



Australian Government
Productivity Commission

Collection Models for
GST on Low Value
Imported Goods

Productivity Commission
Inquiry Report
Overview & Recommendation

No. 86, 31 October 2017

© Commonwealth of Australia 2017

ISSN 1447-1337 (online)

ISSN 1447-1329 (print)

ISBN 978-1-74037-648-8 (online)

ISBN 978-1-74037-647-1 (print)



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An appropriate reference for this publication is:

Productivity Commission 2017, *Collection Models for GST on Low Value Imported Goods*, Report no. 86, Canberra.

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

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OVERVIEW

Key points

- The Australian Parliament recently legislated to apply the GST to low value imported goods from July 2018, using a streamlined collection model that places the responsibility for assessing, collecting and remitting the tax on foreign suppliers.
- Given the decision to collect GST on low value imported goods, the legislated model is the most feasible among the imperfect alternatives at this time. Implementing the legislated model:
 - should go some way to improving tax neutrality between imported and domestically retailed low value goods.
 - will bring partial rates of GST collection (due mainly to exemptions for small suppliers, as well as significant compliance challenges), but the revenue obtained is likely to significantly outweigh the administrative and compliance costs.
 - should avoid major disruption for consumers when importing goods, although some electronic distribution platforms have warned they may disable foreign vendors from selling to consumers in Australia.
- Among the alternatives, ‘transporter-based’ collection models that require the delivery agent to collect GST could capture more revenue, but their feasibility is hampered by paper-based declaration processes still used for international mail; and the difficulties for Australia Post to negotiate agreements with myriad other postal services. They would also impose high administrative and compliance costs, and some would cause inconvenience for consumers.
- ‘Purchaser’ and ‘financial intermediary’ collection models, using advanced technological solutions to minimise high compliance and enforcement costs, have also been proposed. However, their efficacy is untested and their lack of readiness for deployment by mid-2018 make them unsuitable at this time.
- There is an in-principle case to contemplate delaying implementation of the legislated model, to provide more time for technological changes to play out, to learn from the experiences of other nations and to avoid ‘first mover’ risks.
- Nonetheless, the Commission considers there is insufficient basis to recommend delaying the implementation schedule, given the Australian Parliament’s decision to apply the GST to low value imported goods. Waiting for better alternatives will not necessarily prove fruitful. Nor would implementation now preclude change later.
- The Commission has identified some prospective improvements to the design of the legislated model and enforcement strategy, although it has not been in a position to adequately evaluate these options. If the legislated model does not perform broadly as expected, these options should be considered as part of a future review.
- The legislated model and the suitability of alternatives should be reviewed five years from commencement, or sooner if triggered by evidence of unduly low compliance, unintended impacts on consumers or adverse trade policy responses.

Overview

1 Setting the scene

A consumer purchasing books, clothing, electronic devices, sporting equipment or other consumer goods from a domestic retailer will have to pay the GST. However, the same goods purchased from overseas are exempt from GST if their value is no more than \$1000.

Domestic retailers have long argued that this GST exemption for low value imported goods creates an uneven playing field, harming the economic viability of their businesses. The exemption also means State and Territory governments are foregoing GST revenue. Although hard to gauge, Treasury conjectures the leakage is now around \$400 million per year (equivalent to about $\frac{2}{3}$ of a per cent of GST revenue).

The growth of online commerce (from a very low base) has increased these concerns. For the year ending June 2017, the National Australia Bank estimated that online retail sales totalled \$22.7 billion, of which about one fifth were from abroad, equivalent to around 1½ per cent of retail sales by all ‘bricks-and-mortar’ retailers.

In 2011, the Productivity Commission examined whether the ‘border’ collection model — collection by customs authorities as currently applied to higher value goods — should be extended to goods below \$1000. The Commission concluded that the benefits of doing so would be far outweighed by the collection costs. However, it also found that there are strong in principle grounds to treat imports and domestic sales equally, and so recommended the investigation of new approaches to collection that could improve the cost-effectiveness of levying GST on low value imported goods.

Following more debate and research, the Australian Parliament recently legislated for new measures to collect GST on these goods, to commence on 1 July 2018. The legislation retains the \$1000 ‘low value threshold’, but provides for a new, streamlined collection model for imported goods falling under the threshold. In essence, under the legislated model:

- foreign vendors, as well as redeliverers and ‘electronic distribution platforms’ (EDPs), such as Amazon and eBay, would be liable for GST on low value imported goods sold to an Australian consumer (without the involvement of customs authorities)
- only those foreign suppliers that make sales of more than \$75 000 to consumers in Australia each year would be required to register for and collect GST. (Sales from foreign vendors below that threshold, if supplied through EDPs or redeliverers, would also be liable for GST)

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- foreign suppliers would be expected to include a GST component in the price of their goods, as domestic businesses do, and periodically remit this to the Australian Tax Office (ATO).

Some stakeholders have criticised the model, contending that it relies on voluntary compliance, is unlikely to be effective, and that better collection models should either augment or replace it.

This inquiry's main tasks are to check that the legislated model is the best available collection model to extend the GST to low value imported goods, and to consider any practical improvements to support its implementation. The Commission has not revisited the question of whether it makes economic sense to impose GST on low value imports.

Impacts of extending the GST to low value imported goods

Extending the GST to low value imported goods will have an impact on Australian consumers, retailers, governments and foreign suppliers, and these will depend on the collection model used.

Australian consumers will face prices for low value imported goods that are around 10 per cent higher. The breadth and extent of the price increase will depend on collection rates, compliance costs and the level of competition in the market. The higher prices for imports could allow prices for competing domestic goods to rise too.

There may also be impacts on consumers beyond the price effects. Some collection models could require consumers to handle the GST paperwork themselves or entail delays in receiving their goods, while with others there is a risk that some foreign suppliers might cease servicing Australian consumers.

State and Territory governments stand to benefit from the distribution of the extra GST revenue collected. However, the scope for gains needs to be kept in perspective. Even if a model were to collect all of the revenue that Treasury projects, of around \$400 million per year, that amount is very small relative to total GST revenues, which run to over \$60 billion per year.

Australian retailers should benefit from the more equal tax treatment of competing imports. However, the magnitude of this benefit is also expected to be limited, since low value imports represent an insignificant share of most retail subsectors (some segments such as bicycle parts and accessories are larger). Moreover, the relative competitiveness of Australian and overseas retailers is influenced by other drivers, including non-price factors. In this regard, the Commission notes that greater benefits to the retail sector (and more broadly) could be secured by proceeding with reforms in areas such as workplace relations, shopping hours, and planning and zoning regulation.

What makes a good collection model?

The Commission has identified several ‘desirable attributes’ of GST collection models, drawing on established tax and economic policy principles. Beyond their basic feasibility, GST collection models for low value imported goods ideally should:

- induce strong rates of compliance and revenue collection
- limit business compliance and government administration costs
- minimise burdens and disruption for consumers
- avoid adverse trade policy effects.

There are nuances in assessing these attributes, and policy design involves trade-offs between these desirable characteristics. Synergies with other policy domains should also be taken into account.

The Commission’s approach

Using this framework, the Commission has assessed the feasibility and/or merits of the legislated model and several other collection models suggested in previous reviews or in submissions. It has drawn on earlier research by the Commission, the OECD and other bodies, along with information gained during the inquiry.

There is scant evidence on some matters. For example, without well-established precedents here or overseas, it is difficult to forecast the legislated model’s compliance rates and costs. The four month timeframe set by the Australian Parliament for this inquiry has also limited scope for consultation and detailed analysis.

Given that the Parliament has already agreed to the legislated model, the moves towards adoption of vendor-based collection models overseas and the tight timeframe, the Commission has placed a large onus on parties opposed to the legislated model to demonstrate the feasibility and superiority of an alternative approach.

2 The legislated model

Key advantages

The legislated model avoids the pitfalls that would arise from extending the ‘border collection model’ (currently used for high value imports), or other models that involve holding goods pending inspection, assessment or collection processes. With more than 50 million low value packages and parcels now being imported annually, the need for customs authorities or other parties in the supply chain to assess and collect GST for individual items would swamp the system’s current capacity, impose substantial costs, and could result in significant delays and compliance burdens for consumers. The legislated

model does not require any additional customs involvement at the border. Further, the model provides transparency for consumers as GST-inclusive prices would be indicated at the time of purchase.

The legislated model may also perform well from a tax administration efficiency perspective. The Australian Government claims that it will deliver around \$300 million during its first three years of operation, at little cost to government — \$13 million up to the same point. This equates to an administration cost of around 4.4 cents for every dollar of additional revenue. Although the basis for the Treasury revenue estimates is contestable (see below), the model's expected ratio of administrative cost to revenue is materially superior to the other plausible collection models examined by the Commission.

Adoption of the legislated model is broadly in line with international initiatives in this area, particularly plans by the European Union. And it is akin in design to the vendor collection model for imported services and digital products that is being adopted widely (including in Australia, from 1 July 2017).

Concerns and uncertainties

There are four main areas of concern and uncertainty around the legislated model.

First, several stakeholders have argued that the model will collect limited revenue, and less than the government claims. (The Government's revenue estimates assume the collection rate reaches 27 per cent in the first three years and a maximum of 54 per cent after six years.) This is attributed to what stakeholders regard as the essentially 'voluntary' nature of the collection model. They contend the ATO has limited abilities to enforce compliance on suppliers beyond the immediate reach of Australia's legal system.

While there is little doubt that enforcement will be an ongoing challenge, the ATO is adopting a cooperative approach to compliance and has already gone to considerable lengths to alert overseas vendors of their new obligations. It is likely that most major foreign suppliers will comply to avoid tarnishing their reputations, suggesting that significant rates of compliance appear achievable. The ATO also pointed to the early performance of the similar scheme for imported services and digital goods, although these imports are concentrated among a few major international companies and that model was adopted following successful implementation in other jurisdictions (particularly the European Union).

Second, foreign suppliers will face significant burdens collecting the GST (particularly where the legislated model and existing border collection for high value goods come into conflict). The design of the legislated model has attempted to limit these costs through the ATO's use of a limited registration system and simplified system of remittance. While the legislated model still places the bulk of collection costs on foreign suppliers, many of these costs mirror those borne by domestic businesses in the broader GST system.

Third, some EDPs claim they cannot implement the model in its current form as they do not collect sufficient information about the transactions they facilitate. eBay has warned it may even block foreign vendors from selling to consumers in Australia when the legislated model is introduced. The veracity of these claims is difficult to assess. Most of eBay's public statements say only that blocking imports to the Australian market is *possible*, not guaranteed. That said, Australia's position as the first to implement a vendor model for all physical low value imported goods gives EDPs strong incentives to try to suppress the widespread uptake of a model that requires them to collect GST.

Fourth, a few stakeholders have commented that the legislated model is tantamount to a breach of Australia's international trade treaty agreements, as it adds unduly to the cost of trade. The Commission considers this risk as small. The application of the GST to imported goods to achieve equivalent treatment with domestic goods does not usurp on national treatment, and the added impost of complying with the model born by foreign suppliers is viewed as unlikely to be interpreted as indirect protection. However, there is less certainty around some specific aspects of the legislated model, particularly the different treatment of foreign and domestic goods sold through an EDP.

Can the legislated model be improved?

The Commission has identified some prospective improvements to the design of the legislated model and enforcement strategy, although it has not been in a position to adequately evaluate these options. If the model does not perform broadly as expected, these options should be considered as part of a future review.

In particular, if the level of compliance falls short of expectations, the ATO's enforcement toolkit could be expanded. Options include enabling the ATO to 'name and shame' non-compliant foreign suppliers and/or requiring them to establish an Australian agent. A stronger enforcement option, recommended by several inquiry participants, would be to supplement the legislated model by applying 'border' processes to imports from persistently non-compliant suppliers.

These options have their own costs and complications. For example, publicising non-compliant suppliers might backfire by alerting Australian consumers to websites offering (tax-free) bargains. And a comprehensive program of stopping all goods from non-compliant suppliers at the border would be very costly to administer (although there may be scope to devise a more limited, targeted approach, particularly for the cargo stream). These options would require further analysis before deployment.

Looking further ahead, there may even be scope to avoid the issues that arise with two collection models sitting side-by-side (one for low value goods and another for the remainder), by extending the legislated model to higher value goods. Of course, this would depend on whether the legislated model is successful (particularly through strong compliance rates) and would also require much further analysis before deployment.

3 Is there a superior collection model?

The legislated model is one of several options that could be used for GST collection on low value imported goods. Options are distinguished by where in the supply chain for online imported goods the legal obligation to assess, collect and remit GST is placed (box 1). This choice is important because it bears on the efficiency of tax administration, compliance costs and non-pecuniary factors, like consumer convenience.

Transporter models

In examining possible alternative models, the Commission has focused on transporter-based collection models that require the delivery agent to collect GST. In particular, two transporter collection models appear as the most suitable alternatives to the legislated model. These are the approach recommended by the 2012 Low Value Parcel Processing Taskforce (the Taskforce model) and the ‘modernised transporter model’ proposed to this inquiry by Amazon.

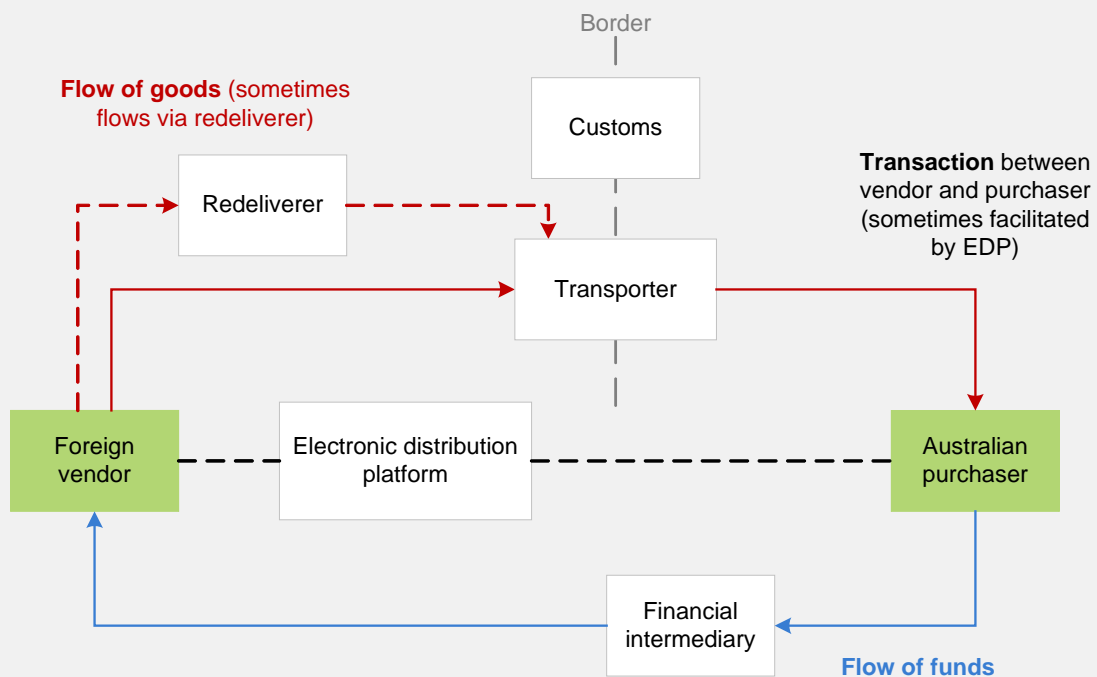
- The Taskforce model would involve low value goods being assessed for GST by customs authorities at the border before being released to transporters (such as Australia Post or express couriers) that would take responsibility for collecting and remitting the GST.
- The ‘modernised transporter model’ is similar, but transporters would also take responsibility for assessing GST liabilities on items they transport. Amazon envisages that the transporter would seek to collect the GST upfront from the foreign supplier rather than in a second payment by the purchaser.

Because neither model places the liability for assessing and collecting the GST on entities outside of Australia’s legal jurisdiction, or exempts goods from small suppliers, both are likely to achieve higher compliance and collection rates than the legislated model — although at the cost of a higher administrative and compliance burden.

Neither model could sensibly be considered as a feasible alternative in the near term because of the legacy paper-based declaration processes still in operation for most goods sent by international mail. The Universal Postal Union (the international postal organisation) is currently promoting an upgrade to a system involving electronic data transmission, but indications are that this may not become widespread until 2023. In addition, the modernised transporter model would require Australia Post to negotiate agreements with overseas postal operators to facilitate collection upfront from the vendor, which could further hamper and delay its implementation.

Box 1 The online goods importation system and models for collecting GST

The supply chain for online imported goods differs significantly from the traditional model of importing, warehousing and then retailing goods. The figure below depicts the process, and the main entities involved.



The OECD (2015) has identified four broad collection models that are distinguished by the party liable to account for and collect GST. The broad models are:

- *'traditional' or 'border' collection* — the model currently used in Australia to collect the GST and customs duties on imports of goods valued above \$1000. Customs authorities assess the value of the imported goods and hold them until the appropriate GST payment is made by the recipient of the goods.
- *vendor collection* — the obligation to collect and remit the GST is placed on the foreign vendor, who is required to register for GST in the destination jurisdiction.
- *intermediary collection* — this umbrella term describes models where the obligation to collect and remit GST is placed on intermediaries in the supply chain, including financial intermediaries, EDPs or transporters (including redeliverers).
- *purchaser collection* — the purchaser is required to self-assess and remit GST on purchases of low value imported goods.

In practice, there are myriad ways collection systems could be configured, with GST assessment and GST collection potentially happening at different (and multiple) points in the supply chain, and involving multiple parties. Proposals for collection systems often draw on elements of the four broad collection models listed above.

Other models

Several inquiry participants proposed collection models based on other points in the supply chain for imported goods, and for some in combination with sophisticated technological solutions that their advocates claim would minimise otherwise high compliance and administration costs. For example:

- a border collection model (currently used to collect GST and customs duties on imports of goods valued above \$1000).
- self-assessment by purchasers
- collection by banks, credit card schemes and other financial intermediaries.

The border collection model was examined in depth by the Commission in its 2011 inquiry. It concluded that the model was unworkable for low value goods because the administrative and compliance costs would far outweigh the revenue collected and entail delays and disruptions to the delivery of goods. The Commission has not received in this inquiry any new evidence that changes this conclusion.

The financial intermediary and purchaser self-assessment models have some features of merit. In particular, the legal liability for GST collection falls on entities within Australia's jurisdiction and the scope for information technologies to monitor enforcement at modest cost could go some way to addressing two of the criticisms with the legislated model.

However, current payments systems do not transmit sufficient information for assessing GST liabilities under a financial intermediary model, and it is uncertain whether this will change in the future. While payment system upgrades are allowing for greater information capture and transmission, the most common payment methods for cross-border purchases are unaffected, and the diversity of payment options presents additional challenges. And for both models, the information technology requirements needed go well beyond system upgrades and remain untested. The Commission considers their unproven feasibility and effectiveness make them unsuitable at this time.

4 The way ahead

While the legislated model has limitations and carries significant uncertainty about levels of compliance and the reactions of EDPs, the Commission does not have sufficient sound evidence to recommend an alternative collection model at this stage. That said, which collection model is best may change as technologies develop and as other countries implement their own systems. This raises the question of whether there is merit in delaying implementation of the legislated model and adopting a wait-and-see strategy.

Is there a case for delaying implementation?

Delaying implementation of the legislated model would provide more time for technological innovations or other developments that could favour the feasibility of alternative collection models. Significantly, the provision of electronic data with goods sent via international mail is expected to become compulsory by 2023 (and maybe sooner in some countries), making transporter-based models more feasible and attractive than they are at present.

Delaying implementation would also allow time to learn from (though not necessarily emulate) other countries' choices and experiences with vendor-based collection models. There are several overseas initiatives in the pipeline, the most significant one being that of the European Union, which is scheduled to take effect from 2021. The prospect of moving after other countries, or concurrently, could abate the risk of EDPs disabling foreign vendors from selling to consumers in Australia.

The Commission considers these arguments offer insufficient ground to recommend delaying the implementation schedule. While it is possible that superior collection models *may* eventually emerge, the pivotal issue is whether the legislated model would preclude their subsequent adoption. The Commission sees only limited 'lock in' risk and, as such, the value of waiting for potentially better models is low.

Delaying implementation to take stock of international developments is likewise a two-way street. The fate of the legislated model does not play out in a policy vacuum — a decision to delay its implementation could slow global momentum on this front, potentially extending the life of existing inefficient border collection mechanisms overseas, and/or opening the door to more onerous alternative collection models that hamper trade and disadvantage Australian exporters.

Other considerations also suggest against delaying implementation.

- While the introduction of the legislated model will not be a panacea for the challenges facing the retail sector, it should assuage concerns about the inequities of the current GST collection arrangements.
- Some foreign vendors will have already incurred costs associated with implementing the legislated model. The ATO has also engaged in an extensive communication campaign abroad, and delaying implementation could undermine its credibility.

Although the Commission has not found sufficient reason to recommend delaying the legislated model's implementation, the Australian Government needs to be prepared to manage the risk that some EDPs may campaign against the measure by blocking imports to Australian consumers. The ability of large online businesses to mobilise consumers to campaign against cost burdens or imposts ultimately borne by consumers should not be underestimated.

What should future reviews do?

Following the implementation of the legislated model, two reviews are anticipated:

- A post implementation review within two years, which is essential following the failure to prepare a regulation impact statement prior to announcing the measure.
- A later review to ensure that the arrangements are operating as intended and to take account of international developments.

The post implementation review should provide an early indication of the efficacy of the legislated model. In particular, it should assess compliance and gauge the extent to which the measure represents an ongoing burden on foreign suppliers. It could also consider whether any measures are warranted to strengthen compliance with the model.

The later and more substantial review should revisit these matters, and also consider developments abroad and technological advances (relating to electronic data transmission between international postal operators and the technologically advanced collection models outlined earlier). It should not take place until at least five years after implementation. This would provide certainty, demonstrate commitment to the model, and enable sufficient time to gather evidence and for overseas developments to proceed. However, there should also be scope for the review to be brought forward if triggered by exceptional circumstances, such as very low compliance, unintended impacts on consumers or significant trade policy issues.

Conclusions and recommendation

The legislated collection model

CONCLUSION 1

The legislated model should improve tax neutrality between imported and domestically retailed low value goods, and avoid major disruption for consumers when importing goods. However, the revenue collected is likely to be modest and will depend on the rate of compliance, for which no precise estimates are possible. Foreign suppliers will incur significant costs in complying with the legislated model and, as under any collection model, consumers will face higher prices.

Is there a superior model?

CONCLUSION 2

Collection models where the legal liability for GST falls on entities within Australia's jurisdiction and information technologies are used to monitor enforcement or facilitate collection at modest cost would avoid some of the limitations with the legislated model. Models of this kind (e.g. transporter, financial intermediary and self-assessment by purchasers) have been proposed. However, their efficacy is untested and they would not be ready for deployment by mid-2018.

The way ahead

CONCLUSION 3

Given the decision to collect GST on low value imported goods and the current limitations of alternatives, the legislated model is the most feasible at this time.

CONCLUSION 4

There is an in-principle case to consider delaying implementation of the legislated model, to provide more time for technological changes to play out, to learn from the experiences of other nations and to avoid 'first mover' risks. However, the Commission considers there is insufficient basis to recommend delaying the implementation schedule.

RECOMMENDATION 1

The Australian Government should conduct a comprehensive review of the collection of GST on low value imported goods five years after the commencement of the legislated model, unless exceptional circumstances — such as extremely low compliance, unintended impacts on consumers or significant trade policy issues — warrant an earlier review.

The review should consider:

- the performance of the legislated model
- *if* the model is achieving unduly low rates of compliance, the merits of measures (including those identified by the Commission) for lifting compliance
- *if* the model is achieving high rates of compliance, the merits of measures (including those identified by the Commission) to extend the model to higher value imported goods
- whether there is a case to adopt a different collection model, taking into account technological advances and process and policy developments here and overseas (including in relation to electronic data transmission between international postal operators).