No to the GST tax attack

Why the exemption for online purchases should stay

Mikayla Novak
Senior Research Fellow

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About the Author

Dr Mikayla Novak is a Senior Research Fellow with the Institute of Public Affairs. She has previously worked for Commonwealth and State public sector agencies, including the Commonwealth Treasury and Productivity Commission. Mikayla was also previously advisor to the Queensland Chamber of Commerce and Industry. Her opinion pieces have been published in *The Australian*, *Australian Financial Review*, *The Age*, and the *Courier Mail*, on issues ranging from state public finances to social services reform.

Executive Summary

- Following recent direct and indirect tax increases, there has been speculation that the Abbott government is considering extending the GST to low-value imports of $1,000 or less.
- Putting a GST on low-value imports is unlikely to revive Australian retailing in the face of intense online shopping competition, given the significant price differentials for many popular consumer products.
- There are several important drivers of high retail costs in Australia, including a highly regulated labour market, severe land use restrictions, and trading hour conditions, which are not being addressed by governments.
- Available estimates suggest that the administrative costs of ending the GST exemption threshold would greatly exceed actual revenues collected, violating a basic principle of tax policy if implemented.
- If the GST low-value import exemption is abolished, there can be no assurances that governments will spend the additional revenue in ways that give good value to taxpayers.
- The Abbott government should rule out the anti-consumer and anti-taxpayer proposal to extend the GST to low-value imports.

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Introduction

In recent years Australians have borne the brunt of frequent tax increases, including as well as the introduction of new taxes. These have merely served to reduce disposable incomes and distort economic activities, without making any meaningful contribution in resolving the systemic problem of budgetary overspending.

During its six years in office the Rudd-Gillard government introduced over 40 new or increased taxes (including the carbon and mining taxes belatedly abolished last year). These initiatives had have contributed to a lifting of the overall Australian tax burden in recent years, with IPA research indicating in 2012 that our tax-to-GDP ratio of 33.5 per cent (including compulsory superannuation payments by employers, and premium incomes raised under health insurance mandates) was comparable to the OECD average of 33.7 per cent.

Despite pre-election commitments to not increase taxation, in the space of little over a year in office the Abbott government has, among other things, increased tobacco excise rates by 12.5 per cent, imposed a budget deficit levy of two per cent for high income earners, and reintroduced fuel excise indexation arrangements.

This listing does not include the numerous increases in state or local government taxes and charges since the 2008-09 'global financial crisis.'

The problem for taxpayers is that the political clamour for claiming even more taxes from the Australian public has shown no signs of letting up. A primary example of this has been the repeated calls for federal and state governments to agree to eliminate the exemption from goods and services tax (GST) of overseas purchases valued at $1,000 or less.

It should come as no surprise that lobbyists for the Australian retail industry should seek to nobble their overseas competitors - especially those who operate in a low cost, online fashion - and, by extension, the consumers who engage with them, by seeking to scrap the low-value import exemption.

The previous federal government, in conjunction with the states and territories, flirted with the idea of extending the GST base in the way described, but ultimately shied away from implementing the proposal, partly on the basis of the hefty compliance costs associated with collecting GST from low-value imports. But if recent public comments from Abbott government ministers are any guide, moves to extend the GST are threatening to become a federal bipartisan political project.[1]

This paper makes the case against extending the GST to products purchased overseas costing less than $1,000.

The proposed tax policy is likely to be ineffective in achieving its policy goals of supporting the Australian retail sector in light of flexible and intense global competition. Therefore, it will merely represent yet

[1] This view appears to be shared by some Australian financial commentators, for example Michael Smith, 2015, 'Dynamics shift in GST debate', The Australian Financial Review, 9 January.

another revenue grab by governments at the expense of consumers, especially those on lower incomes who are rightfully seeking to stretch their limited purchasing power even further.

The extent of the online retail market: A brief summary

An obvious reason why traditional Australian 'bricks and mortar' retailers are demanding the removal of the GST exemption on low-value imports is that online shopping from overseas is a significant component of e-commercial activities by Australians, and is projected to keep growing over time.

The National Australia Bank undertakes a monthly survey of online retail sales (both from domestic and international sources), showing significant growth in online retail sales, in seasonally adjusted terms, since the survey series commenced in early 2010.[2] In effect, sales from online retail sources have more than doubled from January 2010 to November 2014.

It is estimated that Australians spent $16.3 billion on online retailing in the year to November 2014. This is equivalent to approximately seven per cent of spending on traditional retailing establishments, as measured by the Australian Bureau of Statistics. The fastest growing category of products being sold online during the period were electronic games and toys (39.4 per cent). Other products exhibiting strong online retail growth included books, movies and music (8.7 per cent), and items sold by grocery and liquor stores (7.4 per cent).

Increasingly, Australian shoppers are purchasing their items using smartphones and other mobile devices. Some estimates suggest that 30 per cent of internet users aged between 15 and 65 purchased goods using a smartphone, and 19 per cent undertook purchases using a tablet. People are also using these devices to compare prices prior to the act of shopping for items.[3]

The available evidence suggests that the extent of online shopping from retailers and suppliers based overseas is widespread. Based on a survey of 1,000 online shoppers, market research consultancy Frost & Sullivan found that 79 per cent of Australians who shop online purchase from overseas websites to some extent, and an estimated 45 per cent of Australian online expenditure is directed towards international online sites.[4]

There is some suggestion that most of the individual products purchased online from overseas providers are of relatively low value, and hence not liable to GST (Table 1). According to the Productivity Commission, over three-quarters of goods purchased between June 2008 and February 2011 from overseas, where the credit card was not physically present, were valued at under $100.[5] Furthermore, the average value of goods purchased online internationally was $112.

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[2] National Australia Bank, 2014, 'NAB Online Retail Sales Index', November.

[3] Frost and Sullivan, 2013, 'Online shopping to Australia to account for nearly 10% of total retail sales by 2017', http://www.frost.com/prod/servlet/press-release.pag?docid=281435628.

[4] Ibid.

[5] Productivity Commission, 2011, *Economic Structure and Performance of the Australian Retail Industry*, Report No. 56, Canberra.

Table 1: Distribution of domestic and international purchases where credit card was not physically present, value of transaction, June 2008 to February 2011

Value of transaction/s ($)	Domestic share (% of total)	Overseas share (% of total)
<$100	73.4	76.5
$100-$199	14.7	12.8
$200-$299	4.8	4.1
$300-$399	2.1	2.0
$400-$499	1.1	1.1
$500-$999	2.2	2.1
$1,000-$1,999	1.0	1.0
$2000-$2,999	0.3	0.2
$3000 and above	0.4	0.2
Total	**100.0**	**100.0**

Source: Productivity Commission, 2011, Economic Structure and Performance of the Australian Retail Industry, Report No. 56, Canberra.

There is a widely held expectation that online retail activities, and e-commerce more generally, will continue to expand over the next few years. In some quarters it has been projected that total online retail spending by Australians (both domestically and overseas) would grow by about 14-16 per cent annually over the course of this decade, to reach a total of $41 billion in expenditure by 2020.[6]

All of the trends cited here suggest that the Australian retail sector has certainly experienced significant structural change. In these circumstances, it would seem the best response to the online winds of 'creative destruction,' being felt by bricks and mortar retailing firms, would be to perform their own Schumpetarian acts of innovation that offer discerning consumers compelling product value and exemplary service.

In sharp contrast, demanding that government imposes a new tax hike to try to deter Australians buying online from overseas would be counterproductive to future innovative efforts by the domestic retail scene, and thus be against the long term best interests of Australian retailing.

[6] Urbis, 2011, 'Unravelling online retail', http://www.urbis.com.au/think-tank/white-papers/unravelling-online-retail-%E2%80%93-urbis-reveals-all; Urbis, 2013, 'Retail Trends, Drivers & Outlook'.

Putting GST on low-value imports is unlikely to revive Australian retailing

As indicated in consumer surveys, there are a number of motivations underlying the increasing inclination of Australians to purchase goods online (including from overseas retailers and others suppliers). The available survey evidence suggests it is not reasonable to reduce all of the often complex and multi-dimensional motivations down to just one factor (e.g., price).

For some purchasers the decision to buy may indeed hinge upon a price differential between identical or similar items provided both domestically and internationally, in favour of the imported product. But for others, purchasing decisions are primarily informed by the availability of products, the speed and ease of goods delivery, or the ability to buy online from overseas during a time of day or week in which domestic retailers are closed.

A 2013 survey of Australian online shopping habits by *Choice* magazine, for example, indicated that the major reason why those surveyed shopped online was to purchase during hours which suited them, followed closely by the convenience of products shipped to their residences or preferred delivery destination.[7]

The same survey suggested that 12 per cent nominated saving on 'paying duties and taxes by purchasing on overseas websites' an important factor in purchasing commodities online. That the GST-free threshold on low-value imports may not be a decisive factor for many purchases is reinforced by the fact that, according to *Choice*, most online retail sales in Australia are made through Australian websites whose products (regardless of value) are liable to GST.

Other surveys have suggested that prices do, indeed, represent a key driver for online shopping by Australians. A consultancy study indicated that about three-quarters of Australians shopping online make purchases from offshore overseas websites, and that 'by far the main consumer reason for shopping through international sites is to obtain lower prices than available locally.'[8]

Whilst not paying GST on low-value imported goods was cited by a small share of respondents (about three per cent of the total) as their main reason for purchasing from overseas online shopping websites, other factors may have played a more important role in influencing people to purchase mainly on the basis of price.

Most notably, the study referred to the strength of the Australian dollar, relative to the US dollar, as one factor influencing online shopping patterns. This has probably been a major influence in consumer decisions to purchase various goods online from overseas, at least until relatively recently.

[7] 'Survey: GST loophole has little to do with the decision to buy online', http://www.choice.com.au/media-and-news/media-releases/2013-media-releases/survey-gst-loophole-has-little-to-do-with-the-decision-to-buy-online.aspx#close.

[8] PwC, 2012, *The rapid growth of online shopping is driving structural changes in the retail model - Australian online shopping market and digital insights*, http://www.pwc.com.au/industry/retail-consumer/assets/Digital-Media-Online-Shopping-Jul12.pdf, p. 4.

Other things being equal, imposing the GST on imported items valued at $1,000 or less may encourage some consumers to switch from overseas to domestic shopping options, but a comparison of selective popular sales items would suggest that a GST on low-value imports would, by no means, dissipate the price advantages presently enjoyed by overseas retailers (Table 1).

Given the significant price differential between domestic and imported products of like character, as illustrated here, imposing a GST on low-value imports would be unlikely to encourage significant switching by price-sensitive consumers toward products sold by Australian retailers.

Table 1: Price comparisons of identical goods, Australian dollars

Item	Domestic price (retailer)	International price (retailer)	International price (incl. GST on import)	Difference between domestic & international price	Difference between domestic & international price (incl. GST on import)
Books: 'Gone Girl' by Gillian Flynn	$25.98 (Dymocks)	$13.94 (Book Depository)	$15.33	46%	41%
Cameras: Nikon Coolpix P600 (digital)	$508.95 (Camera House)	$362.54 (Camera Paradise)	$398.79	29%	22%
Personal: Amouage Jubilation 25 Women Eau de Parfum 50ml	$304.00 (David Jones)	$257.40 (HQ Hair)	$283.14	15%	7%
Shoes: Men's Clarks Desert Boot	$149.95 (Clarks Australia)	$128.69 (Planet Shoes)	$141.56	14%	6%
Toys: Star Wars Ultimate FX Lightsaber	$89.98 (Toys R Us)	$67.05 (Amazon)	$73.76	25%	18%
Deal of the day: Fit Band (models vary)	$76.53 (Catch of the Day)	$48.95 (Living Social)	$53.85	36%	30%
Groceries: Gillette Fusion ProGlide Power Razor Cartridges (8 pack)	$51.10 (Coles)	$15.27 (FastTech)	$16.80	70%	67%
Health products: Optimum Natural 100% Whey Gold Standard	$94.95 (Nutrition Warehouse)	$59.06 (Bodybuilding.com)	$64.97	38%	32%
Apparel: Ben Sherman Red Harrington jacket (men)	$139.99 (Ben Sherman Australia)	$106.91 (Atom Retro)	$117.60	24%	16%
Watches: Hugo Boss Orange Men's watch (woven strap)	$349.00 (David Jones)	$263.10 (Macy's)	$289.41	25%	17%
Music: AC/DC 'Rock or Bust' (compact disc)	$24.99 (Sanity)	$19.83 (Grooves Inc.)	$21.81	21%	13%
Homeware: Fred Hopside Down beer glass	$29.95 (David Jones)	$14.06 (AliExpress)	$15.47	53%	48%

Source: Michael Petrut, IPA

Categories sourced from NAB Online Retail Sales Index (except separate categories of cameras, books and shoes). Specific items selected by the Institute of Public Affairs. Calculations in final two columns are absolute values of percentage changes. Prices for identical goods collated on the same day. Delivery charges (including free shipping) based on cheapest option available. US dollar conversions to Australian dollar as of 9 January 2015.

Debating the GST diverts attention away from the high costs of retailing, and doing business, in Australia

The emergence of e-commerce activities on a global scale has firmly trained the spotlight on the performance of the Australian retail sector, traditionally shielded from international competition due to its primary role in servicing domestic customers as well as our distance from major Asian, European, and North American markets.

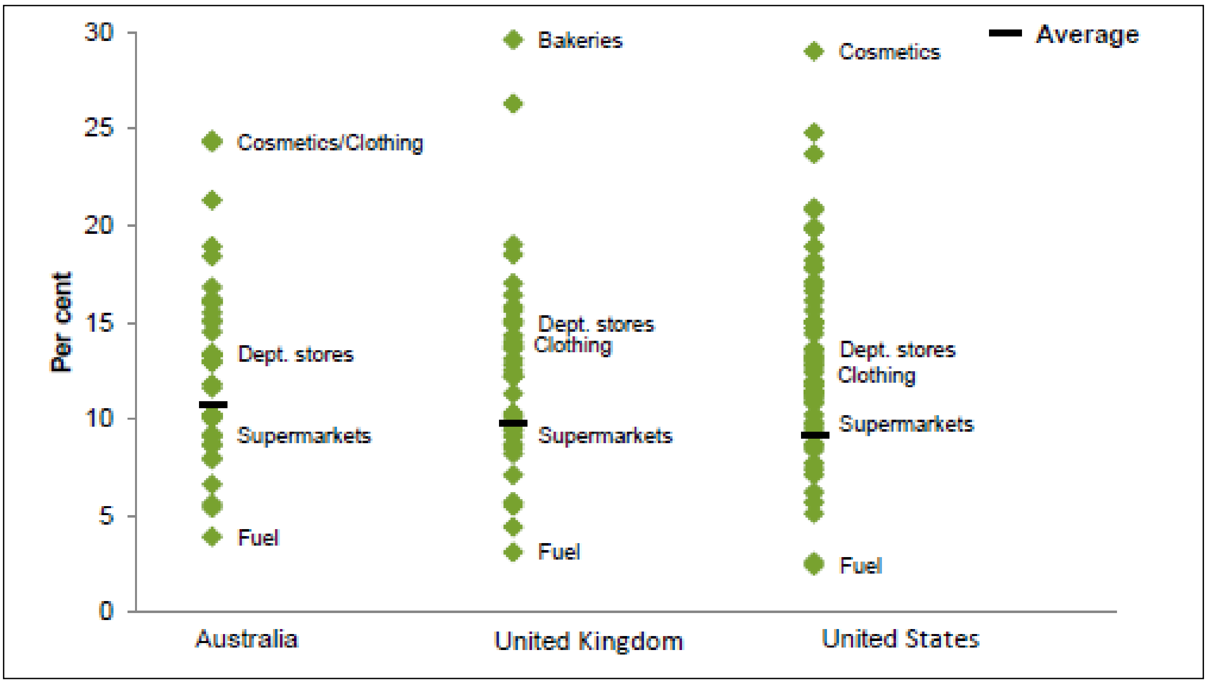
Fluctuations in the business cycle, such as the more subdued economic growth record in Australia since the 2008-09 'global financial crisis,' have added to the perceived pressures faced by retailing businesses.

A number of major studies by the Productivity Commission in recent years have pointed to a relatively high-cost environment under which local retailers conduct their business, compared against overseas counterparts.

For most traditional bricks and mortar establishments, labour costs would represent the major component of retailing expenses. In Australia, these costs not only include base rates of pay allocated to staff, but penalty rates and loading, other allowances and entitlements, the costs of hiring, firing and training, as well as on-costs including payroll tax, workers' compensation premiums and superannuation contributions.

Figure 1 provides information on the wage costs incurred by various retailers in Australia, the United Kingdom and the United States. In general, wage costs are higher in Australia than in other countries, with some retailing segments (especially clothing and footwear) facing substantially higher costs than their overseas peers.

Figure 1: Wage costs as a share of revenue for different retail categories, Australia, UK and US

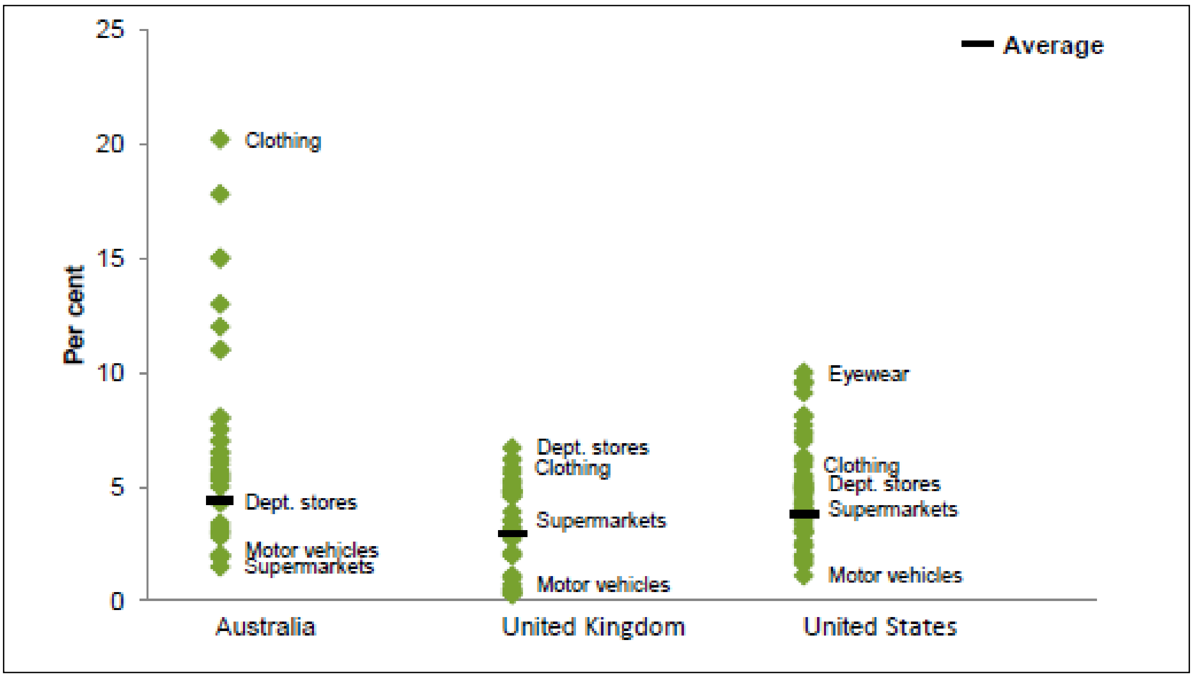


Source: Productivity Commission, 2014, Relative Costs of Doing Business in Australia: Retail Trade, Research Report, Canberra.

Another major element of the retailing cost structure are occupancy costs, or the costs associated with maintaining a shop space (such as rent, fit-out costs, and shared expenses relating to security, cleaning, electricity, insurance, etc.). The costs of occupying space tend to account for a significant proportion of overall costs faced by many retailers, especially traditional enterprises, in Australia.

Despite differences in cost structures due to operating practices and location, and so on, it has been found that commercial rents, as a share of revenue, in Australia is higher than that found in the United Kingdom and United States (Figure 2). For the retailing of some products, such as clothing, footwear, and furniture, the share of rent is much higher than the Australian average and in other countries.

Figure 2: Rent costs as a share of revenue for different retail categories, Australia, UK and US



Source: Productivity Commission, 2014, Relative Costs of Doing Business in Australia: Retail Trade, Research Report, Canberra.

The assessment from the Productivity Commission found that 'the cost of doing business in the Australian retail sector is inflated by unnecessary regulations.'[9] Many industry participants in recent years have noted that centralised workplace relations regulations, including penalty rates and high minimum award wages, are a factor inhibiting the cost competitiveness and productivity of retail operators.

Land use planning and zoning regulations enforced by state and local governments restrict the commercial uses of land in certain locations, diluting the effects of competition within the retail sector with some adverse flow-on effects for costs and prices.

A longstanding problem affecting traditional retail establishments in Australia is the continuing imposition of retail trading hours by governments. Such regulations obviously tend to restrict consumer choices, but they also prevent retailers from trading to the extent that they would wish hence depriving them of potential sales revenues to cover their relatively high costs (from an international perspective).[10]

There are other aspects of the business operating environment which adversely affect the retail sector, such as the costs associated with distributing parcels and other packages of goods directly to consumers within, and to, Australia.

Some anecdotal accounts suggest that delivery and freight charges have made it increasingly infeasible for some Australian retailers to send small parcel consignments to consumers. Several local bookstore

[9] Productivity Commission, 2014, *Relative Costs of Doing Business in Australia: Retail Trade*, Research Report, Canberra, p. 5.
[10] Productivity Commission, 2011, op. cit.

proprietors, in particular, have noted that delivery charges are considerably lower for consumers to receive books from overseas.

For example, a senior Australian Booksellers' Association representative has stated it costs ten times more to send a book from Mosman to Penrith (both Sydney localities) than to post the same book from the United Kingdom to Sydney.[11] One bookshop owner indicated they would pay $11.70 in postage to send an $8 paperback book, whereas UK booksellers could send the same book to Australia for about $3.[12]

Another important issue deserving of more attention in the current policy debate is the effect of parallel import restrictions in driving up the cost of goods for Australian retailers. Previous analysis by the IPA has shown that parallel book import restrictions restricts available titles on sale through retail stores, and thus unnecessarily raises the price of these items for consumers.[13] In effect, parallel importing restrictions acts effectively as a trade barrier and should be liberalised.

Finally, as noted above, government taxes and charges will also play some part in raising the prices of goods offered by retailers.

It is not straightforward to quantify how the compliance and economic burdens of these, and other, regulations and taxes flow through to higher costs for retailing establishments, which then have an effect on relative prices. In a complex, evolving economy there are a myriad of factors which affect final product prices, and in an increasingly open trading environment for consumer goods exchange rate movements should also be borne in mind.

Although Australian retailers continue to respond to high and rising costs - including by increasing their online shopping presence - the underlying drivers of retail costs, cited here, are mainly outside the control of individual retailers, or even associations of retailers, to influence and adjust.

To the extent that prescriptive regulations and heavy taxes imposed by governments contribute to cost pressures, extending the GST to low-value imports would serve as an ill-directed and meaningless solution in tackling the deep seated problem of high-cost retailing in this country.

[11] Claire Heaney, 2014, 'Australian bookshops 'losing business' because of high postage costs', Herald Sun, 21 July.
[12] Sarah Whyte, 2013, 'Pass the parcel as backlash hits Australia Post over price increases', The Sydney Morning Herald, 9 April.
[13] Tim Wilson, 2009, *Unbinding book barriers: Why Australia should scrap parallel import restrictions on books*, Institute of Public Affairs Backgrounder, June.

Ending the online purchasing exemption is not worth the effort

One of the key questions surrounding the present debate is whether the expected increase in administrative compliance costs merits the imposition of the GST upon low-value imports.

The most authoritative analysis of this issue to date, undertaken by the Productivity Commission (PC), suggests that the compliance costs associated with collecting the GST on low-value imports would exceed the actual revenues collected.

On the basis of the scenario developed by the PC, reduction of the low-value threshold down to $100 whilst retaining the current Customs, and other, processing systems would have raised about $495 million in 2010-11. This estimate is calculated on the basis that the goods contained in an additional 12.6 million international mail parcels and 3.4 million air cargo parcels would be liable to the GST.

However, the costs of collecting taxes is typically not miniscule with a range of bureaucratic and other procedures needing to be put in place to ensure tax collection and enforcement. The PC estimates that businesses, consumers, and the government itself (mainly through Customs) would bear the costs of collecting the extra GST revenue, and this was estimated to amount to about $1.2 billion.

The PC summarised its analysis by stating 'in most scenarios estimated, total collection costs would still exceed additional revenues or generate net efficiency losses for the community.'[14]

Others have similarly suggested that the costs surrounding the proposed GST extension may not warrant its implementation. Economist John Freebairn stated in 2013 that

> 'if the threshold is lowered and current administrative arrangements remain in place, the high costs to government and businesses of collecting GST on a very large number of parcels from all over the world mean the net revenue gains are likely to be small, if not negative.'[15]

To be sure, there are some doubts over the reliability of estimates concerning a hypothetical tax policy change of this nature. The imposition of a GST on low-value imports would elicit some behavioural response on the part of Australian consumers, as well as by importers, which could alter the total value of consignments entering Australia and subject to the extended GST.

Despite these uncertainties, it would seem that some weight should be put upon the estimates of potential net revenue losses from eliminating the low-value threshold. This is because a high proportion of imported items tend to be valued at below $100 - according to a Low Value Parcel Processing Taskforce established under the Rudd-Gillard government, 75 per cent of international mail items, and 65 per cent of air cargo items, were $100 or less.[16]

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[14] Productivity Commission, 2011, op. cit., p. 169.

[15] John Freebairn, 2013, 'States' push for GST on online shopping is just small change', The Conversation, http://theconversation.com/states-push-for-gst-on-online-shopping-is-just-small-change-20755.

[16] Low Value Parcel Processing Taskforce, 2012, *Final Report*, Department of the Treasury, Canberra.

Centuries ago, the moral philosopher Adam Smith enunciated several principles of taxation which policymakers should routinely apply. One of these is that taxes should not be overly expensive to collect. Given the best available estimates suggest that the costs of extending GST to low-value imports would exceed the revenues transferred from taxpayers to government, proceeding with this proposed tax increase would violate a basic principle of good tax policy.

Taxpayers cannot be assured of good value for money from extra GST raised

A neglected aspect of taxation policy is the need to consider the efficiency and effectiveness with which governments will spend the resulting revenue collected. Considering this question applies just as much to the proposal to abolish the GST low-value import threshold to any other idea in the contemporary tax policy discourse.

As is well known the proceeds of the GST (less administration costs incurred by the ATO) are redirected from the commonwealth to the states, in the form of untied general revenue grants. From that point the states have the ultimate discretion concerning the uses with which the funds are put.[17]

The public finance literature makes it plain that the separation of revenue raising and expenditure responsibilities across levels of governments dilutes the capacity of the taxpaying public to keep the public sector accountable for its budgetary and fiscal performances.

With the extent of 'vertical fiscal imbalance' already severe in Australia, by international standards, a further entrenchment of the intergovernmental grants system, by virtue of extending the GST base, is unlikely to facilitate a greater modicum of political accountability to the taxpayer.

A related aspect of this matter is that Australia has devised an elaborate 'fiscal equalisation' system for distributing GST revenue grants amongst the states and territories, with funds distributed on the basis of differential revenue capacities and public service costs among jurisdictions.

Any additional revenues from abolishing the GST low-value threshold would be subject to this arrangement meaning, for instance, that GST from inexpensive overseas online goods purchased by a person residing in NSW or Victoria, say, would be received by the Tasmanian, South Australian or Northern Territorian governments. In these circumstances, it becomes even more difficult for taxpayers to monitor individual governments and ensure they are spending tax revenues wisely.

[17] That said, there is an element of moral suasion exercised by commonwealth politicians concerning how the states should administer their own expenditure affairs, including in politically sensitive areas such as education, health care, and transportation infrastructure. These have even materialised, on occasion, in the form of veiled or actual threats by the commonwealth to claw back GST revenue from the states.

Conclusion

Extending the GST, which is already estimated to raise over $50 billion for the eight state and territory governments, to imports valued at $1,000 or less would be an ill-conceived manoeuvre on the budget policy front.

The fiscal challenge for governments is abundantly clear. What is required of commonwealth, state and local governments is that they reduce wasteful spending, to both repair their budgets and boost long term economic growth, rather than lift taxes.

Increasing taxes is simply a recipe for constricting the freedom of individuals to keep and use their own monies as they see fit, and a program to subdue economic growth and improved living standards in the longer term.

The proponents of extending GST to low-value imports have been obfuscating the fundamental policy rationale for this idea, suggesting that it is necessary to protect local retailers or to help shore up Australia's international trading position.

The analysis presented here suggests that extending the GST would achieve none of those objectives, but would simply be an anti-consumer policy that would hurt hard-working Australians, especially on lower and middle incomes, who are taking great lengths to stretch their buying power further during a period of intense cost of living pressures.

In the best interests of Australian consumers and taxpayers, the Abbott government should immediately rule out any suggestion, including from internal sources, that it would impose GST on low-value imports.