Submission to the Inland Revenue Department on *GST on low-value imported goods: An offshore supplier registration system* discussion document

3 July 2018

Overview

This document is a submission on the proposed imposition of the Goods and Services Tax (**GST**) on Low Value Goods (**LVGs**) sold to and imported by New Zealand buyers (**Proposed Measures**) using electronic distribution platforms (**EDPs**) by an industry group comprising Alibaba Group's AliExpress, eBay and Etsy, which are third party online marketplaces (**3P**).

Applying the same tax burden to remote, often small, retailers is unfair and potentially at risk of being reciprocated by other Governments on NZ small businesses operating online.

The current proposal will result in high rates of non-compliance and thus not achieve the desired revenue increases for the Government of New Zealand, will disadvantage customers on 3P platforms, and will not achieve the Government's objective of levelling the playing field for New Zealand retailers.

We also recommend the establishment of an IRD-led industry working group (including marketplaces, logistics providers, payments systems and retailers) on this matter and a review of any model twelve months after any legislation is passed. Equally NZ should take stock of Europe's timeline on this matter and align with those global timelines.

The extraterritorial imposition of GST is contrary to good tax policy and has the following technical complications:

1. Reduced revenue of $40-65 million per annum – and rising

The Government's own estimates assume that two-thirds of online purchases will be captured by the proposed model.

The Australian Treasury, when proposing a similar model in 2017, assumed a compliance rate of just 25%. Based on a similar compliance rate in New Zealand, the actual revenue raised by this tax would be $40-65 million per annum less than is projected, with the shortfall rising by about 10% annually as the volume of online trade increases.

The proposed model will result in significantly reduced revenue to be reinvested into essential services for New Zealanders compared to a model which captures a larger percentage of online transactions.

2. Very high rates of non-compliance

We believe compliance will be low as consumers will simply turn to websites or marketplaces that are not compliant; or use eBay or AliExpress as a search engine then purchase the equivalent product directly from the seller or through alternative, non-compliant retailers who will be able to offer the products at 15% less than compliant players; and which have spotty track records regarding consumer protection and regulatory compliance.

There will be no new border processes to ensure GST has been captured. We understand that neither IRD nor Customs will be given additional resources to enforce the new rules.

3. We are not traditional retailers

As a technical matter, the proposed model is extremely difficult for 3P marketplaces to implement and we are yet to analyse any issues related to measures taken to comply with the flawed Australian collection model. 3P marketplaces do not hold the goods, and do not control the movement of the goods. We are not the sellers or owners of the goods, we simply connect buyers and sellers. The focus should be on 1P retailers/suppliers in the truest sense of that word. Government could consider an exemption for 3P marketplaces and focus on suppliers in the truest sense of that word. In our view however a logistics services/freight handler model would be far more effective and capture all LVG parcels coming across the border, as we outlined during Australian consultations too.

4. Unprecedented compliance costs will increase costs for Kiwi consumers

The proposed model will require extensive system changes and ongoing compliance costs that will at least be partly borne by consumers as the NZ GST is a consumption tax, and therefore a tax on consumers. What Government is proposing is that suppliers bear the brunt of collection. eBay, Etsy and AliExpress are global platforms. These system changes are technically difficult and will still result in a less-than-optimal rate of revenue collection. There is a high degree of risk that consumers and businesses will face complications with the implementation of the proposed model as it is novel, complex and remains untested.

5. New Zealand retailers remain disadvantaged

To use Australian Treasury modelling as an example, New Zealand businesses will continue to be disadvantaged as up to 75% of low value goods imported into New Zealand will continue not to be taxed, and thus continue to have a tax-price advantage over goods sold locally in New Zealand. This rate could increase should overseas retailers or marketplaces decide not to offer products to New Zealand consumers. This has been the case in Australia where Amazon has decided to restrict cross-border sales. Changing the GST laws as they relate to overseas online purchases will not fix all the issues faced by traditional retailers: for example, but not limited to wages, cost of rent and general cost of doing business in NZ.

6. Unfair to SMBs and individual sellers

Under current GST rules, vendors who sell less than $60,000 of goods into New Zealand are exempt from GST. Under the new proposal, overseas Small and Micro Businesses (SMBs) will no longer be exempt if they sell through a platform like eBay, Etsy or AliExpress. This puts small businesses at a severe, clear and discriminatory disadvantage if they use 3P marketplaces, compared to suppliers who sell directly through websites or other channels which may result in decreased visibility, transparency and compliance in respect of regulations set by New Zealand authorities.

7. Higher trade barriers

The extraterritorial application of New Zealand's GST laws will create additional costs for overseas businesses and limit the free trade of goods into New Zealand. This is not in the spirit of various free trade agreements across the globe.

The proliferation of efforts to expand the imposition of local sales-type taxes on remote small businesses in the name of fairness will make it harder for Internet-enabled small enterprises to export.

Before the Internet very small enterprises and microentrepreneurs rarely, if ever exported. They were generally trapped in their local market, increasingly faced direct competition from large enterprises with greater access to global markets, and were subject to ups and downs of their economic neighbourhood. The Internet has dramatically expanded the opportunity to small businesses to trade. While it is still very difficult for small and micro enterprises to compete head-on with giant competitors, access to global commerce platforms with many millions of users has allowed small enterprises, including in New Zealand, to carve out successful niches and grow. A better future for small businesses, who will continue to face large competitors with their traditional access to global markets, is to maintain low tax barriers and promote access to greater Internet-enabled exports and imports.

A fairer more efficient collection model

The authors of this submission believe the proposed model should be abandoned and replaced with a fairer more effective model, for example one based on an extension of current systems such as via collection at the border. This is what already happens for goods worth more than $400. Under the current proposal, there would be one system for goods under $400, and another system for everything else.

A border collection model would address many of the concerns raised above, and would significantly increase the revenue captured. 100% of imports pass through the border so 100% of GST would be collected.

Alternatively, the current proposals require rewriting to ensure they are workable. In particular, 3P marketplaces that merely provide listing and processing services to users should be treated differently under the proposed amendments. 3P marketplaces do not set the price, hold or handle goods, or have full knowledge of the flow of physical goods – therefore a model intended for online retailers cannot be easily applied to our platforms.

We would welcome the opportunity for further discussion of the points made in this submission.

About Us

The members of the Industry Group operate websites that provide the ability for sellers to list goods for sale to buyers. These services are referred to as "3P". 3P service providers rely on the information provided from users, do not set the price of the goods, and do not handle the goods. It is important to distinguish "3P" services from "1P" services where the website operator acquires the goods wholesale and resells the goods in its own right.

Further information on each member of the Industry Group is outlined below.

Alibaba Group

Alibaba Group's mission is to make it easy to do business anywhere. The company aims to build the future infrastructure of commerce. It envisions that its customers will meet, work and live at Alibaba, and that it will be a company that lasts at least 102 years.

ebay

eBay Inc. (NASDAQ: EBAY) is a global commerce leader including the Marketplace, StubHub and Classifieds platforms. Collectively, eBay connects millions of buyers and sellers around the world, empowering people and creating opportunity through Connected Commerce. Founded in 1995 in San Jose, Calif., eBay is one of the world's largest and most vibrant marketplaces for discovering great value and unique selection. As at Q1, 2018 eBay had 171 million active users globally. For more information about the company and its global portfolio of online brands, visit www.ebayinc.com

Etsy

Etsy, Inc. is the global marketplace for unique and creative goods. Our mission is to keep commerce human, and we're committed to using the power of business to strengthen communities and empower people. We connect millions of buyers and sellers from nearly every country in the world. Buyers come to Etsy to be inspired and delighted by items that are crafted and curated by creative entrepreneurs. For sellers, we offer a range of tools and services that address key business needs. A typical Etsy seller is a female entrepreneur working out of her home to supplement her household's income. In 2017 Etsy had 1.9 million such microentrepreneurs.

Complications with the Proposed Measures

The Proposed Measures are most likely to be ineffective in levelling any playing field due to a number of complications with the Offshore Supplier Registration Model. It is essential that the GST treatment of LVGs is aligned to best practice tax policy, particularly as it is currently intended to apply extra-territorially.

The stated goal of the Tax Working Group was to achieve a collection method which has:[1]

- Sufficiently low compliance costs;
- High compliance rates; and
- And is consumer friendly.

The proposed model does not achieve any of these goals as it will face high rates of non-compliance and unprecedented high costs to online platforms, sellers and consumers. The model is untested anywhere in the world (given the Australian model only commences on 1 July 2018) and there is a significant risk that New Zealand consumers will suffer, while local retailers continue to be disadvantaged by non-compliant online traders. In fact the OECD is working on a longer timeline for consideration of this issue and we recommend that the NZ Government consider aligning with those timelines.

Finally, it is quite likely that Internet-enabled small businesses in New Zealand will be harmed by the new Australian model and negotiating more beneficial treatment for small exporters is a better long-term policy than competitive tax efforts.

1. Reduced revenue of $40-65 million per annum – and rising

> *We believe the Proposed Measures will raise only 25% of the available revenue for LVGs. Even based on the Government's more optimistic forecasts, $40 million of revenue will be foregone in 2020/21, increasing every year after that.*

The proposed measures will only capture a fraction of the available revenue, thus only addressing a fraction of the problem.

It is difficult to forecast the potential revenue and compliance rates for collection of GST. The Government's own forecasts estimate that the foregone GST revenue was around $80 million in 2016. This is lower than the previous estimate of $140 million, and the Retail NZ estimate of $235 million. The Government assumes payable GST will increase to $127 million in 2020/21.[2]

The Government's current estimate of $53 million collected in 2019/20, increasing to $87 million in 2020/21, anticipates non-compliance of around 33%. We believe non-compliance will be much higher. The Australian Treasury, when proposing the Australian model which the Proposed Measures are based on, estimated only 25% of online transactions would be captured. The Discussion Document has not outlined the rationale that compliance would

[1] Tax Working Group 2018.
[2] Customs and IRD advice cited by Tax Working Group and Government Discussion Document.

be significantly higher in New Zealand than Australian Treasury modelling showing estimated compliance at just 25% in the first year.

If the proposed model is adopted, the Government will therefore be missing out on revenue of between $40 million (based on the Government's best-case estimates) and $65 million per annum (based on the Australian Treasury's estimated compliance rate) by 2021.

These amounts would increase every year based on the Government's projected increases of 12% per annum.

The revenue lost through an unenforceable and inadequate model could even be in the range of $78-176 million if the higher RetailNZ estimate of total volumes is correct.

We have outlined in the next section the reasons for high non-compliance. This is unavoidable under the proposed model. An alternative model could attract compliance of close to 100%, thus much better achieving the Government's objectives of raising revenue.

2. Very high rates of non-compliance

The Proposed Measures are wholly inadequate in achieving a meaningful level of compliance due to the absence of effective compliance and enforcement mechanisms.

Effective compliance mechanisms are absolutely essential. Without some form of solution to identify goods on arrival at the border to ensure duty and/or GST is captured, there will be limited incentive for voluntary compliance.

The proposed compliance mechanisms rely on information exchange and an amorphous joint-registration system with other countries at an unspecified point in the future. We understand there will be no additional resource allocated to IRD or Customs to assist with compliance and collection.

We believe compliance will be low as consumers will simply turn to websites or marketplaces that choose not to collect GST; or use 3P marketplaces as a search engine then purchase the equivalent product directly from sellers or through alternative sites. This not only puts our platforms at a disadvantage; it will make enforcement nearly impossible from the Government's perspective. Furthermore, driving consumers away from large 3Ps who are compliant (and able to invest in other compliance measures to restrict the flow of unlicensed and dangerous goods into New Zealand) to smaller marketplaces and standalone online retailers will provide New Zealand authorities with reduced visibility of listings and product information and data already provided by larger 3P marketplaces.

3. Distinction between online retailers and 3P marketplaces

The proposed model is extremely technically difficult for 3P marketplaces to implement, as we are not involved in the payment transaction between buyer and seller.

3.1. Our marketplaces are not directly involved in transactions

There are two key misconceptions throughout the Discussion Document. The first is that the marketplace is generally in a better position to register and return GST on supplies compared with the underlying supplier:[3]

> *Typically, the marketplace would be larger and better resourced and may have a closer relationship with the customer. Requiring the marketplace to register may also reduce compliance costs, as a potentially large number of smaller suppliers may not be required to register. It is anticipated that the marketplace and the underlying supplier will have commercial arrangements in place that could take any GST costs into account.*

Our marketplaces do not fall in the same category as Amazon, ASOS or other online retailers. 3P marketplaces are not sellers. 3P marketplaces do not own, sell or supply goods. 3P marketplaces are not involved in payment or shipping. Buyers are connected directly with sellers. The assumption that an online platform is directly warehousing and selling goods may be true in traditional retail; but is not true in the case of platforms like eBay, Etsy and AliExpress.

3.2. Applying GST to goods is more complex than intangibles

The second misconception in the Discussion Document is that the successful application of GST on intangibles demonstrates the simplicity of applying GST to goods. Again, this may be the case for suppliers of online services or intangible goods who directly provide a service to consumers. Our platforms do not make direct transactions with customers in the same way. The application of GST via a third party marketplace remains entirely untested. In the vast majority of instances, the GST on intangibles is applied to businesses directly controlling both the supply and pricing of services and intangibles with relatively standardised pricing. 3P marketplaces, on the other hand, do not control the pricing or supply of a vast array of goods.

4. Unprecedented compliance costs will increase costs for Kiwi consumers

The proposed model introduces unprecedented technical difficulty and compliance costs for our global platforms and it is unavoidable that some of these costs will be passed on to consumers.

4.1. Unprecedented compliance costs for global platforms

The Proposed Measures will require extensive system changes and ongoing compliance costs. It is unavoidable that these costs in addition to the GST will be partly borne by consumers.

There has been no modelling released that shows the impact of the proposed model on consumers and we urge the Government to very carefully consider the impact of this model.

[3] Government discussion document.

The development cost of adjusting our platform to meet local demands is significant. AliExpress, eBay and Etsy are global platforms. We will strive to make the investments required, but suggestions that this is a simple or costless process for us are simply incorrect. We believe it is unfair for government to shift expensive compliance costs onto us in this manner, rather than take steps itself to increase collection with the support of 3P marketplaces working in collaboration with Government.

4.2 Untested model

We are aware of suggestions that we are already required to collect GST or VAT in other jurisdictions beyond Australia. This is not correct. If adopted, New Zealand would be only the second country in the world to apply GST to LVGs through an Offshore Supplier/Marketplace Hybrid Registration Model. Nor is it simply a matter of adapting the Australian model to New Zealand. Australia's GST system is vastly different to New Zealand's and significant additional investment will be required.

There is a high degree of risk that consumers and businesses will face complications with the implementation of the proposed model as it is novel, untested and complex.

The Proposed Measures will be ineffective in addressing the Government's stated objective of levelling the playing field for New Zealand retailers and will result in further market distortions.

5. New Zealand retailers will remain disadvantaged

New Zealand businesses will continue to be price disadvantaged as up to 75% of low value goods imported into New Zealand will continue not to be taxed. There is limited incentive for overseas businesses to voluntarily comply as they will be put at a price disadvantage vis-à-vis non-compliant businesses.

This exposes New Zealand small businesses to continued price pressures from non-compliant businesses.

The anticipated levels of non-compliance mean that the Proposed Measures will be ineffective in addressing the Government's stated objective of levelling the playing field for local retailers. The absence of effective compliance and enforcement mechanisms will directly lead to market distortions.

Perhaps the Government could consider some type of reciprocal small business tax treatment between different countries, particularly for those small businesses who rely on export markets.

6. Unfair to SMBs and individual sellers

The Proposed Measures will result in small businesses being disadvantaged and will not achieve the Government's stated objective of levelling the playing field.

The Discussion Document acknowledges that vendors whose total supplies fall below the threshold of $60,000 will be disadvantaged:

> *It is acknowledged that in the absence of marketplace rules, supplies of low-value goods by these smaller suppliers would not be subject to GST because the total value of their supplies to New Zealand consumers would fall below the GST registration threshold. While the purpose of the registration threshold is to reduce compliance costs for suppliers that do not supply many goods and services to New Zealand consumers, the compliance costs for these smaller suppliers fall away when the requirement to register and return GST is shifted to the marketplace.*

It is not correct that these smaller suppliers will not face compliance costs. Obviously, they will face the significant cost of GST being added to the price of their goods. In addition to this they will need to grapple with the uncertainty created when price and taxation differs depending on where the successful buyer is located.

Small businesses typically operate through third party platforms as they do not have the capital or infrastructure required to develop a stand-alone online store. Third party platforms offer small businesses a lower-cost entry to market, including international markets, which is vital for encouraging domestic growth. However, the Proposed Measures put small businesses at a disadvantage compared to larger businesses as the GST turnover threshold is determined at the platform level, rather than based on the individual seller's turnover cost. Small businesses operating through third party platforms therefore lose the benefit of the GST/VAT registration threshold.

For example, Etsy's sellers are predominantly microentrepreneurs, few of whom would ever reach the $60,000 threshold. However, the proposed model treats Etsy as one individual seller, and GST would be applied to each individual seller's product, even if it was the first sale they ever made into New Zealand.

The Proposed Measures will disadvantage small business and create impediments for small business and individuals to access the New Zealand market.

7. Higher Trade barriers

The Proposed Measures create a trade barrier for overseas businesses supplying goods to New Zealand.

The extraterritorial application of New Zealand's GST laws will create additional costs for overseas businesses and limit the free trade of goods into New Zealand. As outlined above, overseas businesses will be subject to compliance costs when they sell goods to New Zealand consumers. This serves as a barrier to trade and is contrary to New Zealand's advocacy for free trade and removal of trade barriers.

There is a risk that other countries may implement reciprocal arrangements, especially as reciprocity has become a key policy argument at the WTO and in other international trade discussions which could put New Zealand at a further disadvantage. This would result in

New Zealand businesses having a registration requirement and compliance obligations in overseas jurisdictions. New Zealand businesses would incur costs in meeting these compliance obligations which may stifle entrepreneurship, innovation and decrease exports.

8. Contrary to Tax Design Principles

The Proposed Measures are contrary to best practice tax design principles.

We have assessed the Proposed Measures in accordance with the principles of the Ottawa Taxation Framework Conditions as endorsed by the OECD in the matrix below:

Tax Design Principle	Rating and observation
Efficiency Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.	Rating: Medium The Proposed Measures expose overseas businesses to increased compliance costs.
Neutrality Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.	Rating: Low While the Proposed Measures are designed to apply to all businesses, the lack of an enforcement mechanism at the time of arrival of the goods will result in compliant businesses being at a price disadvantage vis-à-vis non-compliant businesses.
Certainty and simplicity The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.	Rating: Low The intricacies of determining the correct GST treatment is problematic for overseas businesses with limited familiarity with applying GST to goods.
Effectiveness and fairness Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to the risks involved.	Rating: Low The absence of an enforcement mechanism at the time of arrival of the goods substantially reduces the effectiveness of the proposed measures.

The Proposed Measures should be abandoned and replaced with a fairer more effective model based on collection at the border.

A fairer more efficient alternative collection model

The Proposed Measures lack an effective compliance and enforcement mechanism which will lead to low compliance rates. This would result in New Zealand implementing an inefficient, inadequate and untested system.

Given expectations that the level of online purchases will only increase, we believe that New Zealand should implement a robust system which limits market distortions yet achieves more revenue and results in more low value goods being captured. A variety of models were briefly considered by the Tax Working Group in an addendum to their report. The Discussion Document refers to the Tax Working Group report without providing any further depth. We are concerned by the lack of detail in the analysis that has so far been publicly released.

The Industry Group believes that a border collection model is the best option for reform. It also is business model agnostic by focusing on the actual goods in question rather than the type of online business model. This model addresses many of the concerns raised above as follows:

- Increased revenue and limited market distortions – imports would be captured at the border thereby eliminating the need to rely on voluntary compliance;
- Reduced costs passed on to consumers;
- Increased certainty and simplicity for business – there are already systems in place in relation to goods exceeding the current threshold, and it is reasonable to expect that these systems could be modified to capture GST on low value goods.
- Increased effectiveness and fairness – proximity and sovereignty would allow for more effective enforcement.

Alternatively, the Proposed Measures require a fundamental rewrite to ensure that they are workable. In particular, platforms that merely provide listing and processing services to users should be excluded from the Proposed Measures. 3P service providers do not set the price, hold or handle goods, or have knowledge of the flow of physical goods and should be distinguished from 1P service providers who are acquirers and resellers of goods. 3P service providers should be treated in the same way as online listing services and payment processing services in being excluded from the Proposed Measures. 3P service providers connect sellers and buyers and would require a significant change to our systems and business processes, including the type of information sourced from sellers and buyers, in order to comply.