Impact of removing the LVT on GST revenues

National Retail Association

11 September 2012

Ernst & Young

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11 September 2012

Mr Gary Black
National Retail Association
Overend Street
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Dear Gary

Further to our engagement letter dated 15 August 2012 please find attached our work to date on the *GST impact of the Low Value Threshold (LVT).*

Restrictions on the report use

This report may be relied upon by the National Retail Association for the purposes of understanding the impact of the LVT on GST receipts to State and Territory Governments. It should not be relied upon for any other purpose.

Ernst & Young disclaims all liability to any party for all costs, loss, damage and liability that the third party may suffer or incur arising from or relating to or in any way connected with the provision of the deliverables to the third party without our prior written consent. Any commercial decisions taken by the National Retail Association are not within the scope of our duty of care and in making such decisions you should take into account the limitations of the scope of our work and other factors, commercial and otherwise, of which you should be aware of from sources other than our work.

Basis of our work

Our work in connection with this assessment is of a different nature to that of an audit. We have relied on third party information which was available to us within the timeframe specified for preparation of this report. We have not independently verified, or accept any responsibility or liability for independently verifying, any such third party information nor do we make any representation as to the accuracy or completeness of the information. We accept no liability for any loss or damage, which may result from your reliance on any research, analyses or information so supplied.

If you would like to clarify any aspect of this study or discuss other related matters then please do not hesitate to contact me.

Yours sincerely

Dr David A Cochrane
Economics, Regulation and Policy
Partner

Contents

Executive Summary

In this report, "*The GST impact of the Low Value Threshold (LVT)*", Ernst & Young has quantified the significant and growing loss of GST revenues to the States and Territories resulting from the LVT.

Total GST receipts forgone have been estimated to amount to $2.49b over the three years from 2012/13 to 2014/15 (excluding customs duties and other charges). After allowing for 'general' Australian Taxation Office administrative costs, $2.45b in GST receipts are forgone to State and Territory Governments with the continuation of the LVT.

Previous work undertaken by Ernst & Young estimates that by removing the LVT, between $7.2b and $12.0b in baseline retail sales will shift back to Australian retailers from foreign retailers by 2015. This will have the effect of creating/retaining 33,000 jobs in Australia and increase Gross Domestic Product by between $3.9b and $6.5b by 2015 above baseline levels

Therefore, in addition to lost GST revenue collections, there are broader economic and industry implications from continuing with the LVT, including:

- reductions in GDP from reduced domestic retail purchases which would have consequent impacts on Commonwealth and State Government tax bases (e.g. income tax, GST and payroll tax)

- reductions in employment which would create public costs with regards to social welfare and other government services (e.g., concessions and subsidies).

As an indication, total taxes (less subsidies) in Australia represents around 6.8% of GDP. Thus, a loss of between $3.9b and $6.5b in GDP in 2014/15 could translate to reduced tax revenues across Commonwealth and State Governments of between $0.27b and $0.44b for that year (along with increased social welfare payments).

Table 1: Loss of GST distributions to States 2012/13 to 2014/15 ($m)

	2012/13	2013/14	2014/15	Cumulative Total
NSW	187	248	319	753
VIC	140	185	239	564
QLD	122	162	209	493
WA	35	47	60	142
SA	57	75	97	228
TAS	21	28	36	86
ACT	12	15	20	47
NT	35	46	59	140
Total	608	806	1,039	2,453

Note: Caution should be applied in interpreting these results as the outcomes are also likely to be sensitive to changes to macroeconomic conditions such as exchange rates and online retail growth. Notwithstanding, exchange rates are likely to remain high, as noted by the Australian Treasury in its 2012/13 Budget Papers.
For comparative purposes, the Australian Treasury's (2012) estimate of the GST forgone in its Budget Papers ranges from $690 million in 2012/13, increasing to $830 million by 2014-15 (or a cumulative total of $2280 million). At the lower end of the spectrum, the Low Value Processing Taskforce (2012) cited potential GST revenue on low value parcels of $272.2 million for international mail and $107.3 million for cargo(or a total of $380 million. It was unclear how these estimates were derived and the Taskforce did not indicate which reference year these estimates were based on.
In all likelihood, the total amount would be lower due to deadweight costs of tax collection and non-compliance issues. Ultimately, the extent of these deadweight losses and the level of non-compliance will depend of the reform option undertaken.

The revenues foregone above exclude parcel collection costs. The amounts forgone to the State and Territories would be lower if parcel processing costs are subtracted from these amounts. The ultimate size of parcel processing costs is difficult to determine. However, there is evidence pointing to lower average parcel processing costs going forward. The Low Value Processing Taskforce (2012) for instance has identified a new streamlined approach for handling and administering low value goods to facilitate streamlined GST collection. It supports the consideration of collecting of GST on low value parcels.

Background

In Australia, a 10% Goods and Service Tax (GST) is applied to most goods and services in the retail sector.

Most foreign goods entering into Australia are also subject to the GST (plus any applicable customs duty and fees). However, if the total value of the consignment does not exceed $1,000, it is exempt from these taxes and charges. This is known as the low value import threshold (LVT).

With the rapid growth of online retail, increasing volumes of retail goods will avoid the GST as Australians can readily access imports directly through overseas online channels. As the LVT effectively allows overseas retailers to enjoy a price advantage over Australian retailers, more Australians will shift their spending towards overseas operators and away from local businesses (both traditional and domestic online retailers).

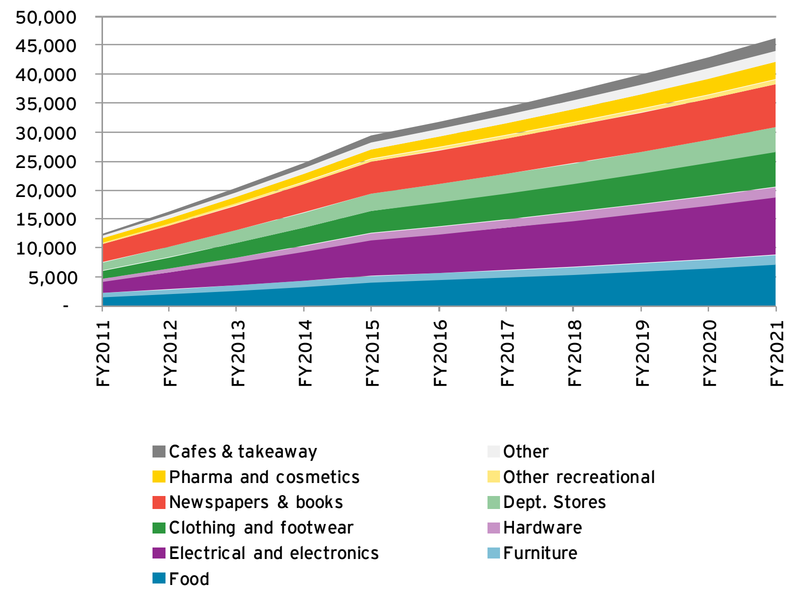
Previous study

In February 2012, Ernst & Young quantified the impact of online retail on the overall Australian retail industry going forward.[1] Based on projected trends in on-line take-up from a range of sources, it concluded that online retail growth will drive further structural change in the retail sector. The findings were:

- total online retail sales growing from $12.5 billion to $29.4 billion between 2011 and 2015 (or 4.9% to 9.5% of all retail turnover)
- non-food online sales in particular increasing from $10.6 billion to $24.2 billion (or 8.5% to 16.9% of non-food retail) over the same period
- overseas retailers accounting for 75% of all non-food online retail sales made by Australians by 2015, growing from $5.3 billion in 2011 to $18.1 billion in 2015.

A recent study by the National Australia Bank had similar findings.[2]

Figure 1: Online retail growth ($m)



Source: Ernst & Young (2012) The Threshold Question: Impact of the Low Value Threshold, prepared for the National Retail Association

[1] Ernst & Young (2012) The Threshold Question: Impact of the Low Value Threshold, prepared for the National Retail Association.

[2] National Australia Bank (2012) *NAB Online Retail Sales Index Indepth report: January 2010 – January 2012*.

This switch towards online retail was found to equate to 118,000 traditional retail jobs being lost in Australia by 2015, or a loss of one in 11 traditional retail jobs. The majority of these job losses will occur in the traditional non-food sectors (e.g., department stores, clothing, electronics etc.).

While some of these job losses will be absorbed by domestic online retailers, the net effect on jobs is negative as the bulk of the online growth accrues to overseas retailers; and the domestic online retail sectors supports fewer jobs per dollar of sales relative to traditional retailers.

Economic impact of the LVT

The Ernst & Young study also concluded that up to 33,400 of the job losses directly relate to retail sales going to overseas online providers with the continued operation of the LVT.

This is because overseas retailers of low value imports effectively enjoy a 14% price advantage over Australian retailers who are required to pay these GST and custom charges. These price distortions ultimately create inefficient patterns of consumption, production, investment and resource use in Australian retail.

This loss is avoidable if the LVT is abolished. In addition to the 33,000 jobs retained/created, Ernst & Young estimates that by removing the LVT, between $7.2b and $12.0b in retail sales will shift back to Australian traditional and online retailers from foreign retailers by 2015. The flow-on impact of this on Australian Gross Domestic Product was estimated to be between $3.9b and $6.5b by 2015.

Table 2: Change in base retail turnover with the removal of the low value threshold

	FY 2015
Baseline turnover with LVT ($b)	
Traditional retail	$279.6b
Domestic Online	$11.2b
Foreign Online	$18.1b
Total	$308.9b
Change in baseline retail turnover without LVT ($b)	
Traditional retail	+$1.4b to $2.4b
Domestic Online	+$5.8b to $9.7b
Foreign Online	-$7.6b to -$12.7b
Change in baseline economic impacts without LVT	
GDP	+$3.9b and $6.5b
Retail jobs	+20,000 to 33,400 jobs
All jobs	+42,000 to 70,000 jobs

Source: Ernst & Young (2012) The Threshold Question: Impact of the Low Value Threshold, prepared for the National Retail Association

Scope of this report

Correspondingly, there would be an increase in GST collected by the Australian Government (both from foreign and domestic retailers) which would ultimately be redistributed back to State and Territory Governments.

The National Retail Association has engaged Ernst & Young to consider in this report the impact of removing the LVT on GST receipts, and the associated revenue impacts to State and Territory Governments.

Impacts on state finances

Gross GST receipts foregone

The low value threshold on imports results in GST and duties revenues foregone as:

- foreign purchases under the $1,000 threshold are exempt from GST and duties
- consumers currently purchase from exempt foreign retailers rather than domestic retailers who are subject to the GST.

There are a number of estimates of the GST forgone under the LVT. These include those estimated by Ernst & Young as well as recent projections by the Australian Treasury (2012) and the Low Value Processing Taskforce (2012).

For the purposes of this analysis, we focus exclusively on GST revenues as duties and customs charges do not flow back to the States.[3] As discussed, Ernst & Young's (2012) projects the value of GST forgone to be around $0.62b in 2012-13. This is projected to increase to $1.05b by 2014-15 with the increased take up of foreign online retail. In total, the GST recepts forgone between 2012/13 and 2014/15 are estimated to be $2.5billion.

Table 3: Projected GST receipts forgone ($m) with the LVT (2012/13 to 2020/21) before administration and parcel processing costs

Source	2012/13	2013/14	2014/15	Total
GST receipts (after admin costs)	$618	$819	$1,055	$2,493

Source: Based on Ernst & Young (2012) The Threshold Question: Impact of the Low Value Threshold, prepared for the National Retail Association.

Note:

In estimating this, Ernst & Young (2012) considered that (i) 95% of the value of foreign online purchases being below the low value threshold (ii) less 3% of these low value imports being products that would be exempt from GST, and (iii) 40% of items being destined for businesses. As business inputs would eventually be subject to GST (through the final sale of goods and services) they are excluded from the value of imports subject to additional GST. A GST of 10% is then applied to the applicable value of imports to approximate GST.

For comparative purposes, the Australian Treasury's (2012) estimate of the GST forgone in its Budget Papers ranges from $690 million in 2012/13, increasing to $830 million by 2014-15 (or a cumulative total of $2280 million). The Australian Treasury noted the reliability of this estimate as being low. It is interesting to note that their estimates were revised upwards from previous Budget Papers, which highlights the unprecedented growth of foreign online retail in Australia.

At the lower end of the spectrum, the Low Value Processing Taskforce (2012) cited potential GST revenue on low value parcels of $272.2 million for international mail (p.193) and $107.3 million for cargo (p.194 of its Final Report) – or a total of $380 million. It was unclear how these estimates were derived and the Taskforce did not indicate which reference year these estimates were based on.

[3] In addition to GST foregone, the Australian Government also forges customs duties. Duties vary depending on the type of product and the origin of the product. Based on an average duty rate of 4% (see Ernst & Young, 2012), an estimate of the total duties foregone between 2012/13 and 2014/15 was $550 million.

GST distributions foregone to States

For the purpose of the analysis, it is assumed that a large proportion (98.4%)[4] of the GST forgone would have been redistributed back to the states in the absence of the LVT (with the difference representing the general cost of GST administration).

In all likelihood, the total amount would be lower due to deadweight costs of tax collection and non-compliance issues. Ultimately, the extent of these deadweight losses and the level of non-compliance will depend of the reform option undertaken.

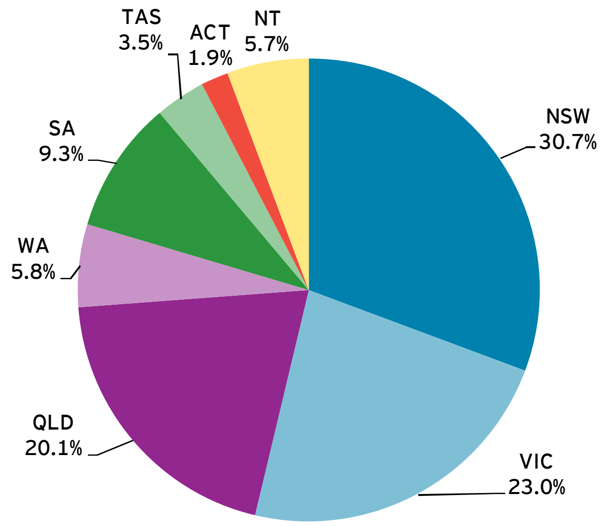
While the GST is a tax levied by the Australian Government, any increase in GST revenue will flow back to State and Territory Governments. However, the amount that would flow back to each respective State/Territory Government is unclear.

Since its introduction in 2000, distributions of GST revenue has been based on recommendations of the Commonwealth Grants Commission according to the principle of horizontal fiscal equalisation. This approach takes account of many considerations including the revenue raising ability of each State and Territory and the provision of services of the same standard in areas such as education, health and public transport.

[4] Based on the 2011-12 Australian Government Budget. The GST administration budget (ATO) is only the cost of GST collection. GST administration costs rise proportionately with the extra GST collection and estimated GST revenues. Receipts and entitlements in the Commonwealth Budget Papers are net of administration costs.

Figure 2 presents the recent projections of the GST distribution shares for each State and Territory Government. While the proportions broadly reflect Australia's population distribution, the Northern Territory, South Australia and Tasmania receive a disproportionately higher share compared with their population, and Western Australia and Victoria receive disproportionately less under the horizontal fiscal equalisation process.

Figure 2: Projected GST Revenue Distribution 2013/14



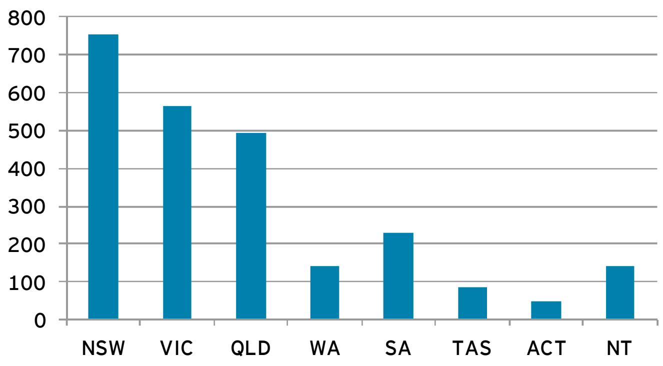
Source: Commonwealth Grants Commission (2012) Report on GST Revenue Sharing Relativities 2012 Update

Table 4: GST distributions ($m) foregone to states and territories

	2012/13	2013/14	2014/15	Cumulative Total
NSW	187	248	319	753
VIC	140	185	239	564
QLD	122	162	209	493
WA	35	47	60	142
SA	57	75	97	228
TAS	21	28	36	86
ACT	12	15	20	47
NT	35	46	59	140
Total	608	806	1,039	2,453

Based on allocating the total GST receipts forgone using projected GST distribution shares for each State and Territory Government as per Commonwealth Grants Commission (2012) Report on GST Revenue Sharing Relativities 2012 Update. It is assumed that 'general' GST collection costs. are 1.6% of GST collected. Therefore, under normal collection cost arrangements, 98.4% of GST collected would be redistributed to the States.

Figure 3: GST revenue ($m) gained by removing the LVT (2012/13 – 2014/15)



Based on these shares, projections of the net GST revenues forgone to State and Territory Governments with the operation of the LVT are presented in Table 4. In determining this estimate it has been assumed that there is no lag over financial years in GST revenue collection or payment to the States.

It should be noted that these revenues exclude parcel collection costs. The amount flowing back to the State and Territories would be lower if parcel processing costs are subtracted from these amounts. The ultimate size of parcel processing costs is difficult to determine. However, there is evidence pointing to lower average parcel processing costs going forward. The Low Value Processing Taskforce (2012) for instance has identified a new approach for handling and administering low value goods to facilitate streamlined GST collection.

In addition, there are broader macroeconomic cost implications on government as:

- reductions in domestic GDP from reduced local purchase would have consequent impacts on the Commonwealth and State Government tax bases (e.g. income tax, GST, and payroll tax).
- reductions in employment would create public costs with regards to social welfare and other government services (e.g., concessions and subsidies).

As an indication, total taxes (less subsidies) in Australia in 2010/11 represented 6.8% of GDP.[5] Thus, a loss of between $3.9b and $6.5b in GDP in 2014/15 could translate to further reduced tax revenues across Commonwealth and State Governments of $0.27b and $0.44b for that year (along with social welfare payments).

[5] Australian Bureau of Statistics (2012) Australian National Accounts: National Income Expenditure and Product Catalogue No: 5206.0 p.14.

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