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Submission to the Productivity Commission

Economic Structure and Performance of the Australian Retail Industry

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1. Introduction

In response to the publication of the Australian Government's Productivity Commission Issues Paper, please accept this submission to the inquiry relating to the Economic Structure and Performance of the Australian Retail Industry.

The focuses of our submission are matters covered at sections 3 and 4 of the Issues Paper, covering the e-Commerce environment and particularly the future of the current Australian indirect tax regime relating to the importation of goods into Australia.

Ezibuy Limited is a New Zealand domiciled business that operates a mail order and e-Commerce business, selling goods to the general public in both New Zealand and Australia. Ezibuy Limited supplies goods from its New Zealand base to Australian customers by way of post. Orders are received online, by phone or by mail.

We currently have 670,000 Australian customers on our database, of which 350,000 are making regular purchases. We send 1.3 million parcels to Australia per annum, with 3% of these being above the AU\$1,000 low value import threshold (LVIT). Our business model is based around high volume, low value imports.

2. Increased Focus of e-Commerce and Indirect Tax mechanisms

Following intense media coverage towards the end of the 2010 calendar year, increasingly vocal calls were being made within the retail sector and media for the current import regime to be reviewed, particularly from an Indirect Tax perspective.

Of principal concern to some sectors of the retail industry was the impact the AU\$1,000 LVIT threshold was having on Australian retailers, who compete with overseas retailers. Those calling for change posited that as the spread and reach of internet shopping increases and access to overseas suppliers of goods becomes easier, the playing field was not level, due to the current GST regime. The supply of goods, dispatched from overseas to Australian customers, imported into Australia with a customs value less than AU\$1,000 would not be subject to GST, whereas those goods supplied by Australian retailers, through their retail outlets or by e-Commerce/ mail order would be subject to GST as taxable supplies connected with Australia and possibly, duty upon importation.

The position put forward by many in the retail sector was that the impost of the 10% GST (and any applicable duty) on the supply by domestic retailers is the key determinate in consumers choosing to source cheaper goods online from overseas suppliers.

It has been proposed that the current AU\$1,000 is lowered or even abolished to assist domestic suppliers compete against overseas suppliers who have a perceived advantage.

3. Lowering the threshold

A recent report by Nielsen suggests that, for each of the major categories of goods bought online, both domestically and from overseas suppliers, the average monthly amount spent online was considerably less than AU\$1,000¹.

The LVIT of AU\$1,000 (for both postal and non-postal goods) has been in place since October 2005. Prior to this date, non-postal imports were subject to a AU\$250 threshold, with the threshold at AU\$1,000 for postal imports. The alignment was seen to provide a necessary balance between revenue collection and administrative efficiency. The then Minister for Customs Chris Ellison stated:

*"I understand that the increased threshold level is reducing costs and streamlining processing for 135,000 importers, small businesses and individuals... this removal in charges also represents a reduction in red tape, which is good news"*².

A reduction in the threshold would affect the efficiency with which importers could move goods into Australia, with increased handling, storage and processing times as the number of formally entered items increases. This would effectively unwind the improvements in administrative efficiency gained through increasing the threshold in 2005.

The additional compliance and administration costs to the ATO as a result of drawing more non-residents into the Australian GST net also need to be considered. The ATO would need to devote considerably more resources to ensuring compliance by these non-resident entities. These additional costs need to be considered in addition to those borne by the ACBPS.

We also note that the threshold was considered in a Board of Taxation review completed in early 2010. The Board recommended that no change be made to the AU\$1,000 threshold, describing it as 'appropriate' in view of the administrative difficulties that would arise if the threshold was lower³. The Government accepted the Board's recommendation not to alter the threshold⁴. The board acknowledged there may be issues regarding competitive neutrality, insofar as goods may be available cheaper from an overseas supplier due to (in part) the GST exclusive nature of the supply.

However the increased costs incurred by ACBPS in processing each individual consignment to assess its value and the applicability (or otherwise) of duty and/ or GST, would appear to have been regarded as too great to contemplate a reduction of the threshold, when compared to the estimated increase in revenue that would have been raised. We note that the data supporting the Board of Taxation's findings has not been made available. We also note that the results of the current trial undertaken by ACBPS on this matter should confirm the cost/ benefit position.

As the Board of Taxation review was undertaken within the last two years we would not expect the compliance costs and processing complications to have altered significantly and would therefore expect the same conclusions in respect of cost/ benefit be reached.

¹ Nielsen's online retail monitor, first half 2010

² Chapter 4.3, *Review of the Application of GST to Cross-Border Transactions*, Board of Taxation, February 2010

² <http://www.customs.gov.au/site/content7046.asp>

⁴ Assistant Treasurer's media release No.95, *Further reductions in GST compliance costs for business*, 11 May 2010

Further, if the current import threshold was reduced to a figure of AU\$250 for example, then the consumer will be significantly impacted. For every consignment the consumer was due to receive with a customs value over AU\$251, under current procedures the following would be required:

- Lodgement of import declaration with ACBPS, with associated import processing charge (in excess of AU\$50 in some instances)
- Payment of any duty and/ or GST due
- Broker or agent fees if engaged to facilitate the import on the consumer's behalf

The additional financial burden and associated time delays arising from the extra steps a consumer must take penalise the Australian consumer merely for their choice of purchasing goods from overseas. Indeed, the additional costs incurred may deter the consumer from making online purchases. A recent ACMA study found that 74% of people who shop online do so partially because it is more convenient⁵. Measures to reduce the threshold will have the opposite effect.

We also note that the additional financial burden and time delays suffered by consumers would likely occur irrespective of the technology used in the administrative process.

4. Alternative Outcome

Alternatively, overseas retailers, when faced with a lower import threshold in Australia, may adopt a different business model. To relieve their Australian consumers of the burden of clearing goods, they could seek to register for GST in Australia, enter the goods for home consumption, and remit GST on supplies they make to Australian consumers. We note that this may already be occurring where an overseas supplier is making supplies of goods with a customs value in excess of AU\$1,000.

Whilst the overseas retailer may claim back any GST payable on its importation of goods into Australia, it will subsequently charge GST on the taxable supplies it makes to Australian customers. Such a course of action would simplify the transaction for the customer. However, the compliance burden and associated costs are merely shifted to the overseas retailer who would be expected to increase prices further to recoup these costs.

The process of registration for GST as a non-resident entity is onerous, before then complying with the ongoing compliance obligations of lodgement of Business Activity Statements and management of the GST deferral scheme. Non-resident entities with no physical presence in Australia that follow this course of action will incur significant advisor costs in order for them to manage their GST obligations appropriately. Indeed the scale of these costs may impact upon their ability and even desire to transact with Australian customers.

It should also be noted that with the imposition of GST on the supply by the non-resident, ultimately the customer will pay more than the simple GST increment.

This broadening of the GST net for those who supply goods to Australian customers appears to be contrary to the objectives set out in the recent discussion paper released by the Australian

⁵ *Australia in the digital economy: Consumer engagement in e-commerce*, Australian Media and Communications Authority, November 2010

Government⁶. In the discussion paper, one of the key goals was to avoid bringing non-resident entities into the Australian GST regime. The concerns of the Board of Taxation, namely:

- the overly inclusive nature of the current GST regime for non-residents
- compliance costs for registered non-resident entities
- difficulties enforcing compliance non-resident entities

add strength to the proposition that the current import threshold is maintained. Otherwise, non-resident suppliers of goods to the Australian consumer will face a stark choice. And under either option, the consumer will pay more.

5. Overseas Comparison

It has been noted that Australia's import threshold is significantly higher than those of similar value added tax regimes around the world. For example, the EU has a threshold of €22. Whilst this may appear to indicate that Australia's regime is overly generous, the differences in the markets (particularly geographic) and ways of doing business in different areas of the globe dictate the need for appropriate thresholds, whatever level they may be. A low threshold in any one jurisdiction does not mean a higher threshold elsewhere is inappropriate.

6. Influence of GST

We do not believe that absence of GST/ duty in the price of goods purchased from overseas is the predominant factor that motivates consumers to purchase items from such sources.

Indeed, a significant factor at the moment for consumers seeking out goods from overseas retailers would appear to be the strength of the Australian currency against the currencies of countries of traditional retail strength, i.e. the United States and United Kingdom. Goods from retailers in those countries are significantly cheaper than they were ten years ago. As technology has developed and online shopping becomes more prevalent, Australian consumers are able to use the strong local currency to their advantage.

Goods that were previously prohibitively expensive in the domestic retail market can now be sourced from overseas for significantly cheaper prices, often well in excess of 20% cheaper. Such a saving belies the purported advantage that non-resident retailers get from being outside the GST regime. Media coverage of the GST issue in late 2010 and early 2011⁷ and the Assistant Treasurer's own press release of 4 January 2011⁸ also highlighted the fact that savings that online consumers may make by buying from overseas retailers (and receiving the goods via post under the import threshold) are significant, even discounting the GST 'saving'.

Research indicates that the two most important factors in consumers' decisions to shop online are convenience and price. Essential Research polling from Crikey reveals that 50% of consumers were attracted by convenience, with 60% stating price was "very important" in their decision to shop

⁶ Implementation of the recommendations of the Board of Taxation's review of the GST cross-border transactions - Discussion paper 15 February 2011

⁷ <http://www.smh.com.au/business/reality-of-net-losses-for-brick-behemoths-20110119-19wmm.html>

⁸ <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/001.htm&pageID=003&min=brs&Year=2011&DocType=0>

online⁹. Monash University research supports these findings, with “better value”, (to) “avoid crowds” and (to) “avoid queuing” cited as the main drivers of online purchasing¹⁰.

Access to a wider range of products is another factor cited by consumers as being central to their decision to shop online. According to Essential Research polling from Crikey, 45% of respondents indicated that the range of available products attracted them to online purchasing¹¹. Similarly, Monash University research found that about 46% of respondents cited “access to a wider range of products” as motive for shopping online¹².

We note that a significant proportion of our Australian customers live in regional areas - approximately 50% of imported goods in 2009 were delivered to people living outside of metropolitan areas. These customers do not necessarily have access to major retail shopping areas and e-Commerce provides their only means of obtaining certain products.

These regional customers will often pay higher distribution costs due to their location and would be penalised further if the threshold were lowered and prices increased. Not only would the base price of the product increase, but these customers would also be subject to customs clearance charges and increased delivery fees, as transport agents attempt to recoup costs related to the handling, storage and processing of imports now subject to formal customs declaration.

In many ways, any lowering of the low value threshold could result in a penalty for regional consumers who choose to embrace e-Commerce. It should be noted that such consumers are embracing the choice and convenience of e-Commerce irrespective of whether they incur GST or not. Quite simply their local choices are restricted due to their remoteness.

Another key driver of demand for online shopping is increasing consumer confidence in internet security and the safety, reliability and privacy of shopping online. IBISWorld research suggests that this is due to “an increase in efficiency, reliability, turnaround time and resolution of refunds”¹³. A 2009 study by the UK Office of Fair Trading reveals that consumer confidence in the security of online shopping is on the rise. The study found that the proportion of respondents with no concerns about shopping online increased from 12% in 2006 to 28% in 2009. Similarly, 54% of respondents felt that shopping online was as safe as shopping in store, compared to 26% in 2006¹⁴.

Whilst these factors are significant, we believe the main reason consumers shop online with Ezibuy (and other online retailers) is the level of customer service we provide. Our database of customer information allows us to provide a level of service far superior to that of traditional ‘bricks and mortar’ retailers. It is for this reason, and not necessarily because of price, that our customers return to us.

7. The Big Picture

Online spending by Australians was estimated to have totalled between \$19 and \$24 billion in 2009. The figure is expected to reach \$34 billion in 2012. Growth in the e-Commerce market is expected of

⁹ <http://www.crikey.com.au/2011/01/18/essential-why-we-love-to-shop-online-and-reject-paying-gst/>

¹⁰ Sands, S and Ferraro, C, 2010, *2010 Consumer Trends Report*, Australian Centre for Research Studies, Monash University.

¹¹ <http://www.crikey.com.au/2011/01/18/essential-why-we-love-to-shop-online-and-reject-paying-gst/>

¹² Sands, S and Ferraro, C, 2010, *2010 Consumer Trends Report*, Australian Centre for Research Studies, Monash University.

¹³ IBISWorld, ‘Online Shopping and Mail-Order Houses in Australia’, March 2011.

¹⁴ Office of Fair Trading, ‘Findings from consumer surveys on Internet Shopping’, May 2009.

up to 14% for the period to 2012 and far outstrips the predicted growth in the traditional, 'bricks and mortar' retail sector¹⁵. Recent research would indicate that 3% of Australian retail sales were made online in 2009. Of this amount, anywhere between 20% and 50% of these purchases are estimated to have been made online from overseas suppliers. In overview, Australia is still a fledgling nation when it comes to e-Commerce.

If, as Nielsen's recent report concluded¹⁶, the average monthly online spend was considerably less than AU\$1,000, then we can see no economic rationale for lowering the threshold.

In that estimated monthly spend, items other than goods are included in the figures and there is no distinction between domestic and overseas suppliers. Therefore, whilst there may be some GST revenue forfeit, it may be that unless the threshold was set at a draconian level (with the attendant compliance costs incurred by both the ACBPS and consumer alike), the amount of this forfeited revenue actually recovered would be relatively low.

The volume of transactions between AU\$100 and AU\$1,000 may be relatively insignificant and the actual GST collected on imports in this range (or from taxable supplies made by non-residents that choose to register for GST) may be relatively insignificant compared with the extra costs for the ACBPS, consumer or non-resident supplier. If this is the case, then it would appear inappropriate to lower the import threshold, as the increase in revenue to the Treasury is likely to be offset by significantly increased costs for the ACBPS in administering the review and assessment of postal imports.

We note that any lowering of the threshold would potentially create a situation where other import thresholds need to be reviewed, notably the duty free concessions for tourist and business travellers. Most general goods, excluding alcohol and tobacco, can be brought into Australia duty-free up to a limit of AU\$900. A lowering of the LVIT to a level below AU\$900 could place pressure on the Australian Government to subsequently lower the duty free threshold to ensure a level playing field. This would then place additional administrative and compliance burdens on the ACBPS, as the amount of formally declared items increased.

Lowering of the LVIT is the equivalent of raising a trade barrier, and the Federal Government has made much of the lowering of trade barriers as a policy issue in recent years. In a December 2010 speech to the Lowy Institute, the Minister for Trade confirmed the Government's position with respect to trade barriers:

"As Trade Minister, I want to reconnect with the Hawke-Keating governments' first guiding principle in economic reform that competition is good, and dispense with the bargaining chip approach to the remaining Australian tariffs. Australia should make its offers, our trading partners should make theirs, and where appropriate we should encourage them to go further"¹⁷.

¹⁵ viAccess Economics Pty Limited 'Household e-Commerce Activity Trends in Australia' 17 November 2010.

¹⁶ Nielsen's online retail monitor, first half 2010

¹⁷ http://trademinister.gov.au/speeches/2010/ce_sp_101210.html

Further, in response to a Productivity Commission research report on Bilateral and Regional Trade Agreements, the Government has agreed to implement Recommendation 8:

The Australian Government should examine the potential to further reduce existing Australian barriers to trade and investment through unilateral action as a priority over pursuing liberalisation in the context of bilateral and regional trade agreements¹⁸.

The additional dollar cost to consumers that would accrue from the lowering of the LVIT is in effect a subsidy to the retail sector within Australia, which as noted in the Productivity Commission's issues paper has businesses within it that are already extraordinarily profitable by international standards.

The overseas experience shows that e-Commerce will continue to increase as a portion of retail spending, and 'bricks and mortar' retailers will have to compete with online retailers irrespective of the LVIT. We do not believe that reduction in the LVIT will significantly change that outcome, merely possibly slow down the inevitable drift to that form of retail spending, but at a cost to both the consumer and the taxpayer.

8. Summary

The way that consumers approach retail has changed rapidly and considerably as technology advances. The global expansion in online retail is a fact of everyday life and reaches into a high percentage of the Australian population.

The current strength of the Australian dollar, combined with increasingly competitive e-Commerce retail options, now means that consumers can seek out their products from anywhere in the world. The current focus of the Federal Government in simplifying the GST system and reducing the inclusivity of non-residents within the GST regime lead us to conclude that the current threshold is suitable. Suitable for revenue protection, compliance purposes and giving consumers choice and value. The current threshold allows non-residents to operate without the encumbrance of GST registration. Similarly, the current threshold allows the ACBPS to operate in a cost efficient manner in both revenue collection and also maintaining border security.

It is doubtful that any proposed lowering of the import threshold or automatic levying of GST on imported goods would achieve any of these goals, despite what may only be a modest increase in revenue.

¹⁸ <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html#attachment>