

**Productivity Commission Inquiry into the Economic Structure and
Performance of the Australian Retail Industry**

**Second submission by the
Shopping Centre Council of Australia**

8 June 2011

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1. Executive Summary

This is the second of two submissions which the Shopping Centre Council of Australia (SCCA) has lodged in response to the Issues Paper released by the Productivity Commission in March 2011. This submission deals specifically with the issue of the current low value importation threshold (LVT) of \$1,000 below which the Australian Government does not seek to collect GST (10%) or, where applicable, customs duty (10% for clothing and 5% for footwear). This is addressed in section 4 of the Issues Paper 'Appropriateness of current indirect tax arrangements'. Our first submission provided the Commission with an overview of the shopping centre industry in Australia and the important role it has played in fostering the retail industry. Our first submission also responded to the matters raised by the Commission in section 5 of the Issues Paper.

In this second submission the SCCA makes the following conclusions and recommendations:

- On best estimates online retailing at present constitutes around 5% of total retail sales in Australia. Domestic online sales constitute around 3% of retail sales and offshore online sales constitute around 1.5% to 2% of retail sales. These macro estimates, however, disguise the very significant impact that online retailing is already having on particular retail sectors.
- The proportion of online retail sales will grow substantially, particularly with the advent of the National Broadband Network. It is likely that offshore online sales will grow faster than domestic online sales, at least for the next decade, since it is generally conceded that Australian retailers have been slower in meeting the online challenge than many overseas countries. The competitive advantage given to offshore online retailers by the LVT, unless corrected, will exacerbate this trend.
- Credible estimates suggest that online sales in the United Kingdom are now nearly 10% of retail spend and nearly 9% in the United States, although these percentages are not necessarily directly comparable to the Australian figures noted above. There are reasons for assuming that Australia will follow a similar trend.
- Australian retailers must now accept that this is a significant (and growing) competitor and must find ways to respond to this competition, both in terms of their traditional retail offer and also by embracing e-commerce in their business models.
- Shopping centre owners and other retail property owners will also have to adjust to a reduction in the rate of growth of demand for retail space, and changes to the tenancy mix of shopping centres, as some retailers scale back their needs for traditional retail space.
- The current LVT creates a competitive disadvantage for Australian retailers and is inhibiting them from making the transition to an e-commerce world.
- The current LVT is inherently unfair to the great majority of Australian consumers who are forced to pay GST on all non-food domestic purchases. ABS data shows that those households that take most advantage of the LVT tend to be higher-income households.
- Claims that it will cost the Government more to administer a lower LVT are simply assertions which have not been tested and must be interrogated by the Commission.
- There is no valid justification for perpetuating this competitive disadvantage and the Federal Government must act to ensure competitive neutrality in the taxation treatment of domestic and non-domestic purchases.

2. The Low Value Importation Threshold Creates a Competitive Disadvantage for Australian Retailers

The key issue in the controversy over the operation of the current low value importation threshold (LVT) of \$1,000 is whether this creates a competitive disadvantage for Australian retailers and, if so, whether this un-level playing field can be justified or whether the Government is effectively prevented from doing anything about it.

There is no doubt that the imposition of a LVT, whether that threshold is set at \$250 (as it was for non-postal items until 2005) or at \$1,000 (as it is now), creates a competitive disadvantage for Australian retailers. An Australian customer of an Australian retailer must pay a tax (GST) of 10% on each purchase, irrespective of the value amount of the purchase. However, if that product is purchased from an overseas retailer, the Australian customer can avoid the payment of GST if the value of that purchase is less than \$1,000. The overseas good therefore receives a price advantage of at least 10% and the overseas retailer also escapes the administrative costs that the GST system imposes on the domestic retailer.

Similarly, if an Australian online retailer was to offer exactly the same product as an overseas online retailer, and if we assume all other things being equal (i.e. both retailers have the same cost structure, the same purchasing terms from the same supplier, the same delivery times, the same warranties etc.) the Australian retailer would still have to charge a customer at least 10% more (and, in fact, slightly higher than this if the Australian retailer wishes to maintain a similar margin to the overseas competitor).

The Fair Imports Alliance has, justifiably, described this as a "reverse tariff."¹ Associate Professor Dale Boccabella, of the University of NSW's Australian School of Taxation and Business Law, has stated the operation of the LVT is "unfair" because domestic retailers can't gain a similar tax exemption as overseas retailers and this means "the tax system is biased against [domestic] retailers and their customers".²

Is this competitive disadvantage justified?

The Issues Paper makes clear that Australia is alone, amongst comparable countries, in having such a high threshold (\$A1,000).

- New Zealand's effective threshold is \$A292;
- Canada - \$A20;
- United Kingdom's effective threshold is zero (threshold for commercial consignments is \$A29 for goods arriving from outside the EU);
- Singapore - \$A314;
- Japan - \$A123;
- Switzerland – zero;

In addition, we understand the average threshold among European Union countries is around \$A30.

¹ Fair Imports Alliance Submission to the Productivity Commission Inquiry May 2011

² 'Offshore GST-free limit needs tweaking *The Sydney Morning Herald* 28 January 2011

Australia's threshold is therefore nearly three times the amount of the nearest country and around 33 times the amount of most European countries. In the absence of international agreement on the taxation treatment of cross-border sales, such a huge discrepancy cannot be justified.

Despite the fact this competitive disadvantage has existed since the introduction of the GST a concatenation of circumstances has meant the full effects of this competitive disadvantage are only now being felt. These include the high value of the Australian dollar; the establishment of trustworthy international payment systems; reductions in delivery times; absorptions of costs; and an increasing sophistication of on-line retailing (including warranties, returns, tracking systems etc.) It is therefore important that the Government acts now to eliminate this monetary competitive disadvantage.

The United States of America does not have a value-added tax so the issue does not arise in that country although, as the Issues Paper notes, a somewhat similar issue has arisen in the USA, between states, over sales tax not collected on online purchases. It is notable that many states in the USA are now considering and passing 'affiliate nexus' legislation or 'streamlined sales and use tax agreements' legislation as a means of counteracting the Supreme Court ruling in 1992 that online retailers (and catalogue retailers) are exempt from collecting state sales taxes unless they have a physical presence (a nexus) in the purchaser's state. A Main Street Fairness Act, to address this at a national level, has also been under consideration by Congress although little progress seems to have been made on this.

While it is true that the customer pays the cost of shipping and handling freight on most imported items, the imported product (which will be zero-rated in those countries that have a value added tax) will also escape a range of other government costs (ignoring business taxes) which are imposed on domestic retailers. These additional costs include quarterly BAS statements, superannuation guarantee charge, National Employment Standards, minimum wage laws; Australian Consumer Law, rigorous occupational health and safety laws etc. The addition of shipping and handling charges, while this may reduce the price differential in some cases, does not create a level playing field. Shipping and handling charges, of course, are also a cost of business for domestic retailers as well.

The operation of the LVT should not be confused with other issues of e-retailing. Whether Australian retailers have been too slow in embracing e-commerce is beside the point. Retailers now accept that this is a rapidly growing competitive threat and must find ways of responding to that competition, both in terms of their traditional retail offer and by also embracing e-commerce in their business models. The advent of the National Broadband Network will undoubtedly accelerate the challenges faced by retailers.

Similarly shopping centre owners will have to adjust to a reduction in the rate of growth of demand for retail space as the growth of e-commerce forces retailers to scale back their need for traditional retail tenancies. The uneven impact of e-commerce, which has impacted some retail sectors more than others, obviously has an impact on tenancy mix and leasing strategies in shopping centres. There are already some categories of traditional retailing which are on the verge of disappearing from Australian shopping centres and shopping centre owners and managers are having to adjust to these changes. As we demonstrated in our first submission, the shopping centre model in Australia has been very adaptable and very flexible and we have confidence that it will further adapt to meet this new competitive challenge.

The competitive disadvantage caused by the operation of the LVT has nothing to do with these challenges, other than the fact that it makes it even more difficult for retailers to make this transition. A reasonably competitively neutral taxation system must be achieved if Australian retailers are to adequately rise to these challenges.

Online sales are still a small percentage of overall retail sales in Australia. We consider the most credible estimate is that of Citigroup³, who have estimated that domestic online sales represent around 3% of total retail sales while offshore sales represent a further 1.5%-2% of retail sales. However this figure of around 5% of total retail sales disguises the very significant impact that online retailing is already having in particular retail sectors such as books, music, sporting goods, toys and hobbies. It is the profound impact that is occurring in these sectors that the Productivity Commission must bear in mind when considering the current LVT.

It is most likely that offshore online sales will continue to grow faster than domestic retail sales over the next decade, and will continue to increase as a proportion, since it is generally conceded that domestic retailers have been slower to adapt to the new model than those in countries such as the UK and the USA. Continuation of the present competitive advantage given to offshore retailers by the current LVT will exacerbate this trend and this will have adverse implications for investment, employment and taxation revenues in Australia.

³ Citigroup *What's In Store?* Issue 33 9 December 2010

3. What is the justification for continuing this competitive disadvantage?

The following arguments have been advanced (principally by the Board of Taxation⁴) for maintaining the threshold at its current level.

3.1 It would cost the Government more to administer (a lower) threshold than it would collect in revenue.

This statement is frequently asserted but no evidence has been produced to justify the claim. We are unaware of any modelling by any Federal Government agency that shows a \$1,000 threshold is necessary to balance revenue collection and administrative efficiency or any modelling of the impact of a lower threshold.

The Board of Taxation in its report in 2010 simply asserted: "It is not administratively feasible to try to bring non-resident supplies of low value goods and services into the GST system at this time." There is no evidence from the report that it had tested this assertion. Nor is there evidence from submissions to the Board of Taxation to draw that conclusion. There is also no evidence that the Board of Taxation Review considered how those countries with very low or zero thresholds handle this matter before coming to its conclusion.

It is difficult to accept that Australian Customs and Australia Post are so inefficient that they effectively require a threshold of \$1,000 to make it cost effective to collect GST whereas their equivalents overseas can apparently do this much more efficiently. This is a difficult position for the Federal Government to advance: that collection of GST is not too administratively complex or costly for ordinary Australian businesses to administer but is too administratively complex and costly for a government-owned business or government instrumentality to administer.

We have examined the reasons why the threshold was increased from \$250 to \$1,000 in October 2005. We have been unable to find any statement that the increase was necessary to compensate for the cost of collection of GST. It seems that the main reason for the increase was lobbying by the express carriers to align the threshold between postal and non-postal imports. (The GST was obviously not a consideration when the threshold for goods arriving by post was increased to \$1,000 in 1986).

This assertion needs to be interrogated by the Productivity Commission in considerable detail. There is also no evidence that the Board of Taxation examined alternative means by which the GST might be collected on imported goods. One suggestion which has been put to the Productivity Commission, and which deserves examination, is to allow purchasers to self-assess GST and impose heavy fines for fraudulent assessment. This would reduce administrative costs by simply requiring Customs and Border Protection to conduct random compliance audits. Another suggestion worthy of examination is that credit card companies be used to collect GST on overseas purchases since these companies now impose a separate charge on such purchases.

It should also be noted that the only reason why the imposition of GST on Australian consumers who buy goods from domestic suppliers does not cost the Government more to collect than it gains in revenue is because the cost of collection is carried by the retailers or service providers. There is no logical reason why the cost of collection of GST on imported goods below \$1,000 should not similarly also be imposed on the businesses which handle such imported goods or directly on the purchaser, through increased charges. This is exactly what happens for purchases which exceed \$1,000.

⁴ Board of Taxation Review of the application of GST to cross-border transactions: A report to the Assistant Treasurer, February 2010.

3.2 The non-indexation of the threshold will mean that the value of goods able to be imported without paying GST will continue to fall over time. This will reduce over time any potential bias in favour of imported goods over local goods of the same quality and value.

This justification by the Board of Taxation, while self evident (if considered only in terms of domestic price inflation), is absurd. The Australian LVT is 33 times that of most European countries. On this basis, it would take many decades before the real value of the Australian LVT equals the thresholds of the countries listed above. This would be cold comfort for those retail sectors currently bearing the brunt of this competitive disadvantage and for the employees who work in those sectors. This argument also assumes that the real value of the current \$1,000 threshold is influenced only by domestic price inflation, whereas foreign price inflation and exchange rate movements will also be factors. Both of these are beyond the influence of the Australian Government and may act to mitigate against the Board of Taxation's reasoning.

3.3 Reduction of the threshold means imposing a tax on Australian consumers.

The Board of Taxation also listed a concern that reducing the threshold would mean that consumers would bear the cost. Some politicians and consumer groups have suggested it would amount to imposing a tax on Australian consumers. This argument misses the point: the decision to impose a tax on Australian consumers was taken in 2000 when the GST was imposed. The decision to continue (and then increase) a low value importation threshold was a decision to arbitrarily exempt some Australian consumers from the taxation obligation imposed on those Australians (the vast majority) who purchase goods and services from domestic suppliers. It is absurd to suggest that removal of that exemption is imposing a tax on Australian consumers. This would simply be removing a loophole which has benefited some Australians for nearly 11 years and meant they have not been paying their fair share of taxation. If the Tax Office takes action to close off, say, an income tax loophole which is available only to a few, is this portrayed as imposing a tax on Australians? Of course not! Why should removing this consumption taxation loophole be similarly portrayed?

ABS data⁵ shows that households with greatest access to a home computer and/or the internet tend to be wealthier households. In 2008-09 only 43% of households earning less than \$40,000 pa had access to the internet at home while 94% of households earning \$120,000 or more had such access. It is a reasonable assumption that those who are able to take advantage of the current LVT will tend to be wealthier households.

3.4 Personal shoppers purchasing from overseas e-tailers, whilst avoiding GST when purchasing from local retailers, are required to pay shipping and handling costs, which levelled the playing field.

Shipping and handling costs may reduce the price disparity between imported goods and domestic purchases but, since domestic purchases may also incur shipping and handling costs, this does not by itself lead to price parity. Retailers have also reported that many overseas suppliers are now providing low cost and in some cases free shipping, being able to absorb these costs in product prices, which they are able to do because of the tax advantage (and, in some, cases duty concessions) they receive as a result of the LVT (including not attracting Customs processing fees and charges).

Overseas suppliers also escape other costs imposed on Australian retailers (quarterly BAS statements, compliance with awards and National Employment standards, the superannuation guarantee charge, compliance with the Australian Consumer Law, Australian health and safety standards, domestic taxation etc).

⁵ Australian Bureau of Statistics *Household Use of Information Technology, Australia, 2008-09* 8146.0

3.5 The proportion of imported goods with a value of \$1,000 or more is very low so reducing the threshold will not make a great deal of difference.

The Commission has noted that preliminary results from the trial by Australian Customs suggest that the average value of parcels currently entering Australia and taking advantage of the LVIT is less than \$100. If this is confirmed this is an argument for not reducing the threshold to its previous level of \$250. This is, however, a strong argument for emulating countries such as the UK and Canada and imposing a zero or nominal threshold.

3.6 The amount of GST revenue being lost is not substantial.

The most credible and authoritative estimate of the amount of GST revenue being foregone by the current LVT is the Federal Treasury's *Tax Expenditures Statement 2010*. This estimated that the GST foregone in 2010-11 was \$460 million, rising to \$610 million in 2013-14. This is not an insignificant amount, particularly at a time when State Governments are increasingly under serious budgetary pressure. While the Treasury notes that the estimate reliability is 'low', this may mean the amount of GST foregone is just as likely to be higher than this, as it is to be lower.

Few would disagree, however, that the amount of current revenue being foregone will continue to increase, possibly by much more than the 10% increase per annum estimated by the Federal Treasury. The consequences of this growing tax expenditure must be the greater incidence of other forms of state or territory taxation (which are more likely to affect investment and employment) or a reduction in the public services provided by state and territory governments.

We are concerned that it is mainly the States and Territories which are being disadvantaged by the operation of the current LVT while any additional administration and enforcement costs resulting from a lower threshold would fall on the Federal Government. This may be an explanation why successive Federal Governments have been reluctant to act on this issue. This, however, is a matter which could be dealt with as part of the usual negotiations over Federal-State financial relations.

Nor is it simply a matter of foregone GST (and customs duty, where applicable). As a greater proportion of retail sales migrate online (and an increasing proportion of online sales migrate to overseas online sites) this will inevitably have an impact on employment growth and incomes growth in the retail industry. The National Retail Association (NRA) has provided the Commission with evidence that employment in the retail has already been adversely affected. This means that we can expect the LVT to also have an increasing impact on the growth of payroll tax collections by the States and Territories.

3.7 The problem is caused by the current high value of the Australian dollar, not the current level of the LVT.

There is no doubt that the appreciation of the Australian dollar over the last year, particularly against the US dollar, has exacerbated the competitive disadvantage experienced by Australian retailers. This is no justification, however, for not addressing the issue of competitive neutrality now. Competitive neutrality in taxation treatment is not achieved by speculating on future levels of the Australian dollar. There are many forecasts at present that the Australian dollar will continue to appreciate.

3.8 Reducing the LVT would go against Australia's obligations in international trade.

It has been suggested that any reduction of the existing LVT would be contrary to Australia's commitment to a continuing reduction in international trade barriers. This is a nonsense argument. The Issues Paper notes that Australia's LVT is far in excess of those of other comparable countries. If Australia's LVT threshold was consistent with those of most other countries, and Australia was taking unilateral action to reduce the threshold, this argument would have some validity. It cannot be argued that action to make Australia's LVT reasonably comparable to those of other comparable countries is inconsistent with our international obligations. On the contrary, until there is international agreement on a reasonably comparable LVT, Australia should reduce its LVT to a level which has parity with those of comparable countries.

4. Responses to Questions Posed by the Issues Paper

What evidence is there that Australian retail businesses are being adversely impacted by the low value importation threshold? To what extent does the threshold motivate Australian consumers to purchase online from overseas suppliers? What other factors explain the differences in prices between domestically and overseas sourced products?

The Productivity Commission has received numerous submissions from individual retail businesses which have demonstrated in some detail the competitive disadvantage they are presently suffering as a result of the LVIT.

We have not suggested in this submission that the LVT is the sole reason why Australian consumers purchase online from overseas retailers. It is one factor, but a significant one, in causing overseas prices to be significantly cheaper than Australian prices for many retail goods. The Federal Government has no direct influence over the other factors, although many of these are the result of government policy (such as a return to a more centralised wage-fixing system and fewer opportunities for individual wage bargaining; imposition of National Employment Standards; rigorous health and safety standards; the imposition of quarterly BAS statements etc).

The small scale of the Australian market means Australian retailers will always struggle to match retailers in larger countries when it comes to negotiating supply agreements and prices from manufacturers and wholesalers.

What evidence is there of the extent to which local resellers are using the low value importation threshold? To what extent does this really give them a competitive advantage compared to larger retailers after freight costs and volume discounts have been considered?

We have no information on this issue.

What is the potential impact on government revenue and the integrity of the tax system of sustained growth in the total value of low value items entering Australia without having GST or customs duty paid?

This has been addressed at section 3.6

How do other countries seek to strike the right balance between compliance with their threshold, revenue collection and administrative efficiency? Are their thresholds being effectively enforced? What can Australia learn from overseas experiences?

The Issues Paper has noted that a vast range of countries have a much lower threshold than Australia. There is no evidence that these thresholds are not being effectively enforced. This suggests that these countries have managed to strike a balance between revenue collection and administrative efficiency at a much lower level than is claimed in Australia.

It is of interest to note that the United Kingdom Government, in March 2011, announced that from 1 November 2011 it was lowering the UK low value consignment relief (LVCR) from 18 pounds to 15 pounds. It estimated that this reduction in the threshold would deliver an additional 10 million pounds in revenue per annum. This suggests that, even at a very low threshold level, it is cost effective for the UK Government to collect VAT on many more imported goods.

The UK Government also announced that it was seeking talks with the European Commission to close a long-standing loophole whereby businesses could establish distribution operations on the Channel Islands which would enable them to import low value goods into the UK without paying VAT. The Government said if these talks do not produce a workable solution to prevent exploitation, it will further revisit the level of the LVCR in the 2012 Budget.

The actions of the UK Government stand in contrast to the recommendation last year by the Australian Board of Taxation to allow the LVT in Australia to remain at \$1,000.

What technological developments could be employed to reduce administrative collection costs, particularly given international postal agreements?

We have no information on this issue.

How might continued growth of overseas online shopping affect existing border control and cost recovery arrangements?

We have no information on this issue.

Would a lower or higher threshold be more appropriate? How would any suggested change affect industry, consumers and government? How might people receiving gifts from overseas be affected by a change to the threshold?

We have suggested earlier that a nominal threshold of around \$A30 should be set. This threshold is in line with that of most European countries. Those countries presumably have means of dealing with gifts from overseas which the Federal Government can explore.

Would there be any merit in having a higher threshold for duty collection and a lower threshold for GST?

We assume that a split threshold would make administration of the LVT more complex. If this is the case there would not appear to be any merit in having a higher threshold for duty collection and a lower threshold for GST.

Should imported intangible goods be brought into the Australian tax base? If so, how could this be accomplished?

We see no logical reason why a distinction should be made between tangible goods and intangible goods. The principle of competitive neutrality should also be applied to intangible goods. We have no expertise to advise on how this should be achieved but it would seem appropriate to explore this through the payment system (credit card or Pay Pal etc.)

5. Shopping Centre Council of Australia

The Shopping Centre Council of Australia represents Australia's major shopping centre owners and managers. Our owners own and manage more than 11 million square metres of retail space. Our members are AMP Capital Investors, Brookfield Office Properties, Centro Properties Group, Charter Hall Retail REIT, Colonial First State Property, DEXUS Property Group, Eureka Funds Management, GPT Group, ISPT, Jen Retail Properties, Jones Lang LaSalle, Lend Lease Retail, McConaghy Group, McConaghy Properties, Mirvac, Perron Group, Precision Group, QIC, Savills, Stockland and Westfield Group.

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The Shopping Centre Council would be happy to discuss any aspect of this submission. Please do not hesitate to contact:

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