10018c9d8!OpenDocument>).

Note: The X12-ARIMA seasonal adjustment approach has been used to decompose the SAC consignment series into seasonal, trend-cycle and irregular component. The series shown in this chart has had the seasonal component removed.

Data source: Reserve Bank of Australia, CAPEC and CIE calculations.

In order to examine the relationship between consignment numbers and the exchange rate further, chart 4.4 shows the monthly percentage change in the deseasonalised consignment series and monthly percentage change in the exchange rate. These variables appear to be positive correlated, with appreciations in the exchange rate (positive changes in the red series) generally associated with positive changes in the deseasonalised consignments series (in blue). However, this correlation appears to be somewhat weaker than the relationship in chart 4.3, which would be expected if there is a lag in the effect of exchange rate changes on consignment numbers.

4.4 Consignment numbers and the exchange rate (monthly changes)



Note: The X12-ARIMA seasonal adjustment approach has been used to decompose the SAC consignment series into seasonal, trend-cycle and irregular components. The series shown in this chart has had the seasonal component removed. The exchange rate series used is the trade-weighted index.

Data source: Reserve Bank of Australia, CAPEC and CIE calculations.

Using this data, regression modelling may be used to estimate the exchange rate elasticity of consignment volumes.⁵² Insofar as the exchange rate affects prices, this may provide an indication of the price elasticity of demand. Using a regression model, the relationship between percentage changes in the exchange rate and percentage changes in consignments is estimated according to the following equation:

$$\Delta \text{Consignments} = \beta \times \Delta \text{Exchange rate} + \varepsilon$$

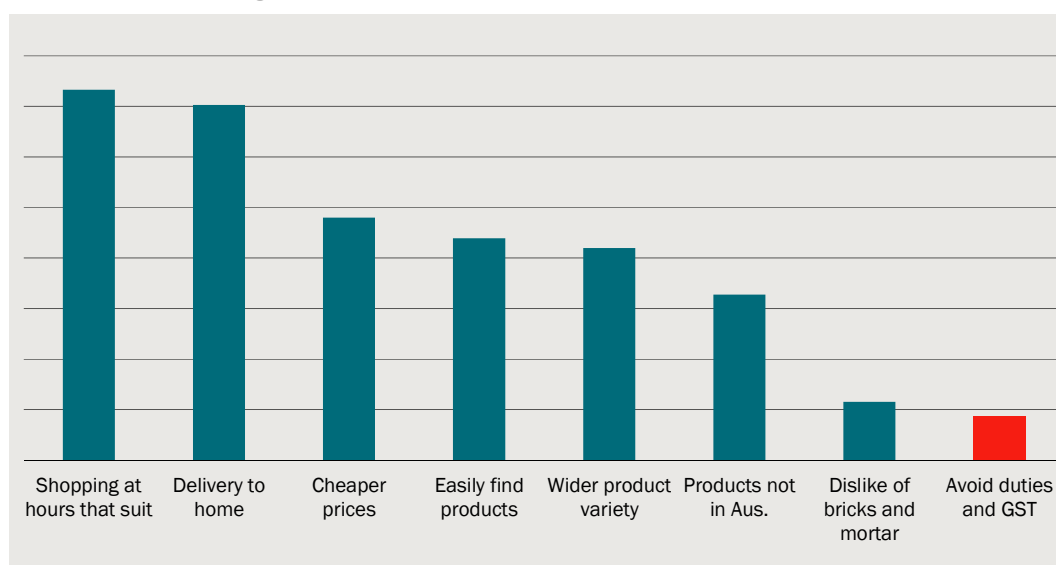
where $\Delta \text{Consignments}$ is the monthly per cent change in consignments, $\Delta \text{Exchange rate}$ is the monthly per cent change in the exchange rate, β is an estimate of the elasticity of demand with respect to the exchange rate and ε is a randomly distributed error term. Using the data presented in chart 4.4 the elasticity of demand with respect to the exchange rate is estimated to be 0.49.

⁵² By taking the first-difference of the time series, we have obtained stationary dependent and independent variables, which will satisfy the standard assumptions for linear regression modelling.

This elasticity is positive, meaning that a 1 per cent *appreciation* in the exchange rate is associated with a 0.49 per cent *increase* in the volume of consignments. Thus, assuming a 1 per cent *increase* in the exchange rate is associated with a 1 per cent *decrease* in the price when expressed in Australian dollars, then a 1 per cent *decrease* in price paid is associated with a 1 per cent *increase* in the volume of consignments. Thus the implied elasticity of demand with respect to prices is -0.49.

This is consistent with the survey of consumers conducted by Choice, which indicated that other factors are more important in driving demand for online sales. The 2013 Choice survey on online shopping found that convenience is more important than price in driving the decision to purchase online, with several other factors (easier to find products and wider product variety) being of approximately equal importance to price.⁵³ It is therefore unsurprising that the price elasticity of demand is low, since other factors may be more dominant in affecting choices to purchase goods online. Interestingly, and as can be seen in chart 4.5, consumers reported that avoiding GST and duty was not an important factor in driving their decision to purchase from foreign online retailers.

4.5 Factors driving decision to purchase online



Note: There were 14 options available to individuals in the survey. Respondents were asked to rank their top three preferences and based on these preferences, each option was given a score. Only results for 8 of the available options have been reported.

Data source: CIE using CHOICE 2013 raw survey data.

A demand elasticity of around -0.5 suggest the economic efficiency losses arising from the preferential tax treatment of low value imports transported into Australia by CAPEC members is in the vicinity of \$3 million per year.

GST compliance costs

The NRS model, if implemented as planned, will not see any changes to current border clearance processing costs. However, the NRS collection model will place GST

⁵³ Choice 2013 Online shopping survey raw data provided by Choice.

compliance costs on foreign suppliers, which could be expected to flow through to higher prices for Australian consumers. The extent of any GST compliance cost impost will vary across the type of NRS and their business model.

Of key importance is whether the NRS sells through a platform, and if so, whether the NRS would have to register for GST (that is, do they exceed the A\$75 000 turnover in Australia threshold) and/or whether their product would be liable for GST.

For those foreign firms required to collect and remit GST and selling through their own website, or through a platform, there will be GST compliance costs. Either they incur such costs themselves, or the platform will on their behalf, with the platform recouping costs through a higher listing charge or a higher commission on sales.

We have assumed that GST compliance costs will be equivalent to 0.7 per cent (of sales value) for a NRS doing its own compliance, and 0.5 per cent for a platform, with the platform being reimbursed for the compliance costs from firms selling through the platform. In the case of the latter, this would see the platform's commission rising from around 10 per cent today (in the case of a platform such as eBay) to 10.5 per cent.

The assumption that GST compliance costs are 0.7 per cent of sales for standalone NRSs is based on two pieces of information. Firstly, 58.2 per cent of internal tax compliance costs for Australia small businesses are GST related.⁵⁴ Secondly, tax compliance costs for businesses with between A\$75 000 and A\$2 million in annual turnover have average tax compliance costs of A\$12 per A\$1000 of turnover.⁵⁵ This implies that tax compliance costs are 1.2 per cent of turnover, and thus that GST compliance costs are 0.7 per cent of turnover.

Those NRSs selling via a platform and which would not be required to collect GST due to not exceeding the GST threshold, face a potentially larger cost impost. These firms already incur the (assumed) 10 per cent platform commission. Under the NRS model, the platform would be required to levy, collect and remitting GST on sales, as the platform's turnover would (most likely) be higher than A\$75 000 in Australia. The NRS model therefore sees a foreign firm which should be exempt from GST, being levied GST by virtue of it selling through a platform. Such firms have a decision to make. Should they continue to sell through a platform and incur costs/price markups of 20.5 per cent (comprising 10 per cent original platform commission, 0.5 per cent additional platform GST compliance commission and 10 per cent GST), or leave the platform and set up their own website to sell over. The fact that the NRS is using the platform must mean the platform's 10 per cent commission is a lower cost than the alternative (setting up and maintaining own website and online sales capability etc). It has been assumed that the cost of setting up a website and online sales capability for sales into Australia is equivalent to 15 per cent of the value of those sales, versus 20.5 per cent if the NRS remains with the platform. Given the lower costs associated with going it alone, this is what these foreign suppliers are assumed to do. Note that the net cost on these foreign

⁵⁴ Evans, C., Hansford, A., Hasseldine, J., Lignier, P., Smulders, S. & Vaillancourt, F., 2015, 'Small business and tax compliance costs: A cross-country study of managerial benefits and tax concessions', *eJournal of Tax Research*, 12(2), p.463.

⁵⁵ The Australian Government the Treasury, 2015, *Re:think – Tax discussion paper*, p.113.

suppliers is 5 per cent (given by the website cost of 15 per cent minus the avoided platform commission of 10 per cent).

There would be no GST compliance costs for those NRSs selling through their own website and below the A\$75 000 GST registration threshold.

The GST compliance cost across all low value imports has been adjusted to account for the 'tax gap', which refers to the difference between total tax liability and the amount of tax received. The tax gap essentially reflects tax avoidance/non-compliance. The average tax gap for GST (domestically) is 5.35 per cent over the 2008-09 to 2013-14 period.⁵⁶ The tax gap may be substantially higher for the NRS system given that compliance in Australia can be increased through a variety of enforcement mechanisms such as prosecutions, while there would be few or no mechanisms available to ensure compliance by NRSs. The tax gap reduces the expected amount of GST collected, and hence GST compliance costs, by approximately 5 per cent.

Chart 4.6 provides a summary of the (assumed) GST compliance impacts on the various NRS groups and across all low value imports. It is estimated that average GST compliance costs for foreign suppliers will be equivalent to 0.85 per cent of (low value) sales to Australia, and 0.81 per cent after the tax gap (non-compliance) is taken into account.

The tax gap, as reported by the ATO, is likely to be a conservative figure. The ATO's tax gap reflects the difference between total GST liability (as assessed by the ATO) and GST collected. However, the tax liability assessed by the ATO may understate total liability because of transactions that occur in cash. The 'cash economy' may involve transactions of goods and services that are undetected by the ATO for the purposes of assessing and collecting GST. Richardson and Denniss (2012)⁵⁷ estimate that the underpayment of GST associated with undeclared business revenue was \$2.7 billion per year at September 2012.⁵⁸ Given that total GST liability in 2011-12 was approximately \$50 billion,⁵⁹ this implies a GST tax gap due to the cash economy of 5.1 per cent. Combining the official GST tax gap with the cash economy gap would see an estimated total GST tax gap of around 10.2 per cent. Given that this rate of non-compliance is observed in Australia, where the ATO has more scope to oversee and enforce the collection of the GST, suggests that the rate of non-compliance maybe higher with NRSs, particularly as the ATO will have fewer options for oversight and enforcement.

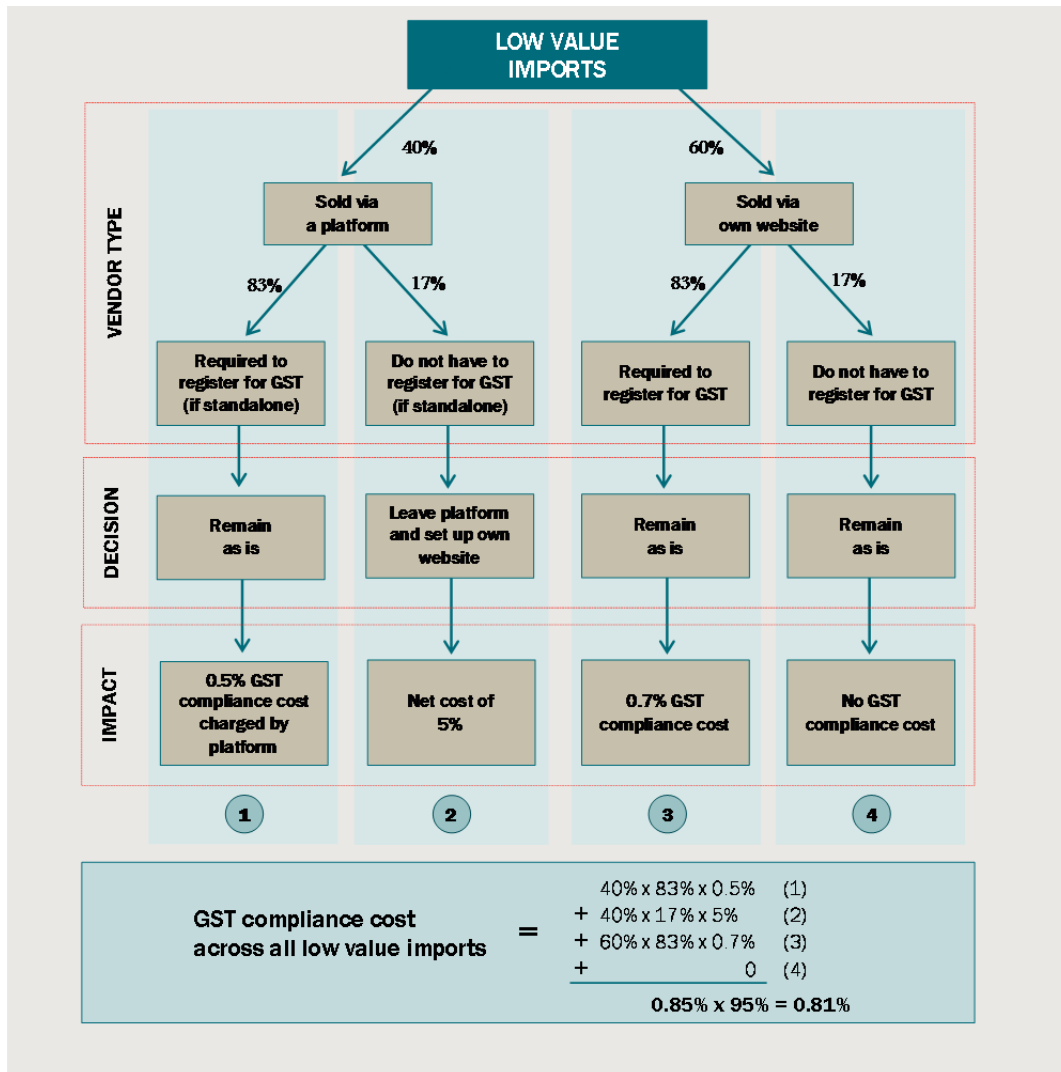
⁵⁶ ATO Annual Review, 2014-15, p.42.

⁵⁷ Richardson, D. & Denniss, R., 2012, 'Cash-in-hand means less cash for states – the impact of tax evasion on public finances', The Australia Institute Technical Brief No. 17, available at http://www.tai.org.au/system/files_force/TB%2017%20Cash%20in%20hand%20means%20less%20cash%20for%20states_4.pdf?download=1, accessed 8 February 2016.

⁵⁸ This study examined lost tax revenue due to cash-in-hand work. GST revenue is lost because businesses that pay cash-in-hand will likely understate their business revenue such that it aligns with their payroll expenditure (and thus avoid scrutiny by the ATO). In estimating the GST lost associated with the cash economy the authors also accounted for hidden non-wage income to calculate total business revenue on which GST has likely not been declared.

⁵⁹ See <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Measuring-tax-gaps-in-Australia,-2014-15/?page=18#Results>, accessed 5 February 2016.

4.6 GST compliance costs



Data source: CIE.

Impacts on consumers

It is estimated that the cost of low value imports will rise by around 9 per cent, reflecting the (average) GST rate of 8.3 per cent and GST compliance costs of 0.8 per cent.

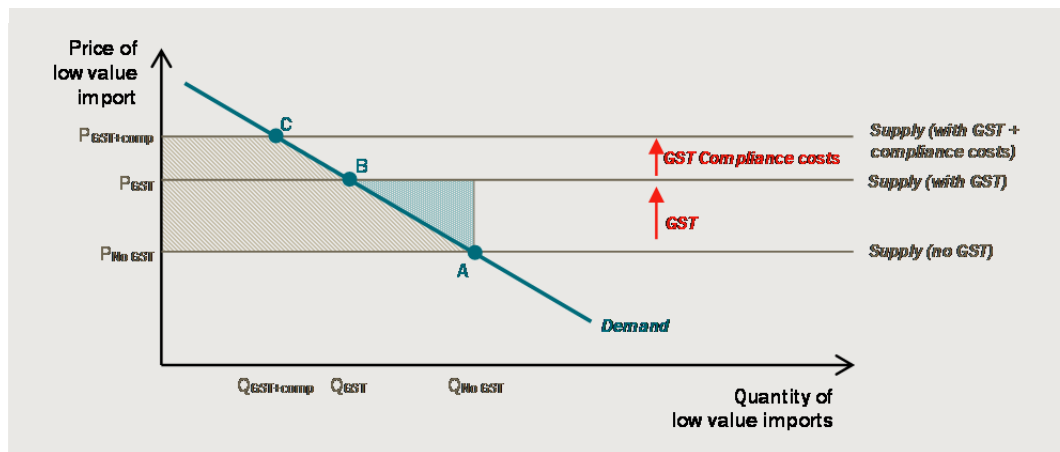
While levying GST on low value imports will see Australia avoiding economic efficiency losses arising from the preferential tax treatment, the higher priced imports will adversely impact consumers (households). Increased regulatory burden may also result in NRSs exiting from the Australian marketplace, thereby further limiting competition and consumer choice.

Chart 4.7 provides a stylised representation of the economic impact of applying GST to low value imports on households. Under the current situation, the price and quantity of low value imports would be given by the intersection of the demand and supply (no GST)

curves, with the market equilibrium being at point A. The benefit to consumers of this market outcome is given by their consumer surplus.⁶⁰

As GST is levied and compliance costs incurred, the price of low value imports rises ($P_{\text{GST+comp}}$ is higher than $P_{\text{No GST}}$) with the quantity of low value imports being consumed falling ($Q_{\text{GST+comp}}$ is lower than $Q_{\text{No GST}}$). The new market outcome is given by the intersection of the demand and supply (with GST + compliance costs) curves (Point C). The change in consumer surplus from moving from market outcome A to market outcome C is given by the grey shaded area. Also shown in chart 4.7 is the economic efficiency welfare loss associated with the preferential tax treatment of low value imports (the teal shaded area).⁶¹

4.7 Impacts on consumers



Data source: CIE.

Table 4.8 reports the estimated changes in consumer surplus (welfare) from levying GST on those low value imports delivered by CAPEC members to Australian households. The impacts on households are a combination of factors, namely:

- GST payments to the Australian Government (given by area $(P_{\text{GST}} - P_{\text{No GST}}) * Q_{\text{GST+comp}}$ in chart 4.7)
- resource costs associated with GST compliance (area $P_{\text{GST+comp}}.C.B.P_{\text{GST}}$)
- increases in domestic supplier activity (and consequential GST revenue) as Australian households move purchases from foreign suppliers to domestic suppliers (given by area $P_{\text{GST}}.B.A.P_{\text{No GST}} - \text{GST revenue}$ (as calculated in first point above)).

⁶⁰ Consumer surplus is an economic measure of consumer satisfaction or welfare, and is given by the difference between the consumers' willingness to pay for a good or service (given by the demand curve) and what they actually do pay (given by the intersection of the demand and supply curves).

⁶¹ Note that there are both private and public costs to GST compliance. In order to collect GST the government must provide funding for the ATO and potentially fund enforcement activities. The ATO Annual Report 2014-15 (p.38) states that the gross cost of tax collections (including GST collections) was 66c per \$100 of tax collected in 2014-15. This public cost of ensuring tax compliance has not been included in the economic impacts estimated in this analysis.

Over the 2017-18 to 2019-20 period, it is estimated that consumer welfare will be A\$482 million lower if GST is applied to low value imports (under the NRS model).

4.8 Changes to consumer welfare from levying GST on low value imports

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
Consumer welfare	0	0	0	-145	-160	-176	-482

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards, with 95 per cent of NRSs (that exceed the A\$75 000 turnover threshold) assumed to comply with the requirement to collect and remit Australian GST.

Source: CIE.

GST revenue collected

The GST revenue collected (assuming full NRS compliance etc) can be calculated as 8.3 per cent of the landed duty paid value of low value imports going to households. The value of these imports is given by their price ($P_{No\ GST}$ in chart 4.7) multiplied by the quantity of low value imports once GST and GST compliance costs have been taken into account ($Q_{GST+comp}$).

In chart 4.7, the GST revenue collected from low value imports delivered by CAPEC members to households is given by the rectangular area of:

$$GST\ revenue = (P_{GST} - P_{No\ GST}) \times Q_{GST+comp}$$

Table 4.9 reports that an estimated A\$427 million in additional GST will be collected over the 2014-15 to 2019-20 period.

4.9 Additional GST collected on low value imports by CAPEC members

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
GST revenue	0	0	0	129	142	156	427

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards, with 95 per cent of NRSs (that exceed the A\$75 000 turnover threshold) assumed to comply with the requirement to collect and remit Australian GST.

Source: CIE.

Economic impacts

The economic impact of levying low value imports involves a comparison of the deadweight losses under the two scenarios — GST free low value imports and GST liable low value imports.

In the former case, the deadweight loss is given by the economic efficiency losses arising from the over consumption of low value imports (the teal area in chart 4.7). Under the GST liable scenario, GST compliance costs impose a real resource cost on NRSs. These costs, akin to a loss of productivity, are associated with a deadweight loss. The deadweight loss arising from levying low value imports with GST and occurring compliance costs is given by area $P_{GST+comp} \cdot C.B. P_{GST}$ in chart 4.7.

A cost-benefit analysis would suggest if the deadweight loss under the with GST scenario is greater than the deadweight loss in the absence of GST, then the proposal to levy GST on low value imports under the NRS supply model is not supported.

Table 4.10 reports the deadweight losses under the two scenarios. As can be seen, moving to levy low value imports with GST is associated with a bigger deadweight loss. Hence moving to address the economic losses associated with the lack of competitive neutrality sees a larger loss of economic welfare.

The quantitative analysis suggests that applying GST to low value imports will see an *increase* in economic welfare losses of over A\$12 million over the period to 2019-20 (noting that it is only in the last 3 years of this period that low value imports attract GST). It is also important to appreciate that these losses only reflect the part of the low value market that CAPEC members see, and hence does not reflect the impact if all low value imports were subjected to GST.

4.10 Economic efficiency losses under the GST free and GST liable scenarios

Scenario	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	\$ million	\$ million	\$ million	\$ million	\$ million	\$ million
Low value imports GST exempt	2.2	2.4	2.6	2.9	3.2	3.5
Low value imports GST liable	Na	Na	Na	6.7	7.3	8.1
Net change in deadweight losses	Na	Na	Na	-3.8	-4.2	-4.6

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards, with 95 per cent of NRSs (that exceed the A\$75 000 turnover threshold) assumed to comply with the requirement to collect and remit Australian GST.

Source: CIE.

As noted, the economic impact figures reported in table 4.10 only relate to low value imports delivered to Australian consumers by CAPEC members. The net economic welfare loss of A\$12.5 million over 2017-18 to 2019-20 excludes low value imports transported into Australia by other intermediaries such as the postal stream.

Data on the number and value of consignments for the entire low value import market was not made available by the Australian Government. It is therefore not possible to arrive at an estimate of the economic impact of levying all low value imports with GST. However, it is possible to approximate the total economic impact through scaling up the figures reported in table 4.10 by:

- CAPEC's share of low value imports delivered by express carriers
- the share of low value imports accounted for by express carriers.

Table 4.11 provides the shares used to scale up the economic losses associated with low value consignments transported to Australia by CAPEC members.

4.11 Share of consignment value accounted for by intermediaries

Consignment value (basket)	Intermediary				Total
	CAPEC	Other express carriers	Air cargo	Sea cargo	
	Per cent	Per cent	Per cent	Per cent	Per cent
\$0-\$100	10.73	3.58	85.60	0.10	100
\$101-\$200	46.40	9.50	43.80	0.30	100
\$201-\$300	61.47	6.83	31.30	0.40	100
\$301-\$400	69.75	5.25	24.60	0.40	100
\$401-\$500	75.53	3.98	20.00	0.50	100
\$501-\$600	79.10	3.30	17.10	0.50	100
\$601-\$700	82.06	2.54	14.90	0.50	100
\$701-\$800	83.71	2.59	13.20	0.50	100
\$801-\$900	85.85	1.75	11.90	0.50	100
\$901-\$1000	86.04	2.66	10.80	0.50	100

Source: CIE calculations based on tables 2.1 and 2.4 of CIE (2011), *The GST threshold for low value products: Economic impacts*, report prepared for the Conference of Asia Pacific Express Carriers.

Note that the figures in table 4.11 relate to year 2009-10 (the latest year for which data is publicly available). Scaling the figures reported in table 4.10 assumes that the abovementioned shares are applicable over the period to 2019-20, and that low value consignments delivered by other express carriers, Australia Post and via sea mail have the same average value, GST liability and demand elasticity as consignments delivered by CAPEC members. With these caveats in mind, table 4.12 reports the net economic impact from levying GST on all low value imports.

4.12 Economic impacts across all low value imports

Economic welfare	2017-18	2018-19	2019-20	Total
	\$ million	\$ million	\$ million	\$ million
CAPEC delivered low value consignments	-3.8	-4.2	-4.6	-12.5
All low value consignments	-8.7	-9.6	-10.6	-28.9

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards, with 95 per cent of NRSs (that exceed the A\$75 000 turnover threshold) assumed to comply with the requirement to collect and remit Australian GST.

Source: CIE.

The analysis suggests that moving to levy low value imports with GST through the NRS model is not justifiable, as economic efficiency losses are incurred.

5 Sensitivity analysis of the GST modelling

The economic analysis presented in chapter 4 is sensitive to assumptions surrounding a number of key parameters/areas, namely:

- the elasticity of demand
- GST compliance costs
- the average price of low value imports, and how this changes over time
- the share of NRSs that comply with the requirement to collect and remit GST to Australia.

Table 5.1 identifies the values used for each of the above key assumptions when estimating the economic impact of levying low value imports with GST, the results of which were presented in the previous chapter. Also reported are the alternative values considered in the sensitivity analysis to gauge the stability of the results to the assumptions made.

5.1 Sensitivity analysis

Parameter/area	Values used in sensitivity analysis		
	Value used in main scenario	Alternative value #1	Alternative value #2
Elasticity of demand	-0.49	-0.25	-0.98
GST compliance costs	Equivalent to 0.8% of sales	0.40%	1.6%
Growth in average prices over 2014-15 to 2019-20	11.5%	5%	15%
NRS non-compliance (tax gap)	5.35%	0%	20%

Source: CIE.

The stability of the economic modelling results to differing assumptions is reported below.

Elasticity of demand

Table 5.2 shows the sensitivity of the results to varying the elasticity of demand. A greater elasticity of demand implies smaller welfare losses, with an elasticity of -0.98 being associated with efficiency losses that are 16 per cent of the magnitude of the losses estimated with an elasticity of -0.49. This analysis illustrates the importance of the elasticity of demand assumption.

5.2 Changing the elasticity of demand

Net welfare change	2017-18	2018-19	2019-20	Total
	A\$ million	A\$ million	A\$ million	A\$ million
Elasticity of -0.49 (main result)	-3.8	-4.2	-4.6	-12.5
Elasticity of -0.25	-5.3	-5.9	-6.5	-17.7
Elasticity of -0.98	-0.6	-0.7	-0.7	-2.0

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards, with 95 per cent of NRSs (that exceed the A\$75 000 turnover threshold) assumed to comply with the requirement to collect and remit Australian GST.

Source: CIE.

GST compliance costs

In this sensitivity analysis we halve and double the assumed GST compliance costs for both NRSs selling through platforms and those not selling through platforms. The main result assumes GST compliance costs of 0.7 per cent for NRSs not selling via a platform and 0.5 per cent for suppliers selling via a platform, and this ratio of 0.7 to 0.5 per cent is maintained. For example, where GST compliance costs for NRSs not selling via platform are changed to 0.35 per cent, GST compliance costs for firms selling via platform are 0.25 per cent.

The results are sensitive to the assumed level of GST compliance costs, with a level of 0.35 per cent implying welfare losses that are approximately half (A\$6 million) the magnitude of the main result (A\$13 million).

5.3 Changing GST compliance costs

Net welfare change	2017-18	2018-19	2019-20	Total
	A\$ million	A\$ million	A\$ million	A\$ million
GST compliance costs of 0.7% (main result)	-3.8	-4.2	-4.6	-12.5
GST compliance costs of 0.35%	-1.8	-2.0	-2.2	-5.9
GST compliance costs of 1.4%	-7.8	-8.6	-9.4	-25.8

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards, with 95 per cent of NRSs (that exceed the A\$75 000 turnover threshold) assumed to comply with the requirement to collect and remit Australian GST.

Source: CIE.

However, the main result assumption of 0.7 per cent is a conservative estimate of these costs, given that it is based on the compliance costs for Australian firms with the GST, while foreign firms would likely face significantly greater costs in becoming familiar with Australian taxation practices.

Growth in average prices over 2014-15 to 2019-20

In this sensitivity analysis, the assumed 11.5 per cent CAGR is varied to be 5 per cent and 15 per cent. Estimated total welfare losses are relatively insensitive to this assumption, with the range of results shown in table 5.4 ranging from A\$10 million to A\$14 million.

5.4 Changing growth in average consignment value

Net welfare change	2017-18	2018-19	2019-20	Total
	A\$ million	A\$ million	A\$ million	A\$ million
Growth in average value of 11.5% (main result)	-3.8	-4.2	-4.6	-12.5
Growth in average value of 5%	-3.2	-3.3	-3.4	-9.8
Growth in average value of 15%	-4.2	-4.7	-5.4	-14.2

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards, with 95 per cent of NRSs (that exceed the A\$75 000 turnover threshold) assumed to comply with the requirement to collect and remit Australian GST.

Source: CIE.

NRS compliance

The sensitivity analysis relating to NRS compliance varies the size of the tax gap above and below the tax gap for current domestic GST collections. A tax gap of 20 per cent may be feasible given that there are fewer enforcement options available for the NRS model compared to the domestic GST collection system. A tax gap of 0 per cent would imply perfect compliance, which is infeasible. Nonetheless, the results are relatively less sensitive to this assumption except at extreme values (0 per cent compliance would imply no increase in economic efficiency losses as no tax is collected). Under the range of assumed tax gaps shown in table 5.5, total welfare losses remain between A\$9 million and A\$14 million.

5.5 Changing rate of foreign supplier compliance

Net welfare change	2017-18	2018-19	2019-20	Total
	A\$ million	A\$ million	A\$ million	A\$ million
Tax gap of 5.35% (main result)	-3.8	-4.2	-4.6	-12.5
Tax gap of 0%	-4.1	-4.6	-5.0	-13.7
Tax gap of 20%	-2.8	-3.1	-3.4	-9.3

Note: GST is assumed to apply to low value imports from 1 July 2017 onwards.

Source: CIE.

Note that rates of foreign supplier compliance will be associated with particular levels of public expenditure on ensuring compliance, such as additional funding for the ATO. This analysis has not included loss associated with public expenditure to ensure compliance.

6 *Import processing charges*

In November 2014, DIBP released its Joint Border Fees Review Draft Position Paper. The Position Paper noted that low value goods impose import processing and biosecurity costs on ACBPS and the Department of Agriculture and Water Resources (DAWR) (respectively). However, low value imports are currently exempt from meeting/paying such costs.

DIPB contend that the exemption from IPCs is inconsistent with Australian Government Cost Recovery Guidelines — low value goods are not appropriately contributing to border and biosecurity costs that they occasion. Furthermore, as imported goods of greater than A\$1000 (high value goods) in value incur IPCs, low value goods are in effect being cross subsidised by IPCs levied on high value goods.

In light of these issues, the Position Paper puts forward various options for charging arrangements for low value goods.

Principles guiding cost recovery charges

While most government activities are funded from Consolidated Revenue, some regulatory (and some other) agencies are partly or fully funded by user fees and charges. Some of the common reasons for encouraging direct funding from users, from strongest to weakest, include the following.

- ***Economic efficiency*** — cost recovery arrangements can improve economic efficiency by ensuring that the full cost of government services is included in the price of goods and services. This encourages consumers of government services to consider the cost of the resources involved in providing the service in making their economic decisions, thereby improving the allocation of resources.
- ***Equity*** — there is also an equity dimension associated with the ‘beneficiary pays’ or ‘impactor pays’ principles, even where there are weak efficiency arguments for seeking funding from users.
 - ‘Beneficiary pays’ — funding arrangements where the beneficiaries of government services and regulatory regimes pay for it reduces the burden on general taxpayers, many of whom may not consume the products provided or regulated by the government.
 - ‘Impactor pays’ — funding arrangement where those that cause the costs are responsible for paying them.
- ***Cost consciousness*** — cost recovery can also instil cost consciousness in government agencies and users. Where user charges reflect the cost of providing the service, this increases the accountability of the agency to users and can create an incentive to improve efficiency. For example, a user charge would reveal the costs implicit in

importing goods, which would provide a benchmark against which to consider the value of this expenditure.

- **Revenue raising** — in some instances, cost recovery arrangements have an explicit revenue raising motive. However, general revenue raising is typically not considered an appropriate basis for user charging.

If low value imports do occasion import processing costs, then the above guiding principles would suggest economic efficiency would be improved if low value imports were levied with (the appropriate) IPC and the cross subsidy between FID and SAC consignments was removed. However, any economic efficiency gain would need to be compared against (any) efficiency losses attributable to collecting the IPC.

Costs associated with import processing

ACBPS report that they and DAWR undertake a number of tasks to ensure that low value imports are appropriately managed.⁶² These tasks are essentially related to:

- administrative tasks — import processing/recording and document receipting
- border/community protection tasks — cargo and mail inspections, risk assessments and profiling, intelligence, investigation and prosecution
- biosecurity tasks — pest and disease surveillance, risk assessments, screening, risk management, investigation and prosecution.

Over 2013-14 DIBP allocated nearly A\$495 million to import processing tasks, of which nearly 68 per cent (A\$335.6 million) was recovered through IPCs.⁶³ The amount allocated by DAWR to import processing is not known, although DAWR does engage in some cost recovery from low value imports (those that are identified for further inspection/quarantine). It is not clear whether the A\$495 million allocated to import processing by DIBP reflects variable, or total (variable costs plus a share of fixed costs and overheads) import processing costs. Furthermore, no insight is provided into how these import processing costs are distributed across low (SAC) and high (FID) value imports. DIBP's import processing costs were occasioned by the processing of some 29.5 million low value and 3.5 million high value consignments over the course of 2013-14.⁶⁴

Devising import processing charges

In recovering IPC from low value imports, there are three elements to consider, namely:

- the structure of the IPC
- setting the IPC

⁶² See DIBP 2014, *Joint Border Fees Review Draft Position Paper: Low value goods*, November 2014, page 4.

⁶³ See <http://www.border.gov.au/CostRecovery/Documents/implementation-statement-cargo-trade.pdf>, Table 1, accessed 17 February 2016.

⁶⁴ ACBPS personal correspondence (16 February 2016), and DIBP 2014, *Joint Border Fees Review Draft Position Paper: Low value goods*, November 2014, page 6 (respectively).

- how/from whom should the IPC be recovered?

Structure of the IPC

Cost recovery charges can be set a number of ways, from a simplistic fixed charge per SAC consignment through to sophisticated arrangements that eliminate all cross subsidisation (between SAC and FID and within SAC consignments). Possible import processing charge structures include:

- fixed fees per consignment, where the fees could either be set as a dollar amount or as a per cent of consignment value
- fixed fees (once again, a dollar or per cent amount), but with fees on a sliding scale according to a (border protection and biosecurity) risk assessment

Whatever approach is adopted, transparency and cost consciousness will be improved if the IPC separately identifies/reflects the three areas of import processing undertaken by ACBPS and DAWR — routine administrative tasks, border/community protection tasks and biosecurity tasks. Under this arrangement the IPC would be a three-part charge.

As to the actual nature of the charge itself, there seems, as noted in the Draft Position Paper, little reasons to suspect that the costs of routine administrative tasks, border protection or biosecurity vary according to consignment value. There would therefore appear to be little justification for differentiating IPC according to import value.

However, there may be a stronger case for differentiating charges according to perceived border and/or biosecurity risk associated with low value imports. Under this arrangement the (border/community protection and biosecurity components of the) IPC would be set on a sliding scale according to associated risks of low value imports from that NRS or country. This approach would better reflect the true cost of importing low value consignments from differing NRSs/countries, and prevent imports from low risk origins cross subsidising those from higher risk origins (which, presumably, would impose higher costs on ACBPS and DAWR).

The sliding scale approach goes further in eliminating cross subsidies between low value consignments, and should therefore be further investigated. However, this approach will not be without its challenges. For example, if consignments are routed through third countries it may be difficult to identify the original source country or NRS.

Given such challenges, it can be expected that DIBP and DAWR will opt for a fixed flat IPC per consignment, despite this approach not eliminating within SAC cross subsidies.

Setting the IPC

As noted above, there is not the data available to estimate what the IPC should be for low value consignments. However, a ballpark figure can be arrived at with some assumptions regarding import processing costs borne by DAWR, and the share of total import processing costs that are occasioned by low value imports. Table 6.1 shows the indicative IPC for low value (SAC) consignments in 2014-15.

6.1 Indicative cost recovery IPC in 2014-15

Share of import processing costs occasioned by low value (SAC) consignments	Import processing costs incurred by DAWR during 2014-15		
	A\$100 million	A\$200 million	A\$300 million
	A\$	A\$	A\$
10 per cent	1.40	1.71	2.01
20 per cent	2.79	3.41	4.03
30 per cent	4.19	5.12	6.04

Note: The above figures assume that import processing costs incurred by DIBP grow 5 per cent between 2013-14 (A\$335.6 million) and 2014-15. It is also assumed that the import processing costs reflect the total cost of processing imports, hence comprise variable costs, and a share of fixed costs and overheads. ACBPS reports that the number of SAC consignments in 2014-2015 totalled 32.4 million (including those with a reported value of A\$0).

Source: CIE.

If levying IPCs on low value consignments is purely about eliminating the current cross subsidy between high and low value imports, then any IPC cost impost on SAC imports should be offset by an equal reduction in IPCs levied on/recouped from FID imports. That is, levying low value imports with IPCs will see a transfer from (consumers of) low value imports to high value imports. As such, the net economic impact of the IPC itself will most likely be negligible.

However, and as was the case with levying low value imports with GST, whether or not economic efficiency will be improved depends on how the IPC will be collected, and the costs of the associated collection and compliance burdens.

From whom should the IPC be recovered?

There are three main agents in the supply chain that the IPC could be recovered from, namely:

- the importing person/business via an at-the-border charge
- the intermediary
- the non-resident supplier.

If the IPC is to be collected via an at-the-border charge, then we are back to the Productivity Commission's 2011 findings concerning the non-viability of collecting GST, and by extension IPCs, at-the-border. The collection costs will be many multiples of the IPC, with the large collection (and compliance) costs being associated with net economic efficiency losses. Given the strength of the Productivity Commission's findings, it is assumed that an at-the-border IPC would not be considered.

DIBP (then ACBPS) reports that during 2013-14, 625 different cargo reporters were responsible for transporting low value imports to Australia.⁶⁵ One option would be to collect the IPC from these intermediaries. While this option is appealing, it is not immediately clear that it is legally possible. The issue concerns the arrangement under

⁶⁵ See DIBP 2014, *Joint Border Fees Review Draft Position Paper: Low value goods*, November 2014, Table 1.

which international freight is transported (governed by the INCOTERMS) and the contractual relationship between the NRS, intermediary, and the Australian buyer.

CAPEC members suggest that the vast majority of low value consignments are transported to Australia under delivered at place (DAP) INCOTERMS, which sees:

- the Australian purchaser being contractually responsible for meeting border clearance costs and import duties/taxes
- a Contract of *Sale* between buyer and seller
- a Contract of *Carriage* between seller and intermediary.

Hence, it appears as if there is no (contractual) relationship between the Australian purchaser liable for the IPC, and the intermediary who would be charged with collecting it. It is noted that legal opinion would be required as to whether, under the DAP INCOTERMS, intermediaries are allowed to collect monies for a charge that appears to be in no way directly related to carriage.

If it is found that intermediaries are allowed to include IPCs in carriage rates, then IPC collection and compliance costs would likely be minimised through levying the 625 cargo carriers who transported low value imports to Australia (in 2013-14) with the appropriate user charge (given by number of SAC consignments times the charge per consignment).

However, if the INCOTERMS do not permit intermediaries to charge/collect IPCs, yet intermediaries are nonetheless levied with the IPC as a 'cost of doing business in Australia', then there will clearly be implications for the financial viability of carriers. For example, if we assume that the IPC is A\$3 per consignment, then over 2014-15 some A\$97 million will have been collected from intermediaries transporting SAC consignments to Australia. If intermediaries are not able to recoup these costs, then returns to invested capital will fall, which may in turn see some intermediaries exiting the market. This will adversely impact the availability of carriage services to Australia and reduce competition.

An alternative option would be to collect the IPC from the NRS. If these entities are to be registered for GST anyway, then it should not be too difficult a task to calculate the number of consignments sent by each NRS, and to then levy that NRS with the appropriate IPC. NRSs would need to build the IPC into the price of goods sold to Australian purchasers. While possible, there are nonetheless some complicating factors to levying NRSs with IPCs, namely:

- it is estimated that only 83 per cent of NRSs will need to register for GST (by virtue of exceeding the A\$75 000 turnover in Australia threshold), meaning 17 per cent of low value consignments transported to Australia will be from NRSs without a relationship to the ATO (and hence route to invoice for IPCs)
- it is estimated that during 2014-15, some 12 per cent of SAC consignments had a reported value of A\$0 (presumably letters, documents and the like), it is not immediately clear how consignments of zero value would be captured if the NRS/sender is not registered for GST.

The above points mean there will either be leakage and the IPC will not recover all import processing costs occasioned by SAC imports, or the IPC will need to be structured

around 37 per cent higher than otherwise (and as reported in table 6.1) to ensure full cost recovery.

Levying SAC imports with IPC

If low value imports occasion import processing costs on DIBP and DAWR, then economic efficiency would suggest that those imports are levied with an IPC to recover costs. Revenue raised from any IPC cost impost on SAC imports should be offset by an equal reduction in IPCs levied on/recouped from FID imports.

Setting the IPC itself is a relatively straightforward matter, but it is noted:

- IPC levied on FID imports are recovering only 68 per cent of import processing costs incurred by DIBP (and is this the benchmark going forward, or should 100 per cent of costs be recovered?)
- DIBP and DAWR would need to undertake activity based costing exercises to ascertain what share of import processing costs are occasioned by SAC imports.

Whatever IPC is arrived at, transparency and cost consciousness dictate that the IPC should be expressed as a three part charge — comprising a routine administrative component, a border/community protection component, and a biosecurity component.

A more problematic issue concerns how/from whom should the IPC be recouped. The need to minimise collection and compliance costs rules out an at-the-border charge. This means IPC will need to be levied on either intermediaries or NRSs. Under current INCOTERM arrangements, it is not immediately clear that intermediaries have the legal ability to build into freight rates charges that are not directly related to the cost of carriage.

Given this, levying an IPC on intermediaries will see a cost impost on those intermediaries that they may be unable to pass on (to Australian purchasers), with a resultant lower return to invested capital. In such circumstances it would not be unreasonable to expect to see some intermediaries leaving the Australian market place (or reducing services) and a reduction in competition.

If the INCOTERMS prevent intermediaries from collecting and paying IPC on behalf of purchasers, then perhaps the only viable option is to collect IPCs from NRSs (a large number of which will be registered for GST anyway). However, levying only those NRSs registered for GST with IPCs will see revenue leakage as not all NRSs will need to register for GST. For example, only 83 per cent of NRSs will need to register for GST by virtue of exceeding the A\$75 000 turnover in Australia threshold, and it is not immediately clear how consignments of zero value would be captured if the NRS/sender is not registered for GST.

7 Findings

During 2014-15, the CAPEC group of express carriers — comprising DHL, FedEx, TNT and UPS — delivered around 5.7 million low value consignments to Australian households. These consignments, worth over \$1.7 billion, typically entered Australia import duty, import processing charge, and GST free by virtue of the individual consignments being at or below the A\$1000 Low Value Threshold.^{66,67}

The non-resident supplier model

The Australian Government has announced that as of 1 July 2017, low value imports will attract GST. The model being proposed is a NRS model, which would see:

- a non-resident platform or supplier with a turnover of greater than A\$75 000 in Australia would be required to register for GST and to remit GST liabilities to the Australian Government
- where a NRS is GST liable, goods and services of A\$1000 or less in value would no longer be GST exempt
- transactions related to carrying on a business would continue to be GST exempt.

Compared to the model being considered in 2011 (GST on importation), the GST on NRS model offers a substantial improvement in terms of GST collection costs. In 2011 the Productivity Commission estimated that levying all low value imports with GST, with the GST collected at-the-border, would raise around A\$480 million in additional GST revenue (and around A\$135 million in import duties), but cost well over A\$2 billion to collect.⁶⁸

The NRS model should dramatically lower the cost of GST collection. However, it will not be costless. It is estimated that GST compliance costs incurred by NRSs will be equivalent to around 0.8 per cent of their sales to Australia. For NRSs using CAPEC members to deliver their products to Australian households, the GST compliance costs will amount to an estimated A\$44 million over the 2017-18 to 2019-20 period. In comparison, the GST revenue collected is estimated to be \$427 million over the same period. It can only be expected that such GST compliance costs will be passed onto Australian consumers.

⁶⁶ For alcohol and tobacco low value imports, the full range of taxes and fees/charges apply.

⁶⁷ Whether or not imports are below the A\$1000 Low Value Threshold is assessed at point of sale, hence the free-on-board value.

⁶⁸ Productivity Commission 2011, *Economic structure and performance of the Australian retail industry*, Inquiry Report, Figure 7.1 and surrounding text

Potential implementation issues for the NRS model

While GST collection costs are expected to be lower, the NRS model has a number of significant implementation and enforcement issues.

- It is not immediately clear how foreign suppliers will be made aware of the need to register for GST, nor how will compliance be enforced. To put the scale of the NRS identification problem into perspective, CAPEC members alone had around 12 500 unique NRSs in the week of 14–20 June 2015, of which around 12 per cent (1100) were estimated to exceed the A\$75 000 turnover figure. The number of NRSs would obviously be larger if all intermediaries, including postal operators, were considered.
- Monitoring NRS compliance will require the ATO to verify GST liable sales to Australian households and remitted GST. However, apart from activity statements lodged by NRSs, the ATO does not have access to other data sources that could be used to reconcile/validate NRS activity statements and remitted GST.
- It is also not clear that Australia has the legal jurisdiction to invoice NRSs for GST monies owing (assuming it could be accurately determined) nor audit them. Doing so will likely raise sovereignty issues.
- Relying on international treaties to assist with enforcing compliance may also prove difficult.
 - While Australia and most of our major trading partners are signatories to the Conventional on Mutual Administrative Assistance in Tax Matters, foreign tax bodies can deny requests for assistance from Australia if the administrative burden to the assisting country is disproportionate to the benefit/tax revenue at stake
 - Furthermore, jurisdictional differences across tax agencies may require the ATO to deal with state based tax agencies, which will add to the complexity (and cost) of pursuing owed GST monies.
- Given these difficulties, it is not immediately clear that foreign suppliers will comply with the NRS model. GST compliance within Australia runs at about 95 per cent (meaning 5 per cent of estimated GST monies are never forthcoming). It would not be unreasonable to expect that NRS non-compliance would be many times the Australian non-compliance rate.
 - Large businesses and platforms may register due to social pressure and the value associated with being seen as a ‘good corporate citizen’. CAPEC estimates that 40 per cent of purchases are conducted through platforms, and it can be expected that these businesses would agree to collect GST on sales to Australia.

Economic impacts of GST collected through the NRS model

There is a strong in principle case for levying low value imports with GST, and in so doing moving towards (tax) competitive neutrality between foreign and domestic suppliers.

- Exempting low value imports from GST will see an overconsumption of those goods in Australia, with the over consumption being associated with a loss of economic efficiency. However, our analysis, supported by Choice survey work, suggests demand for low value imports is not very price sensitive. The low elasticity of demand sees the

welfare loss from the over consumption being small (equivalent to around 0.2 per cent of the value of low value imports).

- The GST and compliance costs will see low value imports rising in price by around 9 per cent. This will negatively impact households, with lost consumer welfare over the 2017-18 to 2019-20 period estimated to be \$482 million. Note that these losses only relate to low value imports delivered to Australian consumers by CAPEC members only.
- The impacts on consumers reflect a number of factors, namely:
 - GST payments to the Australian Government
 - resource costs associated with GST compliance
 - increases in domestic supplier activity as Australian households move purchases from foreign suppliers to domestic suppliers.
- While different agents — Australian households, the Australian Government, foreign suppliers and their domestic competitors — are impacted to differing extents, the aggregate economic impact is given by the change in economic efficiency losses.
 - With low value imports being GST exempt, there is a loss of economic efficiency associated with the overconsumption of low value imports.
 - However, moving to levy low value imports with GST brings with it GST compliance costs, and such costs represent a real resource cost increase (akin to a loss of productivity). Resource cost increases bring about losses in economic efficiency.
- It is calculated that the economic efficiency loss associated with the preferential tax treatment of low value imports is equivalent to 0.2 per cent of the value of those imports. The economic efficiency loss arising from the GST compliance costs is calculated as being 0.4 per cent of value. Hence moving to address an economic efficiency loss of 0.2 per cent brings about an efficiency loss of 0.4 per cent.
- In a cost-benefit sense, and even if the implementation and enforcement challenges can be overcome, these results suggest moving to levy low value imports through the NRS model is not justifiable as it brings about a net increase in economic efficiency losses of some A\$12.5 million (consignments transported to Australian by CAPEC members) or A\$28.9 million (all intermediaries).
- Sensitivity analysis indicates that the core result — that levying low value imports with GST through the NRS model has a negative net impact on economic efficiency — is robust to alternative parameter assumptions.
 - The sensitivity analysis identified that the estimated impact on economic efficiency is most sensitive to the assumptions of compliance costs and the elasticity of demand.

Levying low value imports with import processing costs

As was the case for levying low value imports with GST, there is a case for levying low value imports with IPCs in order to recover the costs incurred by DIBP and DAWR in processing those imports. The cost impost on low value imports would be matched by a reduction in IPCs levied on high value imports.

Similar to the GST narrative, whether or not levying low value imports with IPCs, and in so doing removing the cross subsidy between SAC and FID imports, delivers a net improvement in economic efficiency depends in large part on how the IPC will be collected and the associated collection/compliance costs.

The Productivity Commission's findings suggest that collecting the IPC via an at-the-border charge would see collection costs being many multiples of the IPC revenue raised, with the high compliance costs resulting in a net loss of economic efficiency. The need to minimise collection and compliance costs rules out collecting IPCs via an at-the-border charge.

The arrangement under which international freight is transported is governed by the INCOTERMS. It is not immediately clear under the current DAP INCOTERM arrangements whether intermediaries have the legal ability to build into freight rates charges that are not directly related to the cost of carriage. If this is indeed the case, then levying IPCs on intermediaries will see a cost imposed on those intermediaries that they may be unable to pass on (to Australian purchasers), with a resultant lower return to invested capital. In such circumstances it would not be unreasonable to expect to see some intermediaries leaving the Australian market place (or reducing services) and a reduction in competition.

If the DAP INCOTERMS prevent intermediaries from collecting and paying IPCs on behalf of purchasers, then the only viable (or remaining) option is to collect IPCs from NRSs. Extending GST to low value imports under the NRS model will see a large number of these suppliers being registered for GST anyway, hence accessible to the Australian Government for both GST collection and import processing cost recovery.

Concluding comments

Under current arrangements, low value imports are preferentially treated on two fronts. Firstly, low value imports (excluding alcohol and tobacco products) do not attract GST, putting the NRSs of those products at a competitive advantage relative to Australian retailers. Secondly, low value imports occasion import processing costs on DIBP and DAWR, yet these costs are borne by high value imports. This sees low value imports being marginally cheaper (on average) than otherwise by virtue of a cross subsidy from high value imports.

The objectives of competitive neutrality and meeting the Australian Government's Cost Recovery Guidelines suggest that there is a strong in principle case for levying low value imports with GST and IPCs (respectively).

The proposed NRS model for collecting GST on low value imports has substantial implementation and compliance/enforcement issues. Even if these challenges can be overcome, the proposed GST collection regime will not be costless. GST collection and compliance costs are estimated to be equivalent to 0.4 per cent of the value of low imports delivered to Australian consumers. This real resource cost increase, akin to a loss of productivity brought about by additional red tape, sees a loss of economic efficiency. Indeed, the compliance cost driven loss of economic efficiency exceeds the economic benefits brought about by levying GST and reinstalling competitive neutrality.

It is estimated that over 2017-18 to 2019-20, the Australian economy will experience a net A\$28.9 million loss of economic efficiency if GST is levied on low value imports. On a cost-benefit basis, there would seem to be no economic justification for extending GST to low value imports.

Levying low value imports with the appropriate import processing cost recovery charge would be consistent with the use of cost recovery measures used elsewhere in Australia. However, the issue here is not the charge itself, but rather how, and from whom, it will be collected. Collecting IPCs as an at-the-border charge is not considered a viable option due to prohibitive collection costs. There is legal uncertainty as to whether, under the INCOTERMS that govern international trade, intermediaries are allowed to build into their freight rates charges that appear not to be directly associated with the cost of carriage.

If intermediaries can legally do this this, then it makes sense for the IPC to be levied on intermediaries, who in turn can recover import charges from Australian purchasers (and via the NRS). If intermediaries are not allowed to build IPCs into their freight rates, then the only remaining option is for the IPC to be levied on the NRS, a large number of which will be registered for GST and therefore have a connection/visibility to the Australian Government.



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