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Productivity Commission

Collection Models for GST on Low Value Imported Goods

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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.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au).



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31 October 2017

The Hon Scott Morrison MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, I have pleasure in submitting to you the Commission's final report into *Collection Models for GST on Low Value Imported Goods*.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'J. Coppel'.

Jonathan Coppel
Presiding Commissioner

Terms of reference

Collection Models for GST on Low Value Imported Goods

I, Scott Morrison, Treasurer, pursuant to Parts 2 and 3 of the Productivity Commission Act 1998, hereby request that the Productivity Commission (the Commission) undertake an Inquiry into collection models for GST on low value imported goods.

Background

Historically, GST has not applied to the supply of low value imported goods, creating an uneven playing field. The Government is committed to addressing this and strengthening the integrity and fairness of our tax system.

Legislation has been passed that will collect GST on low value imported goods from 1 July 2018. The legislation uses a vendor collection model, whereby vendors (including suppliers and online marketplaces) will collect the GST on low value imported goods at the time of sale.

Scope of the inquiry

The Inquiry will consider the matter of the amendments to the A New Tax System (Goods and Services Tax) Act 1999 in relation to collecting GST on low value imported goods, including:

1. the effectiveness of the amendments
2. whether models for collecting goods and services tax in relation to offshore supplies of low value goods other than the amendments might be suitable (including evaluation of the effects of the models on Australian small businesses and consumers)
3. any other aspect the Commission considers relevant to the implementation of the amendments.

The Commission is required to make recommendations in relation to matters (a)-(c).

Process

The Commission is to hold hearings for the purposes of the Inquiry. The Commission should consult with consumer representatives, small businesses, industry stakeholders and Commonwealth, State and Territory governments.

The final report should be provided to the Government by 31 October 2017 to allow certainty for industry on legislation that is to commence on 1 July 2018.

Scott Morrison
Treasurer

[Received 30 June 2017]

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The Commission would also like to thank the staff who worked on the inquiry. The inquiry team was led by Tom Nankivell and comprised Lawson Ashburner, Jasmin Boncales, Senna Eswaralingam, Pragya Giri, Aaron Mollross and John Papadimitriou. The early part of the inquiry was overseen by Commissioner Melinda Cilento.

Abbreviations

ABN	Australian Business Number
ABS	Australian Bureau of Statistics
ATO	Australian Taxation Office
B2B	business to business
CAPEC	Conference of Asia Pacific Express Carriers
CBFCA	Customs Brokers and Forwarders Council of Australia
DIBP	Department of Immigration and Border Protection
EAD	electronic advance data
EDP	electronic distribution platform
GST	Goods and Services Tax
JSL	joint and several liability
LVT	low value threshold
NPP	New Payments Platform
OECD	Organisation for Economic Cooperation and Development
VAT	value added tax

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)

-
- 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.

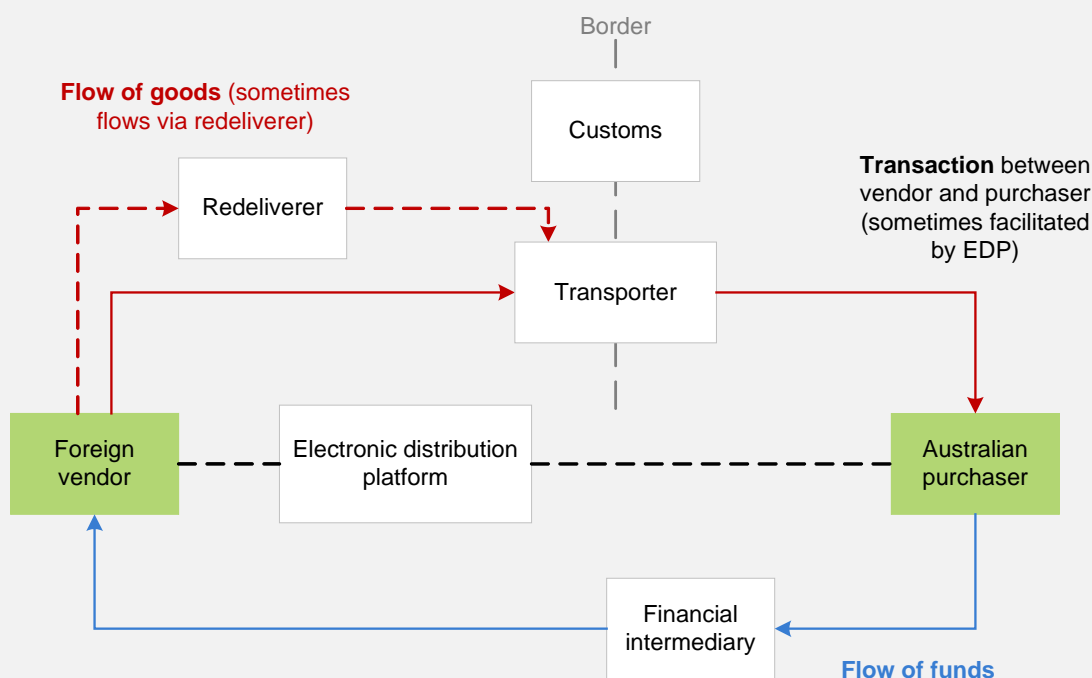
Because neither model places the liability for assessing and collecting the GST on entities outside of Australia’s legal jurisdiction, or exempts goods from small suppliers, both are likely to achieve higher compliance and collection rates than the legislated model — although at the cost of a higher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

CHAPTERS

1 Setting the scene

Key points

- Low value imported goods are exempt from GST, creating concerns about a competitive disadvantage for Australian retailers, impaired tax neutrality and a loss of revenue.
- The Australian Parliament has passed legislation to introduce a vendor-based model to collect GST on these goods, to commence in July 2018.
- This decision has occurred in a landscape where:
 - online commerce is increasing in importance
 - online imports take a small but significant share of Australian retail sales
 - the supply chain for online sales is complex, providing multiple points at which a GST collection model could operate
 - the trend abroad is towards vendor-based collection models.
- The Commission's task is to check that the legislated vendor-based model is the best available for Australia and to consider improvements.
- The Commission has assessed available information and consulted stakeholders, but has been restricted by a lack of solid evidence on some matters and the inquiry's short timeframe.

1.1 The drive to apply GST to low value imports

Following more than a decade of debate and several government studies, the Australian Parliament recently legislated the introduction of new measures to collect Goods and Services Tax (GST) on low value imported goods, to commence on 1 July 2018.

Aside from tobacco and alcohol products, a consignment of (physical) goods with a total customs value not more than the \$1000 'low value threshold' (LVT) is currently exempt from GST when imported into Australia. In contrast, imports of higher value goods and domestic sales of goods do incur GST.¹

The exemption for low value imported goods was an element of the GST provisions that commenced in July 2000. At that time, with internet commerce in its infancy, direct consumer imports of low value goods were limited.

¹ Some goods are exempt from GST more generally, including GST-free supplies (such as basic foods and some health products) and input-taxed supplies (such as precious metals).

The rise in online shopping has elevated concerns

As internet commerce has grown, so has concern about the effects of the exemption. Local retailers in particular worry about its effects on the health of their businesses, and have also pointed to the broader impacts of foregoing tax revenue. For example, in 2012, Gerry Harvey (chairman of retailer Harvey Norman) argued:

But how do you compete, I ask you? I opened a shop selling tennis racquets and golf clubs, and I put them in the window and I put them there and I've had to pay a lot of rent and I've had to bring these goods in and then another guy can go and buy them off an overseas site, pay no duty, pay no GST ... [T]he retailer here will then have to go out of business. (Lateline 2012, p. 1)

And, more recently, he stated:

We need everyone to pay their fair share so we can pay for our schools and our hospitals and infrastructure. If they [companies opposing the legislated model to apply GST to low value imported goods] win this argument then the Australian economy will go up in smoke. (Scarr 2017, p. 1)

Similar pressures have arisen in other countries too. In 2015 the Organisation for Economic Cooperation and Development (OECD) published a survey of potential approaches to collecting GST (or value added tax — VAT) on low value imported goods as part of its broader *Addressing the Tax Challenges of the Digital Economy* agenda (OECD 2015). Several countries are now investigating methods to improve the efficiency of their collection of GST on imported goods and extend collection to lower value goods.

Several previous Australian Government studies have also examined the issue, albeit without finding a means of applying GST to low value imports that would clearly leave Australia better off overall (box 1.1).

Recent moves towards a vendor-based collection model

In the May 2015 Budget, the Australian Government announced a vendor-based measure to collect GST on imported *digital* products and services. Legislation was passed and the change took effect on 1 July 2017. This follows implementation of similar measures elsewhere (such as the European Union), and is distinct from GST collection on low value imported *physical* goods.

In mid-2015, the Council of Australian Governments agreed to extend the GST to low value imported goods, and in 2017 the Australian Government introduced the *Treasury Laws Amendment (GST Low Value Goods) Bill 2017*. The Bill retained the LVT at \$1000 but provided for a new system for imported goods that fall under the LVT. It places the onus on foreign vendors, as well as redeliverers and electronic distribution platforms (EDPs), to collect and remit GST on those goods (see box 1.2 and chapter 3). These new measures were also to commence on 1 July 2017.

Box 1.1 Previous government studies on GST and low value imports

In 2009, the Australian Government asked the Board of Taxation to review the application of GST to cross-border transactions. Among other things, the Board found that the collection of GST on such transactions can be inefficient due to the difficulties of enforcing GST compliance on non-residents outside Australia's jurisdiction (Board of Taxation 2010).

In a 2011 inquiry into the retail industry, the Productivity Commission examined whether the \$1000 LVT (which also applies to customs duties) should be removed or lowered, thereby extending the reach of the border collection model to lower value goods. The report found the economic benefits of doing so, at that time, would be far outweighed by the collection costs. The Commission stated:

There are strong in-principle grounds for the low value threshold (LVT) exemption for GST and duty on imported goods to be lowered significantly, to promote tax neutrality with domestic sales. However, the Government should not proceed to lower the LVT unless it can be demonstrated that it is cost effective to do so. The cost of raising the additional revenue should be at least broadly comparable to the cost of raising other taxes, and ideally the efficiency gains from reducing the non-neutrality should outweigh the additional costs of revenue collection. (PC 2011, p. 214)

The Commission recommended the investigation of new approaches for handling low value imported parcels that could enhance the cost-effectiveness of reducing the LVT, particularly as the volume of online purchasing increased (PC 2011).

The Government subsequently established a Low Value Parcel Processing Taskforce (LVPPT 2012). Its 2012 report advocated a new and simplified approach to collecting GST on low value imported goods that could allow the LVT of \$1000 to be lowered for GST collection (but maintained at \$1000 for the collection of customs duties). (The collection model proposed by the Taskforce is described and examined in chapter 5.)

Following the Taskforce's report, in 2013 a Low Value Threshold Working Group, comprising government agencies and industry stakeholders, was established to consider different collection models, including border collection, vendor collection, 'premium' vendor collection, purchaser registration and remittance, and financial intermediary collection (DHL, sub. 23).

In 2015, the Government announced its intention to implement a vendor-based model (see text).

When explaining the Bill, the Government stated:

[T]he fact that neither the supply nor the importation of such low value goods is subject to GST represents a significant risk to the integrity of the GST system. It also places Australian based suppliers at a growing competitive disadvantage ... (Australian Government 2017c, p. 7)

The Bill was subsequently referred to the Senate Economics Legislation Committee, and then passed into legislation in June 2017 with two amendments. These were to delay by one year the commencement of the new measures, and that there be a Productivity Commission inquiry on the matter.

This inquiry's main task is to check that the legislated model is the best collection model available to extend the GST to low value imported goods, and to identify any practical improvements to support effective implementation come 1 July 2018.

1.2 The importance of online retailing

Online retail sales have become a sizable share of total retail sales. National Australia Bank (NAB) estimated that online retail sales totalled \$22.7 billion in 2016-17, the equivalent of about 7½ per cent of retail sales by all bricks-and-mortar retailers (NAB 2017a). However, a significant share of total retail sales are from food retailing (including groceries) and cafes and restaurants, which face some natural protection from online competitors due to the short shelf life of food and the hospitality offered by eat-in venues. Excluding these categories, online sales are the equivalent of about 12 per cent of total retail sales.

Consumers purchase goods online for reasons that include price, convenience, choice (as some products or variants may not be available in local stores) and ease of access. Online shopping also enables consumers to access a greater range of products at a time that suits their preferences.

The share of retail sales attributable to online shopping is likely to rise further, as more consumers embrace it and if delivery times and costs reduce.

Online imports relative to domestic sales

Despite the internet significantly reducing consumers' barriers to purchasing from foreign vendors, domestic retailers account for the majority of online sales. NAB estimated that overseas retailers accounted for 20 per cent of consumers' online purchases in 2016-17, or 1½ per cent of domestic retail turnover. Moreover, the share of online purchases from overseas retailers has fallen slightly over the past five years (NAB 2017b).

While domestic retailers account for the bulk of online sales to Australian consumers, some of this may occur via 'offshoring', where an Australian business warehouses goods overseas and consigns them directly to consumers as sales are made. As the consignments normally cross the border under the low value threshold, GST is not applicable, creating a price advantage for that business. The Commission is unaware of any data on the extent of this practice, although it seems likely to be limited, given economies of scale realised through bulk transportation.

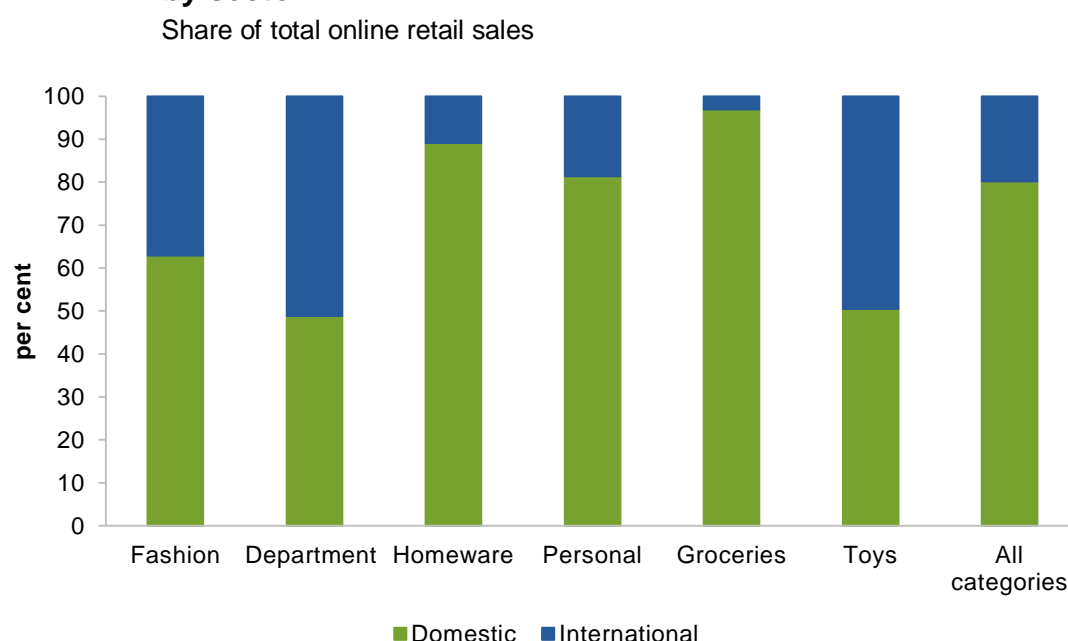
Consistent statistics on the share of low value imports relative to retail sales are also hard to come by. In part, this is because low value imports are currently untaxed, and as such there is little need to systematically record their details at the border. Other challenges with collecting reliable data are linked to the variable documentation requirements, the alternative freight pathways used and the sheer volume of low value imports.²

² The Commission's earlier inquiry (PC 2011) noted the problematic nature of this task and recommended that the Australian Bureau of Statistics (ABS) monitor and report online expenditure both domestically and overseas by Australian consumers. The Government response to the inquiry (Australian Government 2011) stated that the ABS would continue developing surveys to capture emerging retail trends, subject to budgetary considerations.

Notwithstanding these data issues, the size of low value goods entering Australia for consumers is small. The most credible estimates range from about \$4 billion to \$7 billion in 2016-17 (based on estimates of GST foregone using Treasury and ABS data, see chapter 2) — equivalent to between 1⅓ per cent and 2⅓ per cent of total Australian retail turnover of \$310 billion in that year (ABS 2017).

Some domestic retail sectors are more susceptible to competition from overseas online retailers than others. Industries that are more naturally protected are those where transport costs are relatively high as a share of the price of goods, or where timeliness of supply and perishability are important (such as food — as mentioned above). The NAB survey shows that the share of online retail activity accounted for by overseas retailers varies between sectors (figure 1.1). For example, in 2016-17, overseas retailers accounted for approximately 50 per cent of online purchases of toys, but only about 11 per cent of online purchases of homeware. However, this data does not indicate the value of overseas online sales as a share of total domestic sales in each sector.

Figure 1.1 Share of online purchases to overseas retailers varies by sector



Source: NAB (2017a).

1.3 The online goods importation system and models for collecting GST

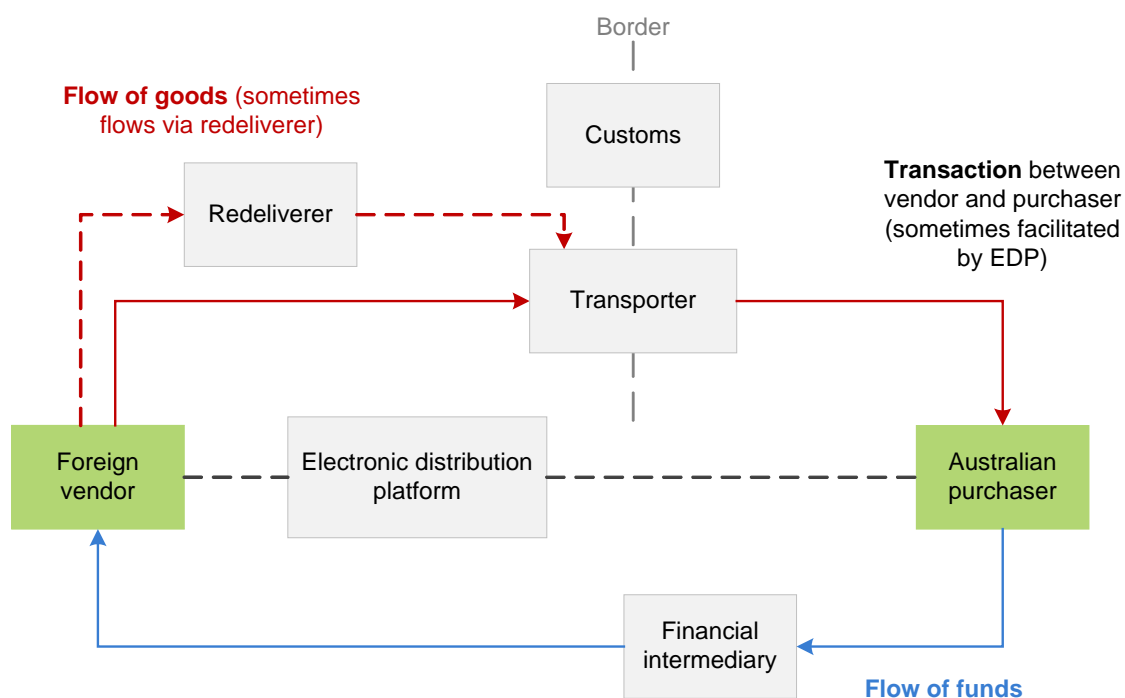
The supply chain

The supply chain for online imported goods differs markedly from the traditional model of importing, warehousing and then retailing goods. The entities covered in the chain can include:

- the vendor of the goods
- an EDP or ‘online marketplace’, such as Amazon or eBay
- an intermediary for making payment to a vendor abroad (traditional financial institutions or relatively new payment intermediaries such as PayPal)
- transporters, including those overseas and domestic firms making the final delivery (postal operators such as Australia Post, and express carriers such as DHL)
- ‘redeliverers’, that take delivery of goods from vendors or transporters overseas and assist purchasers to bring them into Australia
- the purchaser.

Figure 1.2 depicts the process.

Figure 1.2 **Supply chain for online sales of imported goods^a**



^a This is a simplified representation of the supply chain for online sales of imported goods.

GST collection models

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

- *‘traditional’ or ‘border’ collection* — the model currently used in Australia to collect GST and customs duties on imports of goods valued above the LVT of \$1000 (details of Australia’s system are set out in box 1.2). Customs authorities assess the value of the imported goods and hold them until the appropriate GST payment is made by the recipient. Also known as the ‘ransom’ model
- *vendor collection* — the obligation to collect and remit the GST is placed on the overseas 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 domestic purchaser is required to self-assess and remit GST on purchases of low value imported goods.

Box 1.2 **Australia’s arrangements for collecting GST on imported goods**

Current arrangements for higher value goods

GST is currently levied on importations of goods only where their value exceeds the LVT of \$1000 (except for tobacco and alcohol products). The process varies between the air cargo and international mail streams.

International mail is transported with a paper declaration affixed to the exterior of each article that includes details of the sender, the recipient, and a description and the value of the goods. The Department of Immigration and Border Protection (DIBP) filters and manually assesses parcels for illicit products and security matters as well as tax liabilities. If the value of a parcel exceeds the LVT, DIBP refers the item to Australia Post which sends the addressee a First Notice advising them of the need to complete an Import Declaration (Customs and Border Protection 2011b). On receipt of this and before releasing the parcel, DIBP sends the addressee a notice to pay duties, GST, and any other taxes. Cost recovery charges are also applied — \$90 if the declaration is submitted in paper form or \$50 if it is submitted electronically (DIBP 2015).

The process for air cargo — mostly transported by the major express carrier businesses DHL, TNT, FedEx and UPS — is more efficient. The carriers typically collect sufficient information when the parcel is lodged and employ customs brokers to identify the correct tariff classification and lodge an Import Declaration electronically (PC 2011), which commonly attracts a cost recovery charge of \$50 to DIBP and at least \$33 to the Department of Agriculture and Water Resources for biosecurity clearance (DAWR 2017; DIBP 2015). This charge and any outstanding GST or other duties are generally collected from the addressee prior to delivery of the parcel.

(continued)

Box 1.2 (continued)

The legislated 'expanded vendor' model for low value goods

Under the legislated amendments that are to take effect in July 2018, the current 'border model' arrangements for collecting GST on imports above the LVT will be retained.

However, imports of physical goods with a value of \$1000 or less (except tobacco and alcohol products) will be subject to a new and separate regime (Australian Government 2017c):

- The legislated model is an expanded vendor collection model. It requires vendors, as well as electronic distribution platforms (EDPs) and redeliverers, to register with the ATO and then collect and remit GST on low value imported goods (of \$1000 or less).
- GST will be collected on transactions with consumers only. Australian businesses registered for GST can provide their Australian Business Number (ABN) and inform the supplier that they are registered to avoid being charged GST.
- Domestic GST exemptions — for example, GST-free treatment of some medical supplies — will also be retained for imports (ATO 2017c).
- Only foreign suppliers with taxable consumer sales to Australia of \$75 000 per year or more are required to collect and remit GST under the legislated model. However, EDPs that facilitate taxable sales to Australia of more than \$75 000 are required to collect GST on all sales of low value goods that occur on their platform, including by sellers with sales of less than \$75 000.
- Under the legislated model, registered vendors, EDPs and redeliverers must provide DIBP with details of their Vendor Registration Number and (where applicable) the purchaser's ABN. This means that, although the legislation does not require that freight companies and express carriers collect this information and report it to DIBP, in practice they will need to do so.

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. Indeed, proposals for collection systems often draw on different elements of the four broad models listed above.

The model legislated in Australia (box 1.2) could be described as a hybrid vendor/intermediary model under the OECD taxonomy. Depending on the supply chain for the good in question, the obligation is placed on the vendor, the EDP, or the redeliverer. The legislated model is discussed in detail in chapter 3.

International shifts in collection models

Like Australia, other countries have been considering how to more efficiently apply GST (or VAT) to imported goods.

Currently, many jurisdictions use the traditional (border) model to assess and collect the GST/VAT on imported goods and have in place very low exemption thresholds — Australia's \$1000 LVT is the highest amongst OECD countries (OECD 2015). A number of countries are now attempting to move to alternative collection models for imported goods.

In many, vendor-based collection models appear favoured, although often with some variation (box 1.3).

Many countries have also adopted the vendor collection model for cross-border supplies of certain digital products and services. Among others, these include member states of the European Union, South Korea, India, Switzerland, South Africa, Taiwan, Japan, New Zealand and Russia. Most, though not all, of these countries extend the liability to EDPs.

Box 1.3 GST collection models for imported goods in other countries

A number of jurisdictions are either implementing or considering new collection models for imported goods.

- *European Union (EU)*: A vendor collection model is in place for goods sold within the EU for supplies of certain digital products and services. In 2016, the European Commission agreed to work towards implementing an optional vendor collection model (which would include EDPs) for imported goods from outside the EU from 2021, with a default border collection for goods from non-EU vendors who choose not to adopt the vendor collection approach (Committee on Economic and Monetary Affairs 2017; European Commission 2016).
- *Switzerland*: In 2016, the Swiss Parliament passed legislation that will require overseas vendors (but not online platforms) supplying imported goods to Swiss consumers to register, assess, collect and remit VAT once they exceed an annual turnover threshold of CHF100 000 (taking into account global sales). The law was originally to apply from 1 January 2018, but this has been delayed by a year (Ernst & Young 2017; Federal Council 2017).
- *United Kingdom*: In March 2017, the United Kingdom Government called for evidence on the technical feasibility of using financial intermediaries to extract and remit the VAT component from payments in real time (HMRC 2017a). It is currently analysing the submissions received.
- *United States*: While the United States does not impose a consumption tax at the federal level, 45 states levy their own sales taxes. Vendors must collect the state taxes on goods they sell in those states where they have a physical presence; otherwise the customer is meant to remit the tax. Minnesota has recently passed a law imposing sales tax obligations on online platforms from 1 July 2019, and several other states (including New York, Washington and North Carolina), as well as the National Conference of State Legislatures, are considering doing likewise.
- *Singapore*: In February 2017, the Singapore Government indicated that it would be looking to adjust its GST system to ensure a level playing field between domestic and overseas businesses (Heng 2017). Singapore subsequently circulated to select stakeholders a discussion paper proposing a vendor collection model, similar to Australia's, with application to online platforms and redeliverers (Inland Revenue Authority of Singapore 2017).

1.4 The inquiry

Against this backdrop, on 30 June 2017 the Australian Government asked the Commission to inquire and report by 31 October 2017 on:

- the effectiveness of the legislated model for collecting GST in relation to offshore supplies of low value goods
- the suitability of other models (and their effects on Australian consumers and small businesses)
- any other aspect relevant to the implementation of the new measures.

The Commission was asked to consult with consumer representatives, small businesses, industry stakeholders and governments, and to hold public hearings.

The inquiry's terms of reference are set out in full at the front of this report, and the parties consulted are listed in appendix A.

Broad approach

In approaching the inquiry, the Commission was cognisant that the Australian Parliament had already decided to tax low value imported goods, with the model legislated to take effect from 1 July 2018. Moreover, when agreeing to commission the inquiry, the Treasurer said:

We have done the work to determine the best model for Australia that balances the needs of consumers, the timeliness of clearance of goods at the border and the impact on businesses in the supply chain. We cannot burden our domestic businesses with the current inequitable arrangements while we wait for the technology to catch up and support other hypothetical models. We do not believe that another review will deliver superior models, so it is important that we all get on with the job of implementing. (Morrison 2017, p. 7208)

This means the inquiry has appeared, to a substantial degree, to be examining a *fait accompli*. Accordingly, the Commission has interpreted the main purpose for this inquiry as being to provide a high-level check that the legislated model is the best available to extend the GST to low value imported goods in Australia, and to identify any practical improvements to support its implementation. It has also considered whether alternative models, even if not suitable now, might become suitable and potentially superior to the legislated model in the future. The Commission has not revisited the question of whether it makes economic sense to impose GST on low value imports.

Consistent with the views put in the recent Senate inquiry, most participants in this inquiry strongly supported the principle of collecting GST on low value imported goods, but views varied on the merits of the legislated model as the means to do so. Several participants put forward other models they saw as preferable. Some also suggested 'improvements' that could be made to the legislated model, including by coupling it with other models (box 1.4 and chapter 4).

Box 1.4 Inquiry participants' views

Several retailers supported the legislated model. The Large Format Retailers Association stated:

[W]e consider the legislated model is the most effective and suitable model to extend GST to low value imported goods [and] unlike other alternative models, it can be implemented to take effect from 1 July 2018 preventing any further delays. (Large Format Retailers Association, sub. 19, p. 3)

The ARA saw the legislated model as a useful starting point for addressing tax neutrality issues:

[T]he ARA has supported the Government's vendor collection model as a first step in collection and the quickest and simplest means on initial collection. This does not mean we do not support other methods of collection which could be implemented on 1 July 2018 and would collect more revenue more efficiently. Retailers believe the Government should investigate other models, improve collection methods or indeed introduce new collection methods. (Australian Retailers Association, sub. 21, p. 2)

One domestic retailer emphasised the employment benefits of applying GST to low value imports:

Web-based selling to Australia disadvantages local Retailers for Items below \$1000 in value and has a detrimental effect to employment. ... With a level playing field we could hire extra staff, and extra staff means extra PAYG tax revenue. (Hans Marti, sub. 38, p. 1)

However, most stakeholders were concerned that the legislated model would be difficult to enforce:

The legislated model ... is dependent on voluntary compliance from many thousands of non-residents vendors (including small businesses) and marketplaces that have no presence in Australia. The legislated model also requires offshore enforcement of Australian laws against each of these businesses in every country in which they operate. As a result, many businesses will not comply with the legislated model, without consequences. (Amazon, sub. 11, p. 1)

The application of the legislated collection model to EDPs drew mixed views:

As online third-party marketplaces, our companies are opposed to the problematic collection model proposed by the Australian government ... We do not distribute or supply tangible products and our business models do not support the collection or remittance of GST ... To comply with the legislation from 1 July 2018 our businesses can prevent Australian buyers from accessing the online shopfronts of foreign sellers. (Alibaba, eBay and Etsy, sub. 25, p. 1)

... [The Australian Sporting Goods Association] is opposed to any attempt by EDPs to shirk their responsibility for collecting the GST under the current legislation. In our view, any changes to the legislation to make the system more efficient should not remove EDPs from the vendor registration requirements. (Australian Sporting Goods Association, sub. 15, p. 2)

Several participants raised trade-related issues and the risk of reciprocation from other countries:

The imposition of a GST charge on low value imported goods will ... be a disaster for small businesses like ours should our overseas trading partners impose a goods and services tax on exporting Australian businesses in retaliation. (Anna's Farm Pty Ltd, sub. 2, p. 1)

Some stakeholders pointed to the importance of considering the impact on consumers.

Any collection model that creates costs above the 10% GST for consumers or introduces onerous processes or delays will likely reduce competition in some retail markets ... A reduction of competitive pressure will likely see overall changes to price and quality of service for Australian consumers. (CHOICE, sub. 20, p. 2)

A number of stakeholders supported or proposed alternative collection models. For example:

Amazon is proposing a ... modernised transporter [which is] a significant improvement over the legislated model. (Amazon, sub. 35, p. 6)

Compliance for the 'border' model will certainly be far higher as will the collection rate. (Hi-Tech Freight Solutions, sub. 5, p. 1)

[WiseTech proposes lowering the LVT and] imposing a flat import processing charge, rather than a variable GST, on each consignment that falls within the de minimus range. (WiseTech Global, sub. 9, p. 4)

In assessing different collection models and potential improvements, the Commission has drawn on established policy principles in relation to tax and economic efficiency. It has given particular attention to the feasibility of different approaches and their likely impacts on: tax neutrality between domestic and foreign suppliers; GST revenue; and administrative and compliance burdens. It has also considered the impact of any delays and disruptions for consumers, and effects on Australian businesses including small businesses. The analytical framework used to assess these models is set out in chapter 2.

Challenges

The Commission has faced some challenges in assembling robust information with which to assess different collection models.

While there has been considerable debate on how to apply GST to low value imports, limited analysis is publicly available on the legislated model itself. For example, the Government has not published a regulation impact statement on the model. Further, without well-established precedents here or overseas for vendor collection for physical goods, it is hard to estimate the effects of the legislated model on matters such as compliance and tax administration, ahead of its implementation.

Similar difficulties arise with some other possible collection models, including those referred to the Commission for consideration by Netsweeper and Professor Lamensch (chapter 6), which rely on advanced information technology solutions for which there is not yet a track record in the GST context.

There are also scant or variable quality official data on some of the matters relevant to the inquiry, including the total value of low value imported goods consigned to Australia each year, the proportion of business-to-business transactions among these imports, and the split of such imports between the mail and cargo streams.

These problems have been intensified by the short timeframe set by the Parliament for the inquiry, which necessitated streamlined consultation processes. In particular, the Commission has had insufficient time to issue and receive supplementary submissions on a draft report.

In view of these challenges, the Commission has pursued several strategies:

- Given the unusual context for the inquiry, the Commission has placed a large onus on parties that consider the legislated model should not be implemented as scheduled to demonstrate the feasibility and superiority of an alternative approach.
- The Commission conducted a preliminary high-level analysis of different collection models, presented in a discussion paper released on 28 July 2017, with a view to narrowing the range of models that would subsequently need to be considered in detail.
- The Commission held public hearings and sought public submissions on the matters under reference. Eleven participants presented or made statements at the hearings, held

in Sydney and Melbourne on 22 and 24 August, respectively. 44 public submissions were received (appendix A).

- To help test the veracity and merits of new information and models provided through the hearings and submissions process, and in lieu of a draft report process, the Commission engaged with selected participants following those processes.
- To address the limited statistics on some matters, the Commission has devised indicative estimates from secondary sources, using assumptions in some cases. While these estimates are fit for the broad purposes of the inquiry, they should be used with due caution for other purposes.

2 The Commission's assessment framework

Key points

- The Commission has adopted an economic framework to assess GST collection models for low value imported goods.
- The Commission has also been guided by established taxation principles and the Government's stated objectives of tax integrity and neutrality between domestically retailed goods and imports. These principles relate to:
 - Fiscal performance — a model should be effective in collecting tax revenue, and do so with limited administrative costs for the Government, measured by the ratio of additional revenue to administration costs for the Government.
 - The extent of compliance and collection — collection models should induce a high rate of compliance and especially a strong 'collection rate' as the latter accounts for the size of any tax exemptions.
 - Business compliance costs — both fixed and variable compliance costs borne by businesses should be minimised, noting that businesses generally pass these costs on to consumers.
 - Consumer burdens and disruptions should be reduced, particularly by not adding delays at the border and additional administrative requirements.
- These tax design principles (and more broadly those of efficiency, simplicity and equity) cannot all be achieved simultaneously. Trade-offs are necessary, requiring nuanced assessments.
- Any GST collection model also needs to be compatible with Australia's international treaty obligations and commitments. In assessing different GST collection models, the Commission has paid particular attention to any aspects that may not extend equivalent treatment to imported goods.

To assess the legislated GST collection model for low value imported goods and the suitability of alternatives to it, this chapter sets out the features that a GST collection model should ideally have. They relate to fiscal performance (section 2.1), the extent of compliance and collection (section 2.2), business compliance costs (section 2.3) and consumer burdens and disruption (section 2.4).

The Commission has also been guided by established economic and taxation principles (box 2.1) and the Government's stated objectives for the GST extension of tax integrity and neutrality between domestic retailers and imports (chapter 1). Trade-offs between the

desirable characteristics of a tax collection model are inevitable, as it is not possible or practical to achieve them all simultaneously.

Synergies with other policy domains should also be taken into account as far as practical. For example, where a collection model might be able to improve other related customs processes or have broader benefits if extended to other areas of tax collection, this would generally be a desirable feature. Likewise, policy design needs to ensure compatibility with other policy domains, notably trade policy and Australia's international trade treaty obligations (section 2.5).

Box 2.1 **Overarching taxation principles**

Jean-Baptiste Colbert (Finance Minister to King Louis XIV from 1665 to 1683) quipped that 'the art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing' (The Economist 2014).

In modern times, economic institutions have converged on less colourfully articulated, but more disaggregated and usable, principles that tax systems should adhere to.

Although terminology can differ, the Asprey Tax Review (1975), the Henry Tax Review (2009) and the Australian Government's (2015) tax discussion paper all outlined the same three principles for a well-designed tax system:

- *efficiency* — tax systems should raise revenue at the least possible cost to economic efficiency, maximising tax neutrality and minimising the 'waste' created by distorted consumer and business choices (the 'deadweight loss')
- *simplicity* — the tax system should be easy to understand and simple to comply with, minimising administration costs for governments and compliance costs for businesses and consumers
- *equity* — fairness in the distribution of the tax burden, both horizontally (taxpayers in similar circumstances should bear a similar tax burden) and vertically (taxpayers in better circumstances should bear a larger part of the tax burden as a proportion of their income).

The Henry Tax Review also suggested two other design principles: revenue sustainability (through durable yet flexible design) and policy consistency across the entire tax system.

The OECD (2015) has also identified a range of principles that a well-designed tax system should endeavour to uphold, which include: neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility.

There are other tax principles that apply to specific tax bases and which help to ensure consistency between different jurisdictions. The aim is to reduce the potential for double taxation or tax avoidance through uneven rules, as well as minimise compliance burdens and maximise simplicity for entities operating across borders. For consumption taxes like the GST, the main principle that applies for imported goods is the 'destination principle' (discussed further in section 2.5)

2.1 Fiscal performance

A critical attribute of good tax design is the tax system's fiscal performance. From this standpoint, what matters is that a model is effective in collecting tax revenue, and that it does so with limited administrative costs for the Government.

Attainable GST revenue

The additional revenue that would be directly obtained from extending the GST to low value imported goods is dependent in the first instance on the extent of the GST currently not collected on those goods.

As little data is available to reliably estimate the GST currently foregone on low value imported goods, assessments vary widely, ranging from around \$400 million to \$1 billion for 2016-17 (box 2.2). The lack of data on the exemption's value is mainly the result of the exemption itself — as low value imported goods are not stopped at the border, data about their value is not collected (particularly in the international mail stream, where electronic data remains limited).

Box 2.2 Estimates of total GST foregone on low value imported goods

A wide range of estimates exist on the value of GST foregone due to the current exemption for low value imported goods.

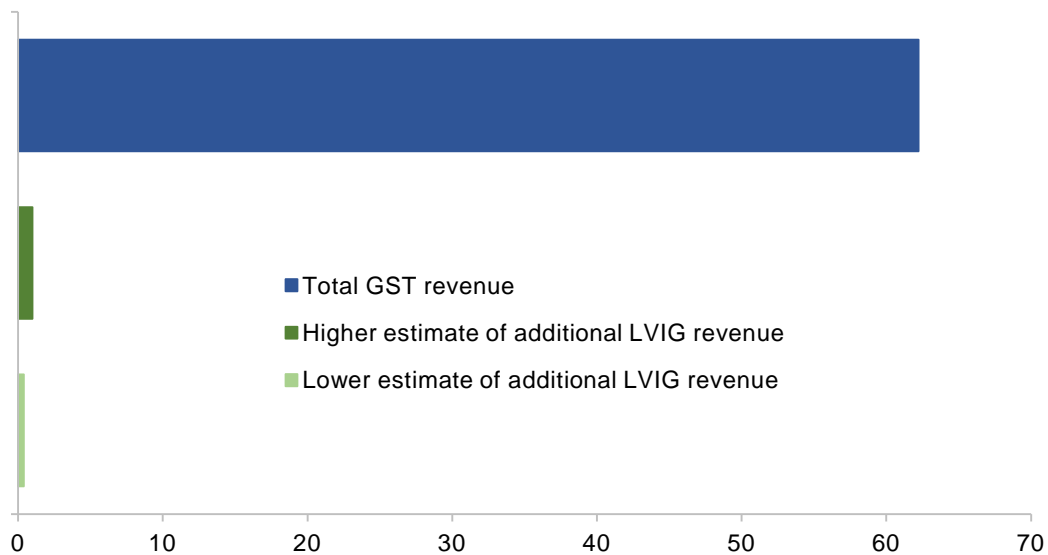
In 2011, the Commission estimated that the GST foregone was \$480 million for 2010-11, using Customs data on the value and volume of packages arriving by mail and air cargo and relying on various (in some cases rough) assumptions, particularly relating to the share of packages destined for households (PC 2011). Evidence suggests that this value is now significantly higher, including data supplied by DIBP that indicates the value of air cargo shipments nearly tripled between 2010-11 and 2016-17 (DIBP, pers. comm., 16 October 2017), while international mail volumes rose by 20 per cent in the four years to 2015 (Australia Post 2017).

More recent estimates of GST foregone, for 2016-17, include:

- \$390 million — from Treasury (2017b), which attached a low reliability to the estimate
- \$450 million — derived from the National Australia Bank's (NAB) estimated proportion of total online retail sales (\$22.7 billion) that are imported from overseas merchants (NAB 2017a)
- \$730 million — estimated from Australian Bureau of Statistics data on total low value imported goods (ABS 2013, 2014), adjusted to reflect the Commission's estimates of business imports (see chapter 3)
- around \$1 billion — implied from Australian Retailers Association statements that online retail sales represent 7½ per cent of the \$310 billion annual retail turnover, with a little over half of this figure imported (Zimmerman, trans., p. 5), also adjusted to reflect the Commission's estimates of business imports.

Although estimating the amount of GST foregone is a difficult task, it is clear that the value of GST foregone from low value imports is a very small share of total GST revenue collected (figure 2.1). For instance, Treasury's estimate for GST foregone in 2016-17 (nearly \$400 million) is equivalent to only $\frac{2}{3}$ of one per cent of total GST revenue (\$62.2 billion), while even the Australian Retailers Association's more expansive (implied) estimate of \$1 billion would amount to around $1\frac{2}{3}$ per cent of total GST revenue (Australian Government 2017b).

Figure 2.1 Additional GST revenue from low value imported goods against total GST revenue
\$ billions, 2016-17



Sources: Australian Government (2017b); Treasury (2016).

Whatever collection model is used, applying GST on low value imported goods will not significantly increase tax revenue. Above all, this reflects the fact that online commerce from foreign suppliers is a small share of total retail sales. For the year ending June 2017, the NAB estimated that online retail sales totalled \$22.7 billion, of which about one fifth were from abroad, equivalent to about $1\frac{1}{2}$ per cent of retail sales by all 'bricks and mortar' retailers (NAB 2017a).

The GST revenue that could be collected by the Government is further affected by the collection and compliance rates that would be achieved — low rates under a specific model would mean limited additional revenue for the Government (outlined in section 2.2).

Tax administration costs

The Government will incur administration costs under any GST collection model for low value imported goods. These costs stem from ongoing monitoring and compliance activities and from systems changes at the implementation stage. The magnitude and type of costs vary greatly between different models, and can be expected to be incurred by the Australian Taxation Office (ATO), the Department of Immigration and Border Protection (DIBP, formerly Australian Customs and Border Protection Service) or Australia Post, depending on which model is used.³

An oft-used measure of a tax instrument's fiscal efficacy is the ratio of revenue collected to administration costs. Those collection models with a higher ratio would be preferable, other considerations aside. As a benchmark, the ATO estimates that across *all* Commonwealth tax revenues and refunds, the cost to collect \$100 is generally less than \$1 (ATO 2016). And, of course, the total amount of tax revenue obtained is also relevant.

Some caveats

While it is desirable that collection models perform well fiscally, a more positive fiscal balance sheet is not an end in itself. For one, the additional tax revenue raised by the Australian Government is not an outright gain to the broader economy, but is instead a 'transfer' from Australian taxpayers. Moreover, a collection model with a low administrative burden may still generate net economic costs if it shifts collection burdens onto other entities in the supply chain, such as vendors or intermediaries. While a collection model with excessively high compliance costs could shift more demand towards domestic sales, with attendant increases in GST from that source, public policy is generally not desirably used in this manner. Accordingly, the Commission also looks to a broader suite of indicators of merit and performance when assessing the desirability of different collection models.

2.2 Extent of compliance and collection

Collection models that generate higher GST remittances may also be desirable because they help to achieve better tax neutrality between domestic and imported goods, as more imported goods are subject to GST.

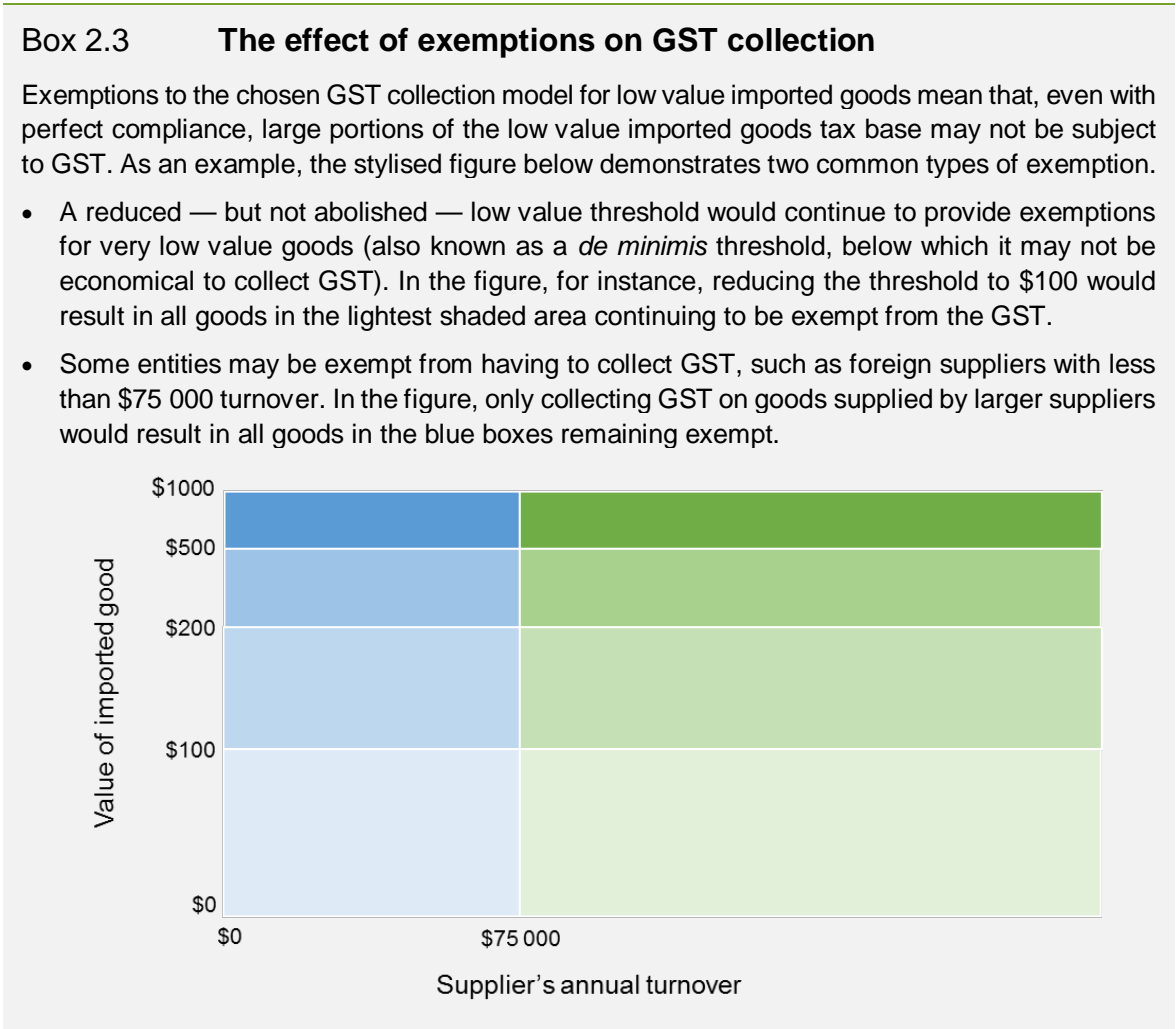
The *compliance rate* measures the proportion of imported goods that meet the relevant tax obligations under a given collection model.⁴ To the extent that liable entities avoid complying with a model's requirements (such as by evading payment or undervaluing goods), then the compliance rate will be less than 100 per cent.

³ As a wholly government-owned entity, Australia Post's costs of collection are ultimately borne by the Government.

⁴ Normally measured by the total *value* of goods that are compliant, rather than the volume of goods or the proportion of suppliers that are compliant.

However, some low value imported goods can be exempt under one collection model but taxable under another (box 2.3). Such exemptions in collection models can mean that compliance rates do not give a complete picture. Achieving a high rate of compliance on a collection model that exempts most goods does not necessarily make that model superior to one with lower compliance but fewer exemptions.

As a result, the Commission’s assessments also consider the *collection rate* of different models, which accounts for both compliance rates and the proportion of exempted goods. Broadly, the collection rate calculates the proportion (by value) of the total potential GST (on all low value goods imported for final consumption, or the total area of the figure in box 2.3) that is actually collected under the given model.



2.3 Business compliance costs

It is desirable that the collection model for GST on low value imported goods also limits the costs businesses incur to assess, collect and remit the GST. Although all taxes create

compliance costs related to collection — resulting in some net loss during the process of transferring revenue from the entity paying the tax to the government — a good collection system would seek to minimise, or at least limit, these costs.

Accounting for compliance costs

Compliance costs can be incurred by consumers and the Government (administration costs, discussed in section 2.1 above) as well as by businesses.

Depending on which collection model is used, compliance costs can fall on businesses (including vendors, transporters or financial intermediaries) at different points throughout the supply chain. They will have fixed and variable components:

- upfront fixed costs — such as for rewriting and trialling new software systems, establishing internal processes that align with new legal responsibilities, retraining staff, or purchasing and installing new physical capital
- ongoing variable costs — the annual cost of continued compliance with and administration of the tax system. Examples include additional reporting and auditing requirements, extra manual handling and inspection for goods, continued correspondence and communication with other parties, and financial transaction costs.

The likely size and incidence of these compliance costs forms an important part of the Commission's analysis of different GST collection models. Better collection models generally minimise costs, including by being resilient to future technological or policy developments and thus ensuring subsequent changes (with their associated fixed costs) are not needed.

However, data availability and the lack of precedent for some collection models limits the Commission's capacity to account for compliance costs. Moreover, as firms vary in their size and complexity, a given collection model can have very different effects between firms. For example, a collection model that may result in minimal burdens for a larger firm (because it is relatively easy to incorporate into its business model and processes) could result in massive burdens for a small firm, which may need fundamental changes to accommodate the new system.

Compliance costs for overseas entities

Compliance costs borne by non-Australian entities are typically not of any direct and immediate concern to the welfare of Australian consumers or the Australian Government. As such, policy makers may be tempted to ignore compliance costs incurred by foreign entities as not relevant to considering the merits of a given collection model.

In fact, these costs are likely to be highly relevant, because the economic incidence of a tax will typically fall on consumers, rather than the entities remitting the revenue and incurring

the compliance costs (box 2.4). It is also possible that, were Australia to introduce a collection model that imposed unreasonably large compliance burdens for overseas entities, this could create trade policy risks (discussed in section 2.5 below).

The Commission thus considers all business compliance costs, not just those impacting on Australian entities, when assessing and comparing different collection models.

Box 2.4 Prices and the incidence of tax burdens

The entity that actually pays a tax (such as through remitting to the ATO) is seldom the one that bears the economic incidence of that tax. This is particularly the case for the GST, which is a broad-based tax on final consumption.

Although the mechanism to apply the GST to low value imported goods can vary (such as by restricting the access of foreign entities to input tax credits), the basic principle of consumers bearing the incidence of the GST still applies. As such, the main effect of extending the GST to low value imported goods would be to increase prices for low value imported goods, by up to 10 per cent.

Additional price rises, beyond 10 per cent, are also possible if the collection model used results in significant compliance costs for entities throughout the supply chain. These businesses would have strong incentives to recover any compliance costs through increased prices.

The extent to which the GST and compliance costs flow through to price increases for low value imported goods also depends on market conditions, including the level of competition in the market, the prices charged by competing vendors and the price sensitivity of Australian consumers, all of which would vary from product to product.

2.4 Consumer burdens and disruption

Imposing GST on low value imported goods inevitably leads to detrimental effects for consumers of those goods. As noted in box 2.4, the price of these imports is likely to rise by up to 10 per cent or more (with the exact increase depending on business compliance costs and the market conditions that determine the extent to which imposts in the supply chain flow through into the good's final price). As the prices of low value imports rise, so to some extent will the prices of competing domestic goods.

Given these inevitable price rises, what is desirable in a collection model is that it avoid creating further, undue burdens and disruption for consumers. Such burdens or disruption will depend on the GST collection model and how it is implemented, and they could arise from several sources:

- One source of potential consumer detriment is if the GST collection model used for low value imported goods were to result in extensive delays between order and delivery, such as an expansion of the border model (also known as the 'ransom' model) currently used for high value goods.

-
- Aspects of some models could burden consumers through administrative complexity. Examples include requiring consumers to complete extensive paperwork (such as full import declarations or accounting for any low value imported goods in annual tax returns), or where consumers have to seek GST refunds from vendors due to miscalculation or the misclassification of goods.
 - Importantly, some of these consumer burdens could also be detrimental to small businesses, which often operate on a similar scale to many consumers. More specifically, additional administrative complexity or border delays would greatly affect Australian businesses that rely on small-scale goods importation.
 - It is also possible that some models could lead some suppliers to cease providing services to the Australian market — for instance, some online marketplaces have warned that they might block Australians from purchasing from foreign sellers once the legislated model comes into force (chapter 3). If consumer choices are curtailed by these withdrawals or competition across the economy declines, consumers would suffer.

It is difficult to put a price tag on the cost of increased administrative complexity or border delays for consumers. This is partly because the cost depends on the time taken to complete any new requirements, the length of any border delays, how many goods are affected, and the value placed by consumers on their own time and efforts.

As a general rule of thumb though, better collection models would avoid or at least limit these burdens. And the Commission sees as undesirable any model that is likely to introduce substantial unnecessary consumer burdens (particularly through border delays).

2.5 Compatibility with treaty obligations

A few stakeholders raised concerns that applying the GST to low value imported goods could be tantamount to a breach of Australia's international trade treaty obligations, to the extent it adds unduly to the cost of trade and breaches 'national treatment'. It is a requirement under the *Productivity Commission Act 1998* (Cth) to have regard to the need for Australia to meet its international obligations and commitments.

Under World Trade Organisation (WTO) rules, the taxation of imported goods is only permitted to the extent that they are treated equally to domestic goods (the national treatment principle). In particular, Article III of the 1947 General Agreement on Tariffs and Trade (GATT) states that imported products 'shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied ... to like domestic products.' The Annex to the GATT also extends this provision to 'a directly competitive or substitutable product'.

Unequal treatment could occur in different ways, depending on the collection model adopted and how it operates.

- If imported goods are subject to the GST, whereas similar domestic goods from otherwise identical suppliers are not, this would be unequal.
- If foreign entities are subject to greater compliance costs than their domestic peers, this would advantage domestic retailers.
- If there are significant delays at the border for imported products, this would give domestic goods a time advantage over imported goods.
- If the time or monetary costs of completing any administrative processes for importation significantly increase (such as through having to make more frequent full import declarations), imports would be comparatively more costly for Australian consumers and businesses.
- If incidences of double taxation start occurring frequently due to unintended interactions between the collection model and existing customs systems, this would further raise the cost of *all* imports (not just low value imports) for Australian consumers and businesses.

If unequal treatment occurs, offending aspects of the system could risk a challenge from another jurisdiction at the WTO. For example, in 2008 the Philippines lodged a complaint against Thailand for the unequal application of value added tax (VAT) to imported cigarettes. The WTO's Dispute Settlement Board ruled that 'by imposing additional administrative requirements only on resellers of imported cigarettes, Thailand's VAT treated imported cigarettes less favourably than "like" domestic cigarettes' (Daly 2016, p. 32).

The 'destination' principle for consumption taxes, which promotes consistency between jurisdictions, is also relevant. Under this principle, consumption taxes are levied by the jurisdiction in which the final consumption occurs. In general, this means that exports should be exempt from GST (in the exporting country), while imports should be taxed on the same basis and at the same rates as similar domestic supplies (in the importing country).

In assessing different GST collection models, the Commission has considered trade-related issues, paying particular attention to any aspects of a collection model that may not extend equivalent treatment to imported goods or that create any undue barriers to trade.

3 The legislated model

Key points

- A hybrid vendor-intermediary collection model for the GST on low value imported goods is legislated to commence on 1 July 2018.
- The legislated model should go some way to improving tax neutrality between imported and domestic low value goods and avoid major disruption for consumers when importing goods.
- However, without precedent here or overseas, no precise estimates are possible for the model's effect on matters such as collection rates and compliance costs ahead of its implementation.
 - Even if all of the potential revenue were to be collected, that amount is very small relative to total GST revenues, which run to over \$60 billion per year.
- While encouraging and enforcing compliance with the legislated model will be an ongoing challenge, most major foreign suppliers seem likely to register for and collect the GST.
 - Where major suppliers do not comply, the ATO has a suite of enforcement mechanisms available for use (although some, such as website blocking, would be overly draconian).
- Third-party EDPs have argued that they cannot readily comply with the legislated model, and a few warn they may disable foreign vendors from selling to consumers in Australia on their platforms rather than collect the GST. It is difficult to assess the veracity of these claims.
- Foreign suppliers will incur significant costs in complying with the legislated model and consumers will face higher prices.
- The legislated model should not put Australia in breach of its international trade treaty obligations, but there is residual uncertainty around the different treatment of domestic and imported goods from small suppliers selling through an EDP. A successful challenge could necessitate changes to relevant provisions.
- The introduction of the legislated model alone (or any other model) will not be a panacea for the broader challenges facing the retail sector. Wider benefits to the retail sector (and more broadly) could be secured by proceeding with reforms in areas such as shopping hours, planning and zoning regulation, and workplace relations.

This chapter explains how the legislated model works (section 3.1). It then considers issues and concerns raised in consultations with inquiry participants relating to the Government's revenue and costs estimates (section 3.2), compliance and enforcement (section 3.3), the treatment of EDPs (section 3.4), impacts on businesses (section 3.5), impacts on consumers (section 3.6), and whether the collection model breaches Australia's international trade treaty obligations (section 3.7).

3.1 How the legislated model works

The GST collection system passed by Parliament on 21 June 2017 and commencing on 1 July 2018 (the ‘legislated model’) is based on a vendor collection model.

In very simple terms, the legislated model requires major businesses, mainly based overseas, to register for and collect the GST on low value goods sent from overseas to consumers in Australia.

More technically, under the model:

- Offshore supplies to Australia of goods with a customs value of \$1000 or less (‘low value imported goods’) will now be deemed a domestic supply (except for alcohol and tobacco products) and subject to the GST. However, this only applies if the recipient of the supply is a consumer — imports for business purposes (business-to-business or ‘B2B’ imports) are not taxable under the model. Supplies of goods that are GST-free (such as basic foods and some health products) or input-taxed (such as precious metals) are also not taxable under the model.
- Supplies of taxable low value imported goods contribute to the GST turnover of the entity making the supply (the ‘foreign supplier’⁵). Once this turnover exceeds a ‘registration threshold’ of \$75 000 per annum (or \$150 000 for non-profit bodies), the foreign supplier is required to register for, assess, collect and remit the GST. Supplies that are not taxable, including B2B supplies, GST-exempt supplies or supplies to other jurisdictions do not contribute to an entity’s turnover for this purpose.
- Some suppliers can opt for ‘limited registration’ rather than ‘full registration’ (section 3.5), particularly if their supplies are connected to Australia only because of the legislated model. Other suppliers are not able to do so, as they are resident domestic businesses, whose supplies are caught by the legislated model because they have previously eluded the GST by using an ‘offshoring’ strategy.⁶

The legislated model can be described as a ‘hybrid’ vendor collection model, since it goes beyond requiring only direct vendors to register for, assess, collect and remit the GST, by also treating electronic distribution platforms (EDPs) and redeliverers as ‘foreign suppliers’. EDPs are included because they are generally larger and better resourced entities than the individual vendors using their platform, and the rationale for including redeliverers is to close an obvious loophole.⁷

⁵ The Commission has used the term ‘foreign supplier’ throughout this report to refer to entities making taxable offshore supplies of low value goods to Australian consumers. This term covers both normal vendors, as well as electronic distribution platforms and redeliverers. Technically speaking, the entities do not need to be based overseas to be caught by the legislated model, but for ease of exposition the Commission has used the term foreign supplier to cover these entities too.

⁶ ‘Offshoring’ generally occurs when an Australian business warehouses goods overseas and consigns them directly to consumers as sales are made. As the consignments normally cross the border under the low value threshold, GST is not applicable, creating a price advantage for that business.

⁷ By using a redelivery service, purchasers could hide their connection to Australia from the overseas suppliers.

EDPs are websites, internet portals, gateways, stores or marketplaces that allow other vendors to make sales online using their platform. If the EDP facilitates taxable supplies totalling over \$75 000, then the platform has to register for and collect GST on *all* taxable supplies made through its platform, including those from vendors with turnovers under the \$75 000 registration threshold (Australian Government 2017c).

The EDPs differentiate themselves as either a ‘one party’ (1P) platform, where the platform has pricing or product control over the goods sold through its website, or a ‘third party’ (3P) platform, which allows third party vendors to sell their own products on its platform. Some entities, such as Amazon, operate both as a 1P and 3P EDP, whereas eBay (for example) only operates as a 3P platform. Under the legislated model, 1P platforms are treated as the supplier of the goods, and 3P platforms are *deemed* to be the supplier of the goods because of the extension of the vendor model to EDPs.

‘Redeliverers’ (sometimes referred to as mail, post or package forwarders) are businesses that help to bring goods into Australia on behalf of the purchaser. They include businesses making or helping to arrange the initial purchase (such as by acting as a personal shopper), providing a mailing address for delivery in the relevant jurisdiction, making arrangements for storage, and delivering the goods to the consumer (Australian Government 2017c).

3.2 The Government’s revenue and costs estimates

The additional revenue collected is likely to be modest, due to the very small share of low value imported goods in overall retail sales, exemptions for some goods (such as those from small foreign suppliers and GST-exempt goods like basic foods and medical devices) and because of compliance and enforcement challenges.

While intrinsically difficult to estimate, in the 2016-17 Budget the Government forecast that the legislated model would raise around \$300 million in GST during the first three years of operation (Australian Government 2016, p. 19). The Government also expects to incur administration costs of \$13.1 million over its first four years (some of which have already been incurred due to the initial commencement date of 1 July 2017).

Most of the administration expenses are for the Australian Taxation Office (ATO), related to their ongoing compliance and enforcement activities (described further below). There are also fixed set-up expenses for the Department of Immigration and Border Protection (DIBP) to make systems updates to the Integrated Cargo System, in order to capture (where relevant) the supplier’s registration number, the recipient’s Australian Business Number (ABN) and whether GST has been paid.

Hence, the anticipated net revenue gain is around \$287 million over the first three years of operation. This equates to an administration cost of 4.4 cents for every dollar of estimated additional revenue (compared with a cost of 1 cent for every dollar collected across all Commonwealth tax revenues).

3.3 Compliance and enforcement issues

The additional revenue that the Government expects to collect from the legislated model critically depends on foreign suppliers registering for, assessing, collecting and remitting the GST. The Government's revenue estimates are based on an assumed collection rate that reaches 27 per cent after the first three years and a maximum of 54 per cent after six years (Ewing 2017, pp. 60–61).

Some inquiry participants took exception to these rates, which they consider overly optimistic, highlighting the compliance and enforcement challenges that the Government is likely to face (box 3.1).

Box 3.1 Stakeholder views on assumed rates of compliance

In evidence to the Senate inquiry on the legislated model (discussed in chapter 1), the Tax Institute contended that compliance of around 25 per cent after three years 'might actually be on the high side' (Deutsch 2017, p. 57). Similarly, CPA Australia described the assumed rates of compliance as 'highly speculative', while also noting that they 'could be on the high side.' (Drum 2017, p. 56).

The Australian Retailer's Association stated that it is 'concerned that the collection rates will be reasonably low with the vendor model' and that '[T]reasury's figures were not painting the collection rate in a great light', before noting that the actual rate 'could very well be below 50 per cent' (ARA, trans., p. 10). Likewise, Amazon argued that:

Since non-compliance is likely to grow as an increasing number of vendors leave the established compliant marketplaces and move to new, small, non-compliant marketplaces, Treasury's 54 per cent collection rate is likely to be a maximum rate that declines over time. (sub 35, p. 16).

Language and other cross-cultural barriers might also hamper compliance. In their joint submission, the Australian Taxpayers' Alliance and MyChoice noted that:

As these are foreign vendors, compliance rates are also likely to be reduce[d] by the level of English knowledge and difficulty in interpreting Australian legislation without the aid of legal and technical advice. (sub. 29, p. 6).

Extraterritorial enforcement challenges

The scepticism around the expected compliance rate is understandable. The novelty of the collection model and the scale of the challenges in enforcing compliance on suppliers operating in jurisdictions beyond the direct reach of the Australian legal system mean no precise estimates are possible.

Detractors argue that with limited direct legal authority over foreign suppliers, the ATO will struggle to enforce compliance, making non-compliance a more attractive prospect. As noted by Gonsalves, the 'risk is that overseas vendors will disregard the law because they are not physically located within Australia's jurisdiction' (sub. 7, attach., p. 9). Similarly, Hi-Tech

Freight Solutions suggested that '[i]f the GST is to be collected from the overseas sellers then it will be very difficult to enforce compliance' (sub. 5, attach., p. 2).

Low compliance with the legislated model would:

- limit revenue, affecting the size of the GST distribution to the states and territories
- mean less of an improvement in tax neutrality between foreign suppliers and domestic retailers
- create new tax distortions between foreign suppliers that are compliant and those that are not.

The Government is aware of the compliance challenges and has factored them into its expected revenue assumptions. However, the assumed rates are expected collection rates (explained in chapter 2), which means that part of the remaining 46 per cent of low value imported goods will be exempt from the legislated model and not liable for any GST (rather than from non-compliant suppliers, as noted by Treasury 2017a).

For instance, a major exemption to the legislated model is for small suppliers with an Australian turnover of less than \$75 000. Rough Commission estimates suggest that this exemption reduces the collection rate by around 22 to 49 per cent (box 3.2), meaning that, even with 100 per cent compliance from foreign suppliers, the maximum collection rate would still only be between 51 and 78 per cent.

Box 3.2 An illustration of the impact of the small supplier exemption

The small supplier exemption is for foreign suppliers with an Australian GST turnover of less than \$75 000. The proportion of low value goods consigned by small suppliers is important to ascertain, as it is a key factor for the maximum possible collection rate under the legislated model. As such, the Commission has devised a (rough) estimate of the effect of the small supplier exemption from what information is available.

In air cargo, the Centre for International Economics (CIE) has estimated that foreign suppliers under the \$75 000 threshold accounted for around 17 per cent of low value shipments (by value, CIE 2016, pp. 22–23). Assuming these numbers are replicated across the remainder of the cargo stream, the maximum collection rate among cargo consignments would be 83 per cent.

In international mail, the maximum collection rate is likely to be significantly lower, as parcels in the post tend to come from far more diverse sources and the proportion of foreign suppliers that are under the registration threshold is higher. Information provided by Australia Post indicates that less than 2 per cent of supplies are from repeat 'direct access' customers that have an ongoing commercial relationship with Australia Post (pers. comm., 6 October 2017). As there are likely to be other large suppliers that do not use the direct access scheme, the Commission has assumed that between 5 to 20 per cent of supplies through international mail are from large suppliers liable to pay the GST.

(continued)

Box 3.2 (continued)

Commission estimates indicate that the cargo stream transports between 33 and 37 per cent of low value imported goods (by value), with the remainder transported by the international mail stream.^a These proportions mean that, together, the maximum collection rate achievable after excluding all goods sold directly by small suppliers is between 31 to 43 per cent.

However, the legislated model's inclusion of EDPs means that goods from many of these otherwise exempted small suppliers will be captured (discussed further in section 3.4). The proportion of low value imported goods from small suppliers using EDPs is difficult to determine, due to the variety of individual vendors that operate through these platforms. As credible estimates of imports facilitated by EDPs range from 25 to 40 per cent of purchases (CIE 2016, p. 10; Park 2017, p. 20), purchases through EDPs from small suppliers are estimated to increase the maximum collection rate by between 20 to 35 per cent (assuming that some EDP purchases are from large suppliers).

Including purchases from small suppliers using EDPs increases the maximum collection rate to between 51 and 78 per cent, once goods sold directly by small suppliers are excluded.

^a Commission estimates based on data from Australia Post (sub. S5; 2017); CIE (2016); DIBP (pers. comm., 16 October 2017); LVPPT (2012); and PC (2011).

Voluntary compliance

Despite these concerns about enforcement, some stakeholders have highlighted that major foreign suppliers may willingly comply with the legislated model to preserve their reputation and goodwill. The ATO, for example, commented to the Senate inquiry that:

Generally, we believe that most organisations that have an obligation to comply with the legislation will do so ... They are predominantly large organisations that have a history globally of complying with obligations that they are required to comply with around the world. (Dyce 2017, p. 8)

Early experiences from the collection of GST on imported services and digital products (which commenced on 1 July 2017) suggest that high rates of compliance may be achievable. Although initial tax receipts were not available prior to this report's finalisation, the ATO has indicated that, broadly, the number of entities undertaking limited registration is better than rates experienced in many other jurisdictions. The GST revenue remitted for this measure is also likely to exceed expectations for 2017-18 (ATO, pers. comm., 26 October 2017). However, the applicability of this example may be limited, given differences between the markets for physical and intangible imports (including greater market concentration for imported services and digital products) and that the vendor model is well-established for intangible goods (with an existing system in the European Union).

Others also support this view:

- The Large Format Retail Association stated that they ‘agree with the Australian Taxation Office’s view that a high rate of compliance is expected due to the desire of large overseas vendors and EDPs to avoid potential reputation risk or damage’ (LFRA, sub. 19, p. 7).
- The Australian Taxpayers’ Alliance and MyChoice argued that ‘companies that do comply will be motivated by international reputation, goodwill and corporate social responsibility policies’ (sub. 29, p. 7).
- Gonsalves contended that ‘large organisations such as Amazon will likely be compliant where tax obligations are clear, because it is generally within the interests of such organisations to be seen as good “corporate citizens”’ (sub. 7, attach., p. 10).
- The GST Distribution Review in 2012 noted that, under a vendor collection model, ‘the cooperation of overseas suppliers could be forthcoming for the bulk of transactions’ (Greiner, Brumby and Carter 2012, p. 160).
- Evans (2012) argued that ‘The clear theme, in my view, is that the offshore suppliers, whilst preferring not to incur the compliance costs of registration and reporting, will respond to gentle persuasion and simple compliance regimes’ (p. 12).

Moreover, some commentators pointed out that corporate governance regulations in some countries may even compel major foreign listed companies to comply with Australia’s regulatory regime (including tax regulations). For instance, Evans (2012, p. 12) suggests that ‘while it might be possible (as a matter of extra-jurisdictional enforcement) to ignore Australian GST obligations’, the *Sarbanes-Oxley Act 2002* in the United States and other corporate governance requirements ‘mean that controls would be put in place to ensure compliance with the Australia law’.

The enforcement toolkit

Voluntary compliance is, of course, not sufficient and model proponents also point to the suite of ‘soft’ and ‘hard’ enforcement mechanisms available to the ATO.

The ATO’s enforcement strategy uses both mechanisms and is based on encouraging foreign suppliers to meet their new obligations, by making the legislated model as simple as possible, taking a cooperative approach to compliance, and assisting foreign suppliers to fulfil their obligations (box 3.3).

Box 3.3 **The ATO's strategy to encourage compliance**

The ATO is focusing on 'communicating, educating and assisting affected businesses to comply with the measure' (2017a, p. 6) through a series of activities that include:

- identifying foreign suppliers that may be potential registrants through enhanced data matching capabilities with DIBP
- contacting those foreign suppliers, to inform them of their potential obligations and how to seek further assistance
- developing a range of advisory products, including webcasts and materials in other languages, to assist foreign suppliers and tax advisers to understand the legislation
- providing direct support through 'client relationship managers' to assist the largest suppliers (based on experience of similar assistance for the imported services and digital products measure)
- carrying out targeted face-to-face engagement activities with international businesses, tax professionals and supply chain entities to create broader awareness (sub. S3).

The ATO has also encouraged businesses to seek advice through contact mechanisms that have been specifically established for non-resident queries. Businesses can also receive certainty on the treatment of their supplies by requesting a private binding ruling.

The 'limited registration' system that the ATO developed for the measure on imported services and digital products (discussed further in section 3.5 below) is also available for suppliers under the legislated model, making registration and remittance significantly easier.

Sources: ATO (2017a; sub. S3), Dyce (2017).

The efficacy of the ATO's compliance and enforcement strategy is yet to be tested, but there are reasons to be cautiously confident. If a foreign supplier persistently refuses to comply, stronger mechanisms, including issuing 'garnishee' notices⁸ and blocking websites are available to the ATO, although there are material concerns on the latter (box 3.4). These enforcement mechanisms have not featured prominently in the ATO's public statements, likely because its cooperative compliance strategy might be undermined if suppliers were threatened with punitive actions. Indeed, the Chartered Accountants Australia and New Zealand noted this at the Senate inquiry on the legislated model, stating:

I should point out also that the ATO has perhaps a little bit more power here than some might suggest ... the ATO may have given the impression that all they can do is jawbone these offshore entities into compliance with the measure when in fact our experience ... is that this process is about much more than just GST. (Croker 2017, pp. 51–52)

⁸ A garnishee notice compels a third party that owes money to the supplier to pay that money to the ATO instead, thereby satisfying the supplier's tax debts (ATO 2017d; Hayes 2013). In principle, this could include revenues from Australian customers, any liabilities owed by Australian companies or any assets (such as bank funds) that the supplier has in Australia. The ATO's ability to use this power would depend on the scale of the supplier's connection to Australia.

Box 3.4 Website blocking as an enforcement instrument

Under subsection 313(3) of the *Telecommunications Act 1997*, government agencies can require internet service providers (ISPs) to disrupt or block certain internet protocol (IP) addresses in order to safeguard national security, enforce criminal law and (crucially for the ATO) protect the public revenue.

Some stakeholders (such as the ARA 2017; Zimmerman 2017, p. 48) have suggested that the Government could use these powers to block the websites of persistently non-compliant vendors. There are several technical problems with this approach, however.

- Website blocking is unlikely to be effective, as consumers can circumvent it by using a virtual private network to hide their activity from ISPs. Polling by Essential Research (2015) suggested that 16 per cent of Australians already use a virtual private network (including 22 per cent of 18 to 34 year olds), while Glance (2015) contended that this is probably still increasing, based on data from virtual private network providers.
- There are risks of unintended consequences, as a single IP address can host multiple websites, such that an agency may inadvertently block unrelated websites hosted on that same IP address. In 2013, the Australian Securities and Investments Commission did just this, inadvertently blocking access to more than 1000 websites hosted at the same IP addresses of two foreign websites it was targeting (HoR SCIC 2015).^a
- Overseas retailers may also be able to circumvent website blocking by re-establishing their website using a different IP address.

There are also issues with proportionality in using website blocking to enforce the legislated model — with relatively limited tax revenue at stake, its use could be overly draconian. Tellingly, the ATO has never used this power to protect public revenue (Dyce 2017, p. 9). It was for these reasons that Gonsalves concluded that website blocking ‘is rife with controversy’ (sub. 7, attach., p. 13), while CHOICE have expressed ‘major concerns’ in the past (Turner 2017, p. 30) and have repeatedly opposed its use (sub. 20).

^a Since then, the Department of Communications and the Arts has released whole-of-government guidelines on the use of these powers, requiring that agencies maintain internal policies on its use, make requests as targeted as possible, and have access to appropriate technical advice (DoCA 2017).

International cooperation

Australia is also a signatory to the OECD Convention on Mutual Administrative Assistance in Tax Matters (the Convention). The Convention covers all taxes (including GST) and provides for assistance from other countries through exchange of information, service of documents and assistance in the recovery of tax (including the ATO using foreign court systems).

However, the Convention does not cover all jurisdictions. Notably, the United States has signed but not yet ratified the Convention, and has declared an exemption (‘reservations’) for the provisions guiding recovery assistance (CoE 2017), in line with its historical position not to enforce the tax laws of other jurisdictions (as per the ‘revenue rule’; Mallinak 2006; Silver 1992). Moreover, most countries are focused on advancing the direct taxation cooperation agenda first (particularly on corporate taxes). Even if it were a priority, invoking

the Convention's recovery provisions is unlikely to be easy, cheap or quick for the ATO (Bain and Boccabella 2016; OECD 2011).

These barriers may ease as more countries seek effective ways to collect GST on imports. There is some evidence this is already occurring for imported services and digital products. Indeed, using the Convention, the ATO has already issued six exchange of information requests for the measure to different jurisdictions, with all six requests satisfied (ATO, pers. comm., 23 October 2017).

The ATO has also suggested that other jurisdictions will likely be interested in enforcing Australia's legislated model for purely self-serving reasons — namely, that non-compliance with Australia's GST system is likely to indicate similar non-compliance with their domestic tax systems:

Businesses in other jurisdictions have said to us that they do not want their reputation in their own jurisdiction impacted by not complying in Australia. By that, I mean that, if we were to notify another jurisdiction that a business in that jurisdiction was deliberately not complying with a known obligation in Australia, the revenue authorities in that country would then know that that information might be an indicator of attitudes towards compliance by that business. (Dyce 2017, p. 9)

Market concentration

The ATO's task of enforcing compliance is also made easier by the concentrated market for low value imported goods. In evidence provided to the Senate inquiry, the ATO stated that:

The model that has been proposed has a very small number of organisations that will be required to remit revenue. As I said, our figures show around 3000 at the moment. (Dyce 2017, p. 12)

Among these 3000 suppliers (compared with over 2.6 million domestic firms registered for the GST) there is a high level of concentration, meaning that compliance efforts would only have to focus on a few firms. For instance, the CIE found that 1100 unique foreign suppliers accounted for 83 per cent of all consignments transported by the Conference of Asia Pacific Express Carriers (CAPEC), with around half of supplies from just the top few suppliers (2016, pp. 22–23). Similarly, Evans (2012, p. 54) contended that '[it] is likely that 90 per cent of the value of supplies of imported goods and services that are presently untaxed is made by 10 per cent of the total suppliers.'

Information about the top suppliers (by value) in the air cargo stream, provided to the Commission by DIBP, supports this conclusion. While the declared value of goods from the top 200 consignors accounted for 52 per cent of all low value goods in air cargo in 2016–17, half of this came from just the top 25 consignors. Indeed, if the legislated model registered only the 50 largest consignors in the air cargo stream, it could still raise nearly \$85 million in GST revenue (Commission estimates, based on CIE 2016 and DIBP, pers. comm., 6 October 2017).

3.4 The treatment of electronic distribution platforms

As discussed in section 3.1, the definition of a foreign supplier includes EDP intermediaries. These platforms facilitate a sizable proportion of Australian low value imports (see box 3.2 above), yet some 3P EDPs argue the legislated model should not apply to their platforms (particularly eBay, Alibaba and Etsy). These 3P EDPs identify themselves as online marketplaces with no or limited product or pricing control and serve only ‘to support ... connection between sellers and purchasers around the world’ (eBay, Alibaba and Etsy, sub. 25 attach., p. 13).⁹

The capability of EDPs to collect GST

These 3P EDPs argue they will face difficulties implementing the legislated model under their existing business structures, as they ‘do not distribute or supply tangible products and [their] business models do not support the collection or remittance of GST’ (sub. 25, p. 1).

Moreover, they claim that their existing systems are not designed to collect the GST on sales to consumers in Australia, and the needed changes to support this capacity would be prohibitively expensive. The Managing Director of eBay Australia and New Zealand, for example, stated that ‘we do not have tax collection capabilities. As I said, we do not even receive money from buyers. If the bill passes, we are not sure whether we can build tax collection capabilities into our system’ (Park 2017, p. 19). Similarly, Etsy says that:

... the legislation grossly oversimplifies the technology and human resource requirement to implement such a system on our platform. Our business model does not currently support, nor was it ever built to support, the collection of GST. (Steen 2017, p. 22)

The 3P EDPs also contend that their lack of control over both the goods being sold and the money being transacted means they cannot collect the GST, as they have little visibility over the transaction. As noted by eBay during the public hearings, ‘[it] is the sellers who own, control, warehouse price and distribute their products. Our businesses do not’ (Foster, trans., p. 67). There was also broader support for this argument from other inquiry participants, with the Freight and Trade Alliance (FTA) stating that:

FTA believes that as a non-owner of goods, as a non-distributor of goods, and as a non-agent of goods, that third party marketplaces are not making the supply, simply connecting the buyers and sellers. (FTA, sub. 34, p. 4)

⁹ The 3P marketplaces contend that this lack of pricing or product control makes them different to 1P marketplaces that do have control, such as Amazon (sub. 25 attach., pp. 12–13).

The Commission has not been able to make a definitive assessment on these issues, based on the information that has been submitted, but there are reasonable grounds to conclude that EDPs have the capacity to assess and collect the GST.

For one, control over both the goods and financial flows associated with an import transaction is not a necessary precondition for allocating responsibility to collect the GST. Rather, the key criteria are the availability of sufficient and accurate information to assess the amount of GST owing, and the means to extract the GST from vendors. On these criteria, aside from having a commercial relationship with vendors, there are indications that 3P EDPs collect much of the needed information at the time of the sale. The adequacy of the information collected by the 3P platforms was noted by other submissions, including Shafer (sub. 6), who contended that ‘the EDPs have access to all of the relevant information required to ensure that the appropriate amount of GST is collected on relevant transactions’ before noting that:

The information they are provided with by the parties to the transaction include (but are not limited to):

- the value of the transaction
- the nature of the goods (and consequently the GST classification)
- the supplier and supplier location and point of origin of the goods
- the customer and customer location. (sub. 6, p. 5)

The submission from Chartered Accountants Australia and New Zealand made similar claims, stating that the legislated model ‘leverages the scale, aggregating, centralising power of electronic distribution platforms and intermediaries in the supply chain, and to the data already available to them ... to provide an efficient and effective solution’ (sub. 22, p. 4).

Finally, it is noteworthy that if 3P platforms truly do not collect the correct information or have adequate control over the transactions occurring on their platforms, then it is possible that the legislated model may not even apply to them (box 3.5).

Box 3.5 **EDP exclusions**

The ATO has released draft Law Companion Guidelines on the application of the legislated model to EDPs. In it, the ATO explains that platforms are not automatically responsible for the GST on supplies occurring through their sites. If they meet certain criteria for their operations, then the platform is excluded from the EDP rules and the vendor is the only entity responsible for the GST. The following criteria must be met:

- the platform does not authorise the charge to the recipient of the supply
- the platform does not authorise the delivery of the supply
- the platform does not set (whether directly or indirectly) any of the terms and conditions under which the supply is made
- a document relating to the supply issued to the consumer in Australia identifies the vendor (not the platform) as the supplier
- the vendor and the platform have agreed in writing that the vendor is the entity liable for paying the GST for the supply. Alternatively, the vendor and the platform have agreed in writing that the vendor is the entity liable for paying GST for a class of supplies that includes the supply concerned (ATO 2017f, para. 66).

As noted by the Freight and Trade Alliance, '[in] some cases, these criteria will apply to third party marketplaces in full, providing an exemption, despite the seeming intent of the legislation to target these types of platforms' (sub. 34, p. 4). For instance, a 'classifieds' advertising-only platform (such as the Taobao platform raised by Alibaba during the public hearings; Hudson, trans., p. 75) is likely to meet these criteria and so be exempt from the legislated model (as per ATO 2017f, para. 83).

Source: ATO (2017f).

EDPs may disable foreign vendors from selling to consumers in Australia

Regardless of whether EDPs have sufficient information to collect GST, there is limited reason to doubt the 3P platforms' claims that their cost of implementing the legislated model will be high, as it involves fundamental changes to their business model and global platforms. Citing these high costs, some EDPs have warned they may disable foreign vendors from selling to Australian consumers on their platforms, rather than incur the costs of complying with the model.

eBay, for example, noted during the public hearings that there is a 'real consideration of stopping imports from 1 July 2018' (Foster, trans., p. 77).¹⁰ There have also been numerous media articles repeating the warning that this course of action is possible (for example, see Powell 2017; Scarr 2017), as well as statements by eBay's Managing Director at the Senate inquiry hearing:

¹⁰ eBay has clarified that this does not mean it would exit the Australian market entirely. Sales from domestic vendors to Australian buyers would continue and domestic vendors would still be able to export to foreign buyers (Foster, trans., p. 78).

If the legislation passes as is — while we have no tax collection capabilities — it will force marketplaces like eBay to prevent Australian buyers from purchasing from foreign sellers. Because we do not want to violate the law, we may have to stop all overseas sellers from selling to Australians. (Park 2017, p. 19)

Alibaba made similar statements during the Senate inquiry hearing:

Alibaba Group ... is of the view that [the legislated model] may not be able to be applied to AliExpress. If that were the case, we would have no choice but to geoblock Australian users from using the AliExpress platform. (Hudson 2017, p. 25)

Australia's position as the first mover to apply a vendor model to EDPs for tangible goods gives the platforms a strong incentive to act now, to try to suppress widespread international uptake of the collection model. The platforms have acknowledged this is a consideration, with eBay stating at the Senate inquiry that:

... we are worrying about the global implications. If we start to collect tax here in Australia we have to assume all other countries, all other governments, will ask eBay and other marketplaces to collect GST. Not just will it impact our import business in Australia; we have to assume this will impact all of our cross-border trading. (Park 2017, p. 26)

The credibility of 3P platforms' warnings that they may block consumers in Australia from purchasing from foreign vendors is unclear. Most public statements only say such a course is possible, not explicitly saying that it will occur, making it conceivable that the platforms will comply with the legislated model and collect GST from 1 July 2018.

Moreover, while disabling imports might be the simplest option for the 3P platforms to comply with the legislation, it would come with its own costs and benefit competitors that opt to stay. With Amazon planning to expand its Australian operations (Opray 2017), blocking consumers from purchasing from foreign vendors could put a permanent dent in the market share of those 3P platforms. It would also provide an opportunity for newer platforms with more adaptable business models (capable of collecting GST on sales) to fill the gap.

However, if the warnings to disable imports were to materialise and be widespread, it would undoubtedly be detrimental, decreasing competition, restricting choice and likely resulting in higher prices for Australian consumers. Inquiry participants noted these detrimental effects, with the joint submission from the Australian Taxpayers' Alliance and MyChoice stating that:

... to the extent that foreign vendors and EDPs exit the Australian market, the levels of competition experienced by Australian retailers will reduce and this connotes upward pressure on prices for consumers due to a decline in the threat of competition faced by Australian retailers. (sub. 29, p. 5)

Ultimately, the Australian Government needs to be prepared to manage the risk that some EDPs may campaign against the measure by blocking imports to 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.

Inequities with the registration threshold for domestic firms

The EDPs have also argued that the registration threshold rule for EDPs is unfair. Registration for an EDP is \$75 000 of Australian turnover, the same as for independent suppliers. But EDPs are required to collect GST on all taxable supplies occurring through their platforms, not just those from vendors with over \$75 000 turnover. In their joint submission, eBay, Alibaba and Etsy observed that ‘small business sellers using a platform will not even need to meet the \$75 000 threshold before they must start charging Australian consumers GST’ (sub. 25, p. 2).

More specifically, EDPs are not required to collect GST on domestic (non-imported) goods supplied to consumers in Australia, as that is the responsibility of the domestic firm. In contrast, a small vendor (with under \$75 000 of turnover in Australia) using the EDP to import goods to a consumer would have the GST applied to its sales by the EDP, putting it at a competitive disadvantage to a similar sized domestic competitor. During the Senate inquiry, ASOS raised this issue, remarking that:

... a business that transacts through a marketplace but is located in Australia would not be taxable were it below the registration threshold therefore it does not seem to be equitable for an overseas supplier to become taxable in the same circumstances. (ASOS 2017, p. 2)

The differentiated treatment between small domestic and foreign vendors using EDPs creates the risk that other jurisdictions will perceive the legislated model as a breach of Australia’s trade obligations (due to the lack of ‘national treatment’ between domestic and foreign suppliers, discussed further in section 3.7) and challenge its implementation on these grounds. If this occurs, the Government would have several options available that could help to reduce the concerns of other jurisdictions, without necessarily undermining the broader legislated model (box 3.6).

Box 3.6 Options to negate potential challenges

One way to resolve the unequal treatment between imported and domestic goods sold on an EDP is to follow the suggestion of the 3P platforms and exempt 3P EDPs from the legislated model (or utilise a joint and several liability notice mechanism discussed in chapter 4) (Alibaba, eBay and Etsy 2017). This would result in imported goods from small foreign suppliers not being subject to the GST, while imported goods from suppliers over the \$75 000 threshold would be, creating equivalence with domestic supplies.

An alternative option is to move in the opposite direction, bringing small domestic vendors into the GST system by applying the EDP rules to domestic goods alongside imported goods. This would mean that the EDP would collect GST on *all* sales to consumers in Australia, regardless of whether the low value goods were domestic or imported, unless the vendor provides an ABN and is registered for GST. By collecting GST on both domestic and imported goods from small vendors, this would equalise their treatment. However, it would also be a significant departure from the domestic GST system and entail other potentially large costs.

Would small vendors leave the platforms?

The differentiated treatment of EDPs also create incentives for small-scale vendors to leave the platform and establish their own website, so as to sell directly to consumers in Australia and benefit from the \$75 000 threshold. This prospect was raised by eBay, which noted that ‘these sellers will have no incentive whatsoever to continue using these marketplaces’ (eBay 2017b, p. 2).

The significance of this incentive is easy to exaggerate. Vendors gain substantial market exposure from using an EDP, which they would struggle to achieve through their own website. The 3P platforms also offer other benefits to small business, as highlighted in the submission from the Aegis Consulting Group, including research and analysis of data about consumer spending and preferences; administrative support to lower the cost of transactions; and a reliable digital shopfront (sub. 25 attach., p. 48).

Rather than abandon the EDPs en masse, a more likely outcome is that small vendors will use the EDP as an advertising platform, rather than a sales platform, with the vendor directing any prospective buyers to their own website for a (roughly) 10 per cent price discount. However, there are already strong commercial incentives for vendors to do this, as most EDPs charge a fee for transactions concluded on the EDP. While those incentives would be heightened under the legislated model, the EDPs also have strong incentives to crackdown on any vendor attempting this ruse.

3.5 Impacts on businesses

Compliance costs

In tax policy design, a key issue is the size of the compliance burden on businesses or individuals (chapter 2). Under the legislated model, foreign suppliers will incur compliance costs because of their responsibility to register for, assess collect and remit the GST on low value imported goods.

Often, these costs will be lower than they would be for Australian firms, as most foreign suppliers can opt for ‘limited registration’, rather than the full GST registration that is required for domestic suppliers. The limited registration system involves reduced reporting and administration requirements, as well as fixed quarterly reporting periods, to make registration and compliance as simple as possible. In exchange, foreign suppliers are not permitted access to input tax credits, which are generally unnecessary for businesses operating overseas anyway (as their Australian inputs are limited) (Australian Government 2017c).

Nonetheless, the compliance costs for foreign suppliers will remain considerable, due in part to complicated criteria to determine the taxable status of the sale, which suppliers are required to assess each time they sell a good bound for Australia. Even though software will

do much of this decision-making automatically, it can be an expensive up-front cost and each additional step in the process adds another layer of complexity that the software must work through. Integrating updated software into a supplier's existing business systems and ensuring it is robust to handle a range of scenarios further add to the compliance burdens.

Existing features of the GST also create burdens for both domestic and foreign suppliers. Examples include the need to determine whether the good is GST-free (such as some food and health products) or input-taxed (such as precious metals) before charging GST. Several inquiry participants, including Amazon (sub. 35, p. 18), James (sub. 28, p. 5) and Gonsalves (sub. 7, attach., pp. 11-12), highlighted these complexities. These costs could be avoided (for both domestic and foreign suppliers) if the GST was less complex, including by having fewer exemptions.

Another compliance impost unique to foreign suppliers is a requirement to differentiate between sales to businesses and consumers in Australia (box 3.7). This provision is identical to the one in the vendor collection model for imported services and digital products. The exemption for B2B supplies is justified by the risk of 'missing trader' fraud — where foreign suppliers charge GST on their sales to Australian businesses, but fail to remit the collected GST to the ATO. This practice could result in a net revenue loss for the Government.¹¹

Box 3.7 B2B or not B2B — exempting business supplies

Under the legislated model, most suppliers will be required to ask for a customer's ABN at the time of sale, as well as a declaration that the customer is registered for GST. If this information is provided, the sale would then be exempt from GST as a business-to-business (B2B) sale.

To give an idea of the magnitude of this exemption, there is some limited information available on the proportion of B2B supplies among low value imported goods. For air cargo, the PC (2011, p. 180) and the LVPPT (2012, p. 33) estimated using CAPEC data that the proportion of B2B supplies ranged from 30 to 60 per cent (by value) in 2011. Similarly, CIE estimated (using updated CAPEC data for 2015) that, on average, 37 per cent of low value goods (by value) are destined for businesses (2016, p. 21).

In international mail, it seems likely that the proportion of business imports is lower, but adequate data are more difficult to come by. The Commission has previously noted this issue, stating in 2011 that the 'proportion of business parcels arriving through international mail will probably be lower, but there are no data on this' (2011, p. 179). The Commission at the time assumed that the proportion of B2B supplies in international mail was around 10 per cent (2011, p. 181).

¹¹ Missing trader fraud has already been identified as a significant problem for intra-European Union trade (see for example European Union Committee 2007), with Europol estimating that it costs European revenue authorities around €60 billion each year (2017).

Dual GST collection systems

A core characteristic of the legislated model is that it operates as an expanded vendor collection system for low value imported goods (which are ‘taxable supplies’), alongside the pre-existing border collection model for high value imported goods with a customs value of over \$1000 (which are ‘taxable importations’). These different collection mechanisms for imported goods, based on their values, lead to risks of either unintentional double taxation (by both systems) or non-taxation (by neither system) in some circumstances.

The legislation tries to prevent these instances of friction between the two collection systems by making the legislated model deferential to the existing border collection model for high value goods. Where the systems may be in conflict (or the foreign supplier has a ‘reasonable’ belief that they will be), suppliers are required not to apply the GST at the time of the sale. The secondary treatment of the legislated model can interact to increase the compliance burden on foreign suppliers, notably for goods near the \$1000 threshold. There are two reasons for this.

First, under the legislated model, imported goods sold by foreign suppliers are only taxable if they are low value. This means that, unlike domestic suppliers, foreign suppliers are required to determine whether the customs value of the goods is A\$1000 or less¹² before applying GST to the total value of the sale. Two separate calculations are therefore required: one to determine the customs value of the goods, and another to determine the taxable value of the goods (the ‘consideration for the supply’) (box 3.8).

Box 3.8 **Calculating the value of imported goods**

Typically, the customs value of goods sold by foreign suppliers will be determined by using the GST-exclusive transaction value of the goods, expressed in Australian dollars. However, adjustments to this value may apply:

- any amount that was included in the price for freight and insurance from the place of export to the Australian address must be removed
- any Australian administrative costs upon importation (such as brokerage fees) must also be removed
- foreign inland freight and insurance charges incurred to get the goods to their place of export must be added to the price
- foreign sales taxes are to be included in the price (ATO 2017e).

Once the goods are determined to be low value, a separate calculation is then technically needed to determine the consideration for the supply — the value on which the GST must be calculated. In particular, freight and insurance costs in transporting the goods to Australia are normally charged GST (ATO 2017e).

¹² Unless the goods are alcohol or tobacco products, in which case they are always taxed at the border.

The second reason is because foreign suppliers are required to take ‘reasonable steps’ to obtain a ‘reasonable belief’ about whether or not the low value goods will be consigned to Australia as a high value good (which are taxable importations). This involves determining, at the time of sale, if goods purchased by a consumer in Australia are likely to be shipped to Australia in a single consignment with a combined customs value of over \$1000. If this belief is held by the supplier, it is required to treat the goods as non-taxable (and so not apply the GST at the time of the sale), leaving GST collection for the existing border processes.

Compliance costs estimates

Assessing the likely magnitude of the compliance burden is difficult, but some estimates exist. The ATO claimed the costs for each foreign supplier would be \$2600 for implementation and an annual ongoing compliance cost of \$400 to collect and remit the GST. Using an expected supplier population of 2500, this equates to \$6.5 million in initial implementation costs and \$1 million of ongoing annual costs (ATO 2017g).

The ATO’s estimates have been subject to strong criticism by other stakeholders. Amazon considers that the ATO’s number ‘is unrealistic for even the simplest Australian business – let alone a foreign business operating in multiple jurisdictions’ (sub 35, p. 17). It goes on to say that:

[given] the complexity of the changes needed to address the requirements described above, the ATO estimate of costs per vendor ... are very likely vastly understated even for the simplest business trading internationally. (sub. 35, p. 19)

Amazon’s own calculations of total compliance costs for all foreign suppliers are materially higher, with an estimated initial setup cost of between \$70 000 and \$140 000 per supplier, and average annual ongoing costs of between \$10 000 and \$20 000.¹³ Based on an assumption of 2500 foreign suppliers, this corresponds to initial fixed compliance costs of \$175–350 million and annual ongoing costs of \$25–50 million (sub 35, p. 20).

Another way to estimate compliance costs is to look at the costs of complying with the GST system for domestic firms, and then apply these costs to foreign suppliers (with reasonable adjustments). The CIE used this approach and concluded that foreign supplier costs are likely to be 0.7 per cent of sales and 0.5 per cent for EDPs, which equates to around \$4 million in ongoing compliance costs per year (CIE 2016).

Other research by MYOB (2015) attaches a value to the time spent on internal compliance by domestic firms. Using this as a basis suggests that annual GST compliance costs could be around \$6800 for small-to-medium-sized enterprises. Similarly, Lignier and Evans (2012) estimated the median GST compliance costs for domestic businesses at \$4718. If replicated for foreign suppliers, these estimates would equate to annual total ongoing costs of between \$11 million and \$17 million across 2500 foreign suppliers.

¹³ For its own business, by contrast, Amazon estimated its initial setup costs would be US\$2.5 million, with US\$500 000 of ongoing annual compliance costs (sub 35, p. 18).

These estimates only relate to ongoing costs, and do not include the initial fixed setup costs that foreign suppliers would have to incur. To estimate these costs, the closest benchmark available for use is the set-up costs that businesses incurred when the GST was introduced in 2000. These range from \$5427 (Tran-Nam 2000, using data collected by the Victorian Employers' Chamber of Commerce and Industry) to \$7626 (Rametse and Pope 2002) for each domestic business. Applying these figures to the 2500 foreign suppliers implies total fixed costs of compliance in the order of \$13.6 million to \$19.1 million.

An important caveat with these estimates is that they do not directly relate to the burden faced by foreign suppliers. As discussed above, there are reasons to believe that foreign suppliers would incur a higher compliance burden and other reasons to suggest the burden could be lower. This makes it difficult to gauge the precision of the available estimates for foreign suppliers. With this caveat in mind, the Commission has tabulated the bandwidth of the available estimates (table 3.1). The breadth of the bandwidth underscores the point that no precise estimates are possible.

Table 3.1 Compliance cost estimates for foreign suppliers

Ongoing or fixed set-up costs, by estimating organisation, based on 2500 suppliers

<i>Organisation providing evidence</i>	<i>Fixed set-up costs (\$m)</i>	<i>Annual ongoing costs (\$m)</i>
Australian Taxation Office	6.5	1
The Centre for International Economics	na	4
Productivity Commission ^a	15–60	10–20
Amazon	175–350	25–50

^a Commission estimates. Assumes that the annual ongoing costs outlined in MYOB (2015) and Lignier and Evans (2012) will be broadly replicated for foreign suppliers and that the fixed set-up costs calculated by Tran-Nam (2000) and Rametse and Pope (2002) are a minimum estimate for foreign suppliers.

Australian retailers

Domestic retailers should benefit from the more equal tax treatment of competing imports. However, the magnitude of this benefit is expected to be limited, since low value imports represent a small share of most retail subsectors (some segments such as bicycle parts and accessories are larger).

The introduction of the legislated model alone (or any other model) is therefore unlikely to be a panacea for the broader challenges facing the retail sector. The relative competitiveness of Australian and overseas retailers is influenced by other drivers, including non-price factors. In this regard, the Commission notes that wider benefits to the retail sector as well as the broader economy could be secured by proceeding with reforms in areas such as shopping hours, planning and zoning regulation and workplace relations (box 3.9).

Box 3.9 **Broader reforms affecting bricks-and-mortar retailers**

Regulation of retail trading hours

Retail trading hour regulations are out of step with modern patterns of work, leisure and trade. They restrict domestic employment, increase costs of doing business and reduce consumer convenience.

Trading hours are now deregulated in Victoria, Tasmania, the Northern Territory and the ACT, and largely unrestricted in New South Wales. They remain most restricted in Queensland, Western Australia and South Australia. In its 2011 inquiry into the retail sector (PC 2011) and its 2014 research report into retail industry costs (PC 2014), the Commission recommended that retail trading hours should be deregulated in those states that still set trading hours. This would help to narrow the advantage (domestic and international) online vendors have over domestic brick-and-mortar retailers.

Planning and zoning regulations

The Commission's 2014 report into retail industry costs found that depending on how planning and zoning restrictions are designed and implemented by the planning authorities they can act as a major impediment to competitiveness of the domestic retail sector (PC 2014).

Reforms to planning and zoning systems that are critical to the development of competitive markets for retail space include: broadening and simplifying business zoning to remove the need for ad hoc changes to council plans to accommodate each variation in business model; and removing consideration of the commercial impact on existing business when assessing development applications. Proceeding with reforms in these areas would contribute to lower retail rents, a major cost pressure for domestic retailers.

Workplace relations reforms

Labour costs also account for a large share of retail business costs. In fact, pressures that increase labour costs have a larger impact on total costs and profits than in most other industries. In 2015-16, a 5 per cent increase in wages and salaries in bricks-and-mortar retailing would decrease profits by around 13 per cent.^a

Penalty rates for Sundays are the most prominent pressure on retail costs. They have two effects, akin to a double-edged sword. When a retail outlet is open on a weekend, they inflate domestic costs, and if instead of incurring high costs they remain closed, a consumer can still shop and purchase goods from an online vendor.

Workplace laws also affect the flexibility and costs of the retail sector (and businesses more generally) in more subtle ways. Procedural rules in unfair dismissal law and in approving enterprise agreements when poorly designed can act as frictions to the orderly management of businesses. There are also barriers to the adoption of Individual Flexibility Arrangements, which provide scope for considerable benefits to employers and employees alike.

The Productivity Commission made recommendations to address these and other problems with Australia's workplace relations system (PC 2015). On penalty rates the Fair Work Commission determined (consistent with the Commission's recommendation) that retail penalty rates for Sunday work would fall progressively from 200 per cent to 150 per cent by 2020 — to be in parity with Saturday rates. For the other recommendations in the Commission's Workplace Relations report, the government has yet to issue a formal response.

^a Commission estimates based on ABS (*Australian Industry, 2015-16*, Cat. no. 8155.0, table 2).

For those Australian suppliers that currently engage in ‘offshoring’ — warehousing goods overseas and consigning them directly to consumers as sales are made — the introduction of the legislated model will disrupt their business model, preventing them from gaining a price advantage over other Australian businesses that pay GST on domestic sales.

3.6 Impacts on consumers

While the statutory incidence of the legislated collection model falls predominantly on businesses, ultimately consumers in Australia will bear the economic incidence of the tax and its associated compliance burdens. This will generally manifest through higher prices for low value imported goods, in the order of 10 per cent. 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 stakeholders raised concerns about the erosion of consumer protections (box 3.10). Others highlighted the (albeit small) risk of double taxation associated with operating a vendor collection system for low value imported goods alongside a border collection system for high value goods (box 3.11).

It is difficult to determine the magnitude of these imposts on consumers, as there is no precedent for the legislated model. In practice, they will depend on how frequently such errors occur and the nature of the processes in place to manage these issues if and when they occur. It is one of many aspects to monitor once the legislated model is in force.

Box 3.10 Online shopping protections

Several submissions contended that implementing the legislated model would result in more consumers purchasing goods from less reputable online suppliers, which are not only non-compliant with the legislated model, but also do not offer the same consumer rights and protections.

Davidson (2017, p. 13) suggests that the legislated model ‘is likely to expose Australians to darker elements of the internet’, while the submission by Berg and Davidson argues that:

The tax will lead to Australian consumers substituting away from large reputable electronic distribution platforms to more disreputable platforms leading to higher rates of internet fraud and possibility [sic] criminality. Product safety and consumer protection rights are likely to be compromised. (sub 33, p. 2)

Similarly, Amazon noted that the legislated model ‘creates real concerns for Australian consumers in respect of the safety and quality of goods they purchase, as well as increased risks of engaging with fraudulent vendors / marketplaces’ (sub 35, p. 15).

However, the extent to which consumers would be willing to sacrifice their consumer protections to avoid the GST on their low value imports is unclear. Such actions would come with their own unique costs and risks for consumers, which may well outweigh the approximately 10 per cent price impost of the GST.

Box 3.11 The limited risks of double taxation

The dual collection systems can create opportunities for unintentional double taxation in some limited circumstances, such as:

- if a foreign supplier collects GST on a sale of multiple low value goods to a consumer in Australia, but then chooses to transport them together in a consignment valued above the low value threshold, such that it becomes liable for GST on importation
- if the currency fluctuates between the time of purchase and importation, such that a good is under the low value threshold when purchased (so is taxed by the foreign supplier), but is then over the threshold when imported (so is taxed again at the border).

In most of these circumstances, a mechanism is available at the border to prevent double taxation. Full import declarations can use a 'GST paid' exemption code to exempt the relevant items within the consignment from any GST owing at the time of importation (although not from any customs duty or border processing charges).

However, this exemption code is unlikely to prevent all circumstances of double taxation, due to errors (such as consumers not realising that double taxation is imminent) or because adequate proof of GST paid is not provided to enable the use of the exemption code. In these cases, neither the ATO, DIBP nor Australia Post are legally able to provide the consumer with a refund for the GST paid at the border.

Where instances of double taxation do occur, the consumer (or business) is required to seek a refund of GST directly from the foreign supplier. This requirement is likely to frustrate consumers, involving back-and-forth communication with the supplier and the need to send adequate proof of GST paid at the time of importation to justify a GST refund.

3.7 Trade matters

A few stakeholders have commented that the legislated model is tantamount to a breach of Australia's international treaty agreements, as it adds unduly to the cost of trade, or inconsistent with broader trade policy goals. For instance:

- the Aegis Consulting Group stated that the legislated model 'may be contrary to the principles in the General Agreement on Tariffs and Trade 1994 which treat such actions as non-tariff barriers to trade' (sub. 25 attach., p. 15)
- the Australian Taxpayers' Alliance and MyChoice asserted that the legislated model is 'contrary to international trends towards trade liberalisation' and would affect Australian consumers through the 'loss of foreign trade opportunities' (sub. 29, p. 1)
- Berg and Davidson claimed that the 'tax is inconsistent with the government's commitment to ... the promotion of international trade' (sub. 33, p. 1).

The key trade issue is whether the legislated model breaches the World Trade Organisation's national treatment provision, which requires that imported products not be treated less favourably than 'like' or 'directly competitive or substitutable' domestic products (chapter 2). As long as it treats foreign suppliers and their imported goods the same as

domestic firms and locally produced goods, the legislated model would not be a barrier to trade.

At a high level, there are good reasons to consider the model compliant with Australia's international trade agreements. Taxed goods will still cross the border as non-taxable importations and there will not be added delays at the border. Moreover, the legislated model extends Australia's taxable supply system to foreign suppliers by applying domestic tax treatment to imported goods (including the same tax rate and all of the associated rules and exemptions).

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 by a small supplier (discussed in section 3.4), and the additional compliance costs imposed on foreign suppliers (discussed in section 3.5) may also pose risks.

Reciprocal actions

Many submissions to this inquiry expressed concerns about the possible repercussions on small Australian exporters from the adoption of the legislated model. For example:

- the FTA stated that it 'hopes that the Australian Government has engaged in discussions with our key trading partners, in relation to the introduction of this tax regime, to ensure that we are not exposing our export businesses to retaliatory trade measures.' (sub. 34, p. 6)
- the Australian Taxpayers' Alliance and MyChoice contended that the legislated model 'is likely to result in a range of adverse impacts including ... potential tariff retaliation from our trading partners' (sub. 29, p. 1)
- eBay, Alibaba and Etsy claimed that the legislated model 'invites a response from other nations and will ultimately be damaging to Australian productivity, consumers and small businesses' (sub. 25, p. 2). Their supporting report from Aegis Consulting Group also stated 'it would be a perverse outcome if the Australian administrative apparatus resulted in retaliatory administrative regimes by our trade partners/competitors such that Australian small businesses faced new nontariff barriers against their desire to build export markets.' (sub. 25 attach., p. 22).

Not all these 'reciprocal' actions would have adverse effects for Australia. For example, other countries increasing their low value thresholds (LVTs, also known as *de minimis* thresholds) alongside collecting GST (or value added tax — VAT) from Australian exporters could be beneficial, to the extent it reduces border delays and administrative burdens for overseas consumers (box 3.12).

Box 3.12 Not all reciprocal actions are punitive

Currently, many LVTs overseas are significantly lower than the \$1000 threshold in Australia — including a £15 threshold in the United Kingdom and a €22 threshold in the European Union (OECD 2015, pp. 217–218). As a result, goods exported by Australian businesses are often already taxed equivalently using the traditional border collection model, with the foreign consumer bearing the (often considerable) compliance costs and associated border delays. As the submission from Anna's Farm notes:

Our experience with sales to the EU is that our small parcels are often stopped by EU Customs and Custom's charges and value added taxes end up doubling the cost of our product to our customer which makes it unaffordable. (sub. 2, p. 1)

Hence, if the reciprocal action by other jurisdictions involved implementing a collection model similar to the legislated model and increasing their LVTs, this could help Australian exporters, by reducing border delays and administrative burdens for Australian goods, making them more competitive.

Further, if Australia's model became the international standard, large businesses with significant cross-border sales would be more likely to comply with Australia's system. International uptake could also improve cooperation between the ATO and its counterparts in other jurisdictions on matters of tax administration.

However, in other ways, small-to-medium-sized businesses are concerned about the prospect of other countries adopting the same model as Australia. For example:

- Anna's Farm contended that '[i]f by retaliation the USA was to instigate this charge how would small Australian businesses cope with each state in the US having their own state taxes?' (sub. 2, p. 1).
- Robert Clark argued that '[t]here are approximately 196 countries in the world, and many more taxing jurisdictions. If they apply the same policies, then every Australian exporting entity (i.e. person, small company, or large company) would be required to research and then possibly assess, collect, and remit a tax on exports.' (sub. 1, p. 1)

A requirement for Australian exporters to familiarise themselves with foreign indirect tax laws would be exceedingly onerous. But if Australia's model is adopted elsewhere, the minimum turnover threshold and inclusion of EDPs would also apply. This means that small Australian exporters with a limited presence in the other market are unlikely to have to register for VAT or GST collection themselves, while any EDPs involved would incur most of the compliance charge. However, these burdens could still be passed on through changes in the fees that EDPs charge Australian to exporters.

4 Potential improvements to the legislated model

Key points

- The two main areas of uncertainty regarding the efficacy of the legislated model relate to enforcement and the size of the compliance burden.
- In the event that the legislated model does underperform in these areas, the Commission has identified some adjustments to the design of the model that aim to strengthen enforcement and contain the compliance burden.
- In particular, if the level of compliance achieved falls short of expectations, possible improvements that warrant further examination include:
 - stopping non-compliant goods at the border and charging GST to the purchaser, where it is cost-effective to do so
 - a targeted approach to requiring foreign suppliers to appoint ‘resident agents’, and obtaining security deposits from them
 - using adverse publicity for non-compliant suppliers (‘name and shame’ powers).
- If, on the other hand, the legislated model exceeds expectations and attains high rates of compliance, there could even be merit in extending the model to high value imported goods. Concomitant reform to customs duties should also be considered.
- These options have their own costs and complications and some also have broader ramifications on the tax system and in other policy domains. Further analysis, consultation and testing is needed before any could sensibly be endorsed or implemented.

This chapter canvasses some potential changes to the legislated model that could improve its effectiveness, strengthen enforceability and reduce compliance costs. The options covered are drawn from stakeholders’ suggestions, approaches used abroad, and the Commission’s assessment of the legislated model’s strengths and weaknesses (chapter 3).

The options are grouped under three headings and relate to backstopping the legislated model with border collection processes (section 4.1), expanding the Australian Taxation Office (ATO) enforcement toolkit (section 4.2), and simplifying interactions between the border collection system and the legislated model (section 4.3).

Given the restricted timetable for this inquiry, the Commission has not been able to fully analyse the options or test them among stakeholders. Further, since some options have broader ramifications, they would require additional analysis and consultation before any could sensibly be endorsed or implemented. The Commission envisages the anticipated reviews of the legislated model (box 4.1) as an opportunity that should not be let go to,

among other things, review and evaluate prospective improvements to the vendor collection model.

Box 4.1 Anticipated future reviews

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

A post-implementation review

A post-implementation review (PIR) is required within two years, due to the absence of a regulation impact statement prior to announcing the measure (OBPR 2015). The legislated model's PIR should provide an early indication of the model's efficacy — particularly the extent of collection rates and compliance costs. It could also consider whether any measures are warranted to strengthen compliance with the model, particularly if early signs suggest compliance is poor.

A longer term in-depth review

The 2016-17 Budget stated that the legislated model's arrangements 'will be reviewed after two years to ensure they are operating as intended and take account of any international developments' (Australian Government 2016). Given the PIR is required within two years, it would be reasonable for the in-depth review to not take place until five years after implementation (unless exceptional circumstances arise that warrant bringing it forward). This would provide certainty, demonstrate commitment to the model, enable sufficient time to gather evidence and allow overseas developments to proceed (particularly the introduction of an optional vendor collection model for extra-European Union imports in 2021, and the compulsory provision of electronic advance data on all international mail items).

4.1 Backstopping the legislated model with border collection processes

Many stakeholders expressed the view that the ATO will struggle to enforce the legislated model because it applies principally to foreign suppliers, which are beyond the Australian legal system's direct reach (chapter 3).

Improving compliance with the model means ensuring that foreign suppliers remit what they owe, or making it difficult for them to continue trading into Australia while they are non-compliant. Most of the options discussed in this section and section 4.2 attempt to do one or both of these. They could be evaluated on their own merits or as elements of a package.

The suggestion on how to improve compliance most commonly proposed by stakeholders is for customs authorities (or transporters) to detect imports from non-compliant foreign suppliers during entry to Australia, and charge the GST to the purchaser. The Chamber of Commerce and Industry Queensland (sub. 27, p. 2) suggested that the legislated model 'could be augmented to include elements of the border collection model'. The Australian Sporting Goods Association also supported this approach, although it added:

While we believe the ‘border model’ is best placed to act as the extra enforcement mechanism to the ‘vendor registration model’, we are not opposed to the idea that transporters are also involved in some way, or even take the place of the ‘border model’. (sub. 15, p. 2)

A comprehensive approach would be problematic

In principle, back-up schemes of this type should incentivise compliance and ‘catch’ goods from non-compliant suppliers. In practice, however, customs authorities (or transporters) will find it difficult to distinguish between compliant and non-compliant goods at the border. The Australian Sporting Goods Association envisaged the following mechanism for this:

Where an overseas retailer does register for GST, they would then go on a list that is given to Customs and Australia Post. Goods from those suppliers would be earmarked as having paid GST and so would not be stopped at the border. However, an overseas retailer that has not registered for GST (and who therefore hasn’t charged GST at the point-of-transaction) doesn’t go on that list. Therefore, their goods will be stopped at the border and Customs (or Australia Post) will require the consumer to pay the GST when they pick up those low value goods (sub. 15, p. 2).

For goods transported through the cargo stream, identifying registered suppliers from a list could be relatively straightforward. A first indicator would be the lack of a vendor registration number in the incoming cargo report.

By contrast, for international mail items, the vendor registration number will not be documented, and the patchy nature of item-level electronically reported data (known as electronic advance data — chapter 5) would necessitate the costly manual inspection of supplier details on many items. The data that are available are not generally used for customs clearance purposes, although Australia Post (sub. 37, trans. p. 124) is working with the border agencies to develop an interface to share data.

Even where a supplier’s registration status can be ascertained, more fundamental shortcomings would undermine this hybrid approach. Registration does not necessarily indicate compliance, as a supplier may register but not remit (or only partially remit) the GST. Equally, non-registration by foreign suppliers does not prove non-compliance because, under the legislated model:

- no GST is due on goods from foreign suppliers that fall below the GST registration threshold (\$75 000)
- no GST is due on business-to-business (B2B) items (or GST-exempt items), regardless of whether the foreign supplier is registered, and it would be unclear whether items from non-registered suppliers would be for personal or business use.

Stilling (sub. 3) and Premier Investments (sub. 39) proposed more substantial changes to the legislated model (box 4.2) that go some way towards avoiding these issues. However, their solutions would increase the administrative and compliance burden of the model, and do not fully resolve the shortcomings listed above.

Box 4.2 **Other proposals that could backstop the legislated model**

Stilling's proposal

Stilling (sub. 3) proposed a model with three potential collection 'layers' — optional collection by the foreign supplier (termed the 'supplier assessment system'), optional collection by the transporter (termed the 'carrier assessment system') and backstop collection at the border. The collection of GST and customs duty would be facilitated by the use of revenue stamps, which were used for the collection of various taxes and duties in Australia prior to 1994.

The core elements of the model are as follows:

- Suppliers and transporters that wish to participate would register and purchase revenue stamps.
- Optional vendor collection: After assessing items for GST, participating suppliers would affix the required quantity of stamps to the item before passing it to the transporter.
- Optional transporter collection: If an item is unstamped or not sufficiently stamped, participating transporters could affix their revenue stamps. They would recover the GST from the purchaser prior to delivery, with a handling fee included.
- Backstop border collection: If an item is still unstamped on arrival at the border, it would be subject to a border collection process.

While the use of revenue stamps would allow for clearer identification of items on which GST has been paid at the border, it would introduce additional compliance burdens and delays. Both the acquisition and application of the stamps by the vendor and/or the transporter, and the consequent assessment by the transporters and/or the Department of Immigration and Border Protection, would involve significant manual effort. It would also require the establishment of a global stamp distribution network and measures to prevent forgery and undervaluation. Moreover, the legislated exemption for suppliers with annual turnover of less than \$75 000 would be difficult to manage under the Stilling proposal.

Stilling suggested that the model could be implemented within 3 months, with an extension to collect for higher value goods 12 months after commencement.

Premier Investments' proposal

Premier Investments (sub. 39) proposed an augmentation where registered suppliers would apply unique barcodes to their items that would be scanned on entry into Australia. This could allow for item-level auditing, which will not be possible under the legislated simplified GST registration system (chapter 3).

As with the Stilling proposal, Premier Investments' proposed augmentation (although closer to the legislated model) would increase the administrative and compliance burden on foreign suppliers and at the border. It is also unclear how the legislated exemption for suppliers with annual turnover of less than \$75 000 would be handled.

In light of these practical constraints, the Commission considers that a comprehensive backstop augmentation to the legislated model would be infeasible or at least disproportionately costly to administer. Moreover, it risks leading to significant delays at the border, especially for goods transported by international mail.

A targeted approach could be more feasible

An alternative option to improve compliance would be to implement a supporting border collection mechanism targeted at foreign suppliers that are known to be persistently non-compliant (rather than non-registered). This could be cost-effective provided offending items can be easily identified and isolated at the border without disrupting the movement of other items. This in turn suggests it would be most viable for large foreign suppliers.

However, it is not clear that the approach would pinpoint the actual sources of non-compliance and prove successful. This is due to several factors:

- Large foreign suppliers present less of a compliance risk (chapter 3).
- Targeted foreign suppliers may respond by obscuring their items — for example, by changing the details inputted in the sender field.
- Implementation challenges linked to the paper-based processes still in place for most international mail items.

For international mail items, a more feasible approach could be to implement random sampling exercises to check for items from identified non-compliant suppliers, although it may also be more costly and produce less ‘bang for buck’ than a targeted process for the cargo stream.

The Commission’s view is that stopping non-compliant goods at the border and collecting the GST from purchasers on a limited and targeted basis should be considered as an option (among others) in the future, but only if clear and significant patterns of non-compliance emerge and a cost-effective mechanism to do so can be developed.

4.2 Expanding the ATO enforcement toolkit

The ATO (sub. S3) has developed a multifaceted strategy to assure compliance with the legislated model that includes:

- undertaking communications initiatives in key international markets
- publishing guidance and advice
- profiling and engaging with affected businesses
- providing direct support to the largest, most influential businesses, electronic distribution platforms and redeliverers.

The ATO also has some existing mechanisms to enforce compliance — including the use of bilateral and multilateral tax treaties, garnishee notices and website blocking (discussed in chapter 3).

This suite of instruments, in combination with the ATO's expertise in domestic GST administration and the reputational incentives for foreign suppliers, should reduce the downside compliance risks associated with the legislated model (chapter 3). Moreover, the ATO will be able to refine and better target its compliance strategy as it learns more about how foreign suppliers are applying (or failing to apply) the measure.

However, if the ATO's enforcement strategy does not deliver adequate compliance, there would be a case to consider additional enforcement options. This section canvasses four:

- the power to mandate the appointment of resident agents
- the use of name and shame powers
- financial transaction blocking
- making electronic distribution platforms (EDPs) 'jointly and severally' liable for ensuring that vendors selling via their platforms are registered.

The Commission is aware of other options, such as the United Kingdom's fulfilment house due diligence scheme (HMRC 2016a) and Gonsalves' (sub. 7) suggestion to give the ATO power to make a claim against the goods. And there are broader questions about whether international tax cooperation treaties should be bolstered, and what Australia might do in this realm. However, the Commission has not further pursued these issues.

Appointment of resident agents

A number of countries require foreign suppliers to appoint a resident agent as a condition for supplying goods that are subject to GST (or value added tax — VAT) into their jurisdictions. These countries include China, Iceland, Japan, and half the member states of the European Union. Depending on the country, the resident agent may be liable for the GST of the foreign supplier. Some countries also require the foreign supplier or the resident agent to provide a security deposit or bank guarantee to mitigate against the foreign supplier reneging on their GST liabilities.

Appointment of a resident agent and requiring a security has the following advantages:

- the resident agent is more likely to be familiar with the GST laws of the jurisdiction
- the revenue authority will have an entity upon which it can readily enforce the law
- the resident agent can readily respond to queries from the revenue authority
- requiring a security deposit/bank guarantee ensures that the revenue authority will have access to funds to meet (even if only in part) the GST liability.¹⁴

¹⁴ The Australian Tax Commissioner already has the power to require a security deposit from taxpayers if the circumstances warrant it (Subdivision 255-D of the *Taxation Administration Act 1953* (Cth)).

In Australia, it is not mandatory for foreign suppliers to appoint a resident agent in order to make taxable supplies into Australia. The GST legislation does seek compliance through resident agents who act for a foreign supplier in making supplies into Australia, but the legislation does not enable the ATO to compel entities to appoint a resident agent. Now that the legislated model includes foreign suppliers for the purposes of collecting GST on low value goods, and the challenges this entails, there are potential benefits in the ATO being able to compel foreign suppliers to appoint resident agents.¹⁵

However, mandating that foreign suppliers appoint a resident agent could add to compliance costs of doing business and may discourage foreign suppliers from selling to the Australian market. Further, it may be difficult to get an Australian firm to act as the representative agent if it is to be held liable for the GST on supplies made by the foreign supplier into Australia where the resident agent is not directly involved in the importation.

A more targeted approach may be preferable.

- Instead of a mandatory requirement, the ATO could have a *discretionary* power which it could use against persistently non-compliant foreign suppliers. This is in line with the United Kingdom's approach adopted in 2016, when Her Majesty's Revenue and Customs (HMRC) was given *discretionary* powers to compel foreign suppliers to appoint a resident agent if there is a risk of non-compliance (HMRC 2016b).
- The liability of the resident agent could be limited to the amount of a specified security deposit/bank guarantee (which needs to be set at a level sufficient to deter non-compliance). The foreign seller would remain liable for the balance of the amount payable that is not met by the bank guarantee.

A more targeted approach to appointing representative agents and requiring security deposits may be a line of further inquiry for the Government, if the ATO's ability to enforce the legislated model needs bolstering.

'Name and shame' powers

Some jurisdictions use 'name and shame' powers to encourage tax compliance from persistently non-compliant entities, in the expectation that the commercial or reputational damage will encourage compliance. Countries such as Finland, Sweden and Norway publish tax information on both businesses and individuals (Devos and Zackrisson 2015). And in the United Kingdom, details of deliberate tax defaulters (including individuals) are published periodically (HMRC 2017c).

In Australia, the ATO must comply with strict provisions in the *Taxation Administration Act 1953* (Cth) and other relevant privacy laws before disclosure of protected taxpayer information is possible. Trust that the ATO will treat tax information confidentially helps to foster

¹⁵ In 2010 the Board of Taxation decided against allowing a resident agent to appoint a tax representative. This decision was made in the context that foreign suppliers not be drawn in unnecessarily into the GST system.

voluntary compliance. However, since 2013, the ATO has been required to publish information including the total income and taxable income of certain businesses, in part to discourage aggressive tax avoidance (Australian Government 2013).

In the context of the legislated model, giving the ATO new ‘name and shame’ powers might be an attractive enforcement tool. Given the compliance difficulties in relation to foreign suppliers beyond the direct reach of Australia’s legal system, it could provide a large deterrent for non-compliance at relatively low cost. Major suppliers are particularly likely to be sensitive to risks to their reputation. It also provides transparency to the domestic retail sector and Australian consumers on which foreign suppliers are not complying with the measure.

However, a ‘name and shame’ power can also be an imprecise instrument that may have unintended results.

- There is a possibility that a list of non-compliant suppliers can act as free publicity for those businesses, alerting consumers to suppliers that can offer lower prices than their compliant rivals, helping to boost their sales rather than penalise them.
- The list may not be effective if the supplier’s non-compliant status was not widely known amongst consumers (although the ATO could work to promulgate information on non-compliers to Australian consumers).

This highlights that naming and shaming can, in its effects, penalise similar breaches quite differently, depending on how the information spreads and how consumers respond.

This option may have more value if there were stronger enforcement mechanisms in place to deter consumers from using the foreign suppliers that appear on the list (for example, the risk that the delivery of their goods will be delayed or they will be liable for the GST). Any consideration of this option would also need to take account of the broader implications on taxpayer confidentiality and its impact on the tax system more generally.

Financial transaction blocking

An enforcement measure that may become feasible in the longer term is financial transaction blocking of non-compliant foreign suppliers. This involves directing banks and other financial intermediaries to stop processing payments made to entities that are in breach of tax laws.

This mechanism has been proposed mostly in the context of curbing problem online gambling. For example, the now lapsed *Interactive Gambling Amendment (Sports Betting Reform) Bill 2015* included a provision giving the Federal Court power to issue injunctions to block financial transactions to prohibited gambling merchants.

However, there are practical difficulties associated with this option. Some industry stakeholders have argued that banks and financial intermediaries could find it difficult to

identify the relevant financial accounts that need to be blocked, and any blocks could be easy to circumvent (box 4.3).

Even if financial transaction blocking were technically feasible, this mechanism would be especially problematic as a means of enforcing the legislated model, as it would block payments to the foreign entity from all transactions, not just those related to its sales of low value imported goods. This raises proportionality issues and, with limited tax revenue at stake, its recurrent use would be excessive.

These concerns should be revisited if financial transaction blocking is to be considered as an additional means of enforcing the legislated model.

Box 4.3 Difficulties with financial transaction blocking

During the Senate inquiry into the *Interactive Gambling Amendment (Sports Betting Reform) Bill 2015* by the Senate Environment and Communications Legislation Committee, the Australian Bankers' Association raised concerns about the efficacy of blocking financial transactions. In particular:

- prohibiting transactions based only on a name is not possible and banks and authorised deposit-taking institutions (ADIs) would need account number(s) and/or beneficiary details;
- unless account number(s) and/or beneficiary details are provided, banks and ADIs will not be certain that they have the correct information and therefore would not be able to block a transaction;
- internet gambling services may create and maintain accounts in multiple names and merchant ID numbers thereby limiting the effectiveness of financial blocking;
- the implementation of a new compliance obligation to block transactions from a customer's bank account would involve the development of significant systems which would have an impact on the cost and efficiency of banking and payment systems ... (SECLC 2017, p. 31)

Sportsbet Pty Ltd also contended that this mechanism can be circumvented by measures including the use of foreign bank accounts or alternative payment methods that do not use the same identifications or classifications (e.g. merchant ID as used by established financial intermediaries), and/or the use of non-traditional payment systems like e-wallets.

Sources: SECLC (2017); Sportsbet (2016).

EDPs being responsible for unregistered vendors using their platforms

As noted in chapter 3, third-party (3P) EDPs (particularly eBay, Alibaba and Etsy) argue they will face difficulties implementing the legislated model under their existing business structures, as they 'do not distribute or supply tangible products and [their] business models do not support the collection or remittance of GST' (sub. 25, p. 1). These EDPs have consistently argued that these issues could be avoided if they were exempted from the legislated model (through restricting the scope of the EDP provisions), and have warned that they may disable imports to Australians using their platforms should the model proceed.

As an alternative to restricting the scope of the provisions, eBay, Alibaba and Etsy have suggested the use of a joint and several liability (JSL) notice mechanism, similar to an existing mechanism in the United Kingdom (sub. 25). While this option still carves out 3P platforms from legal responsibility for collecting the GST, it does entail some additional reporting and compliance activities, which could assist the ATO in its enforcement efforts (box 4.4).

Box 4.4 Joint and several liability notice mechanism for EDPs

Under the United Kingdom's (UK) joint and several liability (JSL) notice mechanism, vendors using an EDP are required to register if their sales are over the VAT registration threshold. Where these vendors are not compliant, EDPs have 30 days to make the vendor comply or to remove the vendor from their platform. If the EDP fails to take action within this period, then the platform may become liable for the VAT on any sales made by the vendor ('joint and severally liable').

The UK found that since implementing the measure, there has been a substantial increase in the number of registered foreign suppliers — from 700 in 2015 to 17 537 as of August 2017. As at September 2017, the UK has issued approximately 400 JSL notices to platforms and all the vendors have been removed from the platforms.

The UK Parliament's Public Accounts Committee is currently conducting an inquiry into measures to tackle online VAT fraud and error, including the use of the JSL notices. The Committee was advised by representatives from HM Revenue and Customs (HMRC) that, despite the large increase in registrations, the JSL notice measure brought in only £50 million in additional VAT payments in the last year (a small fraction of the annual VAT gap from online sales).

A constraint with the UK approach is that it has to detect non-compliance and enforce payment, which is difficult where vendors are removed from platforms. A participant in the UK Parliamentary inquiry stated that:

The problem with this rule is that HMRC has to spot the fraud first, then issue a notice, then Amazon or eBay has the choice of removing the seller and if it does, it avoids the liability. In my view, no one is ever going to be liable, and HMRC will never get the VAT back because the VAT evaders run off. (Richard Allen, quoted in Public Accounts Committee 2017, p. 5)

Sources: HMRC (2016b); National Audit Office (2017); Public Accounts Committee (2017).

However, a JSL mechanism is not without drawbacks. For one, detecting non-compliance would be more resource intensive, as a multitude of individual vendors would be liable, rather than just a few platforms. The Government would also collect less revenue under a JSL mechanism, as small suppliers using EDPs would no longer be captured. Where large vendors using an EDP are found to be non-compliant, the Government may also face difficulties enforcing collection and remittance on these vendors (as the United Kingdom's experience shows), because the EDP can simply remove the vendor from its platform to avoid the GST liability.

4.3 Simplifying interactions between the border and the legislated models

Another way to encourage compliance with the legislated model is to reduce the compliance burden for foreign suppliers, including by making the system easier to navigate. Fewer compliance burdens also means a reduction in the costs passed back to consumers.

For foreign suppliers, complexity will be created by the operation of two GST collection systems for imported goods sitting alongside each other — one for low value goods (the legislated model) and one for high value goods (the traditional border collection model). The legislated model aims to avoid many of the frictions that this situation would create (particularly instances of double taxation) by making it deferential to the border collection system for high value goods. In doing so, however, it introduces a range of checks and balances that impose compliance burdens on foreign suppliers (chapter 3).

There are several options available to the Government to reduce these burdens. These range from increasing the low value threshold (LVT), to merging the dual collection systems, to even supplanting border collection with the legislated model.

Increase the low value threshold

The simplest option would be to increase the LVT, thereby expanding the range of goods defined as ‘low value’ for GST purposes (as well as for customs duties, border processing charges and reporting requirements). These newly defined ‘low value’ goods would then be subject to the legislated model (as taxable supplies), rather than the traditional border collection model (as taxable importations).

Although raising the LVT from the current \$1000 would not resolve the fundamental cause of friction between the two collection systems, it would reduce the frequency of issues (such as double taxation) occurring. This is because the number of imported goods and the proportion of those goods destined for consumers (rather than businesses) declines as the value of the goods increase (LVPPT 2012, p. 33).

Increasing the LVT would cost the Government some revenue (primarily from foregone customs duties and border processing charges), but would help to facilitate trade by reducing costs and delays at the border for goods below the new threshold. There is also a strong in-principle argument to adjust the LVT for inflation and maintain its real value over time. In their submission, Berg and Davidson contended that the threshold would now be around \$2800 if the Government had maintained its real value since it was first adopted for customs duties in 1985 (sub. 33, p. 9).

However, given that the LVT also affects customs duties, border processing charges and reporting requirements, further consideration would be required, as well as consultation with DIBP and other industry stakeholders. One additional possibility could be to split the LVT

for GST off from the threshold for these additional charges and requirements, although operating two different thresholds at the border would introduce new complexity.

Merge the dual collection systems

An alternative option, involving more systemic changes, is to allow foreign suppliers to collect GST on goods of *any* value that are supplied to consumers in Australia, rather than just low value goods. Effectively, this would merge the legislated model with the border collection model, creating a system where:

- large suppliers and EDPs (with over \$75 000 turnover in Australia) collect the GST on all goods (both high and low value) consigned to consumers
- high value goods from smaller suppliers (or large suppliers that are not compliant with the legislated model) have GST collected at the border
- low value goods from small suppliers remain untaxed, as currently occurs.

Benefits of a merged system

Some major foreign suppliers have already signalled their support for such changes. During the Senate inquiry, ASOS (an overseas clothing retailer) argued that the presence of information on customs documents about whether GST on imports has been paid ‘should make it possible for the supplier to account for GST regardless of the value, without interfering with the Custom’s Duty process’ (2017, p. 2). Similarly, Wiggle (an overseas bike retailer) stated that:

The simplest implementation for us and the best experience for our Australian customers and in accordance with Australian Consumer Law is for us to add Australian GST to all Wiggle website prices displayed when a customer has selected an Australian delivery destination. This would mean any order for an individual item over \$1000 or for any order of sub-\$1000 items that totals more than \$1000 would have GST paid. (2017, p. 2)

A merged system would not only remove the need for foreign suppliers to differentiate between goods based on their value, it would also eliminate the need for suppliers to determine whether goods will be consigned together as a single high value consignment, reducing complexity for those suppliers.

Risks of a merged system

However, allowing foreign suppliers to collect GST on high value goods sent from overseas to consumers in Australia would still result in those goods being stopped at the border as taxable importations. This is because DIBP would still collect customs duties and border processing charges on goods with a value over \$1000. As a result, there would be limited benefit for consumers, as many of the existing border delays and administrative processes for high value goods would remain.

Using a merged system could also increase the risk of double taxation, as GST would still be liable on goods stopped at the border unless there was proof that GST was paid at the time of the sale. Although the legislated model will include a mechanism to exempt taxable importations from GST (discussed in chapter 3), wider use of this mechanism for high value goods would create revenue risks for the Government (box 4.5).

Box 4.5 Accounting for GST paid at the time of sale

The legislated model includes a 'GST paid' tick-box that allows goods to be exempt from *all* GST owing on a taxable importation. However, this amount owing is often more than the GST paid at the time of sale, primarily because the GST on taxable importations is calculated based on the value *including* customs duties and border processing charges. Hence, the Government foregoes some GST revenue each time the 'GST paid' exemption is used.

One option to solve this issue would be to account for the *amount* of GST that was paid at the time of the sale and then collect any net GST owing, rather than exempting the goods from all GST liabilities. More specifically, changing the 'GST paid' tick-box on the customs documents to a number field that reports the GST amount (in Australian dollars or other currency) that was paid at the time of the sale would enable this amount to be deducted from any GST owing on the taxable importation. The net amount of GST liability on the taxable importation (if any) could then be paid under the usual border processes, alongside any customs duties and border processing charges.

Accounting for the amount of GST paid would result in lower revenue leakage than the current 'GST paid' tick-box exemption, reducing the risks for the Government of expanding the reach of the legislated model. However, it would introduce some minor complexity for suppliers and consumers, while DIBP would need additional time and resources to make the necessary systems changes.

More frequent use of a GST exemption code under a merged system could also increase the risks of fraudulent use, particularly where GST is claimed to have been paid at the time of sale, but was not. However, this is already a risk under the legislated model, leading to the requirement for adequate proof that GST has already been paid before the exemption can be used.

As the existing border collection system would remain largely unaltered, allowing foreign suppliers to collect GST on high value goods would not necessarily require acceptable rates of compliance with the legislated model before consideration — if suppliers refuse to comply with the legislated model, their high value goods would continue to be stopped at the border, as currently occurs. Nonetheless, if the Government deemed the revenue risks from a move to a merged system too large, a transitional option would be to create a list of trusted major vendors with which to trial the system first.

Use the vendor collection model to collect GST on all imports

Another, more systemic option is to collect *all* GST on *all* imported goods using the legislated model, abolishing GST collection through the traditional border model.

Arguments for this approach

Relying on the legislated model to collect GST on all imported goods could reduce compliance costs for foreign suppliers, considerably benefit trade and reduce administrative burdens for Australian importers, with goods no longer systematically stopped and delayed at the border to collect GST. Estimates from Hummels and Schaur (2012) suggest that each additional day that goods spend in transit is equivalent to a tariff of between 0.6 and 2.3 per cent (depending on the time sensitivity of the goods).

Further, the Government currently refunds (or defers) most of the GST revenue that it collects from high value imported goods, as many of these goods are B2B supplies and GST applied to business inputs is refundable. For example, the ATO estimated that in 2015-16 imported goods with GST liabilities totalling \$29.3 billion crossed Australia's borders, but that Australian businesses deferred (and later settled without payment) \$25.7 billion of these liabilities (equivalent to 88 per cent of the total GST liability). It is likely that much of the remaining \$3.5 billion that was paid was refunded as well, through smaller businesses claiming input tax credits on their taxable importations (ATO 2017h).¹⁶ As such, the total net GST revenue collected on high value imports could feasibly be less than \$1 billion, despite the extensive border delays and administrative burdens created by assessing nearly \$300 billion worth of goods each year for GST.

Counter considerations

While there is a strong in-principle case for using a vendor-based model to collect GST on all imports, it would be a fundamental shift to the treatment of imports under Australia's GST system, and so would require extensive stakeholder consultation and long-term testing and development prior to implementation. Some revenue would also be lost, as GST would no longer be collected on high value goods from small foreign suppliers under the \$75 000 registration threshold, unless they sold their goods through an EDP.

At this stage, it is also unclear whether the legislated model will have sufficient rates of compliance among suppliers of low value imported goods to allow it to form the basis of all GST collections on imported goods. This is a fundamental precondition as without high rates of compliance, substantial GST revenue would be forfeited.

¹⁶ The GST deferral scheme is available for business-related imports to prevent cash flow issues associated with businesses paying and then being refunded the GST on taxable importations. As the GST deferral scheme is only available to businesses that report GST monthly (generally those with over \$20 million turnover), many smaller businesses would claim input tax credits on imports. However, the proportion of the \$3.5 billion that is refunded in this way is unknown (ATO 2017b).

Moreover, a move to collect all GST through a vendor model would still result in customs duties and border processing charges being collected at the border. This is problematic, as it means that many of the administrative burdens and effects on trade would still remain unless the extension of the legislated model is accompanied by reforms to customs duties.

Concomitant reforms to customs duties

One option would be to extend a vendor collection model to customs duties, but this is likely to create significant complexities (box 4.6).

Box 4.6 Using a vendor-based model to collect customs duties

Requiring vendors to collect customs duties (instead of using the existing border processes) would substantially reduce the parallel administrative and compliance burden at the border that duty collection currently entails. Indeed, a system whereby goods are classified once for tariff purposes prior to sale (a 'set and forget' classification) would likely be more efficient than the current system which requires each good to be classified by an importer or customs broker every time it enters Australia.

However, such a system would significantly increase compliance costs for foreign suppliers, due to the complexity involved in classifying goods for tariff purposes. Given these increased burdens, it is likely that rates of non-compliance would be high, undermining the viability of this approach.

A better option (recommended by the Commission in the General Tariff Review in 2000) would be to abolish remaining tariffs, as well as the border processing charges associated with their collection. Most tariffs in Australia have been at 5 per cent or less since the 1990s and on average have fallen further since that time, suggesting that the worth of the remaining duties is increasingly marginal. Aside from having merits in its own right (for example, avoiding the complexities of managing rules of origin procedures), abolishing Australia's remaining tariffs would help to reduce the costs of supply for domestic retailers.

The broader implications of such a change need further consideration, however. For one, there would still be some marginal delays at the border even with the abolition of remaining tariffs due to existing risk-based screening and quarantine processes, which help to protect Australia from biosecurity, national security and contraband risks. Related to this, border processing charges that recover the costs of these activities would also have to be reformed, as they are currently collected alongside customs duties.

In the Commission's view, the Government should give consideration to this option, subject to the precondition that the legislated model attains a high rate of compliance.

5 Transporter collection models

Key points

- Transporter models are distinguished by a reliance on transporters — operating in the cargo and international mail streams — to collect and remit the GST.
- There are two distinct transporter models. Both have been proposed by stakeholders as alternatives to the legislated model.
 - The model set out by the 2012 Low Value Parcel Processing Taskforce where low value goods are assessed for GST by customs authorities at the border before being released to transporters to collect and remit the GST.
 - The ‘modernised transporter model’ proposed by Amazon, which is similar, but transporters also take responsibility for assessing GST liabilities on the items they transport. Amazon envisages the transporter would collect the GST upfront from the foreign supplier, rather than the purchaser.
- Because neither transporter 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 models could achieve higher compliance and collection rates than the legislated model.
 - Were the Taskforce model to be implemented with a GST-specific low value threshold, this collection rate advantage would fall away.
- However, neither transporter model could sensibly be considered as a feasible alternative to the legislated model in the near term. This is due to:
 - the legacy paper-based declaration processes still in operation for most goods sent by international mail. Item-level electronic data is patchy, although improving
 - the requirement under the modernised transporter model for Australia Post to negotiate GST collection arrangements with overseas postal operators, so that GST is collected upfront from the vendor.
- Moreover, the transporter models would impose considerably higher administrative and compliance burdens on the Government, businesses and consumers than the legislated model. While precise estimates are not possible, their order of magnitude could be similar to or even exceed the revenue the tax would raise.
- While the near term barriers to the adoption of a transporter model can be overcome with time, their structure leads to an inherently less efficient collection model than the legislated model. This precludes their suitability for the time being, but they should not be excluded from future consideration, especially if the legislated model underperforms or creates unintended consequences.

In the discussion paper issued for this inquiry, the Commission indicated that it would examine the model proposed by the Low Value Parcel Processing Taskforce (the Taskforce model), and any workable proposals to improve it, as a possible alternative to the legislated

model.¹⁷ The Taskforce model, also referred to as the ‘transporter’ or ‘logistics’ model, was supported by a number of electronic distribution platforms (EDPs) including Alibaba, Amazon, eBay and Etsy.

Amazon (subs. 11, 35, S4) has subsequently proposed a different transporter model, which it terms the ‘modernised transporter model’. Amazon claims that its model builds on the Taskforce model to take account of post-2012 technological developments. The Commission has consulted with the proponent of the model, and those parties likely to be most affected by it (box 5.1).

Box 5.1 Modernised transporter model consultation process

The modernised transporter model was outlined by Amazon in a pre-hearing submission received on 23 August 2017 and at the Melbourne public hearing the following day. The model was explained more comprehensively in Amazon’s main submission received on 4 September.

The Commission subsequently engaged with the two stakeholders that would be heavily impacted if the modernised transporter model were to be implemented — Australia Post and the Conference of Asia Pacific Express Carriers (CAPEC) — and invited them to make supplementary submissions on the matter. These were received between 20 September and 2 October.

Amazon was afforded a right of reply to these submissions, and the Commission held further discussions with Amazon and Australia Post.

This chapter examines both transporter models as potential alternatives to the legislated model. The models are first described (section 5.1), before their feasibility is considered, with an emphasis on the technological and commercial developments needed to make them viable (section 5.2). Both transporter models are then compared with one another and assessed against the legislated model using the framework set out in chapter 2 (section 5.3).

5.1 The models

Transporter models place the legal liability on the transporter to collect and remit the GST. As such, their design reflects the nature of the transportation process (box 5.2).

¹⁷ The Taskforce arose from a recommendation of the Commission’s 2011 inquiry into the Australian retail industry. Its terms of reference directed it to ‘investigate new approaches for the handling and administration of low value imports of goods, including options for revenue collection’ (LVPPT 2012, p. v) guided by the Commission’s finding that ‘there are strong in principle grounds to lower the low value threshold exemption for [GST] and duty on imported goods when it is cost-effective to do so’ (LVPPT 2012, p. v). However, the Taskforce focused its recommendations on the collection of GST because duties are levied at a lower rate and are more complex to administer.

Box 5.2 Factors influencing the design of transporter collection models

International mail and cargo

Low value goods enter Australia via the international mail or cargo streams. Australia Post is responsible for all domestic carriage of international mail, while cargo is carried by either integrated international express carriers (such as the CAPEC members DHL, TNT, UPS and FedEx) that offer end-to-end transportation or non-integrated domestic freight forwarders that contract carriers to bring goods to Australia.

In 2015-16, about 38 per cent of low value imported goods by *volume* were transported through the cargo stream, with the rest transported by the international mail stream.^a In *value* terms, and excluding business-to-business (B2B) items, the Commission has estimated this split at 33-37 per cent cargo and 63-67 per cent international mail (chapter 3) — which reflects both the higher average value of items transported by cargo, and the higher share of B2B items in the cargo stream. The cargo stream can be further broken into air and sea cargo, although the share arriving through sea cargo is very small — approximately 0.1 per cent of the total volume of low value consignments in 2016-17 (DIBP, pers. comm., 6 October 2017).

While cargo transporters operate on commercial terms, aspects of Australia Post's activities in the international mail stream are subject to Universal Postal Union agreements, which limit the ability of the Australian Government or Australia Post to achieve improvements to international mail stream processes. That said, Australia Post is a member of several commercial multilateral fora (such as the Kahala Posts Group and the International Postal Corporation^b) that, in some instances, have developed their own inter-country pricing arrangements and are driving technological improvements to keep pace with growing competitive pressure from the cargo stream. Australia Post also has commercial bilateral agreements with some overseas postal operators, including the United States Postal Service.

Simplified basis for GST assessment

Transporter models require GST assessments to be based on information held by the transporter. In the international mail stream, this is currently limited to the information contained on a CN22 or CN23 customs declaration. Any changes to these forms would need to be considered and endorsed by Universal Postal Union member countries and would also require consultation and approval from the World Customs Organization (Australia Post, sub. 37).

In recognition of these constraints, the Taskforce recommended a simplified GST assessment process, with the GST to be calculated on the basis of items' declared values (possibly with an adjustment for transport and insurance costs) subject to compliance measures.

^a About 49 million non-letter items with a positive declared value (that is, greater than \$0) were cleared through international mail (Australia Post 2017; sub. S5), compared with 30 million cargo items (DIBP, pers. comm., 16 October 2017). ^b Founded in 2002, the Kahala Posts Group is an international alliance of the postal operators of Australia, Canada, China, France, Hong Kong, Japan, Korea, Spain, Thailand, the United Kingdom and the United States. The International Post Cooperation, founded in 1989, is an association of 24 national postal operators from major countries in Europe, Asia Pacific and North America.

Taskforce model

The Low Value Parcel Processing Taskforce (2012) made a suite of recommendations relating to the processing and collection of GST from imports of low value goods. This chapter focusses on the core model for the collection of GST set out in the Taskforce's recommendation 4.1 (box 5.3).

Box 5.3 Low Value Parcel Processing Taskforce recommendation 4.1

The following is an abridged version of the Taskforce's recommendation 4.1.

Reform to the handling and administration of low value goods, incorporating a new option to collect revenue, would best be achieved through the application of simplified GST assessment arrangements for low value imported goods between a separate low value GST threshold set above \$0 and below \$1000. This would require modifications to existing processes, including:

- reconfiguring the systems to enable data capture and the simplified assessment of GST through reporting and clearance processes in the cargo environment, pre-arrival data exchanged electronically by Australia Post and Customs and Border Protection and data manually captured by Australia Post in international mail gateways
- requiring Australia Post, express carriers and other freight forwarders to be responsible for collecting and remitting the revenue liability
- permitting clearance of goods from licensed depots or the international mail gateways — on an opt in basis — prior to revenue liabilities being met (subject to financial guarantees being in place from the relevant cargo or postal entities). Entities would be permitted to incorporate their collection costs into any direct or indirect charges imposed on importers
- making ancillary changes to cater for increased numbers of business GST deferrals, more compliance activities and processing of claims with respect to GST exemptions.

To further enhance the handling and administration of low value goods, complementary reforms could be undertaken in the international mail environment to establish more consistent reporting and import clearance processes across import streams. This would primarily be achieved through the use of pre-arrival electronic data to streamline border agency processes to allow more targeted, risk based assessment over time.

Source: LVPPT (2012, pp. 15–16).

The Taskforce model could strictly be described as a hybrid border/transporter intermediary model under the Organisation for Economic Cooperation and Development's (OECD's) taxonomy (chapter 1), with the GST *assessment* and *collection* tasks separated and assigned, respectively, to the Department of Immigration and Border Protection (DIBP) and the transporter. As with the border model, DIBP would be responsible for assessing incoming items for GST. Items valued above \$1000 and items valued below the new GST-specific low value threshold (LVT) would proceed through existing processes (chapter 1). Items valued below \$1000 but above the GST-specific LVT would have their GST liability calculated by DIBP before being released to the transporter (both in the cargo and international mail streams) which would take responsibility for collecting and periodically remitting the GST.

The Taskforce envisaged that the transporter would seek to collect the GST liability (likely with a handling fee included) from the purchaser before delivering the item, although this process was left to the discretion of the transporter.

The model is similar to those currently employed in Canada and the United Kingdom.

- In Canada, taxes are due on most imported items exceeding Can\$20 (A\$20) in value. After assessment and calculation of taxes by the Canada Border Services Agency, items are released to the transporter (Canada Post or the cargo transporter) for collection of the taxes and delivery (Canada Border Services Agency 2016). Canada Post charges a handling fee of Can\$9.95 (A\$10) on all tax-attracting items (Canada Post 2017).
- In the United Kingdom, value added tax (VAT) is due on most imported items exceeding £15 (A\$25) in value. The process is similar to that of Canada, and the Royal Mail charges a handling fee of £8 (A\$13) or more on all VAT-attracting items (Royal Mail 2017).

The Taskforce did not formally indicate whether, and to what extent, the GST-specific LVT should be lowered if its recommendations were to be taken up, as this was outside its terms of reference. However, it noted that ‘... some change [to the LVT] could be reasonably assumed to be a consequence of the reforms outlined, if adopted’ (LVPPT 2012, p. 14). This is discussed further in section 5.3.

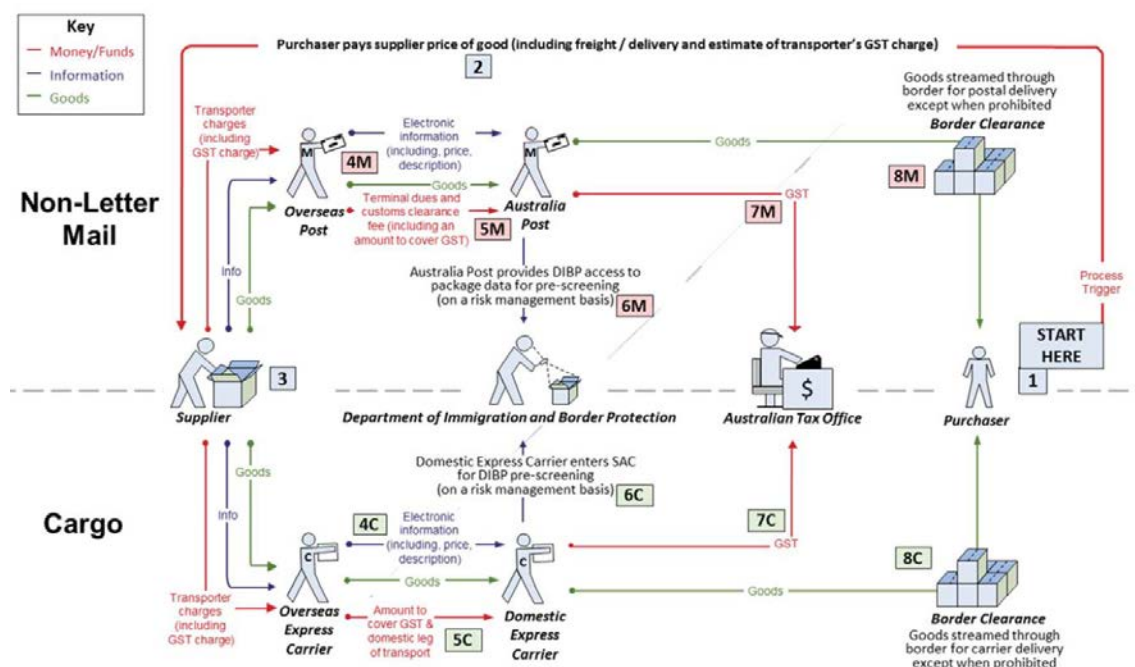
Modernised transporter model

The modernised transporter model proposed by Amazon (subs. 11, 35) can also be described as a transporter intermediary model under the OECD’s taxonomy. The model as envisaged by Amazon is shown in figure 5.1. The model would apply to low value items regardless of value (although Amazon indicated that an exemption could apply to transporters with turnover in Australia of less than \$75 000 per annum (trans., p. 120)).

Amazon (sub. 35) argues that the modernised transporter model would collect significantly more revenue than the legislated model — twice as much in its first year of operation and up to \$1.5 billion more over its first five years. After five years, Amazon claims that it would collect GST on 95 per cent of low value imported goods.

Amazon’s proposed model differs from the Taskforce model in that it assigns the liability for both GST *assessment* and *collection* to the transporter. Under the Taskforce model, the transporter becomes liable for collecting the GST after assessment and release by DIBP, but under the modernised transporter model the transporter’s liability is triggered by the import of the good into Australia.

Figure 5.1 **The modernised transporter model**
Process as envisaged by Amazon



Source: Amazon (sub. 35, p. 14).

Under the process envisaged by Amazon (figure 5.1), transporters (both those in the cargo and international mail streams) would assess and charge the GST to vendors based on the information they supply, and make periodic remittances to the Australian Taxation Office (ATO). In expectation of this, vendors would collect the GST (or an estimate of the GST) from purchasers at the point of sale.

While this suggests a very different process from that envisioned by the Taskforce, the practical application of the modernised transporter model *in the cargo stream* may not differ greatly from the Taskforce model. Even though the modernised transporter model would see the responsibility for GST assessment shifted from DIBP to the transporter, the assessment would be based on information held by the transporter in either instance. It follows that the transporter would be equally well-placed under either transporter model to calculate the GST due on each item, and the decision to collect the GST from the vendor or from the purchaser would be made on similar commercial terms.

Indeed, some cargo transporters are already performing a similar role to that envisaged under the modernised transporter model in order to expedite current border processing arrangements.

- The eBay Global Shipping Program is provided by Pitney Bowes for items sold by eBay vendors located in the United States and the United Kingdom. When a vendor uses the

Global Shipping Program, taxes and duties are estimated and charged at the point of sale and remitted to customs in the destination country (eBay 2017a).

- The AmazonGlobal Program is provided for participating Amazon vendors. It operates in a similar manner to the eBay Global Shipping Program (Amazon 2017).
- Amazon (sub. S4, p. 2) notes that:
... express carriers are *already* effectively implementing key aspects of the model for their shipments into Australia valued over \$1000, as (in many instances) they are currently pre-collecting amounts to cover the GST liability on these imports from Vendors, and using these funds to clear GST liabilities due.

However, the models differ substantially for the international mail stream. Under the modernised transporter model, Australia Post would establish commercial agreements with overseas postal operators that would require those operators to collect the GST as part of their transportation charges (paid to Australia Post). Australia Post would then formally assess the GST liability due on each item based on electronic advance data (EAD) — also known as electronic pre-arrival data — received from the overseas postal authority and make periodic remittances to the ATO.

5.2 Feasibility of the models

Several barriers inhibit the adoption of either transporter model. These relate to the availability and prevalence of EAD in the international mail stream and — in the case of the modernised transporter model — the requirement for Australia Post to negotiate GST collection arrangements with overseas postal operators.

International mail stream

Availability of electronic advance data

EAD is item-level data communicated to the receiving party in advance of the item's arrival at the destination country. It can contain differing amounts of information depending on its intended use — for example, EAD used for tracking purposes may contain only information about the addressee of the goods. But in the context of this inquiry, the Commission is concerned with EAD that contains sufficient information about the sender, contents and value of the item to allow for GST to be assessed.

EAD is widely available in the cargo stream and already incorporated into the cargo clearance process for low value goods. Each consignment's value and contents must be submitted to DIBP electronically via a Self-Assessed Clearance, which is generally lodged alongside pre-arrival cargo reports (Customs and Border Protection 2015). However, EAD in the international mail stream is not readily available at present and may not become widely available prior to 2023 (box 5.4).

Box 5.4 **Timeline for availability of electronic advance data in international mail**

Australia Post has advised that (as of July 2017) it receives electronic advance data (EAD) on approximately half of all inbound non-letter items that are not untracked packets. Untracked packets comprise approximately two thirds of all low value international mail items,^a suggesting that EAD is currently received on about 17 per cent of items. That said, Australia Post has indicated that untracked packets generally hold lower value items, so the share of *value* on which EAD is currently supplied is higher.

An EAD implementation strategy was agreed to at the 2016 Congress of the Universal Postal Union. As a first step, all mail items containing goods are required to display a barcode identifier (which is necessary for the exchange of EAD) from 1 January 2018. However, there is some ambiguity about the point at which EAD will be compulsory for mail items. Amazon (sub. 35) claimed that the Universal Postal Union will require all members to provide EAD to other postal operators by 2020, while Australia Post (sub. S2) stated:

[T]he [Universal Postal Union] is currently progressing work on the EAD roadmap. Whilst this work will take some time, the objective is to agree a data exchange model that will apply to all postal operators in the future. Currently timeframes for implementation of EAD on all mail items is scheduled for 2023. (p. 1)
... Any decision requiring transmission of [EAD] for all items would not be made until after 2020, with implementation not feasible until at least 2023. (p. 3)

Outside of the Universal Postal Union process, bilateral and multilateral agreements provide for EAD exchange. Australia Post has data sharing arrangements in place with 33 countries, 23 of which are covered by agreements of the Kahala Post Group and the International Post Corporation — although only 15 countries currently supply EAD that provides the information necessary for GST assessment, and only for select classes of mail.

Australia Post has also raised concerns about the quality of the EAD that it currently receives, noting that it is variable, and cannot always be relied on to make an accurate GST assessment. However, it expects this to improve over time.

^a Productivity Commission estimate based on Australia Post (sub. S5, p. 3): 'Packets make up 92.1 per cent of volume under \$1000, of which approximately 71.3 per cent is untracked packets'.

Sources: Australia Post (subs. 37, S2, S5); Universal Postal Union (2016).

The availability of EAD in the international mail stream is critical. For both transporter models, EAD would allow:

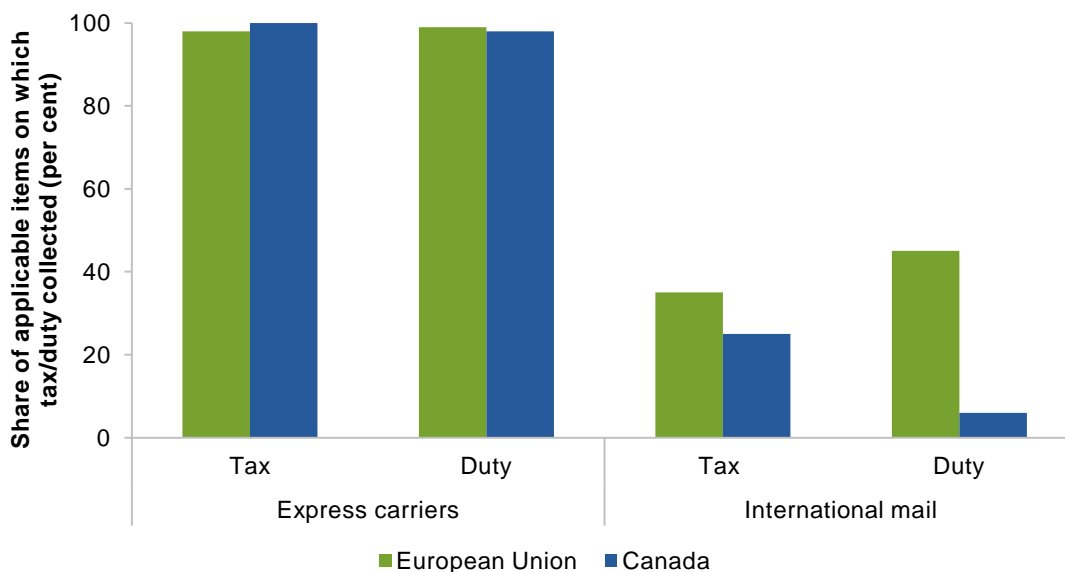
- more efficient identification of items on which GST is due at the border (whether by DIBP in the case of the Taskforce model or by Australia Post in the case of the modernised transporter model), especially if the Taskforce model were to be introduced with a GST-specific LVT — which would imply a higher volume of items on which no GST is due
- more efficient assessment of GST liabilities, potentially in advance of arrival. Without EAD, this assessment would require data contained on the CN22 or CN23 declaration to be manually entered into DIBP's or Australia Post's systems.

It is difficult to predict the magnitude of the impact of EAD on the processing and collection of GST on low value international mail items, especially because current border collection

arrangements apply to only a very small share of international mail items.¹⁸ That said, Australia Post (sub. 37) indicated that if it was required to assess and collect GST on all low value items, an EAD-enabled system (with current levels of EAD) would reduce its costs by around 30 per cent if the Taskforce model were to be implemented.

In countries where a lower LVT is applied than in Australia (and hence where a greater share of international mail items are subject to taxes and duties), there is some evidence of the beneficial impact of EAD on the thoroughness of border processes. UPS (an express carrier) commissioned two separate experiments in which items were imported into the European Union (Copenhagen Economics 2016) and Canada (Copenhagen Economics 2017), with about half transported by international mail and half by express carriers. After undervalued items were removed from the sample, it was found that sales tax — and duties where relevant — were levied on virtually all express carrier items (for which EAD is generally supplied), but only a minority of international mail items (for which EAD was generally not available) (figure 5.2).

Figure 5.2 Thoroughness of customs processes — mail vs cargo
Results of experiments conducted by Copenhagen Economics



Sources: Copenhagen Economics (2016, 2017).

A similar experiment was conducted in the United States, where it was found that the express carriers submitted EAD to the Air Cargo Advance Screening program in all instances, which led to customs declarations being submitted in 98 per cent of cases (Copenhagen Economics 2015).

¹⁸ In 2009-10, only about 0.3 per cent of international mail items were valued at over \$1000 (PC 2011).

These significant and beneficial impacts of EAD on administration costs and compliance underscore their importance for transporter models. In the Commission's view, neither transporter model could sensibly be applied to streams of international mail without the widespread adoption of EAD.

Use of electronic advance data

In addition to the *availability* of EAD, systems would need to be put in place to incorporate EAD into the GST assessment process. At present, DIBP does not use EAD to enhance customs clearance processes for the international mail stream, although Australia Post (sub. 37, p. 5) notes that:

The technology and system requirements for use of the Customs Declaration System to interface EAD are currently being examined under the tripartite arrangements between Australia Post, the Department of Immigration and Border Protection and the Department of Agriculture and Water Resources.

The new technology is unlikely to be available for 1 July 2018.

However, in early 2017 the Prime Ministers of Australia and New Zealand announced a trial to explore improvements to the processing of international mail items sent between the two countries — known as the 'E-commerce green lane' trial (Australia Post, sub. S2; Turnbull and English 2017).

Amazon proposes that an EAD interface between Australia Post and DIBP would not be necessary to implement the modernised transporter model, because GST assessment would be the responsibility of Australia Post. Instead, Australia Post would need to develop internal systems for assessing the GST.

Negotiation with overseas postal authorities

In order to implement the modernised transporter model, Australia Post would need to enter into or amend bilateral and/or multilateral agreements with overseas postal operators to enable them to collect the GST upfront.¹⁹ These agreements may also need to mandate the provision of EAD on all non-letter items where Universal Postal Union processes, other agreements and/or commercial incentives are insufficient to induce it.

Drawing on the example of the existing bilateral agreement between Australia Post and the United States Postal Service, and agreements between members of the Kahala Posts Group and International Postal Corporation multilateral fora, Amazon suggested that the

¹⁹ Amazon states that this arrangement is permissible under Articles 20.3 and 20.4 of the Universal Postal Union Convention, which relate to the collection of customs duties and fees. Australia Post and Amazon agree that bilateral and/or multilateral agreements between postal operators are necessary to implement the modernised transporter model.

modernised transporter model could be implemented by way of a relatively simple amendment:

... the amendment could be made by a simple 1 page rate card amendment (there are existing practices for amending rate cards by short annexures), and the competitive tension between the postal operators and the express carriers should create a commercial incentive to complete any required amendments or renegotiations in a timely manner, especially if the modernised transporter model applies to express carriers from 1 July 2018. (sub. 35, p. 10)

However, Australia Post contended that the negotiations would prove challenging because:

- the agreements referenced by Amazon do not contemplate the prospect of any postal operator collecting taxes for another postal operator
- overseas postal operators would incur significant costs if required to collect the GST, and would expect full compensation for these costs
- as a net importer, Australia Post is often at a disadvantage in terms of bargaining power, particularly in discussions with key exporting nations (although Amazon disputes whether this disadvantage would apply in this context).

The Taskforce also gave consideration to a version of the modernised transporter model for the international mail stream, but did not consider it sufficiently viable to warrant further analysis. Among other issues (some of which could be ameliorated by EAD), the Taskforce noted the challenges around achieving agreements with other postal operators, especially given that no jurisdiction had set up such arrangements (LVPPT 2012, pp. 142–143).

The Commission considers that without agreements in place between Australia Post and overseas postal authorities to collect GST upfront from the vendor, the proper implementation of the modernised transporter model would be hindered.

Cargo stream

Existing processes in the cargo stream appear far more amenable to both transporter models. As noted previously, EAD is widely available and already incorporated into the cargo clearance process for low value goods.

While the modernised transporter model would necessitate contract renegotiations between domestic cargo transporters and their overseas partners, these appear unlikely to present the same complexity as they would for the more regulated and less technologically savvy international postal operators.

When considering the viability of transporter intermediary models, the OECD (2015) found:

In the express carriers environment, electronic data collection and transmission systems are most often already in place and VAT/GST collection and remittance to the tax authorities is also already common practice. A model whereby non-resident vendors rely on express carriers to collect and remit the VAT/GST on imports of low value goods provides an efficient and effective

solution, provided it is combined with sufficiently simple compliance regimes and with fast-track processing. Given the existing commercial relationships between the express carriers and the vendors, such a model would provide certainty and fairness. It must be noted, however, that express carriers must rely in practice on the correctness of the information provided by the vendors for the assessment of the tax liability and the associated compliance obligations. (p. 207)

That said, the Commission is cognisant that, were the modernised transporter model to be implemented, further engagement with domestic cargo transporters would be necessary to facilitate its introduction in the smoothest manner possible.

Summing-up

The analysis above suggests that:

- for the cargo stream, both models are likely to be feasible in the near term
- for the international mail stream, the feasibility of the Taskforce model is limited by the availability of EAD — a matter largely outside of Australia Post’s control. It could be applied to only a small share of international mail items in the near term, and this share would grow as EAD becomes more widely available, as is expected
- for the international mail stream, the feasibility of the modernised transporter model is also limited by the availability of EAD, and the additional constraint of the requirement for Australia Post to negotiate GST collection agreements with overseas postal operators. This could hamper its feasibility for all international mail items in the near to medium term.

In light of these constraints, in principle a phased implementation could be pursued. The selected model could apply to all items transported through the cargo stream with international mail streams incorporated as sufficient levels of EAD become reliably available and, in the case of the modernised transporter model, Australia Post has commercial arrangements in place to facilitate GST collection. Were such an approach to be pursued in the near term, the Commission’s coarse estimate is that both models could be applied to one-to-two thirds of *all* low value imported goods.²⁰

This option was favoured by Amazon (sub. 35, p. 12) for the modernised transporter model:

Under a transitional phased approach, Amazon proposes that Australia Post only be responsible for the GST on [low value imported goods] originating from countries that both electronically transmit EAD (e.g. Group 1 countries, commencing from 1 July 2018 and other Kahala countries)

²⁰ The lower bound of this estimate assumes that the model is applied to all cargo imports but no international mail imports (due to difficulties in negotiating arrangements with overseas postal operators and/or the quality of the currently received EAD being too variable to allow GST assessment). The upper bound assumes the model is applied to all cargo imports, all international mail imports that are not untracked packets, and that untracked packets comprise a negligible value share of international mail imports. Australia Post (sub. S5) noted that untracked packets typically contain very low value goods (often less than \$10).

and where a collection mechanism has been incorporated into the commercial agreements between Australia Post and the originating postal operator.

However, a phased implementation could introduce distortions into the transporter market as GST would be levied on all cargo items but not all international mail items. This could in turn provide incentives for Australia Post to slow the take-up of EAD and/or the progress of commercial negotiations underpinning the modernised transporter model. The Commission would also caution against expediting the introduction of either transporter model due to the models' complexity, the need for further consultation with industry participants and the untested nature of presently received EAD for international mail items.

The Customs Brokers and Forwarders Council of Australia (CBFCA) (sub. 36, p. 23) suggested that a transporter model could be implemented with a 'sunset provision' provided to Australia Post to meet the new requirements. While this would give Australia Post the impetus to negotiate outcomes with overseas postal operators, it may be ineffective and disproportionately punitive to the extent that the feasibility of the model is limited by international developments outside of Australia Post's control. It would also enhance the bargaining position of those overseas postal agencies in commercial negotiations, which could lead to Australia Post making additional concessions to comply with the new requirements.

In conclusion, the Commission considers that neither transporter model could sensibly be implemented until it could be applied to a large majority of international mail items. Assuming its implementation were desirable, a logical point at which to commence would be the point at which the provision of EAD on all mail items is mandated by the Universal Postal Union, which Australia Post (sub. S2) suggests is likely to be 2023.

5.3 Assessment of the models' performance

While recognising that neither transporter model is viable in the near term, the Commission has considered their merits relative to the legislated model at the point where EAD is widespread and — in the case of the modernised transporter model — the necessary agreements with overseas postal operators to collect the GST on Australia's behalf (are assumed to) have been negotiated.

Administrative and compliance costs

To estimate administrative and compliance costs, the Commission has relied on costing estimates submitted to this and previous inquiries by Amazon, Australia Post and CAPEC, as well as the costing estimates of the Taskforce and some limited overseas comparisons. Given this inquiry's short timeframe, the Commission has not been able to verify these participants' costing methodologies in most instances. For this reason, and because these

participants face incentives to overstate or understate (as the case may be) the models' administrative and compliance burdens, all estimates should be interpreted with caution.

International mail stream

Taskforce model

The Taskforce modelled some of the direct administrative and compliance costs associated with its model. The costings were presented on a per-item basis for both the international mail and cargo streams and encompass capital costs associated with implementation and ongoing costs associated with collection.

Administrative and compliance costs in the international mail stream were estimated for four settings of the GST-specific LVT between \$0 and \$500. The estimates ranged from \$12 per item for a \$0 LVT to \$17–20 per item for a \$500 LVT, with the variation between thresholds due to economies of scale in processing.

There was a high degree of uncertainty attached to these estimates. The Taskforce stated that the level of confidence in its preliminary estimates (which were subsequently adjusted upwards to take into account other costs not captured in the initial estimation process) was 'at best in the plus or minus 50 per cent range' (2012, p. 187).

Australia Post (sub. S5) has estimated that, utilising current levels of EAD, it would incur costs of around \$540 million per annum plus a \$162 million capital investment if it were required to assess and collect GST on all non-letter items arriving through international mail. Based on the 49 million non-letter items of positive declared value cleared through international mail in 2015-16 (which is the basis for Australia Post's costings), this would amount to an *ongoing* cost of about \$11 per item. As more EAD becomes available, the Commission expects that these costs would fall.

Experiences in Canada and the United Kingdom suggest similar per-item costs. As previously mentioned, Canada Post and the Royal Mail (the postal operator in the United Kingdom) levy handling fees of Can\$9.95 (about A\$10) and £8 (about A\$13), respectively (Canada Post 2017; Royal Mail 2017). To the extent that these fees reflect actual costs,²¹ they lend some support to Australia Post's cost estimates.

²¹ Canada Post states 'this fee is in line with the government's efforts to help recover costs from those who benefit from services' (Canada Post 2017, p. 1), while HM Revenue & Customs states that 'if customs charges are payable upon importation, Royal Mail will charge a handling fee to cover the costs for carrying out customs procedures' (HMRC 2017b, p. 1). Underpinning these charges is the Universal Postal Union Convention (Article 20.3) which authorises postal operators to 'charge customers a customs clearance fee *based on the actual costs*' (Universal Postal Union 2017, p. J.1, emphasis added).

Modernised transporter model

The modernised transporter model would likely entail lower administrative and compliance costs for international mail items than the Taskforce model, due to:

- reduced storage requirements, as items would not need to be held while the GST is sought from consumers
- lower rates of abandonment, as the GST would be paid upfront at the point of sale.

That said, the modernised transporter model would also impose costs on overseas suppliers relative to the Taskforce model, as suppliers would need to collect the GST at the point of sale.

Amazon estimates that the modernised transporter model would impose administrative and compliance costs of \$3 per item for the international mail stream, based on the costs that the United States Postal Service has stated that it would incur if it were required to collect a duty of \$1 on each item of non-letter mail imported into the United States and provide EAD to United States Customs and Border Protection on *all* mail items — regardless of whether this was supplied with the postal operator in the originating country (US Congress 2016; US Senate 2017). Amazon also included a cost uplift factor of between \$1.60 and \$2.70 per item to account for differences in scale between Australia and the United States.

Australia Post (sub. S5) also undertook an indicative costing of its obligations under the modernised transporter model, by altering its aforementioned costing exercise to assume no additional storage requirements due to GST collection. It estimated that it would incur costs of \$335 million per annum plus a \$63 million capital investment. Based again on 49 million annual items, this amounts to about \$7 per item in *ongoing* costs.

Cargo stream

As mentioned in section 5.1, the Commission considers it likely that both transporter models would operate similarly in the cargo stream, as cargo transporters' decisions of whether to collect the GST from the vendor or the purchaser would be made on a similar commercial basis.

If the Taskforce or modernised transporter model were implemented, it is not immediately clear which option a transporter would take. By collecting the GST from the overseas vendor, the transporter could reduce domestic warehousing requirements and offer a faster service. But if some vendors do not collect the GST at the point of sale, an alternative where transporters are willing to collect from purchasers may emerge — likely with a handling fee to cover the additional costs. Transporters' differing supply chains may also have an impact. Integrated express carriers with end-to-end control of the transportation process may have more influence over the overseas component of their supply chain — and hence more ability to collect the GST from suppliers — than domestic freight forwarders contracting international transportation from carriers.

Hence, costs for the cargo stream will be similar across the Taskforce and modernised transporter models, and will lie somewhere between estimates that assume collection from vendors and estimates that assume collection from purchasers.

The Taskforce based its estimates of compliance costs for cargo carriers on the information supplied by CAPEC (sub. 24, attachment). It argued that the simplified GST assessment process would reduce the estimated \$15 per item for GST and duty calculation under the border collection model, but also suggested that the \$15 per item for invoicing and storage would remain (due to assumed collection from the purchaser). It concluded that costs would range from \$15 to \$30 per item ‘although more likely at the lower end of this range’ (LVPPT 2012, p. 191).

As with its claims about international mail stream costs, Amazon estimates that the modernised transporter model would impose compliance costs of \$3 per item on cargo transporters. These estimates for cargo are based on the Taskforce’s approach, but with Amazon reasoning that invoicing and additional storage would not be necessary under the modernised transporter model (as GST would be collected from the vendor) and that GST calculation should cost only about \$3 per consignment.

Collating the estimates of Amazon and the Taskforce suggests costs in the order of \$3–23 per item for both models. Given the magnitude of the international mail cost estimates, and that existing processes in the cargo stream are more amenable to supporting both transporter models, the Commission considers that actual costs would be toward the lower end of this wide range.

Comparison with legislated model

These estimates by Amazon, the Taskforce and Australia Post suggest that either models’ administrative and compliance burden would be far in excess of that associated with the legislated model (table 5.1). Setting aside upfront capital costs, the Taskforce and modernised transporter models would incur annual ongoing costs of at least \$630 million and \$237 million, respectively (for the volume of low value imported goods in 2015-16).

To see why, consider the operation of the modernised transported model (as envisaged by Amazon) relative to the legislated model. Both require the supplier to incur the costs of charging the GST at the point of sale. While this is on an approximated basis under the modernised transporter model and with no registration and remittance to the ATO by vendors, the burden would extend to those suppliers not required to register for GST under the legislated model (due to low turnover from Australian sales).²² This is the extent of the legislated model’s compliance burden, but with the modernised transporter model the foreign

²² There is a substantial volume of these suppliers. The CIE (2016) estimated that 1100 suppliers transporting low value goods to Australia via the CAPEC express carriers would be captured by the legislated model, which amounted to only about 8 per cent of the total pool of suppliers. Given the lower market concentration among suppliers using international mail (chapter 3), the total share of suppliers captured by the legislated model is likely to be lower than this.

transporter incurs costs approximating the GST due and the domestic transporter incurs costs providing a formal assessment of the GST due and remittance to the ATO (section 5.1).

To extend this comparison to the Taskforce model, it suffices to note that the Taskforce model would feature a higher administrative and compliance burden than the modernised transporter model.

Table 5.1 Comparison of administrative and compliance costs^{a,b,c}
Annual calculations are based on 2015-16 volume of items

<i>Model</i>	<i>GST-specific LVT</i>	<i>International mail (upfront)</i>	<i>International mail (ongoing)</i>	<i>Cargo (ongoing)</i>	<i>Total (upfront)</i>	<i>Total (ongoing)</i>
	\$	\$m	\$m per annum	\$m per annum	\$m	\$m per annum
Taskforce	0	162	540	90–688	162	630–1228
Taskforce	100	162	143	61–466	162	204–609
Taskforce	200	162	72	37–287	162	109–359
Taskforce	500	162	14	14–108	162	28–122
MTM	0	63	147–335	90–688	N/A-63	237–1023
Legislated	0	N/A	N/A	N/A	15–60	13–23

^a All estimates assume aside feasibility concerns outlined in section 5.2, and are based on 2015-16 volume of items, unadjusted for any demand responses to application of GST and collection costs on low value imported goods. ^b Taskforce model estimates assume that ongoing costs are proportional to the volume of items on which GST is due under different settings of a GST-specific LVT. Upfront (capital) costs are assumed constant for different thresholds. Some additional uncertainty stems from estimates about the value distributions in the mail and cargo streams, which are extrapolated from sampling exercises. ^c Legislated model costs are Productivity Commission estimates set out in table 3.1, plus annualised administration costs budgeted for the ATO.

Sources: Productivity Commission estimates based on Amazon (sub. 35), Australian Government (2016), Australia Post (sub. S5), CIE (2016, table 3.3), DIBP (pers. comm., 6 October 2017), LVPPT (2012) and PC (2011, table 7.3).

If the Taskforce model were to be implemented, there would be a case for introducing a GST-specific LVT in order to reduce its administrative and compliance burden. This is because of the high *marginal* cost of collecting the GST on each item — each GST-attracting item would require the purchaser to be notified of the GST due, and the item would need to be stored pending payment of the GST and handling fees. This marginal cost would be high relative to the GST revenue gained for particularly low value items. That said, the imposition of a LVT would substantially reduce the model’s collection rate (see below), compromising its effectiveness relative to the legislated model.

Another option that could reduce administrative and compliance costs is the addition of an optional vendor collection mechanism (box 5.5).

Box 5.5 **Taskforce model — optional vendor collection mechanism**

The Taskforce recommended that its core model could be complemented by an optional vendor collection mechanism, open to ‘appropriately regulated overseas suppliers’ (LVPPT 2012, p. 218).

The scheme would only be open to vendors that:

- have a trusted relationship with all parties relevant to the administration of border and taxation processes
- ensure packing and transportation that would allow for the provision of electronic advance data confirming that GST has been paid.

The Taskforce model's administrative and compliance burden could be lessened by the inclusion of this mechanism, but the extent to which this would occur is unclear and would depend on the uptake of the scheme by overseas vendors (which would in turn depend on the strictness of the eligibility requirements). Participating vendors would also be limited in their transportation options, with international mail likely excluded because of the need for tailored electronic advance data.

Compliance and collection rates

The principal advantage of a transporter model over a vendor model is that it focusses collection on entities that have an Australian presence. This suggests that relatively high compliance should be achievable under both transporter models.

However, this conclusion is not automatic. Both transporter models feature two channels for potential non-compliance.

- Active non-compliance due to undervaluation or consignment splitting. Undervaluing occurs when the vendor declares an item at below its true value to avoid or reduce the payment of GST and any associated delays and handling fees. Consignment splitting occurs when a vendor separates a bulk order into its components so that one or more of them fall below the GST-specific LVT and do not attract GST.
- Passive non-compliance due to inadequate GST assessment and/or collection processes.

The studies by Copenhagen Economics (2015, 2016, 2017) discussed in section 5.2 suggest that if EAD were widely available and integrated into GST assessment processes then neither transporter model should especially suffer from passive non-compliance. Hence, the remainder of this section discusses active non-compliance.

Suppliers' incentives to partake in active non-compliance differ across the two models.

- Under the Taskforce model, the incentive to undervalue or split consignments should be low because the GST is paid by the purchaser at a later point in the supply chain. Nonetheless, the risk remains and is more likely when there is an ongoing relationship between the supplier and the purchaser.
- Under the modernised transporter model, the supplier faces a direct financial gain from undervaluing.

As their dynamics are similar, the extent of undervaluing and consignment splitting under the current border model provides some indication of what could be expected under the Taskforce's model. In 2011 the Australian Customs and Border Protection Service (now part of DIBP) found very low rates of undervaluing and consignment splitting to avoid GST and duties. However, this may have been more a consequence of Australia's high LVT (box 5.6).

Box 5.6 The 2011 Enhanced Compliance Campaign

In 2011, the Australian Customs and Border Protection Service conducted a campaign focused on abuse of the LVT by undervaluing and consignment splitting (Customs and Border Protection 2011c). The campaign's random sampling — which was 'reflective of the general population' (Customs and Border Protection 2011c, p. 4) — examined only instances of non-compliance that, if undetected, would have led to evasion of GST and duties. It uncovered low rates of active non-compliance — 0.1 per cent in international mail and 2 per cent in cargo, overwhelmingly due to undervaluing.

However, these low rates reflect that the campaign considered undervaluing and consignment splitting amongst only those goods whose true customs value exceeded the LVT.

- In 2009-10, about 0.3 per cent of items in the international mail stream were valued at above the LVT (PC 2011).
- In 2010-11, about a quarter of items in the air cargo stream were valued at above the LVT.^a

This implies that around one quarter ($0.1/[0.1+0.3]$) of *high value* items in the international mail stream and around 8 per cent of *high value* items in the air cargo stream were undervalued or part of a split consignment.^b

^a Productivity Commission calculation based on 10.6 million low value air cargo consignments (PC 2011) and 14 million total air cargo consignments in 2010-11 (Customs and Border Protection 2011a). ^b Given the very small share of low value items (as declared) transported through sea cargo, it is assumed that instances of non-compliance in the cargo stream are from air cargo.

Were the threshold for GST to be lowered, it is likely that rates of undervaluing and consignment splitting leading to GST evasion would be higher than revealed under the campaign. One study suggested that some vendors have poor knowledge of tax arrangements in other countries but systematically undervalue their goods in order to reduce the risk that their items attract a tax or duty liability for the purchaser (Pope, Sowiński and Taelman 2014). This suggests that there may also be a small degree of latent undervaluing that would become of consequence if the GST-specific LVT were lowered.

Furthermore, there is evidence that undervaluing is widespread in jurisdictions that have lower thresholds for GST or VAT.

- Some tax authorities within the European Union (where the threshold for VAT is between €10-22 depending on the country) noted that 'almost every parcel checked in customs was in breach of the rules' (Deloitte 2015, p. 62).
- An operation by the New Zealand Customs Service in 2013 found that over a quarter of examined low value items imported by express carriers were undervalued to below the

threshold. New Zealand imposes a threshold of NZ\$400 for duty and GST (New Zealand Customs Service 2013).

Managing undervaluing and consignment splitting

To enforce compliance under its model, the Taskforce recommended:

- DIBP undertake periodic sampling exercises to provide information about the extent of undervaluing and consignment splitting
- a review of offences and penalties relating to undervaluing and consignment splitting
- additional funding be provided to the DIBP for compliance activities.

While these activities would provide data on the source and extent of undervaluing and consignment splitting and reduce it to some degree, the approach underlying them is unlikely to be cost effective for low value goods. Even with sophisticated profiling in place, suspect items would still need to be manually examined in the first instance and (if still thought to be non-compliant) stored while evidence of their true value is sought from the purchaser.

For the modernised transporter model, Amazon proposed that the transporter should not be held responsible for the accuracy of the declared value, and did not suggest a measure to prevent undervaluing. And, in any event, Universal Postal Union regulations state that postal operators accept no responsibility for the completeness and accuracy of customs declarations.²³

Summary and comparison with legislated model

Compliance

The Commission considers the modernised transporter model would likely be more prone to non-compliance than the Taskforce model because it would provide vendors with stronger incentives to undervalue and transporters with weaker incentives to police undervaluation. When making a comparison with the legislated model, three factors are relevant.

1. Overseas vendors that sell through EDPs would effectively be ‘forced’ to comply with the legislated model, provided that their EDP was compliant. Under a transporter model, these vendors may have the capacity to undervalue. Vendors using EDPs supply about 25–40 per cent of low value imported goods (chapter 3).

²³ Universal Postal Union Regulation 151 states ‘Designated operators shall accept no liability for the customs declarations. Completion of customs declarations shall be the responsibility of the sender alone. However, designated operators shall take all the necessary steps to inform their customers on how to comply with customs formalities, and specifically to ensure that CN23 customs declarations are completed in full in order to facilitate rapid clearance of items’ (Universal Postal Union 2017, p. J.2).

-
2. Of those overseas vendors that do not sell through EDPs, it is likely that a larger share would be non-compliant with the legislated model than would be non-compliant with a transporter model (through undervaluing). This is because:
 - the legislated model would impose a higher compliance burden on those vendors than either transporter model
 - vendors would more directly benefit from non-compliance with the legislated model than from undervaluing or splitting consignments under the Taskforce model because they are required to collect the GST upfront under the legislated model.
 3. Undervaluation may lead to only a reduction in GST paid, rather than full evasion of GST.

On balance, it is likely that compliance would be higher under both transporter models than under the legislated model, as points 2 and 3 would suggest. However, to the extent that instances of undervaluation under a transporter model would be concentrated among vendors using EDPs, it is possible that the legislated model could engender higher compliance.

Collection rate comparison

As set out in chapter 2, the notion of a *collection* rate takes into account both compliance and the tax base to which a model applies.

Both the modernised transporter model and the Taskforce model (if implemented with no GST-specific LVT) would apply to a broader base of imports than the legislated model, as they would not exempt goods from suppliers with an annual turnover in Australia of less than \$75 000 (which comprise about 22–49 per cent of the market — chapter 3) (figure 5.3).

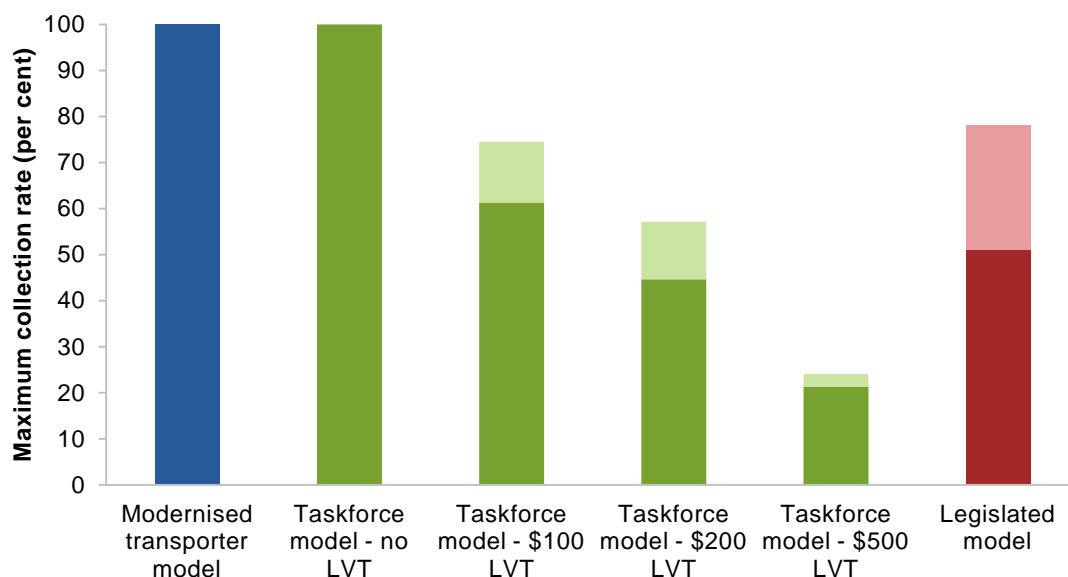
However, if the Taskforce model were to be implemented with a GST-specific LVT, this would substantially reduce its maximum achievable collection rate. For example, a \$100 LVT would reduce the maximum collection rate to about 60–75 per cent, a \$200 LVT would result in a maximum collection rate of about 45–55 per cent, and a \$500 LVT would lead to a maximum collection rate of less than 25 per cent (figure 5.3).²⁴

Factoring in compliance (discussed above) would increase the collection rate advantage of both LVT-free transporter models over the legislated model. Hence, the Commission considers that both transporter models could collect substantially more GST revenue than the legislated model.

This could change if the Taskforce model were implemented with a GST-specific LVT. For any LVT higher than \$200, it is plausible that the Taskforce model would collect less GST revenue than the legislated model.

²⁴ This reflects the fact that the bulk of low value goods are of very low value. PC (2011) estimated that 73 per cent of low value goods transported by international mail were valued at \$100 or less, while the Taskforce’s modelling assumed this figure to be 52 per cent of international mail items by *value*. Similarly, a sampling exercise by CAPEC members found that 46 per cent of low value business to consumer items were valued at \$100 or less, amounting to 11 per cent by value (CIE 2016).

Figure 5.3 Maximum achievable GST collection rates^{a,b,c}



^a All estimates assume aside feasibility concerns outlined in section 5.2. ^b Shading indicates a range estimate. Range estimate for legislated model is calculated in chapter 3. ^c Excludes B2B transactions.

Sources: Productivity Commission estimates based on ABS (pers. comm., 6 October 2017), CIE (2016, table 3.3), DIBP (pers. comm., 6 October 2017), LVPPT (2012) and PC (2011, table 7.3).

Other considerations

Impacts on consumers

To the extent that cargo transporters seek to collect the GST from suppliers, the modernised transporter model would, as with the legislated model, have minimal non-price impacts on consumers. However, it could lead to greater price increases than under the legislated model as suppliers and transporters seek to recover the additional compliance burden.

The Taskforce model would delay the delivery of items as transporters would need to collect the GST from purchasers before making the delivery. The Taskforce estimated an average processing time for items on which GST is due of two to three days for cargo transporters and five days for Australia Post.

Consumers would also face the inconvenience of making a second payment to cover the GST liability. This would potentially include a handling fee in the order of \$15, although it is likely that the consumer would pay a lower price for the item and/or transportation under the Taskforce model as the GST is not collected at the point of sale.

Complementarity with border processes

The similarity of the Taskforce model with the existing border collection process for items valued over \$1000 offers some advantages. Because items valued at or near \$1000 would be separated into either stream at the border, the model would not suffer from the frictions created by the legislated model for such items (as discussed in chapter 3). However, this is a minor benefit that would impact only a small share of items.

The CBFCA (sub. 36) suggested that the imposition of a transporter model would allow for more efficient cost recovery of border regulation activities. The cost recovery charges levied by DIBP and the Department of Agriculture and Water Resources on import declarations (for goods valued at over \$1000) cross-subsidise the clearance of items valued at or below \$1000, on which no fees are charged (LVPPT 2012). The CBFCA (sub. 36) estimates the cross-subsidy at \$12 per import declaration, which amounts to less than \$0.50 per low value item.²⁵

As set out in its 2001 inquiry into cost recovery by government agencies (PC 2001), the Commission considers that cost recovery arrangements should generally avoid cross-subsidisation, on efficiency grounds. However, while a transporter model would present an opportunity to reduce or remove this cross subsidy by extending cost recovery charges to low value goods, other mechanisms could also achieve this end. For example, there may be scope to recover costs from transporters in proportion to the volume of goods they present for customs clearance. If this is not permissible or cost-effective, there may be a rationale for the costs associated with clearance of low value goods to be funded entirely from consolidated revenue.

Incorrect assessments

Due to limitations and inaccuracies in the information available to transporters, it is likely that GST would sometimes be levied on GST-exempt items under both transporter models. As the Taskforce acknowledged, there would need to be a process in place to claim a refund from incorrect GST assessments. It suggested that the transporter should take responsibility for this in the first instance.

While this is a minor issue — as only about 0.6 per cent of low value imported goods are GST-exempt (CIE 2016) — it is likely to be more prevalent under a transporter model than under the legislated model due to the differences in data quality available at the point of GST assessment.

²⁵ Productivity Commission calculation based on Australia Post (sub. S5) and DIBP (pers. comm., 6 October 2017).

Compliance with trade obligations

As set out in chapter 2, GST collection models must not breach Australia's international trade treaty obligations by adding unduly to the cost of trade or infringe national treatment. However, neither transporter model is likely to present such a risk. Models similar to the Taskforce model currently apply in Canada and the United Kingdom and other countries have more onerous border collection arrangements in place, and these practices have not been contested in trade dispute fora. Moreover, as the modernised transporter model would involve a lower administrative and compliance burden than the Taskforce model, it would also seem unlikely to be challenged.

Summing-up

The key virtue of transporter collection models is they place the legal responsibility for assessing and collecting GST for low value goods on entities within Australia's legal jurisdiction. Combining this feature with no exemption for goods from small suppliers means that transporter models could achieve significantly higher compliance and collection rates than the legislated model.

However, the Commission considers that transporter models cannot sensibly be considered as feasible alternatives to the legislated model in the near term. This is due to the legacy paper-based declaration processes still in operation for most goods sent by international mail. Electronic advance data for international mail needs to be prevalent for the models to be effective, but this is not likely for some years yet. The additional need, under the modernised transporter model, for Australia Post to negotiate GST collection arrangements with overseas operators to ensure that GST is collected upfront from the vendor is another barrier to deployment in the near future.

While the near term barriers to adopting a transporter model can be overcome with time, a major downside to their deployment at any time would be the substantially higher administrative and compliance burdens on the Government, businesses and consumers relative to the legislated model. While precise estimates are not possible, the order of magnitude of this burden could be similar to or even above the revenue the model would raise.

Lower administrative and compliance costs would be possible if the Taskforce model were adopted together with a GST-specific LVT. However, a threshold of at least \$500 appears necessary to limit the administrative and compliance burden to anywhere near the same level as the legislated model. At this point, the GST would apply to less than a quarter of low value imported goods by value, limiting prospective revenue and only marginally improving tax neutrality between imported and domestically retailed low value goods.

Hence, on the basis of the analysis undertaken during the inquiry, the Commission considers the structural features of transporter models to be inherently less efficient than the legislated model. This precludes their feasibility for the time being, but they should not be excluded from future consideration, especially if the legislated model underperforms or leads to unintended negative consequences for consumers.

6 Other collection models

Key points

- Alternative models have been advanced for collecting GST on low value imported goods. In addition to vendor and transporter models, other points of collection include purchasers, at the border and financial intermediaries.
- The purchaser self-assessment and financial intermediary models have the merits of placing the legal liability for GST collection on entities within Australia's jurisdiction and the scope for information technologies to monitor enforcement at modest cost. These attributes favour compliance.
- However, current payment and software systems do not transmit sufficient information for assessing GST liabilities or for monitoring and auditing compliance. Moreover, the information technology requirements needed to do so go well beyond system upgrades and remain untested.
- The Commission considers the unproven feasibility and non-readiness for deployment by mid-2018 make the purchaser self-assessment and financial intermediary models unsuitable at this time. A review of the legislated model after five years should revisit this conclusion in light of developments abroad and technological advances.
- The border collection model — currently used to collect GST and customs duties on imports of goods valued above \$1000 — would involve very high administrative and compliance costs and entail delays and disruptions to the delivery of low value imported goods. The Commission's 2011 conclusion that the model is unworkable remains.

The terms of reference ask the Commission to examine whether models other than the legislated model might be suitable for collecting GST on low value imported goods. Options are typically distinguished by where in the supply chain for online imported goods the legal obligation to assess, collect and remit GST is placed. This choice is important because it bears on the efficiency of tax administration, compliance costs and non-pecuniary factors, like consumer convenience.

Other potential collection models are diverse. They include collection: by vendors; by transporters; by purchasers; at the border; and by financial intermediaries. Often they involve combinations of different models and sophisticated technological solutions that their advocates claim would minimise otherwise high costs of compliance and enforcement.

Chapters 3, 4 and 5 discussed the vendor-based and transporter models (and hybrid models based on them). This chapter outlines and provides a high-level assessment of the remainder. It draws upon the findings of earlier reviews into alternative collection options, including the Productivity Commission's 2011 inquiry into retail trade (PC 2011), the 2012 Low Value

Parcel Processing Taskforce (the Taskforce; LVPPT 2012) report, and recent work by the Organisation for Economic Cooperation and Development (OECD 2015).

6.1 Purchaser collection models

Conventional purchaser models

The purchaser collection model requires consumers to self-assess and pay the GST on imports of low value goods. There are three main variants of this model.

- Purchaser pre-registration, whereby the purchaser pre-registers their details with customs authorities and uses an identifier through a web store checkout process, with voluntary self-assessment and payment of tax at that point or at the point of importation.
- Real-time purchaser self-assessment on delivery, where the purchaser is required to self-assess their liability and pay to a delegated tax authority at the time of release of the goods.
- Post-release purchaser self-assessment, whereby the purchaser is required to periodically or annually account for the tax through a reporting mechanism, such as a GST declaration or income tax return.

A major disadvantage of all the variants is that they rely on self-compliance. This requires knowledge by the purchaser about the applicable GST regime (including product exemptions and GST rates, should they vary by product), which is often not the case. Moreover, there is a high likelihood that purchasers would either undervalue the goods, or would not comply if there is no effective sanction.

International evidence supports the view that consumers will not readily comply with efforts to collect indirect taxes even when prompted to do so. The submission from Berg and Davidson pointed to research in the United States that found:

... 27 US states now include a line item in their tax returns for domestic residents to self-declare any sales taxes that are due to the state. The state of Nebraska conducted an experiment where 1000 taxpayers were sent a postcard reminder of their sales tax liability and Anderson investigated the potential for an improved self-reporting rate amongst those taxpayers compared to a sample that did not receive the reminder. The results are not encouraging — the rate of self-reporting increased from 0.7 per cent to 1.6 per cent. (sub. 33, p. 5)

The purchaser collection model requires the development and implementation of administrative and information systems for audit purposes, and to enable purchasers to interface with the tax system. Notwithstanding some ability for customs or tax authorities to use third party data, this would increase the administrative burden considerably and may even be impossible to implement in practice without a non-zero threshold, as it would effectively require monitoring of almost anyone who can make a purchase online. With millions of taxpayers involved in online purchases, this is obviously problematic.

The Taskforce (LVPPT 2012) considered but did not support the pre-registration and post-release variants of the purchaser collection model.²⁶ The Taskforce noted the likelihood of widespread non-compliance under the post-release variant (using declaration and payment via income tax returns), and considered that the pre-registration variant would involve ‘significant procedural and technical difficulties’ (p. 212). A recent OECD (2015) report expressed similar reservations.

New technology-based purchaser models

Recognising these obstacles, one participant to this inquiry — Lamensch (sub. 10) — suggested new technologies that enhance traceability of purchases could make the purchaser collection model more attractive. For example, image scanning and data storage technology could be used at the border to enable tax authorities to identify when GST is due and ensure tax collection from purchasers in a timely and efficient manner. Another option (deployed either in tandem or independently) uses a purchaser’s financial institution to identify, calculate and remit GST on offshore payments (box 6.1).

Lamensch claimed this technology-based purchaser collection model had multiple advantages, including:

- GST remaining within the tax jurisdiction, thereby facilitating improved enforcement
- the ability to identify GST liability and avoid delays in delivery associated with border collection
- addressing the major fraud issue of undervaluation of imported goods
- greater efficiency from streamlined audit procedures through data automation and reduced compliance obligations on suppliers
- removal of the double taxation risk, or unintended taxation in the case of supplies made via platforms (sub. 10, pp. 2–3).

Some aspects of this more sophisticated purchaser collection model appear promising, but the lack of hard evidence on operational risks means it is too early to judge its viability for deployment in the Australian context. The invasiveness of auditing and compliance processes (where GST remains unpaid by the purchaser), for example, would need to be addressed. The Commission also notes that even though the technologies have been trialled, they are not currently operational and would not be ready for the legislated 1 July 2018 start date for the collection of GST on low value goods.

The Commission considers that the future review of the legislated model (chapter 4), which it is recommending be scheduled for 5 years after the model’s introduction, would provide an opportunity to assess international experience with the adoption or piloting of a technology-based purchaser model. That assessment could inform alternative collection mechanisms, should significant problems with the legislated model become apparent.

²⁶ The Taskforce considered the pre-registration variant of the purchaser collection model in conjunction with a border collection process acting as a backstop to enforce compliance.

Box 6.1 Purchaser collection via PAYS and iVAT

Pay As You Shop (PAYS)

PAYS is a method to collect GST on goods under a certain value. It applies when goods bought online are processed through customs and freight carrier facilities for further distribution to purchasers. Every parcel or package coming through mail centres or courier facilities is photographed and the name, address and any customs declaration information on the parcel is captured and inspected automatically. Every parcel image is associated or digitally linked with a unique overseas shopping identifier, quick response code or a unique electronic serial number, which is printed and affixed to the parcel in real time. At the same time, electronic 'events' for every parcel are generated and stored on a central database to enable monitoring, auditing and data analysis.

The system requires purchasers to be registered with the government tax authority. Upon delivery to the purchaser, the overseas shopping identifier/quick response code can be scanned by delivery agents and customers using mobile devices. Upon scanning, the event is triggered on the central database and the image of the parcel and its associated information is delivered electronically. The customer then has to self-declare the GST on the purchased goods and provide (as an electronic attachment) a proof of purchase or an invoice. GST exemptions such as gifts can be incorporated into the process with safeguards (such as a maximum number of gifts claimable per year) monitored by the system. Undeclared parcels are recognised by the automated data system with payment notices or warnings sent to purchasers before penalties may be imposed by tax authorities. Blacklisting of deliveries to non-complaint purchasers until GST is paid is also possible. The incorporation of automated price checking functionality would also ensure accurate valuation for GST liability.

Intelligent VAT (iVAT)

iVAT is an extension of the PAYS system. It aims to improve GST compliance via split payments by allowing the purchaser to pay the GST directly to the tax authority. Purchasers obtain unique iVAT identifiers from a government portal, which are paired to bank accounts or credit card numbers to allow offshore transaction data to be captured by government. The transaction details of a purchaser ordering online from offshore suppliers are transmitted to a government portal which then notifies the purchaser of the need to pay the associated GST liability.

In contrast to traditional split payment procedures (section 6.3), payment is made by the purchaser and not by the financial intermediary. Three components of the system involve the purchaser:

- (a) registering with the tax authority
- (b) linking that registration with a bank account or financial intermediary in order for offshore transaction data to be transmitted to the tax authority
- (c) automatic identification of offshore transactions made by credit card or bank transfer that triggers GST liability with the purchaser notified of the requirement to pay that liability.

Where purchasers fail to either register or link registration to financial accounts, offshore payments could be blocked.

Source: Lamensch and Saraswat (2017).

6.2 Border collection model

The border collection model assigns customs authorities to assess the value of the imported goods and to hold them until the GST payment is made by the recipient of the goods. It is currently used in Australia to collect GST and customs duties on imports of goods valued above the low value threshold. This model could be extended to low value imported goods by lowering the threshold either to zero or to an amount less than \$1000.

In 2011, the Commission concluded that extending the border model to low value imported goods (to collect both GST and duties) would involve disproportionately high administrative and compliance costs and entail delays and disruptions to the delivery of goods. Abolishing the threshold altogether would entail at least \$2 billion in annual administrative and compliance costs to collect around \$600 million in revenue from GST and duties. If instead the threshold were reduced to \$100 it would entail at least \$1.2 billion in administrative and compliance costs to collect around \$500 million in revenue. Extending the border collection model would also lead to delays and inconvenience for consumers.

The Commission concluded that ‘any consideration of a significantly reduced threshold would necessitate a radically redesigned and highly efficient revenue collection system’ (PC 2011, p. 202). More recently, the OECD (2015) also concluded that the border model (which it termed the ‘traditional model’) is generally ‘[not] an efficient model for collecting the [GST] on imports of low value goods’. The Commission has not received any new evidence in this inquiry that changes this conclusion.

6.3 Financial intermediary models

As its name suggests, the financial intermediary model assigns legal responsibility for collection of GST to banks, credit card schemes and/or other payment providers. When coupled with sophisticated information technology systems, it offers the advantage of limited compliance and enforcement costs.

The prospective appeal of the financial intermediary model has motivated past inquiries to assess its merits and feasibility, but they have rejected the model on the grounds it was not yet feasible. The Commission’s 2011 inquiry into retail trade (PC 2011), for example, noted the payment system did not allow the identification of the components of a transaction needed to determine what taxes were applicable (box 6.2). Similarly, the Taskforce (LVPPT 2012) considered that while the model may have future applicability, it was not viable in the short term due to a lack of requisite information and systems.

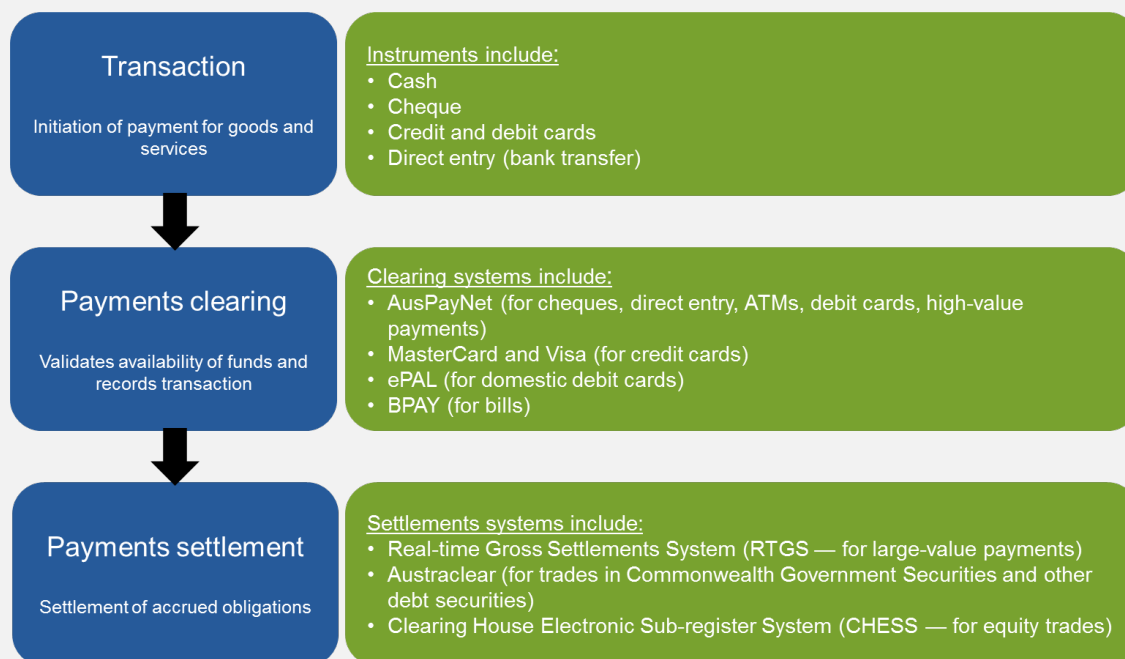
This inquiry has heard evidence that claims new developments are changing the calculus to possibly render the financial intermediary model an attractive option. In assessing these developments the Commission has placed a strong onus on parties to demonstrate the feasibility, superiority and readiness for deployment of the model.

Box 6.2 How payments systems work

Payments systems are based on the exchange of abbreviated messages between participants which carry coded payment/transaction and limited additional information for each transaction or payment. They generally involve three distinct steps: initiating the transaction, payments clearing and settlement (figure below).

- Initiation involves the use of a payment instrument (cash, cheque, credit card or direct entry) to purchase goods or services (online or in person) or to transfer/remit funds between two financial accounts (payee and payer).
- Clearing involves the exchange of payment instructions or messages between payment system participants (banks and other financial institutions) and verifies that sufficient funds are available to complete the transaction. Clearing is facilitated through payment networks such as Visa and Mastercard (in the case of cross-border trade) which process transactions made using internationally accepted credit and debit cards (the dominant payment method).^a
- Settlement involves the final exchange of funds between the purchaser's financial institution and the merchant's financial institution. According to Mastercard:

The Mastercard network enables the routing of a transaction to an issuing bank for approval. Once approved, we help to settle the transaction by facilitating the exchange of funds between parties via settlement banks. (sub. 17, p. 1)



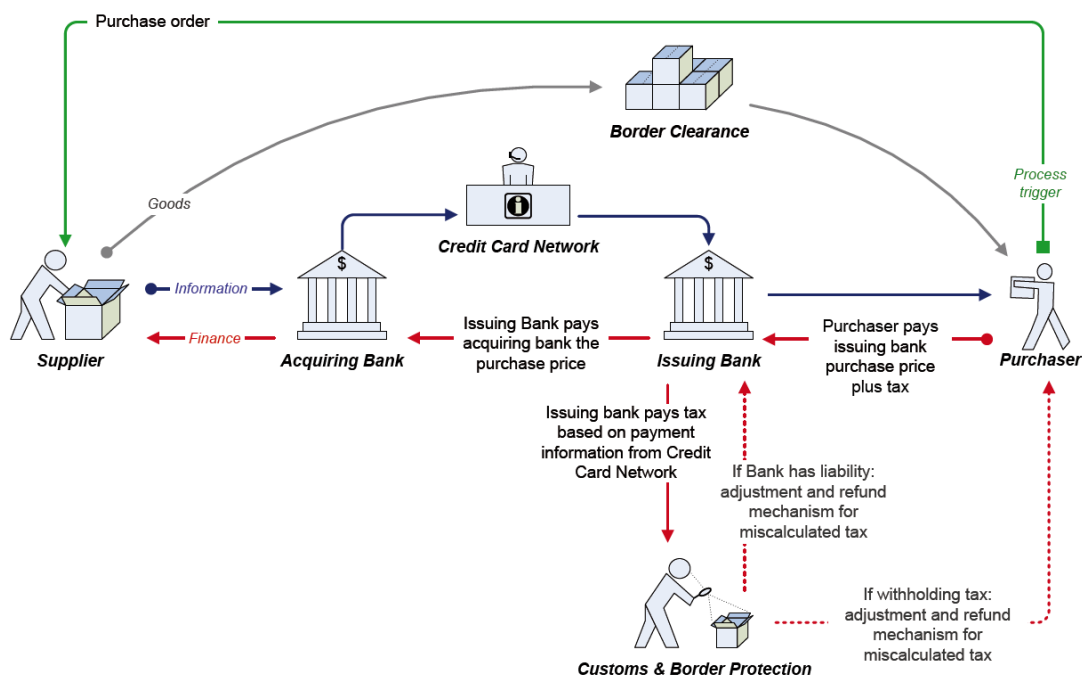
^a Two-thirds of total non-cash consumer payments by value were made using a credit or debit card in 2016. While less than 5 per cent of consumers used PayPal as a non-cash payment medium in 2016 this was double the share reported in 2013. Strikingly, a survey of cross-border e-commerce shoppers in 2016 found that 64 per cent of Australian consumers cited PayPal as their preferred payment option.

Sources: IPC (2017); RBA (2017a).

Merits and feasibility of the model

Under the conventional financial intermediary model, GST would be collected through the payments system by credit card or other payment providers involved in online purchases of goods from offshore suppliers (figure 6.1). The model involves either imposing the GST liability on the financial intermediary itself, or on the supplier or purchaser, with the intermediary recovering the GST liability from either the supplier or purchaser — effectively a withholding tax regime (box 6.3).

Figure 6.1 **GST collection through the payments system**



Source: LVPPT (2012, p. 136).

The key advantages of this approach are that:

- the transaction value is known, hence undervaluing (chapter 5) is not an issue
- GST revenue could potentially be remitted directly to the tax authority in (or close to) real time and without any involvement by the supplier
- it mitigates against fraud through non-payment of collected GST by suppliers, because the GST is paid directly to the tax authority.

In her submission, Lamensch saw further advantages in the approach:

Major positive aspects of a financial intermediary model include, first, the fact that the tax collector has no incentive to not collect the GST (in contrast with vendors whose prices are higher and less competitive when including taxes). Second, under this model the tax collector is located in the jurisdiction having the taxing rights (hence within jurisdictional reach). (sub. 10, p. 2)

Box 6.3 **Withholding tax and split payment systems**

Withholding tax and split payments

Once a transaction has been initiated, there are numerous approaches to quarantining (splitting) the tax component from the payment to the supplier and/or transporter. The method adopted by countries varies and is typically applied to certain domestic registrants or supplies. For example, Thailand has recently proposed legislation that would levy a 5 per cent withholding tax to be collected by banks on *all* online purchase payments (Chantanusornsiri and Paweewun 2017). A withholding tax regime could also potentially apply on payments by residents of a country for goods and services purchased online from foreign suppliers. In practice, the obligation to pay the GST liability is often shifted from the foreign supplier to a local collection agent or a third-party payment processing intermediary (OECD 2015, p. 114). But for such a mechanism to function efficiently the agent or financial intermediary responsible for withholding must have sufficient information about the covered transactions to know when the tax applies and when it does not.

Split payment model using a blocked bank account

Blocked bank accounts are a mechanism for storing GST amounts prior to remitting the GST payment to the revenue authority. The blocked account can be at the level of (a) automated clearing house (b) taxable person's bank (c) tax authority's bank. Under this arrangement, the purchaser pays the GST to the blocked account which can only be used by the supplier for paying GST to the tax authority. The advantage of this approach is that, in an early stage of the GST collection process, the GST collected is transferred to a blocked bank account within the tax authorities' bank. This allows the tax authorities to monitor and block funds on the bank accounts and prevent suppliers from disappearing with GST funds paid to them by the purchaser (PwC 2010). Several countries have either adopted or are considering versions of the split payment blocked bank account approach, primarily for application to domestic supplies, including Italy, Romania, Poland, Peru, Mexico, Costa Rica and the United Kingdom.

Sources: Chantanusornsiri and Paweewun (2017); OECD (2015); PwC (2010).

However, historically the nature and quantity of payment information has reflected the importance of timely processing and settlement (a key attribute of payment systems alongside accessibility, ease of use, integration with other processes, safety and reliability). As such, payment systems were not designed, intended or suited to the collection, transmission and storage of large amounts of data that would enable governments to overlay taxation and other information intensive regulations on those systems.

At present, the direct entry system (the main payment system used for business payments, bulk payments such as wages and salaries, and regular bill payments) can carry a maximum of 18 characters of remittance data with the payment message (BSB, account number and payment amount). For credit/debit card payments, the data available to the acquiring (supplier's) bank are limited to the total payment amount, basic supplier details (merchant code) and credit card number (which identifies the issuing bank). The issuing (purchaser's) bank, on the other hand, only receives information on the time of purchase, supplier name and the payment amount.

For the financial intermediary model to be viable, it requires considerably more detailed information. In particular, the:

- description of the goods purchased in line with product classifications used to exempt items from GST liability
- location of the goods at the time of purchase
- nature (consumer or business) of the end use for the purchase
- location (domestic or offshore) of the recipient of the goods
- sale price of the goods
- cost of transport and insurance (with only the domestic component subject to GST).²⁷

Without this information, relying on financial intermediaries to collect GST would in practice mean levying GST on all transactions. Since many transactions do not relate to low value imported goods, added complexity and over taxation will likely occur, as GST on high value imported goods is collected at the border, and GST on all other taxable supplies (domestic and from offshore) is collected from the supplier. This option would also provide scope for avoiding GST through alternative payment mechanisms (for example, by using a foreign bank issued credit card, digital currency etc).

As the OECD (2015, p. 208) has noted:

Financial intermediaries do not collect the relevant information for the assessment and payment of the VAT/GST and the development of a model relying on the payment system would involve deep changes in the data collection process. It is therefore unlikely that financial intermediaries could play a role in a more efficient collection of VAT/GST on imports of low value goods.

Do new developments alter the model's viability?

Technological and other developments, however, may have the potential to resolve the issues that have thus far excluded the financial intermediary model from consideration as a feasible collection model. There are, for example, several initiatives in the pipeline that might allow additional payments data to be collected and used to determine and collect GST for cross-border payments.

One of these is the adoption of international standards which provide the flexibility to incorporate other information into remittances. The most widely accepted transaction messaging standard for the financial industry (the International Organization for Standardization's ISO 20022 *Financial Services – Universal financial industry message*

²⁷ Although the messaging standard used for credit/debit card schemes (ISO 8583) is technically capable of transmitting considerably more information than is currently used, the collection and transmission of information needed to collect GST would require the operators of these schemes (Visa and Mastercard) to modify their systems so that vendors could input the relevant additional information at point of sale.

scheme) has already been partly adopted in several countries. The international standard does not currently cover the reporting of GST information.²⁸

Another option is to provide additional data capabilities as part of the new real time retail payment system which is currently being deployed (box 6.4). The New Payments Platform (NPP) will enable more information to be attached to a *domestic* payment instruction, with users able to send up to 280 characters of remittance information (RBA 2017b, p. 30). In principle, this could be used to provide information necessary for the calculation and remittance of GST. At this stage, however, the NPP does not cover credit or debit card schemes, which are the main payment method for cross-border purchases.

Box 6.4 New Payments Platform

Recent payment system developments in Australia have been focused on achieving faster processing through faster settlement or payment initiation primarily for direct entry elements of the payment system, including direct credit and debit, BPAY and cheques. The objectives are to provide greater convenience, time saving and certainty about the availability of funds for consumers, and improved cash flow with more timely access to settled funds for business. The NPP will also enhance the ability to send more complete remittance information with payments.

Importantly, the NPP will only be available to domestic payment system participants and is independent of the credit/debit card schemes (e.g. Visa and Mastercard) which administer their own networks and rules for card issuance, acceptance and processing. The NPP is now in the final testing phases and initial functionality is expected to commence by 2018.

Two broad categories of data will be generated by NPP participants – transaction data and PayID records. Transaction data are generated by the payer and payee while generating and processing clearing and settlement messages across NPP infrastructure. While this would include a number of typical data elements (such as account details, transaction value and date) these do not extend to the detailed information that would be needed to determine GST liability. Overlay services (such as those allowing instant payments from financial institutions) developed by participants will potentially enable additional transaction data to be carried in the message payload but it will be up to the Overlay Service Provider to determine what data are included as part of their Overlay Service. PayID services will facilitate the use of email addresses and mobile phone numbers (linked to bank accounts) as payee payment addresses (instead of BSB and account numbers).

Importantly, there is no central store of customer transaction data (or incidental transaction data such as disputes). NPP participants maintain their own customer transaction data in their own back office environments. Neither NPP Australia Limited (owned by 13 financial institutions funding and developing the NPP) or SWIFT (which is building the NPP infrastructure) has access to personally identifiable information (PayID) or details about particular transactions.

Sources: RBA (2012, 2017b).

²⁸ According to the International Council of Payment Association Chief Executives (Lipis Advisors 2014) there are hundreds of national standards already in use and convergence to one global standard would be a major step forward. Convergence is being hampered by the processing capacity requirements for larger, more complex messages, operational risks in moving to a new standard and the lack of a clear business case to support migration in its own right.

Proliferation of payment options

While credit and debit cards schemes are excluded from the NPP architecture, other innovations, such as distributed ledger technology (including digital currencies such as Bitcoin) have the potential to materially alter the role of card payment networks and financial intermediaries in the payment system. There has already been spectacular growth in complementary online payment options, such as PayPal (with 200 million users and 15 million merchants worldwide in 2017), AliPay (with 500 million users in 2017) and POLi (an online direct debit payment method) and a host of other innovations.²⁹

These platforms use their own messaging standards, identifiers (which differ to the industry and product codes used by credit card providers and those used in the administration of Australia's GST system) and information requirements which may or may not allow for the type of good or service being purchased (and in some cases even the merchant) to be described.

The diversity of alternative payment options complicates the achievement of common standards for collecting, transmitting and storing data needed for a financial intermediary GST collection model to be feasible. It may even mean the prospective use of financial intermediaries as a GST collection point is further into the future than was envisaged by earlier inquiries that looked at this issue. And the absence of a means of linking credit/debit transactions with the overseas supplier further detracts from the immediate practicality of a financial intermediary collection model.

There is also a broader issue about imposing a unique obligation on payment systems (such as PayPal and AliPay) that operate across multiple jurisdictions. The need to change the associated platforms to accommodate the collection of a tax for one country has been argued to involve significant costs for these providers that may lead to unintended consequences, such as cessation of supply and retaliatory actions by other countries.

Netsweeper

While the domestic focus of the NPP precludes it from application to GST collection at this time, Netsweeper (subs. 8, 32) claimed that the necessary transaction information and information technology systems were already in place to make a payment system collection model viable (box 6.5).

²⁹ PayPal and AliPay provide overlay services allowing secure storage of credit and debit card details to facilitate payment. PayPal also facilitates direct debit payments by linking PayPal accounts to user's bank accounts.

Box 6.5 **Netsweeper**

Netsweeper offers a proprietary, integrated GST collection, remittance and enforcement system that involves blocking non-compliant vendor websites to provide incentives for participation in GST collection by vendors of low value imports (effectively mandatory registration). The system involves:

- a withholding tax regime imposed at source on overseas vendors (with projected GST revenue estimated at \$400 million annually. (Netsweeper claims that extending the coverage of the proposal to include digital services and other revenue streams would enable it to collect \$3 billion annually)
- a software interface that allows tax authorities to generate reports based on vendor information including goods sold to end users, and the amount of GST and customs duty collected within the jurisdiction
- interoperability with electronic pre-arrival data used by postal carriers, customs and quarantine agencies and other databases as needed to enforce other national laws
- a 'payment stack' that separates each transaction into its component parts including base product value, GST liability, duty liability and freight. The payment stack requires payment gateways to utilise Netsweeper payment information fields. These fields are populated at point of sale and are used to generate GST and HS (Harmonised Commodity Description and Coding System) codes
- a public--private partnership between the national tax authority and Netsweeper, which jointly owns the system that is deployed within the country that is responsible for enforcing the taxation and other laws and interfacing to the payment gateway systems.

For the Netsweeper system to operate efficiently, the vendor's payment gateway would need to compel the vendor to use the customised payment processing system to ensure the correct taxation information is applied.

Sources: Netsweeper (subs. 8, 32; pers. comm. 22 October 2017).

According to Netsweeper (subs. 8, 32), its solution has several advantages over alternative collection models, including:

- delivering 100 per cent compliance
- a low cost of operation (with a merchant fee of 1.1 to 1.2 per cent and a fee to the Australian Government of 5 per cent of revenue collected)
- eliminating potential delivery delays under the various transporter options (where goods may need to be held at the border awaiting payment of GST)
- facilitating the refunding of GST for returned purchases.

However, a lack of detailed operational information (which the Commission understands reflects commercial sensitivities) makes an assessment of this proprietary system difficult. In particular, the Commission is aware of, but has not been able to assess the possible impacts on competition in the payments system, the costs of adapting and maintaining systems that would interface with Australian tax and (potentially) other legal requirements and the opportunities for tax avoidance by shifting payments through intermediaries located in third

countries. The cost of GST collection to Australian taxpayers is also higher than that estimated for the legislated model (chapter 3).

These are issues that could be detrimental to the interests of Australian consumers and businesses and require analysis well before any consideration for deployment. The Commission is not aware of any other jurisdiction where this proprietary model has been deployed or tested for indirect tax collection, although several jurisdictions are reportedly assessing its viability. These prerequisites obviously mean the Netsweeper model would not be ready for the legislated 1 July 2018 start date for the collection of GST on low value imported goods. However, the future review of the legislated model (chapter 4) provides an opportunity which should not be let go to assess international experience with the adoption or piloting of such a system, to inform assessments of alternative collection mechanisms should significant problems with the legislated model become apparent.

APPENDICES

A Consultation

During the inquiry, the Commission received 44 written submissions from inquiry participants, which are listed in table A.1 The Commission also met or spoke with a range of individuals, industry bodies, regulators and other government agencies (table A.2). The Commission held public hearings in Melbourne and Sydney. The participants are listed in table A.3.

Table A.1 Public submissions

<i>Participants</i>	<i>Submission no</i>
Amazon Australia	11, 35, S4
Anna's Farm Pty Ltd	2
Australia Post	37, S2, S5
Australian Retailers Association	21
Australian Sporting Goods Association Incorporated	15
Australian Taxation Office	S3
Australian Taxpayers' Alliance and MyChoice Australia	29
Berg, Chris and Davidson, Sinclair	33
Chamber of Commerce and Industry Queensland	27
Chan, Craig	14
Chartered Accountants Australia and New Zealand	22
CHOICE	20
Clark, Robert	1
Conference of Asia Pacific Express Carriers (Australia)	24, S1
CPA Australia	26
CR Kennedy and Company Pty Ltd	12
Customs Brokers and Forwarders Council of Australia	36
DHL Express (Australia)	23
Disrupt Sport	18
eBay, Alibaba Group and Etsy	25
Freight and Trade Alliance and Australian Peak Shippers Association	34
Gonsalves, Jon	7
Hi-Tech Freight Solutions (Aust)	5
James, Kathryn	28
Lamensch, Marie	10

(continued next page)

Table A.1 (continued)

<i>Participants</i>	<i>Submission no</i>
Lanyon, Michael	4
Large Format Retail Association	19
Lloyd-Jones, Stephen	13
Marti, Hans	38
Mastercard	17
Netsweeper	8,32
Premier Investments	39
Ronneberg, Terie	31
Shafer, David	6
Smith, Edward	30
Stilling, Keith	3
Thompson, Craig	16
Wise Tech Global	9

Table A.2 Stakeholder consultations

<i>Participants</i>
Aegis Consulting Group, on behalf of eBay, Alibaba and Etsy
Alibaba Australia
Amazon Australia
Australian Taxation Office
Australian Treasury
Customs Brokers and Forwarders Council of Australia
Department of Communications
Department of Immigration and Border Protection
eBay
Gonsalves, Jon
KPMG Australia, on behalf of Amazon
Lamensch, Marie
Mastercard
Netsweeper
Organisation for Economic Cooperation and Development
Premier Investments
Reserve Bank of Australia
Stilling, Keith

Table A.3 Public hearings

<i>Individual or organisation</i>	<i>Transcription pages</i>
<i>Sydney – 22 August 2017</i>	
Australian Retailers Association	2-16
Worldwide Consulting in Customs Administration and Technique	16-28
Netsweeper	28-48
Wise Tech Global	48-51
<i>Melbourne – 24 August 2017</i>	
Conference of Asia Pacific Express Carriers	54-67
eBay and Alibaba Group Australia & New Zealand	67-85
Sinclair Davidson	86-91
Amazon Australia	91-122
Australia Post	123-130
Netsweeper	130-131
Worldwide Consulting in Customs Administration and Technique	131
Amazon Australia	131-133

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