Submission From Link International Pty Ltd

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Link International Pty Ltd is an import wholesale distributor of motorcycle parts and accessories. Link currently employs 65 staff and sells directly to over 1600 motorcycle dealers and retailers. Link has carried out detailed surveys of its dealer network in an attempt to understand how their business has been affected by the low value GST threshold.

The survey results have given a clear indication to us that the biggest problem facing our industry at the moment is the attack by overseas websites, directly aimed at the Australian consumer, exploiting the GST import duty loophole. Our surveys indicate that our dealer base is losing somewhere between 10 and 20% of their total retail sales which is beginning to have an enormous affect on the profitability of their businesses and a large number of our customers have started to retrench staff in an attempt to put their businesses back into a profitable position. Unfortunately, a lot of the smaller mum and dad shops (family run businesses), that had no staff and low overheads to begin with just simply cannot compete and are closing their doors.

Since March of this year, we have received a record number of delinquent trading accounts and a record number of businesses going into receivership. We believe this is a direct result of the massive increase in overseas online ordering from the Australian consumers. We as a wholesaler are trying our best to support our dealer network by reducing our wholesale pricing and RRP pricing as quickly as we can to enable our dealers to compete online, but unfortunately there is a long time lag because, in some cases, we are carrying 12 months inventory in our warehouse, so that retail prices cannot drop as quickly as they need to. Unfortunately, because of our higher cost structure, from a wholesale point of view, and our dealers' higher costs, it is virtually impossible to get our pricing down to the level that our US competitors RRP's are currently at.

The flow chart 'Australian Retail Price Value Chain' (Appendix A) demonstrates a rough explanation of how the costs can vary so greatly between the US (Appendix B) and Australian markets. This illustration assumes that 100 widgets cost $10 from China, and the factory offers volume discounts. Bare in mind that our US competitors have a market that is sixteen times bigger, but here we are only assuming a ten times greater volume increase. There are so many variables and factors in this equation that can change, but this illustration shows how dramatically the end price can change, even if the cost price only varies by $2 in the beginning. When you compound the higher costs through the value chain, each step of the way, the $2 cost difference turns into a $19.50 price difference. This illustration is even more dramatic if we increase the wholesale and retail margins from 60% to 100%. The $2 price difference increases to a $41.90 difference, when the final price of $61.14 is compared to the US counterpart of $19.50. A 100% mark-up is required in some industries where there is a high cost of redundant and obsolete stock, or industries that have very low stock turns. Within industries such as clothing and fashion a 100% mark-up is standard.

In the attached flow chart (Appendix A) we refer to higher costs associated with running a business in Australia compared to the US (Appendix B). These higher costs occur in virtually every aspect of the business from the cost of stationary, through to wages, rent and insurance. I have also attached a flow chart (Appendix C) which roughly breaks down the Australian minimum wage into the cost to the employer per hour worked to give you a better understanding of why our costs are so much higher when compared to US minimum wage (see Appendix D). If you look up a website and saw that the Australian minimum wage was $15 per hour and US was $7 per hour you would quickly assume that our wage costs are double. However, the reality is that our minimum wage costs are three times that of the US equivalent. So when an Australian consumer, earning fantastic wages (with all the workplace entitlements), has the opportunity to buy goods with the push of a button from a low cost market, duty and tax free, and have them delivered to their front door within days, we have to expect that they are going to take advantage of this loophole.

Australian Retail Price Value Chain – Appendix A

Cost price from manufacturer declines as order amount increases – e.g.
100 widgets = $10 each
1000 widgets = $8 each

Cost from Chinese manufacturer for 100 widgets
Total: $10 each

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Freight
$10 + 10% = $1
Total $11

10% freight assuming shipment may be an LCL up to 20ft container

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Assuming 5% port and clearance fees and 10% duty. Note: import duty varies from 0-20%.

Port Charges, Customs Fees and Duty
$11 + 15% = $12.65

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LANDED cost to distributor
Total = $12.65

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Distributor mark-up to retailer
$12.65 + 60% = $7.59
Total: $20.24
(gross margin 37.5%)

(refer to appendix B) Australian distributors' costs are up to three times higher due to higher interest rates for business loans and overdraft, higher wages ($21.30 p/hour minimum wage after adding back superannuation, payroll tax, holidays, holiday leave loading, long service leave, sick leave, and public holidays), higher rents (up to three times higher) and higher taxes and costs of compliance of red tape (health and workplace safety, dangerous goods licensing etc.)

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Domestic freight rates are higher due to higher fuel tax and higher wages

Domestic Freight
$20.24 + 10% = $2.02
Total: $22.26

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Retail mark-up
$22.26 + 60% = $13.36
Total: $35.62
(gross margin 37.5%)

For the same reasons as distributor mark-up.

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+GST
$35.62 + 10% = $39.18
Total: $39.18

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Recommended Retail (rounded)
A$39.00

US Retail Price Value Chain – Appendix B

Cheaper buy price because of large volume discounts negotiated from the factories. US market 16 times larger.

Cost from manufacturer for 1000 widgets
Total: $8 each

Freight
$8 + 5% = $8.40
Total $8.40

Freight is much cheaper, utilising 40ft high cube containers, higher volume freight roots, more regular shipping times, quicker turn around time on the water and the wharf.

Cheaper port charges, customs fees and duties.

Port Charges, Customs Fees and Duty
$8.40 + 7.5% = $9.03

LANDED cost to distributor
Total = $9.03

Distributor mark-up to retailer
$9.03 + 40% = $12.64
Total: $12.64
(gross margin 28.57%)

(refer to Appendix A) Distributor can work on lower margins because of cheaper interest rates on business loans and overdrafts, cheaper wages (US minimum wage AU$6.90 p/hour), lower rent, lower taxes and lower cost of compliance because of red tape.

Lower wages and lower fuel tax, and a much bigger economy of scale for transport companies.

Domestic Freight
$12.64 + 5% = $13.27
Total: $13.27

Retail mark-up
$13.27 + 40% = $18.57
Total: $18.57
(gross margin 28.57%)

Lower for same reasons as distributor mark-up.

StateTaxes (average 4%)
$18.57 + 4% = $19.31
Total: $19.31

Recommended Retail (rounded)
US$19.50

Australian Minimum Wage Costs Flow Chart – Appendix C

Minimum hourly Wage
$580 minimum weekly wage / 38h p/w =
Total: $15.26 p/h

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Minimum Annual Wage
$580 x 52 weeks=
Total: $30, 160

↓

+ Holiday Leave Loading 17.5%
$406
Total: $30, 566

17.5% leave loading is added to compulsory 4 weeks leave

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+ Superannuation 9%
$30, 566 + 9% =
Total: $33, 316.94

Compulsory minimum employer contribution.

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+ State Payroll Tax 4.5%
$33, 316.94 + 4.5% =
Total: $34, 816.20

Note: applicable to medium-large businesses and varies between 4.5%-5.0% depending on which Australian State business is located in.

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- Minimum Entitlements
52 weeks – 9 weeks =
43 weeks at 38h p/w =
Total: 1,634 hours worked p/year

Holidays (4 weeks);
Personal leave (2 weeks);
public holidays (2 weeks);
Long service leave (1 week accumulating over 10 years to 3 months leave).

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Compulsory Work Cover (insurance)
$34,816.20 + 1% =
Total: $35, 164.37

Compulsory work cover insurance varies depending on the industry and the amount of claims made can vary between 0.5% and 2%+. Note: here we are using 1%.

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Actual Hourly Cost per Hour Worked
$35,164.37 / 1,634h =
Total: $21.52

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Wage Cost to Employer per hour Worked
$21.52

American Minimum Wage Costs Flowchart – Appendix D

Minimum hourly Wage
Total: US$7.25 p/h

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Converted to AU$
US$7.25 / AU$1.05=
Total: AU$6.90

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No other minimum entitlements
Total: AU$6.90 p/h

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Minimum Hourly Wage
Cost to Employer
AU$6.90

For centuries, countries have been using tarrifs as a way of protecting their own industries, businesses and workers.

With the free trade agreements we are being moved into a zero or low duty environment – Australian businesses are being asked to compete on a level playing field. Australian businesses are doing what they can to drive costs down and save money where they can to be internationally competitive but free trade agreements never are and never were intended to include domestic GST or VAT.

By the government failing in our obligation to collect GST and import duty on low value orders it is having a hugely negative impact on Australian businesses. It is acting like a reverse trade barrier, giving our overseas competitors a tax advantage over our OWN Australian businesses.

This low value exemption has a hugely negative effect on Australian businesses wanting to invest in online businesses – why spend a fortune investing when you know you can't compete, and know that there is an unfair loophole giving your overseas competitors an advantage that you are never going to have no matter how efficient and competitive you are. Import duties were originally set up to protect Australian businesses and encourage industries to invest money and grow; this reverse trade barrier (the low value goods loophole exemption) is having an adverse effect on online retailing. There is no incentive for Australian retailers to foster and develop an online retail business when they have less ability to compete online because of the reverse trade barrier.

We believe that this is the key reason that Australia is lagging compared to the rest of the world in efficient online retail businesses. By getting rid of the low value exemption loophole then Australian consumers would eventually have more opportunities to buy domestically due to a greater investment in Australian online stores. But if this loophole is left, the Australian consumer will continue to shop online from an evermore efficient international online business exploiting our loophole. This will, in turn, drive international freight charges even lower and make it even more difficult for our domestic online stores to compete.

We know that the consumer wants to shop online, that they will continue to shop online, but some markets like the US, because of the sheer size of their market, have an enormous variety of product available to the consumer which Australian retailers will never be able to offer. They have a much lower cost base right through the value chain to enable them to be extremely cheap. In effect, there will still be incentive for the Australian consumer to buy from overseas even if they have to pay import duty and GST when the goods arrive. However, we could definitely narrow the gap between US and Australian retail price and slow the growth of overseas internet purchases and stop the leakage of tax revenue.

Summary of Pros and Cons associated with the removal of the Low Value threshold exemption – Appendix E

Benefits to the Community and the Consumer

- Higher Collection of GST Tax Revenue (Dist. To States)
- Higher Collection of Import Duty Tax Revenue
- More Australian Jobs & Job security
- Higher Company Tax Collection
- Higher Income Tax Collection
- Will encourage more investment in more Australian bricks and mortar retail business
- Will encourage more investment in Australian online retail business
- Improve our economy of scale
- Lower price from Australian bricks and mortar retail business (from volume benefits)
- Lower price from Australian Online Retailer (from volume benefits)
- Lower Volume of Overseas orders makes border protection cheaper and more efficient (scanning for drugs, firearms etc)
- Better consumer protection for Product Liability Insurance, Warranty Issues, Australian Standards.
- Better IP protection - less goods infringing trademarks, copyright etc

Negatives to the Community

- Cost (?) to Collect GST and Duty (may need small handling fee to offset)

Negatives to the Consumer

- Slighter higher cost to land overseas orders
- Slightly longer delivery times (to clear customs)

We feel that where the board of taxation failed in their last review of this issue is that they focussed too narrowly on the actual collection cost of the GST and duty, rather than broadening their scope to look at the community costs (see Appendix E) due to loss of duty, GST, income tax, company tax, employment and the psychological effect on Australian businesses knowing your overseas competitors are being given an unfair advantage.

It was interesting to note that when the then government introduced this low value threshold they exempted tobacco and alcohol from this low value exemption for a very good reason. They knew at the time that if there was a loophole left there would be an opportunity for consumer exploitation. Unfortunately, at the time, they failed to forecast the massive growth in general overseas online business and the ability of the Australian consumer to exploit this loophole.

Fundamentally, no matter what it costs to collect isn't really relevant, it should be about the principle of fairness and the ability for Australian businesses to compete on a level playing field in order to offer the best outcome for Australian consumers and the general community.