SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO COLLECTION MODELS FOR GST ON LOW VALUE IMPORTED GOODS

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INTRODUCTION

The Productivity Commission (PC) Discussion Paper, *Collection Models of a GST on Low Value Imported Goods*, suggests that the inquiry that the PC has been directed to pursue is somewhat of *a fait accompli*.[1] The legislation enacting this policy change (*Treasury Laws Amendment (GST Low Value Goods) Bill 2017*) has already passed the parliament with broad parliamentary support.

However, the parliament's decision to delay the implementation of this policy by one year (the original legislation introduced to parliament was scheduled to begin in July 2017) provides an opportunity for the PC to make clear the practical and philosophical problems with the legislated scheme. A clear statement that this scheme is not in the interest of consumers, is unlikely to be effective, threatens Australia's participation in the global internet commerce economy, and casts Australia as a bad global actor in international taxation, would, in our view, have a concrete public policy impact. The parliament is capable of amending the legislation in response to this investigation, and the government has significant discretionary power to adjust or mollify its implementation.

This submission complements the submission we presented to the Senate Standing Committee on Economics Inquiry into the Treasury Laws Amendment (GST Low Value Goods) Bill 2017, and the evidence we gave to that committee in April 2017.[2] We include our submission, the transcript of our committee evidence (given alongside Satyajeet Mara from the Australian Taxpayers' Alliance), and our paper published in *Econ Journal Watch* in 2017 that tackles many of the issues raised by the GST debate as attachments to this submission. In our Senate submission, we found that:

- The elimination of the low-value threshold for the Goods and Services Tax constitutes a new tax on inbound internet trade – that is, it will function as a tariff imposed on Australian consumers.
- The tax will raise very little revenue and will be expensive and complex to administer.
- The tax deviates substantially from the existing GST design.
- The tax is less a tax on consumption but on the reputation of foreign internet businesses.
- The tax is inconsistent with the government's commitment to deregulation, the promotion of international trade, and its innovation agenda.
- The tax rejects principles that the Howard government established in terms of deregulation and the promotion of international trade.

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[1] Productivity Commission, "Collection Models for Gst on Low Value Imported Goods," (2017), 3.

[2] Chris Berg and Sinclair Davidson, "Senate Standing Committee on Economics Inquiry into the Treasury Laws Amendment (Gst Low Value Goods) Bill 2017," (2017). Commonwealth Official Committee Hansard, Senate Economics Legislation Committee, Treasury Laws Amendment (GST Low Value Goods) Bill 2017, 21 April 2017, p. 13.

- The tax will do nothing to address the issue of high retail prices in Australia.
- While masqueraded as a tax integrity measure, this tax is clearly intended to operate as a form of protectionism.
- The tax will reduce competitive pressure within the domestic Australian economy, and (as a consequence) expose Australian consumers to government sanctioned higher retail prices.
- 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 criminality. Product safety and consumer protection rights are likely to be compromised.
- The tax has few safeguards to ensure compliance and remittance of revenue to the Australian government.
- The tax contributes to increased levels of regime uncertainty within the Australian policy environment.

In this submission we expand on that analysis. We also focus our attention on the specific questions and arguments raised by the discussion paper. It is notable however that the Discussion Paper's approach and argumentation differs from that of the government. For example, the Discussion Paper (rightly) dismisses the protectionist argument for the legislation by stating that "Bricks-and-mortar retailers can offer a different service than online retailers, and the price differential between domestic retailers and online overseas retailers is often far greater than the 10 per cent GST differential" (p. 6). However, in our analysis, this protectionist rationale has been at the centre of the political development of the policy.

In the light of this, it is our view that the PC should recommend parliament comprehensively revisit this legislation with an intention to repeal. This submission first provides some context to the debate and then addresses the questions raised by the Discussion Paper.

THE LOW-VALUE THRESHOLD IN THE CONTEXT OF GLOBAL TAX REFORM

The Discussion Paper leans heavily on a 2015 analysis provided by the OECD as part of its base erosion and profit shifting (BEPS) project, titled *Addressing the Tax Challenges of the Digital Economy*.[3] We have written extensively on the BEPS program, outlining its political origins and conceptual problems, particularly in the context of corporate taxation. In our *Econ Journal Watch* paper earlier this year, we provided a critique and history of the BEPS project.[4] It ought to be taken as a warning sign that the government is moving forward with a policy which has been partly developed under the auspices of the OECD's BEPS project.

The history of the BEPS project has some importance for how the PC should view the likelihood of compliance and cooperation with this policy. The BEPS project has its origins in the OECD's Harmful Tax Competition project, first announced in a G7 communique in 1996. That project sought deeper international cooperation to harmonize tax rates and regimes across the OECD and the world. The Harmful Tax Competition project was however enabled by the prevalence of centre-left governments in

[3] OECD, "Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report," in *OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2015).

[4] See, for example, Chris Berg and Sinclair Davidson, ""Stop This Greed": The Tax-Avoidance Political Campaign in the Oecd and Australia," *Econ Journal Watch* 14, no. 1 (2017).

power around the world in the latter half of the 1990s that agreed on the perceived problems with tax competition. The election of the Bush administration in 2000 put a sharp stop to the OECD's work.[5]

It was only after the Global Financial Crisis redirected attention towards international financial and taxation reform that the political momentum resumed. The BEPS project was first suggested at the second meeting of the G20 in 2009 when it dubiously linked "banking secrecy" with the crisis in credit markets. In the post-crisis environment, the priorities of the G20 and OECD were tightly intertwined, providing a clear political path for reforms proposed by the OECD to be given international and domestic authority in G20 nations. Australian proposals for reform of corporate tax avoidance laws were developed in this period, between 2010 and 2014, and given international legitimacy by similar (although, we have argued, counterproductive) policies being developed and implemented by Australia's economic partners.

This history highlights the significance of a desire at the international level for tax cooperation to succeed. No international tax program can be successfully administered without international cooperation. The OECD specifically notes the need for "enhanced administrative co-operation between tax authorities to enforce compliance". However, the international political environment is not conducive to such cooperation. There are two reasons for this. The first is that international tax cooperation no longer enjoys the political authority that it did while the G20 supported the OECD's efforts. The second is that the Trump administration is unlikely to prove amenable to tax regimes which disfavor American firms.

The G20 can no longer provide the high level political coordination that has been so essential to OECD tax cooperation efforts. Ten years after the GFC, G20 agreements lack momentum, their provisions lack specificity, and overall the forum is treated by domestic players as a further opportunity for international discussion rather than policy development and cooperation. This was particularly evident in 2014 when Australia was host: the Sydney Finance Ministers Communique was both aspiration and empty; and lacked any of the authority that G20 communiques had immediately after the GFC.[6] One analyst has argued that "the G20 has proved about as far from effective as Greece is from solvency".[7] As Martin Gilman writes,

> Since these much-hyped gatherings began amid high expectations in 2008, their added value seems to have declined. Meaningful results are increasingly unlikely … there is no longer a panic to galvanize a consensus. Instead, a form of complacency predominates … Unfortunately, the really important policies affecting the global economy will hardly get a mention because the commitments made were minimal or so vague as to defy meaningful monitoring.[8]

A significant volume of overseas retail to Australia comes from the United States. American cooperation with this regime is highly likely to be resisted by the Trump administration. A number of factors make this likely. First, Trump's "America first" political philosophy has little time for international cooperation that is not perceived to be in the direct interest of the United States. It is hard to see how Australian taxation officials will be able to convince the United States that they should assist the Australian

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[5] R. Eccleston, *The Dynamics of Global Economic Governance: The Financial Crisis, the Oecd, and the Politics of International Tax Cooperation* (Edward Elgar, 2012).
[6] Chris Berg, "Another G20 Deal for Everyone to Ignore," *ABC The Drum*, 25 February 2014.
[7] Jakob Vestergaard, "Establishing a Global Economic Council: Governance Reform at the G20, Imf, and the World Bank," *Global Policy* 3, no. 3 (2012).
[8] Martin Gilman, "A World without G20 Summits " in *The G8–G20 Relationship in Global Governance*, ed. Marina Larionova and John J. Kirton (Surrey and Burlington: Ashgate Publishing, 2015).

government impose a regulatory burden on American firms – and certainly not in the absence of any reciprocal arrangement. Second, the Trump administration has deprioritized the international taxation cooperation that underpinned earlier G20-OECD programs. Even if the G20 had been until 2016 a strong forum for international cooperation, the clash between the Trump administration's agenda and the traditional agendas of international forums has already diverted attention away from tax reform. This is a challenge facing all international forums in the Trump era.[9] The Trump administration is seeking to move ahead with a tax reform program that would, if implemented, significantly increase the competitiveness of firms operating in the United States. Likewise, it has a substantial regulatory reduction agenda.

In this context, the Trump administration is unlikely increase the regulatory burden on American firms simply at the request of Australia. As we argued in our submission to the Senate:

> In the operation of the current GST the legal incidence is placed on the supplier with the assumption being that the tax is passed on in full to the consumer. The refund of the input credit is an important part of the tax design underpinning the assumption of the pass forward. The new tax, however, does not involve the commonwealth government refunding any money to suppliers or even electronic distribution platforms. The assumption that the tax is passed on in full, and so becomes a consumption tax, is now fragile. (Of course, it could well be violated in practice already, but now becomes untenable – see Slemrod (2008) for more discussion). The new tax is a tariff on goods imported into Australia based on online purchases. Another way of looking at it is as tax on Australian inbound internet commerce. It is not clear that the tax falls on Australian consumption, or whether the tax becomes a "trading-with-Australians tax". Most certainly, however, it exposes electronic distribution platforms to arbitrary and uncertain Australian taxation. Very likely some of these platforms will exit the Australian market or refuse to deal with Australian consumers and retailers. This is very likely to isolate Australian internet start-ups and undermine the government's own innovation agenda.[10]

The unlikelihood of the Trump administration imposing this tax on Australia's behalf should be seen as an important factor when considering how effective Australia's compliance efforts are likely to be.

IMPACTS ON AUSTRALIAN CONSUMERS AND BUSINESSES

In the following two sections we directly address the questions raised in the discussion paper.

> **To what extent would the different alternatives entail higher prices for consumers and/or additional processes or delays to purchases they make?**

To the extent that retailers simply pass on the increased tax burden prices for consumers are very likely to rise by the full 10% that the government wishes to impose. By contrast, however, it is very likely that online retailers face highly competitive market conditions and they may be forced to absorb a portion of the impost. To that extent Australian consumers may face lower price increases and foreign retailers lower profit margins when trading with Australians. To the extent that dealing with Australians will result in lower profit margins and higher taxes it is very likely that some online retailers will cease trading with Australian consumers.

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[9] C. Fred Bergsten, Edwin M. Truman, and Jeromin Zettelmeyer, "G-7 Economic Cooperation in the Trump Era," (Peterson Institute for International Economics, 2017).

[10] Berg and Davidson, "Senate Standing Committee on Economics Inquiry into the Treasury Laws Amendment (Gst Low Value Goods) Bill 2017."

Would these effects alter consumer shopping patterns and preferences?

The ability of online consumers to avoid sales taxes has been long recognised. The first major study to investigate this phenomenon was Goolsbee.[11] He examined the behaviour of 25,000 online consumers and found, after controlling for individual characteristics such as age, education, ethnicity, gender, and entrepreneurial status, that those consumers in high-tax areas where more likely to engage in online purchasing than those who did not. Goolsbee finds that nearly a quarter of all internet purchases can be explained by the tax differential between online and bricks and mortar transactions. That effect is very large and Goolsbee suggests taxation plays a very important role in online purchasing.

A more recent study reports a much smaller tax effect. Einav et al. investigate the sales tax sensitivity of online purchases using data drawn from eBay.[12] They report that a 10 per cent sales tax reduces online purchase by 15 per cent and that this effect is larger for "commodity" products such as electronics and computers. They also report that online consumers modify their behaviour to avoid taxes in their home state, so a 1 per cent increase in their state sales tax will lead to a 2 per cent increase in online purchases overall but a 3 – 4 per cent decline in purchases from their home state (where they would be liable for the sales tax).

The Einav et al. paper provides other results that are important in the Australian context. They suggest that online consumers pay less attention to sales taxes than they do actual prices. Also that online consumers care about shipping time and shipping cost. This is an important distinction between the United States and Australia – many of the goods and services being purchased in Australia may not be locally available. Many other goods and services are likely to be available at much higher prices. Novak, for example, has shown that price differentials of 14 per cent to 70 per cent exists between identical Australian sourced goods and internationally sourced goods.[13] So while it is true that the US evidence shows that consumers are highly sensitive to sales tax rates, Australian consumers are likely to also value availability and timeliness. To the extent that the proposed tax adversely affects availability and timeliness Australian consumers are likely to experience large losses in welfare.

The evidence suggests that consumers are highly sensitive to price, convenience and taxation. There is also evidence to suggest that consumers will not voluntarily comply with a sales tax regime. As long ago as 2000 Hal Varian reported that consumers were unwilling to self-report sales taxes on out-of-state (in the United States) purchases.[14] By 2017, things had not much improved. Anderson reports that 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.[15] 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. Consumers do not voluntarily comply with efforts to collect sales tax even when nudged.

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[11] Austan Goolsbee, "In a World without Borders: The Impact of Taxes on Internet Commerce," *The Quarterly Journal of Economics* 115, no. 2 (2000).
[12] Liran Einav et al., "Sales Taxes and Internet Commerce," *The American Economic Review* 104, no. 1 (2014).
[13] Mikayla Novak, "No to the Gst Tax Attack: Why the Exemption for Online Purchases Should Stay," (Institute of Public Affairs, 2015).
[14] Hal Varian, "Taxation of Electronic Commerce: A Us View; E-Commerce and Taxation" (paper presented at the CESifo Forum, 2000).
[15] John E Anderson, "Paying the State Use Tax: Is a "Nudge" Enough?," *Public Finance Review* 45, no. 2 (2017).

Not only do consumers modify their behaviour, firms also respond to sales taxes. Anderson et al. report that those firms that have a high proportion of online sales avoid establishing a physical presence in high taxing states in the United States.[16]

All up the American evidence all suggests that consumers seek out low tax transactions and firms seek to provide low taxation opportunities for consumers to exploit. Given that standard economic theory suggests that a sales tax is simply and mostly passed forward this latter observation requires some explanation. The cost of administering sales taxes are not trivial. As we have argued before, the Australian GST is very expensive to administer and complex to operate.[17]

Slemrod argues that the compliance burden and cost of any tax regime is determined by the opportunity to engage in tax avoidance (high in the case of online consumption) and the incentive to both supply and demand the activity being taxed.[18] As such the legal incidence of the tax may matter for prices and equilibrium quantities. Furthermore the capacity to administer any particular tax regime characterised by high fixed costs can have the effect of excluding smaller suppliers from the market. This becomes particularly important if and when tax regimes change – it is very likely that smaller retailers will simply exit the Australian market (refuse to trade with Australians)

To what extent would imposing GST on online purchases from overseas have a material effect on the competitiveness of domestic retailers?

To the extent that overseas prices rise and/or foreign online retailers exit the Australian market, rivalry between firms seeing to better satisfy Australian consumers will decline.

Which parts of retailing would be most affected? Would there be effects on other Australian businesses?

Baugh et al. investigate the so-called “Amazon tax”.[19] This paper builds more or less on the Einav et al. (2014) paper. For our purposes we wish to highlight their investigation into both substitution effects (the impact on competitors) and income effects (the impact on unrelated business) resulting from the Amazon tax. The sample size in this study is larger and longer than that in the Einav et al. paper and they are able to validate the results of that paper; Amazon sales decline by 9.4 per cent after the Amazon tax is introduced (implying an elasticity of – 1.2). For large purchases (i.e. above US$250) Amazon sales fall by 29.1 per cent (elasticity = – 3.9). Not all Amazon direct competitors benefit from the introduction of the tax, but income effects are marked. “Heavy” Amazon consumers reduce expenditure on restaurants, groceries, and entertainment. The successful introduction of the low-value GST could be expected to have similar effects in Australia – less online purchasing and the now foregone savings from that online behaviour not being spent in other parts of the economy.

[16] Eric T Anderson et al., "How Sales Taxes Affect Customer and Firm Behavior: The Role of Search on the Internet," *Journal of Marketing Research* 47, no. 2 (2010).
[17] Berg and Davidson, "Senate Standing Committee on Economics Inquiry into the Treasury Laws Amendment (Gst Low Value Goods) Bill 2017."
[18] Joel Slemrod, "Does It Matter Who Writes the Check to the Government? The Economics of Tax Remittance," *National Tax Journal* (2008).
[19] Brian Baugh, Itzhak Ben-David, and Hoonsuk Park, "Can Taxes Shape an Industry? Evidence from the Implementation of the “Amazon Tax”," (National Bureau of Economic Research, 2014).

THE LEGISLATED MODEL

What level of compliance can be expected? [and] Are Treasury's estimates of compliance rates realistic?

The Treasury modelling that underpins this proposal are not available in the public domain. Furthermore we note that this tax was introduced and legislated without the preparation of a Regulatory Impact Statement. This combination of failure to comply with best practice raises various concerns about the Treasury modelling. We note that Treasury's modelling efforts have been subject to some severe criticism in the past.[20]

KPMG have estimated that the Treasury is assuming a 27 per cent compliance rate with the low value threshold (LVT) GST.[21] At face value this may appear to imply a relatively low rate of compliance – but we suspect that that this rate of compliance is very high. Recall the result from Anderson's analysis of Nebraska's sales tax collection nudging exercise.[22] After being nudged compliance rose from 0.7 per cent to 1.6 per cent. That increase is more than double, to be sure, but it remains far less than 27 per cent. Anderson investigated consumer response and not business response but the general principle remains the same. If an American state cannot enforce its own law in its own territory what is the likelihood that Australia will be in a position to enforce its own law in the United States and/or China?

To what extent will overseas vendors and EDPs voluntarily comply? [and] what factors will contribute to rates of compliance among them?

Webley, Adams and Elffers have developed a five factor (behavioural) model of VAT avoidance.[23]

- <u>Sanctions and punishment</u>: Generally the higher the probability of detection and punishment the higher the compliance with tax law. The Australian Tax Office, however, has little power to audit and enforce compliance with Australian tax laws if and when all the parties to the transaction are overseas, and the electronic distribution platform has no connection to Australia. The Australian government would require the close cooperation of foreign governments to operationalise the LVT GST new tax.

  To the extent that the US has long resisted collecting sales tax across its own internal borders it seems very unlikely that the US would collect a foreign tax that purported to do what they themselves do not wish to do. To the extent that the GST payment from the electronic distribution platform constituted a deduction under US law, this could reduce the taxable in the US leading to a wealth transfer from the US to Australia. Given the focus of the current US president this would almost certainly not occur.

- <u>Equity</u>: Perceptions of fairness are important in tax compliance. Given low voluntarily compliance with sales taxes, it is clear that these taxes fail any claim to being equitable.

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[20] Sinclair Davidson, "Stimulusgate," *Agenda: A Journal of Policy Analysis and Reform* (2011); Sinclair Davidson, "Treasury Forecasts of Company Tax Revenue: Back of the Envelope or Back to the Drawing Board?," *Agenda: A Journal of Policy Analysis and Reform* (2012); Henry Ergas and Alex Robson, "Modelling as Agit-Prop: The Treasury's Role in Australia's Carbon Tax Debate," ibid.

[21] KPMG, "Estimating the Direct Gst Revenues from Alternative Collection Models," (2017).

[22] Anderson, "Paying the State Use Tax: Is a "Nudge" Enough?."

[23] P. Webley, C. Adams, and H. Elffers, "Value Added Tax Compliance," in *Behavioral Public Finance*, ed. Joel Slemrod and E. McCaffery (Russell Sage Foundation, 2006).

- Personality: Generally, those individuals who are more community minded are less likely to engage in tax avoidance and evasion. Again it seems that there is a large divergence between stated intentions and revealed preference when it comes to taxation.

- Satisfaction with tax authorities: Those individuals who believe that government money is generally wasted money are more likely to avoid and evade paying tax.

- Mental accounting: The issue here is how businesspeople mentally account for the GST. Those who clearly in their minds separate out the GST from the turnover are more likely to pay the tax, while those business people who do not clearly separate the money are more likely to (attempt) to evade the tax.

  According to the Inspector-General of Taxation (2015) 60% of tax debt owed to the Australian Tax Office was from the small business category. Of that amount 74% was owed by micro-business, i.e. businesses with a turnover of less than A$500,000. Clearly, small businesses do not clearly separate out the GST from their turnover.

Applying these five factors to the case at hand, it seems most unlikely that we can expect to see large scale compliance with the LVT GST.

How will complying affect their competitiveness with other vendors in the market?

Those vendors that do comply with the LVT GST will find themselves at a competitive disadvantage. Strictly speaking, however, every business that complies with the laws of the land is at a competitive disadvantage (in price at least but perhaps not on other elements of the marketing mix). But given the expected low rates of compliance we suggest that compliant firms will quickly exit the market.

How effective will the ATO enforcement activities be?

At the Senate Inquiry into the LVT GST the ATO were very vague as to how effective their enforcement activities would be.

> Senator KETTER: Several submissions have highlighted the risk that vendors will move off large platforms, which we would expect will be most likely to comply, and onto smaller platforms, where the risk of noncompliance is high. What is the ATO's strategy to enforce compliance across smaller online platforms and individual sellers?
>
> Mr Dyce: We have a range of strategies in place. Generally, we believe that most organisations that have an obligation to comply with the legislation will do so. Our focus on—
>
> Senator KETTER: What has led you to that belief?
>
> Mr Dyce: The model that has been proposed.[24]

Yet Treasury are assuming a 27% compliance rate on that very model.

Will some vendors 'over-comply', for example by ignoring standard exemptions to GST or purchases by registered businesses?

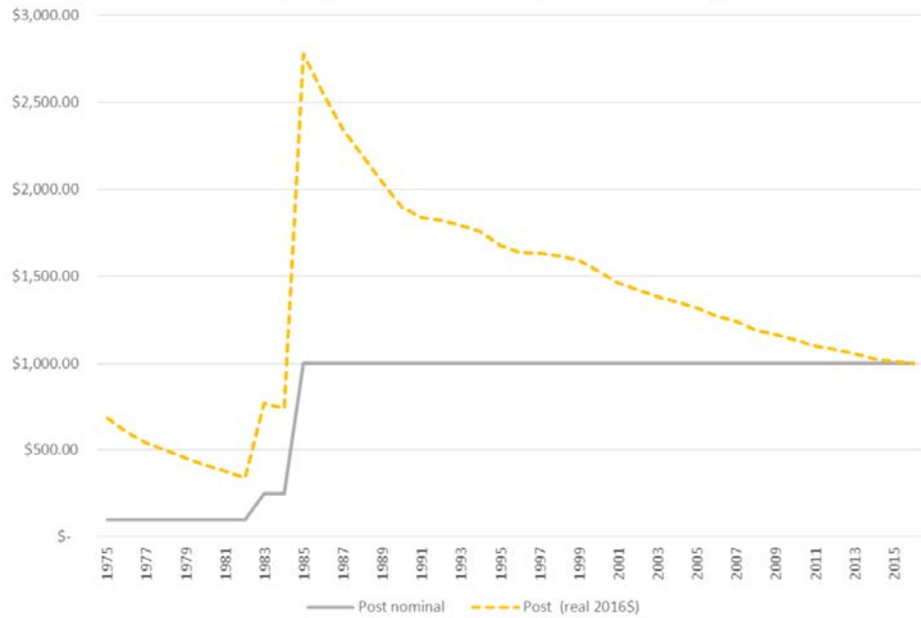
[24] Senate, Official Committee Hansard, Economics Legislation Committee, Treasury Laws Amendment (GST Low Value Goods) Bill 2017, 21 April 2017, p. 8.

Very likely – especially at the introduction of the tax and for smaller vendors. In a competitive environment we anticipate that these vendors will quickly exit the market but Australians will be defrauded in the short term by these unlawful actions.

THE PARCEL PROCESSING TASKFORCE'S MODEL

The Low Value Parcel Processing Taskforce recommended a range of reforms to the collection of the GST at the border that would enable the threshold to be reduced. We are unable to comment directly on some of the questions that the PC is interested in having answered. However, to the extent that it is desirable to reduce the threshold, a lower compliance burden would be achieved by letting inflation continue to erode that threshold. As we demonstrated in our submission, the nominal stability of the threshold masks its reduction from $2,780 in 1985 (expressed in 2016 dollars) to the $1,000 today.

Figure 1: Low value (duty and sales tax free) threshold for post, 1975-2016



Source: Australian Customs Service, Submission to the Joint Committee of Public Accounts Inquiry into Internet Commerce, 29 September 1997; own calculations.

To the extent that the PC is considering reducing the threshold, this 'natural' reduction has implications that the PC should consider. First, maintaining the threshold status quo would not represent inaction from either a political perspective or an economic perspective. The inflation-driven reduction will, over time, eliminate the policy-relevance of the threshold, capturing more goods over time. If the government's concern is to 'level the playing field' by reducing the tax differential between foreign imports and domestically purchased goods, this would achieve that goal. This solution will not be satisfactory however if the government's concern is an immediate revenue boost to the budget.

Second, the inflation-driven reduction in the threshold allows for firms to adjust their processes to suit in an entrepreneurial, rather than government-directed fashion. The Taskforce and PC have placed themselves in the invidious position of having to second-guess the cost of processing after new capital investment, changed compliance costs, and substantial logistical changes. As the PC notes, the Taskforce concluded that their estimates were "*at best* in the +/- 50 per cent range" (emphasis added).[25] While no doubt the PC would value new information from industry in response to its questions about the likely per-parcel cost reductions and how reasonable the Taskforce's original estimates were, it ought not to rely too heavily on the answers.

A sharp reduction, even if phased-in, of the threshold would be unpredictable and could create serious problems at the border. That disruption would not be in the interests of consumers. By contrast, the slow erosion of the threshold has been predictable and allowed for firms to adjust their processing practices with no discernable effect on consumers. Regulatory change has its own costs above and beyond the direct compliance costs of implementing the changes needed to follow the regulation.[26]

CONCLUSION

In our submission to the Senate, we wrote:

> In his Wealth of Nations (1976), Adam Smith proposed four principles of taxation which still inform discussions of the structure of a taxation system today (Alley and Bentley 2005). Taxes should be imposed with regard to their equality, certainty, convenience of payment, and the economy of their collection. The Treasury Laws Amendment (GST Low Value Goods) Bill 2017 violates each one of these principles. It is levied unequally, distorting competition and purchasing decisions. The administration of the tax will be uncertain and subject the Australian tax regime to significant uncertainty. While the tax will likely be convenient to pay for consumers, it is likely to be highly inconvenient for the retailers who will bear the responsibility for remitting revenue back to the Commonwealth government. Finally, while the decision to require the tax to be collected by retailers reduces the cost of collection for the Australian government, the cost and logistic complexity of foreign firms collecting Australian taxes is likely to be substantial.[27]

Unfortunately the government has done little to mollify these concerns. In the Senate hearings on the inquiry, officials from the Treasury and Australian Taxation Office seemed unsure about exactly how the policy would be enforced and administered. We have repeatedly raised concerns that Australia is becoming a 'bad actor' on the global stage in matters of taxation. We hope that the Productivity Commission is able to dissuade parliament from continuing down this path.

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[25] Low Value Parcel Processing Taskforce, "Final Report," (Commonwealth of Australia, 2012), 187.

[26] Chris Berg, "Regulation and Red Tape in a Small Open Economy: An Australian Overview," (SSRN2017); Chris Berg, *The Growth of Australia's Regulatory State: Ideology, Accountability and the Mega-Regulators* (Melbourne: Institute of Public Affairs, 2008).

[27] Berg and Davidson, "Senate Standing Committee on Economics Inquiry into the Treasury Laws Amendment (Gst Low Value Goods) Bill 2017."

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SUBMISSION TO THE SENATE STANDING COMMITTEE ON ECONOMICS INQUIRY INTO THE TREASURY LAWS AMENDMENT (GST LOW VALUE GOODS) BILL 2017

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Executive Summary

- The elimination of the low-value threshold for the Goods and Services Tax constitutes a new tax on inbound internet trade – that is, it will function as a tariff imposed on Australian consumers.
- The tax will raise very little revenue and will be expensive and complex to administer.
- The tax deviates substantially from the existing GST design.
- The tax is less a tax on consumption but on the reputation of foreign internet businesses.
- The tax is inconsistent with the government's commitment to deregulation, the promotion of international trade, and its innovation agenda.
- The tax rejects principles that the Howard government established in terms of deregulation and the promotion of international trade.
- The tax will do nothing to address the issue of high retail prices in Australia.
- While masqueraded as a tax integrity measure, this tax is clearly intended to operate as a form of protectionism.
- The tax will reduce competitive pressure within the domestic Australian economy, and (as a consequence) expose Australian consumers to government sanctioned higher retail prices.
- 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 criminality. Product safety and consumer protection rights are likely to be compromised.
- The tax has few safeguards to ensure compliance and remittance of revenue to the Australian government.
- The tax contributes to increased levels of regime uncertainty within the Australian policy environment.
- Parliament should reject the Treasury Laws Amendment (GST Low Value Goods) Bill 2017.

I INTRODUCTION

In his *Wealth of Nations* (1976), Adam Smith proposed four principles of taxation which still inform discussions of the structure of a taxation system today (Alley and Bentley 2005). Taxes should be imposed with regard to their equality, certainty, convenience of payment, and the economy of their collection. The Treasury Laws Amendment (GST Low Value Goods) Bill 2017 violates each one of these principles. It is levied unequally, distorting competition and purchasing decisions. The administration of the tax will be uncertain and subject the Australian tax regime to significant uncertainty. While the tax will likely be convenient to pay for consumers, it is likely to be highly inconvenient for the retailers who will bear the responsibility for remitting revenue back to the Commonwealth government. Finally, while the decision to require the tax to be collected by retailers reduces the cost of collection for the Australian government, the cost and logistic complexity of foreign firms collecting Australian taxes is likely to be substantial.

Currently imports into Australia purchased by Australian consumers are liable for GST payment at the border only if the purchase exceeds $1,000. By contrast, all goods and services purchased in Australia at Australian retailers (that exceed a turnover of A$75,000 per annum) are liable for GST regardless of their cost. The Bill eliminates the *de minimis* import threshold, making all purchases liable for GST whether they are purchased from firms inside Australia's indirect tax zone or not. The Treasurer has described the purpose of this bill to ensure that "low-value goods imported by consumers will face the same tax regime as goods that are sourced domestically" (Commonwealth Parliamentary Debates, House of Representatives, 16 February 2017, p. 1278).

It has long been recognised in Australia, however, that at a sufficiently low figure, the cost of imposing a tax at the border on low value goods is uneconomical, as, at some point, the cost of collection exceeds the revenue collected. The Productivity Commission (2011: 169) found that "In most scenarios estimated, total collection costs would still exceed additional revenues or generate net efficiency losses for the community". In this context, the Bill is structured to relieve the cost of collection from the Australian government. To do so, it places an obligation on foreign firms doing more than A$75,000 worth of business with Australian customers to collect GST on behalf of the Australian government for their transactions with Australian customers. Overseas firms will be required to "register for, collect and remit" GST to the Commonwealth. Further complexities have been added by the Bill's intent to target "online marketplaces" rather than individual suppliers themselves – the government has in mind here platform retailers such Amazon.com's marketplace service or eBay – and redelivery services, which on-forward goods to Australia from foreign firms that do not natively offer international shipping.

We argue in this submission that the complexity of this tax structure reflects a conceptual confusion about the nature of Australia's Goods and Services Tax and the significance of online retailing that could have substantial consequences for the integrity of Australia's tax system and Australia's reputation as a good international player in global tax administration. This submission follows from work we have done in recent years on the low value threshold GST (Berg 2015; Chung 2015) and on questions of Australia's position in the global tax regime more generally (Berg and Davidson 2015, 2017b; Davidson 2014; Zhang et al. 2017).

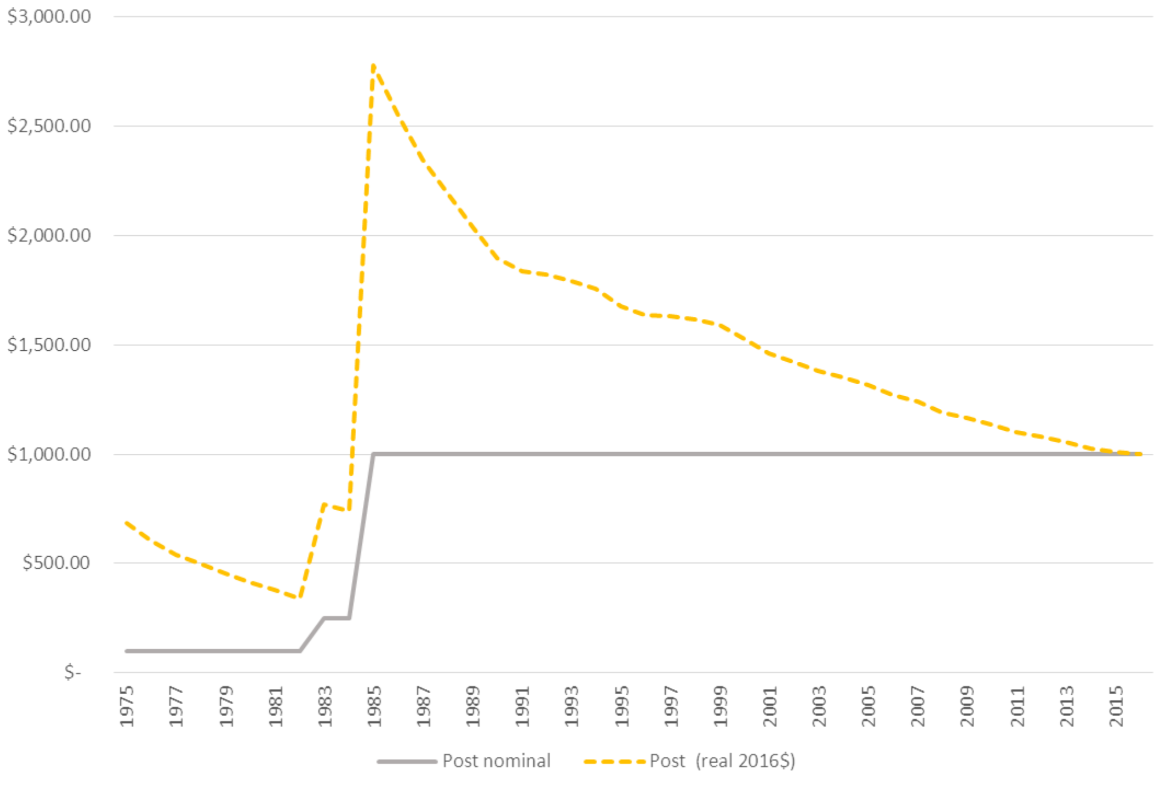
In this Part II of this submission we outline the origins and significance of the $1000 threshold. In Part III we outline the conceptual confusions behind the government's policy. In Part IV we outline some of the likely consequences of this change. In the conclusion we consider how this policy is likely to affect Australia's reputation as a good international player.

II THE PURPOSE AND ORIGIN OF AUSTRALIA'S LOW VALUE THRESHOLD

The A$1,000 low value threshold has its origin in the customs entry (screen free) thresholds and duty and tax free thresholds at which goods entering the country do not have to be formally entered through customs and at which goods are treated as duty and tax free respectively. In her survey of value-added taxes around the world, James (2015: 57) argues that thresholds are set with regard to "striking a balance between revenue foregone and administration and compliance costs". However the Australia thresholds have had a broader purpose than that. The Australian Taxation Office (1997: 7) has characterised the low value threshold as a mechanism to reduce the regulatory burden on international trade. The purpose of the low value threshold is "[a.] minimising delays in the delivery of mail and cargo, [b.] reducing the cost to business of importing low value consignments, [c.] determining a value below which it is uneconomical for [customs] to collect the tax and duty, and [d.] to facilitate international trade by minimising [customs] intervention." The relative cost of collection against the possible revenue raised by collecting revenue at the border is only one of four purposes of the low value threshold – rather, the emphasis is on keeping the burden of red tape low and encouraging, rather than discouraging, trade.

The low-value threshold has been adjusted over time, but does not appear to have any relationship to the cost of collecting revenue at the border. Figure 1 shows the duty and sales tax free threshold between 1975 and 2015 for post. Since the introduction of the GST in 2000, this has become popularly known as the low-value threshold for GST. Set originally at $100 in 1975 dollars, between 1986 and 2005 the threshold distinguished between goods which arrived by post and goods which arrived by means other than post (not shown). In 2005 the Howard government reconciled the two thresholds into the single $1,000 threshold that remains today.

Figure 1: Low value (duty and sales tax free) threshold for post, 1975-2016



Source: Australian Customs Service, Submission to the Joint Committee of Public Accounts Inquiry into Internet Commerce, 29 September 1997; own calculations.

The stable nominal threshold masks the substantial change in the real value of the threshold. As the Board of Taxation (2010: 46) noted, the non-indexation of the threshold, which has remained fixed since 2005 and fixed for goods arriving by post since 1985, "will reduce over time any potential bias in favour of imported goods over local goods of the same quality and value". The table shows the thresholds in 2016 dollars to show how significant that reduction has been. When the A$1,000 threshold was first set in 1985 it was the equivalent of A$2,780 in 2016 dollars.

Why was the uniform threshold fixed at A$1,000 in 2005? Complaints that online trading might compete with Australian firms subject to Australian sales taxes date back at least to the earliest parliamentary reckonings with the digital economy (Joint Committee of Public Accounts and Audit 1998). As documents released under freedom of information legislation reveal, the Howard government considered reducing the uniform threshold to A$500, and this was the position recommended by the Minister for Justice and Customs at the time. However, the prime minister rejected this recommendation at set the threshold at A$1,000. The explicit intent behind this decision was "the government's commitment to reduce the burden of regulation" (Howard 2005). As we have seen, the historical purpose of the low value threshold is not to maximise revenue to the Commonwealth but to reduce the compliance burden of customs and facilitate international trade. The Howard government decision was consistent with that intent.

III A SALES TAX IMPOSED ON FOREIGN SALES IS A TARIFF

It is important to understand that the Australian Goods and Services Tax is a value added tax (VAT). Value added tax is a form of sales tax that is levied on business sales at each level of production and distribution. It is applied to the sales price of goods and services net the cost of purchase and previously paid VAT. As such it is not a tax on gross sales or turnover but rather a tax on net sales. For more detail see Tait, Ebel and Le (2005). The government acknowledges that the GST is a sales tax by listing it as being a sales tax in the Budget Papers.

Value added taxes are usually described as being consumption taxes – this is based on the *assumption* that the tax is passed forward to the consumer. An important component of the VAT is that the government refunds the VAT that has been paid along the value chain until the final consumer purchases the good or service. Like most countries that operate a VAT, Australia employs the credit-invoice mechanism to keep track of the integrity of the tax. This entails a complex paper trail of invoices that can be audited by the tax authorities to minimise fraud. The Australian VAT is quite comprehensive with few exemptions (fresh food, education, health, government services). The other important point is that for-profit businesses only have to register for GST once their turnover exceeds A$75,000, and non-profit organisations only have to register for the GST once their turnover exceeds A$150,000. Finally consumer prices, in Australia, are quoted inclusive of GST.

In this section we argue that the proposed extension of the GST to low imported goods is not an integrity measure or a fairness measure as the government has suggested, but rather it is a new tax.

The key point to our argument is the following feature of the legislation (Explanatory Memorandum, pg.7):

> The reforms:
>
> …
>
> - treat the operator of an electronic distribution platform as the supplier of low value goods if the goods are purchased through the platform by consumers and brought to the [Indirect Tax Zone] with the assistance of either the supplier or the operator.

This is a stark divergence from how value-added taxes are usually constructed. Normally a VAT is a tax on net sales with the assumption that tax has been passed forward. This new tax is a tax on a business that facilitates trade between two separate parties. Imagine if instead of a buyer and seller trading on an electronic distribution platform they conducted their business over the telephone. If this Bill were to operate in a consistent manner it would then be imposing the tax liability on the telephone company.

To highlight the absurdity of the Bill, we make use of one of the examples set out in the Explanatory Memorandum (pg. 21).

> Wei is a resident of Hong Kong who purchases a piece of artwork valued at $700 from a supplier in Vietnam. The supplier arranges for the delivery of the artwork to his niece Li who lives in Australia.
>
> A supply of goods is a supply of low value goods if the customs value would have been $1,000 or less at the time when the consideration for the supply is first agreed. The artwork has a customs value of $700 and is therefore a low value good. The supply of this low value good is connected to the [Indirect Tax Zone], because it is a supply of a low value good that is purchased by a consumer and brought to the [Indirect Tax Zone] with the assistance of the supplier. Wei is not registered for GST and is therefore a consumer for the purposes of the GST law. The geographical location of Wei, being outside Australia, is irrelevant.
>
> Accordingly, the supply of the artwork is connected with the [Indirect Tax Zone].

At present the gift to Li is GST-free. It is proposed that the GST should apply to the gift. Yet neither the artist nor the purchaser is resident in Australia. Clearly the government have decided that having the gift held at Customs until Le pays the A$70 is neither financially viable nor practical. If Wei were to travel to Australia bringing the gift with him, it would remain GST-free and similarly were he ask a family member or friend to bring the gift to Australia it would also remain GST-free. It becomes taxable simply because it was brought to Australia with the assistance of the seller. The point to understand is that the tax liability is generated by the mechanism whereby the good or service enters Australia. (In this instance the artwork becomes taxable in Australia depending upon whether a related service, i.e. the transport of the artwork, is offered by the supplier.)

Now consider whether the artwork would attract GST if it were sold in Australia. If it was bought from a for-profit business with a turnover in excess of A$75,000 it would attract the GST. Yet if it were purchased from an artist with an income of less than $75,000 it would be GST-free. A Vietnamese artist with an income of greater than A$75,000 would be a wealthy artist indeed. The next point to understand then, is that this new tax brings foreigners into the Australian GST tax system where Australians would be exempted. This constitutes a discriminatory tax on foreigners that would not equally apply to Australians.

Imagine now that Wei bought the artwork from the Vietnamese supplier over an electronic distribution platform. Imagine further that the electronic distribution platform is a reputable business located in, say, the United States. This US firm is now liable for the Australian GST because a Hong Kong Chinese national traded with a Vietnamese national who transported a A$700 artwork as a gift to Australia. Again, if the artwork were transported to Australia via a family member or friend, the US electronic distribution platform would not be liable for the GST. The operation of the tax seems very arbitrary, and somewhat voluntary. Ironically, the new tax is being promoted as a mechanism to overcome arbitrariness. As Myer chairman Paul McClintock has argued (Durkin 2016):

> It's absolutely crazy that you pay different tax depending on where you buy a product from," Mr McClintock told the *Financial Review*. "We are now in a completely seamless market. You can sit in your home and order from one site and it's taxed, and another and it isn't. That's balmy. It's outrageous.

It is not clear, from the government's own example, that this new tax resolves the outrageous and balmy situation that Mr McClintock identifies. If anything it is now worse. (As an aside, we suspect Mr McClintock would never agree that his landlord should be responsible Myer's tax liabilities – yet that is what this new tax would imply were applied to his business).

Then there are questions as to the administration of the new tax. Let us assume for arguments sake that the reputable US electronic distribution platform does (somehow) collect the GST from Wei and passes it onto the Australian Taxation Office. Then the new tax will have operated as planned. But what happens if Wei and the Vietnamese supplier transact via a disreputable electronic distribution platform? This electronic distribution platform could, for example, simply not collect the GST or it could collect the GST and not transmit it to the Australian Taxation Office. What mechanism would the Australian Taxation Office have to enforce compliance with Australian law? How would the Australian Tax Office even know that a tax fraud had occurred?

Compliance with this law appears to be somewhat voluntary and arbitrary. The Australian Tax Office has no authority or power to audit any of the participants to the transaction nor is it likely to have any authority or power to audit the electronic distribution platform. To be clear – the example above is one given by the government to illustrate how the new tax is to operate. The fact that it is so easily reduced to an absurdity demonstrates the fragility of the rationale for the tax.

In this instance it is very unlikely that the Australian government would ever receive any GST revenue, unless it adopted the expensive and impractical policy of holding the artwork at Customs until the GST was paid. From the Australian government's perspective this would be case of tax avoidance or evasion. We discuss this in the context of Webley, Adams and Elffers' (2006) five factor model of VAT avoidance:[1]

- Sanctions and punishment: Generally the higher the probability of detection and punishment the higher the compliance with tax law. As we have suggested, however, the Australian Tax Office has little power to audit and enforce compliance with Australian tax laws when all the parties to the transaction are overseas and the electronic distribution platform has no connection to Australia. Strictly speaking the Australian government requires the cooperation of foreign governments to operationalise the new tax. Yet the Vietnamese government is likely to see the sale as an export (and not want to tax it), the Hong Kong government would have no interest as the transaction does not involve importing anything into Hong Kong, the US government, at best, would see this as an export, but most likely show no interest in the transaction beyond taxing the electronic distribution platform on its ordinary income under its own tax laws. To the extent that the GST payment from the electronic distribution platform constituted a deduction under US law, this could reduce the taxable in the US leading to a wealth transfer from the US to Australia.

[1] They appear to conflate the terms "avoidance" and "evasion". Strictly speaking tax avoidance is legal, while tax evasion is illegal.

- Equity: Perceptions of fairness are important in tax compliance. The extent to which either Wei or the Vietnamese supplier thought it fair that the Australian government tax the transaction would determine their willingness to pay the tax or declare the tax liability. We suggest that it unlikely that either party would perceive Australian taxation of the transaction appropriate.
- Personality: We do not have enough information in the example to speculate on how this would operate. Generally, however, those individuals who are more community minded are less likely to engage in tax avoidance and evasion.
- Satisfaction with tax authorities: Those individuals who believe that government money is generally wasted money are more likely to avoid and evade paying tax.
- Mental accounting: The issue here is how businesspeople mentally account for the GST. Those who clearly in their minds separate out the GST from the turnover are more likely to pay the tax, while those business people who do not clearly separate the money are more likely to (attempt) to evade the tax. According to the Inspector-General of Taxation (2015) 60% of tax debt owed to the Australian Tax Office was from the small business category. Of that amount 74% was owed by micro-business, i.e. businesses with a turnover of less than A$500,000. Clearly, small business (those likely to be employing an electronic distribution platform or selling Vietnamese art) do not clearly separate out the GST from their turnover.

Now it could be argued that the example we have chosen for our critique is trivial. Yet – it is the government's intent that the GST should apply in that situation. Consider a simple change – imagine that Wei is resident in Sydney, and he buys an artwork from a Vietnamese supplier and imports it into Australia. Much of our critique remains unchanged. If he was to contact the Vietnamese supplier by telephone it is easy to see the absurdity of making the telephone company liable for the GST. Yet the electronic distribution platform would be liable for the GST payment. The Vietnamese supplier is still brought into the Australian GST system even if not earning an income of over A$75,000. It may well still be the case that a reputable US electronic distribution platform is liable for the GST payable on a transaction that occurs between an Australian and a Vietnamese resident. Of course, we can also speculate on why Wei might buy from an overseas supplier using an electronic distribution platform.

If Australian retailers are to be believed Wei shops online to avoid paying the GST. This invites us to imagine that the only difference between Australian retailers and international retailers online is the 10% price differential. For example (Low and Mather 2015):

> Retailer Gerry Harvey has seized on the proposal, welcoming it as a way of finally levelling the playing field for local shops, which have to charge GST on all items.

Similarly, Treasurer Scott Morrison made the following comment in his second reading speech:

> These changes are about ensuring that Australian businesses, particularly small retailers, do not continue to be unfairly disadvantaged by the current GST exemption that applies to imports of low-value goods.

Yet what Morrison and Harvey, and many other Australian retailers, refuse to acknowledge is that Australian retail prices are high compared to their international competitors. Novak (2015) provides a broad ranging price comparison between identical Australian sourced goods and internationally sourced goods. The price differentials ranged from a low of 14% to 70% for the *identical* products. Novak suggests that rather taxing foreign goods the government should focus its attention on why

Australian prices are so high. Of course, the government earns higher GST tax revenue from higher prices and has no incentive to lower consumer prices for Australians.

We argue that the extension of the GST is a revenue grab by government being passed off as a protectionist measure. It is simply populism. It is in fact a tariff. There are significant deviations from the structure of the GST to suggest that this new tax is not a GST.

We have already canvassed the fact that sellers with incomes less than $75,000 will be drawn into the tax net. We have touched on the changed legal incidence of the GST. We now explore that issue in some detail. It is worthwhile quoting the Explanatory Memorandum in some detail:

> Broadly, the electronic distribution platform rules apply to shift GST liability for supplies made through electronic distributions platforms from individual suppliers to the operators of the platform.
>
> …
>
> The operators of electronic distribution platforms are better placed to comply with GST obligations because they are generally larger and better resourced entities than individual suppliers.

In the operation of the current GST the legal incidence is placed on the supplier with the assumption being that the tax is passed on in full to the consumer. The refund of the input credit is an important part of the tax design underpinning the assumption of the pass forward. The new tax, however, does not involve the commonwealth government refunding any money to suppliers or even electronic distribution platforms. The assumption that the tax is passed on in full, and so becomes a consumption tax, is now fragile. (Of course, it could well be violated in practice already, but now becomes untenable – see Slemrod (2008) for more discussion). The new tax is a tariff on goods imported into Australia based on online purchases. Another way of looking at it is as tax on Australian inbound internet commerce. It is not clear that the tax falls on Australian consumption, or whether the tax becomes a "trading-with-Australians tax". Most certainly, however, it exposes electronic distribution platforms to arbitrary and uncertain Australian taxation. Very likely some of these platforms will exit the Australian market or refuse to deal with Australian consumers and retailers. This is very likely to isolate Australian internet start-ups and undermine the government's own innovation agenda.

The very purpose of the A$1,000 threshold was to promote international trade; the government now seeks to inhibit international trade.

We also need to examine the efficiency of the GST as a tax. The GST is an expensive tax to administer. According to the Australian Tax Office 2014-15 Annual Report the cost to collect A$100, including GST collections, was A$0.84 compared to A$0.77 excluding GST collections. The new tax is not likely to reduce the collection cost of the GST. On the other hand, it is not likely to raise very much revenue. Table 1 shows data from the annual Tax Expenditures Statement prepared by the Australian Treasury on foregone revenue from the A$1000 GST threshold and data from the Explanatory Memorandum as to expected revenue from the new tax. GST revenue data are from the Budget Papers.

Table 1: Estimates of GST revenue from Low Value Goods as % of total GST revenue

	Tax Expenditures Statement					Explanatory Memo	
A$m	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	400.00	390.00	380.00	390.00	390.00	70.00	100.00
Revenue	48,596.00	51,394.00	54,542.00	57,808.00	60,928.00	64,928.00	67,640.00
%	0.82	0.76	0.70	0.67	0.64	0.11	0.15

Sources: Tax Expenditures Statement, Budget Papers 1, Explanatory Memorandum; own calculations.

According to data from the Tax Expenditures Statement the foregone revenue from the A$1000 threshold is less than 1% of total GST revenue. For this financial year we estimate the foregone income to be 0.64% of total GST revenue. Using data from the government's Explanatory Memorandum the expected revenue from the new tax would constitute 0.15% of total GST revenue.

The GST itself is a complex tax to administer and expensive to collect. This new tax being proposed by the Australian government will not be any less complex to administer – in fact, it is likely to more complex to administer and more expensive to collect, yet it is not clear that it will generate substantial revenue.

IV CONSEQUENCES OF REMOVING LOW VALUE THRESHOLD

The first order consequences of the Bill will be to raise the price of goods to Australian consumers and reduce competitive pressure on Australian firms. We see no reason to believe that the revenue raised from this measure will be used by the Australian government in a socially optimal manner. While the Commonwealth is running a substantial budget deficit this is a reflection of the fact that it has increased its recurrent spending rather than suffered revenue declines (Makin and Pearce 2016).

However, the Bill's specific approach to removing the low value threshold is likely to have some significant consequences for Australia's international trade and consumer safety online that the committee should consider.

Consumer safety

The Bill provides no effective mechanism to enforce its requirement that foreign firms participate in the Australian taxation system. In that context, it is a reasonable assumption that only large firms with substantial engagement in Australia – and which intend to extend that engagement over time – will participate. The decision of the government to specifically treat electronic distribution platforms and redeliverers as suppliers, rather than the retailers of the goods themselves, is likely to create substantial problems.

To give context, it is important to recognise how the current ecosystem of online retail has evolved. An early concern with internet commerce was the reliability of service and the enforceability of contracts. Evidence to a 1998 parliamentary inquiry into internet commerce found reasonably high degrees of concern with the response time, access cost, and security of financial transactions online (Joint Committee of Public Accounts and Audit 1998). An influential paper by the economist George Akerlof (1970) identified the apparently high risks of market transactions, finding that information asymmetries between buyers and sellers could leave buyers unsure of the quality of goods and consequently unwilling to make beneficial trades. In the digital space this problem was potentially more pronounced, as buyers and sellers operated at a distance from each other – often in different countries with different legal systems and remedies for fraudulent or unfair trading. The result of these concerns in the late 1990s was the development of principles of electronic commerce that relied heavily on regulatory supervision of online markets (National Advisory Council on Consumer Affairs 1998).

These regulatory perspectives failed to recognise the key role that reputation plays in the establishment and sustainability of market transactions (Klein 1997). As Adam Smith (1997: 17) wrote,

> A dealer is afraid of losing his character, and is scrupulous in observing every engagement. When a person makes perhaps 20 contracts in a day, he cannot gain so much by endeavouring to impose on his neighbours, as the very appearance of a cheat would make him lose. Where people seldom deal with one another, we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they can lose by the injury which it does their character.

A large part of the success of internet commerce has been the development of these reputation mechanisms. Tadelis (2016) notes the central role that reputation management plays in marketplaces like Amazon Marketplaces, Airbnb, eBay, Uber, Taskrabbit, the Chinese eBay competitor Taobao, and the Indian Flipkart. There are a wide range of niche online marketplaces that use similar mechanisms, such as the Lego trading service BrickLink. These platforms trade on both the reputation of the platform itself – and consumer protection mechanisms within – as well as providing buyers and sellers the ability to monitor the reputation of their counterparties.

As Adam Smith noted, the effectiveness of reputation mechanisms are stronger when there are a large volume of transactions. Large established firms like eBay and Amazon Marketplaces harness vast volumes of reputation data and long established protection processes. The Australian government cannot hope to bring all online sellers onto the GST system – a point made explicit by the Bill's treatment of electronic platforms as suppliers rather than the retailers that utilise them. It is inevitable that some marketplaces and retailers will remain outside the net. These are more likely to be the smaller firms whose generic characteristics raise the riskiness of Australian transactions: smaller firms are likely to have less well-developed protection and reputation mechanisms, and less established relationships with Australian purchasers. The level of foreign compliance with Australia's taxation system is likely highly correlated with compliance with other parts of Australian consumer protection law.

Foreign firms which do not sign up to the GST will, all else being equal, operate at a competitive advantage against those who do. The OECD (2015: 125) has identified that one of the risks of encouraging foreign intermediaries – such as online marketplaces - to collect consumption taxes is that doing so "may come at an additional cost that may be passed on to the purchaser". Australians purchasing online – particularly those purchasing goods online that are available at domestic Australian retailers – are likely to be highly price sensitive. The way the Bill has been structured provides an incentive for consumers to shift from large, compliant, and highly refined firms to more unprotected and riskier suppliers.

Fraud

When the GST was introduced in 2000, the then Howard government authorised extensive price surveillance powers for the ACCC to ensure that Australians were not defrauded by unscrupulous sellers hiding price increases under the guise of the new tax. The A New Tax System (Trade Practices

Amendment) Bill 1999 granted the ACCC special transitional powers to monitor prices to ensure that tax reductions and the GST had been fairly applied. As Joe Hockey, then Minister for Financial Services and Regulation, told the parliament:

> This bill is necessary to deal with those instances where price exploitation could occur. The substantial penalties that can be imposed demonstrate this government's determination to ensure that consumers receive the full benefits of the changes to the tax system. (Hockey 1998)

This was a key part of the Howard government's defence of the GST – that consumers would be well protected from fraud. Members of the government repeatedly referred to the ACCC's special responsibilities when defending the GST's introduction in parliament. For example, the Treasurer Peter Costello exhorted the public in parliament that:

> … if anybody believes that a price has been moved in a way which it should not, that matter can be reported to the ACCC, which has strong enforcement powers and which can investigate those particular matters to ensure that there is no price taking under the misleading or deceptive cover of a tax change (Costello 2000).

Between July 1999 and July 2001 the ACCC investigated 5,000 "GST-related matters" which resulted in "9 Federal Court actions, 40 court enforceable undertakings … more than 600 administrative undertakings, such as apologies refunds, corrective advertising and written undertakings refunds totalling almost $9.5 million for about 528,000 consumers" (Australian Competition and Consumer Commission 2001). The ACCC had a similar role at both the introduction of the carbon tax and again after its repeal. ACCC monitoring of major tax changes has become a standard procedure in Australian politics. However, it is not clear how the government will monitor international sellers and marketplaces in the case of the imposition of extraterritorial taxation. It is also not clear how the Australian government will monitor domestic prices that may change as a result of the lessening of domestic competition as a result of this policy change. The government should clarify whether it still considers that fraudulent activity under the cover of taxation changes is of concern, and how the legislation will deal with this risk.

Exiting the Australian market

A likely consequence of this new tax is that some electronic distribution platforms may exit the Australian market. The very large one's may well remain; but smaller second tier electronic distribution platforms – especially those that are just above or below the A$75,000 threshold – may exit the Australian market and so reduce competition among electronic distribution platforms operating in Australia.

Electronic distribution platforms are likely to have a business model that either collects a flat fee per transaction or a percentage of the purchase price of each transaction. (There may be additional features such as bulk discounts and sliding scales and the like.) This constitutes their revenue and they in turn have business costs that must be covered. Electronic distribution platforms will in turn pay the normal company tax rate on their taxable income in those jurisdictions where they are liable for company tax.

The proposed new tax, however, makes them liable for ten per cent of the sales price of their own customers trading with third parties. It is very likely that an additional ten per cent impost on the sales price of good being traded will exceed the profit margin electronic distribution platform's earn from any given transaction. The simplest solution to that situation would be for the electronic distribution platform to exit the Australian market. Alternately they would have to massively increase the prices they charge to their own consumers who deal with Australians in the hope that their own consumers can pass on the additional cost to Australian consumers. Given international competition, that prospect is somewhat unlikely.

Issues with harmonisation and international trade protectionism

The Treasurer has stated that this reform "is a significant world first, but it is consistent with the direction of international tax policy in this area. It is only a matter of time until others jurisdictions follow suit" (Commonwealth Parliamentary Debates, House of Representatives, 16 February 2017, p. 1279). It is true that the possibility of imposing a value-added tax on foreign suppliers and intermediaries, rather than imposing that tax at the border, has been canvassed by the OECD in its work on base erosion and profit shifting (OECD 2015). We do not, however, believe that the government should be so blasé about leading the world on this approach.

It is possible to imagine a situation where internet retailers all register for, comply with, and impose the domestic consumption taxes of their global customers. KPMG identify 121 jurisdictions with their own value added taxes in 2016 (KPMG 2017). Should this come about, the compliance burden on internet retailers, particularly small internet retailers, would be substantial. Tax enforcement under such a system would be near impossible, and the opportunities for arbitrage virtually limitless. The Australian government should not assume that such a global consumption tax system is inevitable, or even probable. In the short term, the OECD (2015) has warned that any implementation of any alternative to tax enforcement at the border "will need to be complemented with appropriate risk assessment and enhanced international administrative co-operation between tax authorities to enforce compliance."

The fact that the government is seeking to lead the world on this approach leaves it vulnerable to accusations – in our view, correct accusations – that the policy is being driven by protectionist sentiment rather than concerns with the viability of the Australian taxation system. The committee will be acutely aware of the political history of the push against the low value threshold. It is significant that this debate seriously begun between 2010 and 2013, when the Australian dollar was at a high against the United States dollar. In that period, the exchange rate meant that foreign retailers where highly competitive against Australian retailers.

If parliament does remove the low value threshold, however, retailers should not feel reassured. Novak (2015: 2) finds that "Putting a GST on low-value imports is unlikely to revive Australian retailing in the face of intense online shopping competition, given the significant price differentials for many popular consumer products." As outlined above, subjecting these goods to the GST does not erase the competitive advantage. Novak attributes Australia's retail disadvantage not to the low value threshold, but to our highly regulated labour market, and regulatory restrictions on retail and land use.

Nevertheless, as discussed in Section III above, a host of retailers have sought to blame their loss of market share on the Australian tax system. For example, the chief executive of Harvey Norman, Gerry Harvey, has claimed that the GST is a "huge, huge problem … If you are in retail selling those sort of goods, you are severely disadvantaged" (AAP 2010). The head of the National Retail Association has argued that the low value threshold "poses the greatest threat to traditional retail jobs and domestic online retail growth" and that if the government does not change it "the Australian retail sector will lose 33,000 jobs" (AAP 2012). A group of local retailers including Myer, David Jones, Angus and Robertson and (the now defunct) Borders argued that imposing GST on low value foreign imports would "create a level playing field where the same rules apply to everyone" (Winterford 2011).

In this context, it is highly likely that the government's policy will be challenged as a violation of Australia's free trade commitments. One of the central positions of Australian foreign policy is its desire to reduce barriers to trade and foster economic integration. This as we have seen is one of the stated purposes of the low value threshold. Eliminating this threshold – particularly in a manner as to try to impose extraterritorial taxation – is likely to bring Australia into conflict with either trading partners or foreign firms wishing to trade with Australia.

The fact is that protectionism (and populist economic policy generally) never achieves it stated aims of promoting domestic prosperity. Ultimately it results in lower living standards and higher prices. This policy will isolate Australians – both consumers and sellers – from the most effective and efficient electronic distribution platforms. In turn it will expose Australians – both consumers and producers – to the less desirable facilitators of international trade. Adding to the costs of international cannot be consistent with the current government's aim of promoting jobs and growth. In the 1970s there was a proposal known as the Tobin tax – the idea that a tax could be implemented to deliberately reduce the efficiency of foreign exchange market, in many respects this appears to be a tax introduced deliberately to reduce the efficiency of internet commerce for Australians.

V CONCLUSION: REGIME UNCERTAINTY IN AUSTRALIAN TAXATION

It is certainly the case that Australia's low value threshold is high by international standards. This should be seen as a feature rather than a bug. In countries with much lower thresholds, there is pressure to raise it. For example, Canada's globally low threshold at C$20 has been under much scrutiny in recent years (Stairs 2016). Australia's threshold might be high relative to other nations but that does not speak to the desirability of lowering it – the goal of any threshold ought to be the minimising of red tape and the facilitation of trade. Efforts to collect tax from trade should not be prioritised over the trade itself.

More fundamentally this policy increases the uncertainty that Australian firms, foreign firms operating in Australia, and firms in foreign jurisdictions trading with Australians will have about Australia's tax regime going forward. That this policy forms part of the OECD's work on base erosion and profit shifting is significant. We have argued that other policies under this umbrella – such as the diverted profits tax which passed parliament in March 2017 – have put Australia's reputation as a good international player in tax administration at risk, have been introduced contrary to the evidence about the erosion of the tax base, and will be implemented in a way that will decrease Australian competitiveness (Berg and Davidson 2017a). We see similar problems with this policy. However, such taxation changes add up to more than the sum of their parts: offering investors a picture of Australia's taxation regime as highly uncertain and confused. We recommend that the government does not proceed with the Treasury Laws Amendment (GST Low Value Goods) Bill 2017.

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COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Treasury Laws Amendment (GST Low Value Goods) Bill 2017

FRIDAY, 21 APRIL 2017

MELBOURNE

BY AUTHORITY OF THE SENATE

BERG, Dr Chris, Private capacity

DAVIDSON, Professor Sinclair, Private capacity

MARAR, Mr Satyajeet, Director, MyChoice Australia; Research Associate, Australian Taxpayers' Alliance

[10:18]

CHAIR: Welcome. Thank you for appearing before the committee today. Do you have any comments to make on the capacity in which you appear?

Prof. Davidson: I am a professor of institutional economics at RMIT University, I am a senior research fellow at the Institute of Public Affairs and I am an academic fellow at the Australian Taxpayers' Alliance.

Dr Berg: I am a postdoctoral fellow at RMIT University, I am a senior fellow at the Institute of Public Affairs and I am an academic fellow at the Australian Taxpayers' Alliance.

CHAIR: I invite you to each make a brief opening statement, should you wish to do so.

Prof. Davidson: We were a bit late, so we are happy to email you our opening statement if that suits, or we can make it now.

CHAIR: It would be very useful for you to make it now, if you can, and perhaps we could have it tabled afterwards.

Prof. Davidson: Sure. Thank you very much for inviting us to address this inquiry. We recommend that the Treasury Laws Amendment (GST Low Value Goods) Bill be rejected by the parliament. It is our view that this is not an integrity measure, that this is not the government closing a loophole in the GST legislation as they claim, but rather that this is a new tax. This new tax does not promote fairness for Australian retailers or consumers. It deviates quite substantially from the current GST design and is only superficially similar to the GST in that it has a 10 per cent rate. The GST itself is a tax which purports to tax Australian consumption, but it is actually a sales tax, and the legal incidence of this tax is on the seller of the goods, and the economic incidence is the assumption that the tax is then passed on to final consumers.

This particular tax, however, does not vest legal incidence in the seller of the goods; it vests legal incidence in the electronic distribution platform and/or the people offering transportation services. It is those companies and entities which facilitate a transaction between foreigners and Australians who will bear the tax, not the seller and not the consumer. This is not a tax on Australian consumption at all, but rather it is a tax on trading with Australians.

As an aside, I noticed before that you were concerned about double taxation. If this tax is collected by the foreign seller or the electronic distribution platform, they may have a problem convincing their own tax authorities that this is not revenue to them, and they may in fact then be taxed on that in their home country. So they need to be able to tell a story that remitting money to the Australian government is actually a legitimate business expense, and I suspect we will find that it is not. So double taxation will come in, in that these foreigners in fact will be taxed in their home countries on a 10 per cent increase in revenue. I was also astonished to discover that the authorities—certainly the tax office—seem to be recklessly indifferent to consumer fraud. That is certainly a massive problem.

The unintended consequences of this tax are such that I think the government has not much thought about these consequences at all. It is very likely to reduce competition in the domestic market as foreign sellers withdraw their services and stop selling. It is likely to expose Australians to darker elements of the internet, reducing antifraud protections and consumer protections that they currently enjoy. It draws foreign entities into the Australian tax net, which currently are exempt from the Australian tax net. No thought has been given at all to the consequences of Australian businesses then being drawn into foreign governments' tax nets. So not only will there be a greater compliance on foreigners imposed by the Australian government; foreign governments will in turn put a compliance burden on Australian businesses hoping to trade with their citizens. That has not been discussed at all. So the net compliance effect of this is unknown, certainly much more than the budgeted amount of $13 million, which I think is just the salaries of the people who will be working on this. The increased compliance cost on small business is likely to create a barrier to growth. Obviously, large Australian businesses are in a position to wear those fixed costs of foreign compliance. This will create a barrier to small business growth in Australia and again will be a barrier to entry.

This fails as a protection mechanism. Australian consumers pay well above 10 per cent price differentials when buying from domestic retailers than with foreign goods anyway. It fails to produce substantial revenue for the Australian government. We estimate it is less than 0.2 per cent of additional revenue on the existing GST. It is not clear to us that these inherent flaws can ever be repaired. If the government were to simply abolish the $1,000 threshold at the moment, they would find themselves in the position of having to borrow money to collect revenue at a loss, which of course is a completely nonsensical position.

We think the government should leave well enough alone, not introduce a new tax, not expose Australians to the dangers of the dark internet and substandard or unsafe goods, and not encourage Australians to move away from reputable online sellers. So this has no redeeming features whatsoever and it should not be legislated into existence. Thank you.

CHAIR: Could you be a little clearer?

Prof. Davidson: People sometimes think I am a bit shy!

Dr Berg: We had to tone him down quite substantially!

CHAIR: Thank you very much—that is terrific. Mr Berg?

Dr Berg: Mr Davidson has spoken for me.

CHAIR: Mr Marar?

Mr Marar: I think Professor Davidson canvassed a few of our reasons, but what I would like to emphasise is that there is a lot of talk in all these discussions about the business and about how local retailers get hit with the GST but foreigners do not. But there is a bigger little guy in all this and that little guy is the consumer. What our organisation basically does is lobby for the consumers' interest.

At a time when housing affordability and affordability in general is one of the biggest concerns for people, especially young people, people my age, who are struggling to make ends meet, our 2013 survey found out that not only is the cost of living the biggest concern for people today but 52 per cent of people surveyed blame the government at every level for it. On top of that, the government now wants to effectively hit consumers with—like Professor Davidson said—a substantial price hike on what they order online. Firstly, we have this premise of a level playing field, which simply is not the case. The massive price difference between what you can buy here and what you can buy online overseas—only three or four per cent of that is because of the GST being applied. Most of it is because it is simply really hard for people to do business in this country. There is an insane amount of red tape. We have restrictions on zoning laws and it is hard to get a business approved. At a time when countries around the world are moving in the opposite direction by liberalising trade and lowering the price of consumer goods from overseas, we are now going in the opposite direction.

In the interests of time I will make a quick final point, which is that the idea of punishing these online marketplaces which connect the buyer and the seller, and do not often deal with the goods or deal with the money, is unjust but also absurd. Because at the end of the day, you are not making them bear the cost; you are not making them bear the burden. They will probably pass that cost onto the consumer, who not only pays for the GST but also plays for whatever the compliance is—hiring a new accountant at eBay, for example. So you are not only putting a gun to consumers' heads, you are making them pay for the bullets as well.

CHAIR: Thank you, Mr Marar. You have actually answered my first question, but I might redirect it to the whole panel, which is that the logic behind the introduction of this legislation was to level the playing field. Can I confirm that you all believe that this, in fact, does not level the playing field?

Dr Berg: This is certainly not a level playing field measure, as Professor Davidson has pointed out. We consider this to be a new tax. It does not level the playing field to impose taxation on foreign transactions or foreign sales. These are transactions and sales and purchases that are filled, distributed and processed in foreign countries. We do feel a great deal of sympathy for Australian retailers, who are having to pay Australian taxes and who are having to bear an Australian burden of red tape. In fact, the IPA has calculated that that burden is as much as $176 billion a year, but that does not mean that the right response is to try to impose those taxes and regulatory burdens on foreign companies. If we have a tax and regulatory problem in Australia, we should be trying to tackle that tax and regulatory problem at home. If we want to level the playing field, we can always reduce taxes and we can reduce regulation at home rather than try to convince foreign companies to raise theirs in response.

CHAIR: Do you think that Australian retailers would prefer that option?

Dr Berg: You would have to speak to them. I suspect they would be very happy with anything that increases their competitive advantage against each other and against foreign companies, but I cannot speak on their behalf.

CHAIR: There have been some quite outspoken Australian retailers on this issue. I was thinking particularly of Gerry Harvey. He is a very clever man and I am sure he understands the issues that you have just discussed. What is it that you think is motivating his assertion that there is not an existing level playing field?

Dr Berg: I am very nervous about attributing someone's motives. I suspect that Gerry Harvey and Australian retailers see themselves paying a tax that firms they now find themselves in competition with do not have to pay. I sympathise with that, but I do not think the answer is to try to impose a tax on foreign companies.

Mr Marar: In their submission, the Australian Retail Council conceded that retail has actually been growing quite a lot which contradicts, to some degree, the point that competition from online stores overseas is really a big problem. Retail stores within Australia have a number of advantages. The fact is they provide a sensory experience to the consumer which an online store cannot provide, their shipping and handling costs are usually a lot lower and their economies of scale are better for, say, a company like Harvey Norman, which is spread across the whole country and they have that sorted out. They certainly are motivated by their own interest, which is that they want to reduce their competition. I would also like to point out that a store like Harvey Norman is probably a lot better prepared to weather regulatory changes than a smaller store. For example, if an Australian store is trying to import stuff from overseas to onsell, they will be hit by this tax and they will less competitive than the big guys like Harvey Norman.

CHAIR: All of your submissions referred to the de minimis threshold. For the sake of the committee and also for the transcript, could you please expand on that issue?

Dr Berg: I am happy to. The de minimis threshold is an old institution in the Australian tariff and import structure. The idea behind de minimis thresholds around the world is that at some certain price it becomes not reasonable or not economical to impose a tariff or tax at the border because the cost of raising that tax or of inspecting those goods is substantially more. That is the standard argument for de minimis thresholds. In Australia, however, a series of governments—particularly the Howard government—made it very clear that the de minimis threshold and the idea that you would not inspect goods below a certain threshold at the border is actually a facilitation of trade measure. It is a positive measure the government has in order to expand trade—not just to level the playing field but to actually favour trade. What happened is that the de minimis threshold got written into the GST discussions. They appear to have seen that structure and just added it to the GST model without adequately, in our view, scrutinising the original justification for the de minimis threshold from a tariff perspective in the context of a consumption tax or a sales tax.

Prof. Davidson: It has not been well explained. A lot of people take the view that this is purely a pragmatic measure, but in actual fact it is a philosophical measure to promote trade between Australians and the rest of the world. Also, as part of the Howard government's deregulation agenda, they deliberately chose a high threshold for reasons not related to the practicality of inspecting goods, although that is itself an issue. The threshold is much higher than the practical threshold would be.

CHAIR: There are two aspects to that de minimis threshold I would like you to further expand on. One is the use of OECD comparisons. What are other countries doing and how do they feel about their de minimis threshold? The second is that there are some countries that impose BAT or GST on the first dollar or on a much lower de minimis threshold. If they can do it, why can't we?

Dr Berg: De minimis thresholds vary across the world. Australia has a relatively high de minimis threshold of $1,000. I have not got the numbers in front of me, but I think Canada's is as low as $20. In countries like Canada, however, there is substantial debate about raising the de minimis threshold because they find that very inefficient, they do not think they raise that sort of money and they think it is a restraint on trade. Our argument would be that this is not actually a comparative question; this is about Australian consumers relating to foreign firms. In this context it does not actually matter what other OECD countries' are. What matters is how competitive our firms are against other firms around the world, not whether they are imposing certain levels of taxation on their borders.

Mr Marar: If I could add to that, even if we look at other countries, America currently has a higher threshold than we do. They lifted it up only recently and one of the main policy reasons, other than the ones that have been already canvassed, is that they believed it would be an advantage in negotiating free trade arrangements with other countries and facilitating that.

CHAIR: Sorry, what is the American threshold? Is it $800?

Mr Marar: It is $800 American, so it is about $50 or $60 above what we currently have here. That was under the Obama administration. We now have President Trump in power. He has made it very clear that he hates the idea of trade arrangements which are really good for one side but where there is no reciprocity. In fact, the word 'reciprocity' was used by the American Chamber of Commerce in reviewing the change they made. So there is a real risk that there might be a tariff retaliation against the United States. We have canvassed this in our submission, but economists agree that when there is a tariff war between two countries the bigger country almost always comes out on top. Either both countries end with a net loss or the bigger country has a significant gain, relative to us. Canada was also mentioned. Canada has a much lower threshold than we do. One of the reasons for that is that they import most of their stuff through America through a land border, where the cost of collecting the revenue is not that much. We have a massive sea border that is very hard to police and there are all sorts of practicalities there.

CHAIR: We heard from our previous witnesses that the $1,000 threshold has been in place since 2005 and has not been indexed. In today's dollars, it is worth about $2,500. What would be the implications of leaving the legislation as it is? What would happen in another 12 years?

Dr Berg: In this context, of course, the problem from the retailer's perspective would diminish over time, as it has been diminishing over time. We think that there is an intellectual case for not imposing the GST on foreign transactions in all circumstances. But as a reasonable status quo measure, just letting inflation eliminate or reduce this problem seems to be a reasonable compromise position and we would be happy with that in the short term.

Prof Davidson: Bear in mind our argument that this is a new tax. The $1,000 threshold is an existing tax design issue. To our mind that is a separate issue really. The $1,000 threshold, to a large extent, is a bit of a furphy trying to drag people into an argument that this is an extension of the GST. In actual fact this is not a GST at all; this is a new tax on foreign internet platforms and transport companies. So it is not actually about the GST at all. The $1,000 threshold, I imagine, will be eroded over time, probably slowly at the moment with CPI being quite low. But all taxes at the moment have basically the same fiscal drag problem.

Senator KETTER: Professor Davidson, could you perhaps take a step back and look at general principles of tax design. What are the good elements of tax design?

Prof Davidson: In the first instance, I would say, a tax that raises revenue is a good thing. A tax that does not impose unnecessary burden on the population is a good thing. A tax that takes money out and keeps money out of people's pockets would be a good thing. The Adam Smith principles of taxation, which were enunciated in 1776, would be the principles of a good tax. To my mind this tax does not raise revenue. That for a start is a problem. It is a social engineering tax. It is designed to change behaviour, which is normally always a bad sign. If this tax was raising a lot of revenue, we might have a different perspective on it. But it is going to raise a miniscule sum of money. The compliance costs, not just the salary costs, of this are actually going to be quite large. So it does not take out and keep out. It has got a high compliance burdens.

Senator KETTER: I am going to put you on the spot and ask you, out of 10—10 being a well-designed policy and zero being very poor—how would you rate this bill?

Dr Berg: Did you listen to the opening statement?

CHAIR: Take your time.

Prof Davidson: I am rather, unfairly, sometimes described as being a hard marker, so I am going to give this one a round zero because I think this is a thought bubble. This is very much a thought bubble. If the government wanted to pursue anything along these lines, the first thing that we would do is go to our international trading partners and start talking about tax treaties. That would be a starting point. When we are going in to taxing international trade, we should be doing this, if at all, in collaboration with our treaty partners.

Senator KETTER: I am wondering if any of the witnesses have heard the Treasury's response in relation to the lack of a regulatory impact statement. Do you have a view about their response or the fact that we do not have a RIS in relation to this bill?

Dr Berg: We have a general principle that you should have RISs in all cases, as a formal procedure thing as well. I suspect, given the evidence that this committee has already heard, that that RIS would not be as informative as it could be. The idea that 3,000 firms are just going to voluntarily stump up on this policy when there is really no direct enforcement mechanism seems to us a bit fantastical.

Mr Marar: Also, one of the reasons why the government are so proud of this policy is that they do not have to collect the tax. They get these foreign sellers and eBay to do their job for them. But the truth is, if we look at how hard it is going to be to enforce this—and they have not done a fully comprehensive impact statement—they have put that responsibility on the ACCC in the way that the ACCC enforces current GST compliance. It will take substantial resources to have the ACCC going out there and making sure that people register for this. So it is not really stopping the government from enforcing it; the government is going to spend a lot of resources just making sure people sign up and to get this thing off the ground. That is going to detract resources from policing the GST within Australia. The ACCC is, I imagine, under some level of stress to—

Senator KETTER: Unfortunately, we are running short of time, but I have a couple of further questions. I want to refer to your reference to one of the examples in the explanatory memorandum to the bill. It is on page 4 of your submission—the situation of the purchasing of the artwork. Could you briefly take us through your concerns?

Prof. Davidson: This is one of the government's own examples from their document, which I also have here, on page 21, where a Hong Kong resident purchases a piece of artwork from a Vietnamese person and gives it as a gift to their niece here in Australia. At the moment it is $700 and it would come through more or less GST free; it would not be stopped at the border or anything along these lines. The government is now proposing that the GST would apply to this gift if the purchaser or the supplier organised for it to be transported into Australia. But, reading some of the other submissions, if it came via the post, Australia Post would not be required to collect the money. So that also seems to be a bit of a loophole, but we have not given too much thought to that one. If they gave the gift to a relative or friend to bring or brought it themselves it would remain GST free. So it is actually triggered by how the artwork is transport into Australia, not by the value of the money itself. It is also the case that, if the Vietnamese artist themselves earned less than $75,000 and was trading that in Australia, it would not necessarily be liable for GST either. But, because of the way this tax is brought up, foreigners are being brought into the Australian tax net even if they would not be included if they were here in Australia.

So there are grave differences between how the government's own example operates, describing when a tax is paid and not taxed and so on and even differential treatment between Australians and non-Australians. Having a tax which targets foreigners and which does not apply to Australians is a tariff, and we are actually opposed to tariffs, generally speaking, as public policy. Senator Cormann is in America at the moment talking about reducing tariff burdens, while the government is trying to introduce a tariff here. So the differentials between the treatment of this artwork are quite random, quite arbitrary and, in many instances, quite absurd. And it does not correct any of the problems which Australian retailers are talking about—in terms of you pay different taxes upon where you buy the good. You pay different taxes on how you transport the good and who transports the good. It is a very arbitrary new tax which we do not support.

Senator KETTER: What do you say about the 1 July start date?

Prof. Davidson: Impossible.

Senator KETTER: Would you prefer a 12-month delay if it had to proceed?

Prof. Davidson: If it had to proceed, I would certainly think a couple of years. A lot of these online marketplaces are simply not geared up to do this. For a lot of them it is going to be a lot easier to geoblock Australians than it is to actually comply. There is actually a very real threat of shutting Australia off from the global international block. And, of course, that goes both ways: we would be shutting Australian businesses out of the global market if there was an Australian geoblock. That is not an ideal; I think this is a very real problem if people find they have been taxed simply for trading with Australians.

Dr Berg: In imposing a tax on firms that you have no enforcement mechanism over, the question is not when the government thinks that the tax is going to start; it is when the ATO or Treasury wanders around the world and convinces firms to follow this procedure. The government may well want it to start on 1 July and it may press the button on 1 July and that will be great for the government, but the taxes will start coming in once the government has convinced foreign firms to sign up voluntarily for a tax they do not have to pay.

Mr Marar: When a company has to implement this, it is going to take a certain amount of time to change its entire software infrastructure. Companies like eBay, which have previously not even dealt with money, will, I imagine, have to have some sort of accounting mechanism to account for the revenue and comply with Australian tax laws. On top of all this, it takes time to test the software to see if it actually works and that there are not any bugs in place. All of that takes a lot of time. To do that in a few months would be monumental for anyone.

Senator KETTER: Mr Marar, I note that you have looked at the European Union, and I just wondered if you could tell us what has happened in the EU with its efforts to implement a similar sales tax. What is your understanding of the situation?

Mr Marar: My understanding of the EU is that they have had a much lower threshold than we have had, but they have had that threshold for a while and they are in favour of maintaining the threshold. They in fact increased it slightly a few years ago, and I mention that in my submission. They are now moving towards a digital tax directive, which will make it a lot easier for businesses to comply with their own VAT requirements. Whereas our measure will in a sense make it quite difficult. Given that they have considered this issue very recently, despite having considered the issue from all angles, they did not at all elect to go with a solution such as the one being proposed today—which is rather radical. In fact, key factors they kept in mind included how hard it would be for businesses to comply with this, what the impact would be on trade liberalisation and so on. If we are to learn from their experience, this particular model is a pretty bad one.

Senator KETTER: What does the inclusion of the online platforms and redeliverers, as in the Net, say about the status of the vendor collection model? Does it say something about the fact that it is somewhat problematic?

Dr Berg: We understand why the government has chosen to do that—because the alternative is the thousands and thousands of eBay merchants and so forth. Any workaround such as this to those sorts of practical problems is going to create opportunities for arbitrage. It is going to create opportunities for sellers and consumers to go elsewhere to do more, shall we say, clever purchasing practices. One of the concerns that we raise in our submission is that some of those more clever purchasing practices may push sellers and consumers off the more established, more stable and more reputation based electronic platforms. The inclusion of something like eBay is a bandaid solution to what the government has obviously recognised is a virtually impossible collection task.

Senator KETTER: Do you think there has been sufficient consultation on this bill?

Dr Berg: This was discussed last year, from memory. Professor Davidson and I had completely forgotten about it, and suddenly it popped up in the new Senate inquiries list.

Senator KETTER: The Treasurer says that the model was announced in 2015 and so there has been plenty of time.

Dr Berg: Certainly there were discussions about imposing the GST on online discussions. This particular model—in the way that it is being implemented and the idea that they are including electronic trading platforms and that it is going to be voluntarily collected—is not that old.

Senator KETTER: Thank you very much.

CHAIR: Thank you very much for appearing before the committee today.

Proceedings suspended from 10:48 to 11:01

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"Stop This Greed": The Tax-Avoidance Political Campaign in the OECD and Australia

Chris Berg[1] and Sinclair Davidson[2]

LINK TO ABSTRACT

In 2014 Australia held the rotating presidency of the G20, hosting the meeting of the finance ministers and central bank governors and the meeting of the G20 leaders. Both meetings saw the G20 nations endorse the Base Erosion and Profit Shifting (BEPS) Action Plan. The BEPS Action Plan had been prepared by the OECD a year earlier as a "co-ordinated and comprehensive" response to the possibilities posed by globalization for tax avoidance by multinational firms (OECD 2013a). For its part, the Australian government announced in its federal budget in May 2015 that it was going to introduce legislation to "ensure foreign and multinational companies pay their share of tax." The *Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015* received royal assent in December 2015.

This paper is a critique of the political claims which have accompanied the debate about multinational tax avoidance, both at the OECD and within Australia. The movement within Australia provides an example of domestic policymakers adapting arguments pushed by international bodies to fit local political agendas. Australia provides a useful example for two reasons. First, Australia's leaders used its presidency of the G20 to drive a domestic agenda on corporate tax avoidance. Second, it has a relatively high reliance on corporate tax revenue as a part of its total tax take (18 percent in 2013, compared to an unweighted OECD average of 8.4

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percent, and ranking in the OECD second only to Norway, which like Australia is rich in natural resources).

Multinational firms conduct commerce across national boundaries, transfer resources between affiliates across those boundaries, and exercise ownership and control over their affiliates. Another feature of multinational firms is a cosmopolitan outlook. Their choice of location is not much constrained by questions of patriotism or cultural identity. They are more or less indifferent as to the jurisdiction in which they invest, "except as determined by expected profitability, risk, or any other objective standard derived from [the] pecuniary goal" (Kopits 1976b, 627).

We describe the practices where corporate or individual taxpayers move income offshore in order to reduce their domestic tax profile as tax *avoidance*, rather than the more pejorative and loaded term tax *evasion*. This distinction is not controversial. It is true that the Australian Taxation Office has attempted to blur the distinction between avoidance and evasion (see Seldon 1979 for a discussion of tax "avoision"). Nevertheless, Australian parliamentary debate reflects the same distinction as we adopt here. As the chair of the Senate Economics References Committee, Sam Dastyari, stated in 2015, "Tax avoidance is questionably moral behaviour. It is legal. Tax evasion is illegal behaviour. I think they are the two terms."[3]

The prehistory of the OECD's "Harmful Tax Competition" and BEPS projects mixes concerns about lawful tax avoidance with concerns about illegal tax evasion and money laundering. In our assessment, popular commentary on these issues, too, rarely distinguishes between tax planning practices which are legal but (judged to be) unfair or unethical, and those which are illegal under domestic tax law.

The 1981 Gordon Report

Political interest in tax havens during the 1970s led the Carter administration in the United States to commission the 1981 Gordon Report, which formulated three key attributes that would positively identify a country as a tax haven: (1) low or no tax on income from foreign sources or certain types of business, (2) common-law or statutory secrecy provisions that were not relaxed in the case of a serious violation of the laws of another country, and (3) a relatively high importance of banking to the economy. The Gordon Report recommended that the United States terminate its tax treaties with known tax havens such as the Netherlands Antilles,

3. Official Committee Hansard, Senate Economics References Committee, April 8, 2015, p. 6 (link).

increase information requirements on U.S. taxpayers concerning their international transactions, seek stronger information exchange from foreign jurisdictions, and dissuade firms from doing business in jurisdictions which maintained secrecy laws (Gordon 1981).

The United States did not immediately adopt the recommendations of the Gordon Report. That slow progress led to an increased political salience of both the existence of tax havens and aggressive tax-planning practices. By the mid-1990s international agencies such as the International Monetary Fund were warning that mobile capital meant the residency principle for levying corporate and personal income taxes would only be sustainable if there was transparent information transfer between tax authorities (Eccleston 2012). Since the 1990s, the Organization for Economic Cooperation and Development (OECD) has chiefly driven international efforts on tax avoidance; the OECD has taken the function of an "informal 'world tax organization'" (Cockfield 2006). The OECD's efforts on tax avoidance can be divided into two waves. The first was fashioned as the Harmful Tax Competition (HTC) project. After the perceived failure of that project, a second effort, from 2013, was fashioned as a move against Base Erosion and Profit Shifting (BEPS). We treat each in turn.

The OECD's "Harmful Tax Competition" project

In May 1996, a communique from the G7 summit in Lyon declared that "Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases" and requested the OECD "vigorously pursue its work in this field" with the aim to establish multilateral action on reducing such competition. The OECD published its report *Harmful Tax Competition: An Emerging Issue* in 1998. This report propounded the notion that tax competition could be harmful, and it proposed to list OECD member and non-member countries with preferential tax regimes alongside its listed "tax havens."

What constituted harmful tax competition? In its treatment, the report distinguished between the positive aspects of tax competition—globalization putting pressure on national tax systems to modernize and reduce tax barriers to capital flows—and what it saw as negative or harmful aspects—the opportunity that globalization has offered firms to "minimise and avoid taxes" and individual countries to "enact tax policies aimed primarily at diverting financial and other geographically mobile capital" (OECD 1998, 14). In this sense the incidence of *harm* in harmful tax competition is placed on domestic tax systems. The report states:

> … these schemes can erode national tax bases of other countries, may alter the structure of taxation (by shifting part of the tax burden from mobile to relatively immobile factors and from income to consumption) and may hamper the application of progressive tax rates and the achievement of redistributive goals. (OECD 1998, 14)

This distinction between positive and harmful tax competition is deeply ambiguous. The consequences outlined above—the erosion of a national tax base, changing structures of taxation, and the hampering of progressive tax rates and redistributive goals—are caused by all forms of tax competition, not only "harmful" competition. Rather than outline the characteristics of harmful competition, the OECD report instead identified the characteristics of tax havens and preferential tax regimes that it sought to tackle through multilateral action. The places against which it pushed for action were described as places where there are: zero or only nominal taxes, a lack of information exchange, a lack of transparency, ring-fencing of tax regimes to prevent residents from accessing the preferential regime or to prevent beneficiaries from accessing domestic markets (in the case of preferential tax regimes), and no substantial economic activities (in the case of tax havens). The report described these as features of "harmful tax competition" based on its own judgment that the apparently negative aspects outweigh the positive aspects. There were no empirical bases for these claims; indeed, the report noted that "The available data do not permit a detailed comparative analysis of the economic and revenue effects involving low-tax jurisdictions" (ibid., 17).

The 1998 report offered definitions of harmful competition that could be best described as casual: "redirect[ing] capital and financial flows and the corresponding revenue…by bidding aggressively for the tax base of other countries," or when "the spillover effects of particular tax practices are so substantial that they are concluded to be poaching other countries' tax bases" (OECD 1998, 16). At a certain level of abstraction, all competition involves "bidding"—sometimes "aggressively"—for business, and the word "poaching" is used regularly to describe events that occur in competitive markets. The existence of aggressive competition is not a black mark against competition. It is possible that tax havens and preferential tax regimes lead to suboptimal flows of capital, but this is not shown by declaring that competition between national tax regimes is "harmful." Later in this paper we explore the economic function of international tax competition.

The OECD/G20 "Base Erosion and Profit Shifting" (BEPS) project

Having found support from a coincidence of center-left governments in major world economies in the mid-1990s, the HTC project floundered when the incoming Bush administration made it clear that the project was not in line with its priorities (Eccleston 2012; Palan et al. 2010). OECD work on tax avoidance was only revived after the 2008 Global Financial Crisis. At its second meeting in 2009, the newly constituted Group of 20 countries declared an intention to "take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over" (G20, 2009). In this way the G20 connected, at least rhetorically, the ongoing financial crisis with a crackdown down on tax competition. The OECD entered a "symbiotic relationship" (Eccleston 2012, 87) with the G20, which was trying hastily to develop an international reform agenda. The G20 structure gave the project greater authority than the OECD could provide (Kudrle 2014). In this period, the OECD and G20 greatly expanded the Global Forum on Transparency and Exchange of Information for Tax Purposes, which had been first established in 2000 to enact recommendations from the HTC project with 32 members. The Global Forum now has 130 members.

The June 2012 G20 leaders meeting directed the OECD's tax avoidance work to be refashioned in terms of "base erosion and profit shifting," and in February 2013 the OECD published *Addressing Base Erosion and Profit Shifting* (OECD 2013b). The report was followed in July 2013 by the *Action Plan on Base Erosion and Profit Shifting* (OECD 2013a). The BEPS project focused on the "erosion" of the tax revenue base from firms shifting profits across borders in a way that might cause double non-taxation. Here the emphasis narrowed to the "integrity of the corporate income tax," rather than personal-and-corporate income taxes (2013b, 8). The BEPS project shifted political attention away from the HTC projects' bellicose rhetoric about tax havens to preferential regimes, "mismatches" between domestic tax regimes that might allow firms to avoid tax liabilities, the treatment of transfer pricing and thin capitalization rules, the taxation of digital goods, and "aggressive tax planning" (ibid., 6).

The BEPS project makes two basic claims. The first is that the corporate income tax base is being eroded. The second is that the cause of that base erosion is firms shifting profits across borders. The initial BEPS paper was careful, however, not to overstate the significance of these claims. The report addressed itself to the "growing perception" that governments are being denied legitimate revenue from corporate tax planning, noting claims in major newspapers about tax avoidance and misleading, "simplistic" arguments by non-government organizations about the nature of corporate taxation (ibid., 13). The OECD admitted that given the relatively small proportion of corporate tax as a percentage of total tax take, "the scale of revenue losses through BEPS may not be extremely large." Furthermore, "it is difficult to reach solid conclusions about how much BEPS actually occurs" (15). However, the OECD argued that BEPS may still be significant "in monetary terms" and may be of more proportional interest due to its "effects on the perceived integrity of the tax system," i.e., that BEPS may undermine tax morale (ibid.). The paper looked at the possible mechanisms by which BEPS might occur—principally mismatches between domestic tax regimes—rather than demonstrating that this was a materially significant tax revenue issue.

In this context, it is important to emphasize what BEPS is not. It is not about making use of bank secrecy to conceal profits, and it is not simply a case of transfer pricing. BEPS is alleged to be making use of those legal provisions to avoid double taxation to ensure the non-taxation of profit. While superficially similar to transfer pricing issues, BEPS is a distinct phenomenon and deserves to be treated as such (Kleinbard 2011a; b). The irony is that multinational corporations could be fully compliant with the letter of domestic tax law and international treaties, and still be 'guilty' of wrongdoing under the arguments being made to justify the BEPS program.

BEPS in Australia

Since the global financial crisis, the Australian federal government has run a sustained budget deficit, largely to cover recurrent expenditure (Makin and Pearce 2016). This deficit has played a large role in Australian politics, as both sides of politics have proposed and sought to implement measures to reduce this deficit. Under the Labor government (2007–2013), the Treasurer Wayne Swan had been concerned with "vested interests" who fought against proposed tax impositions on mining and carbon dioxide emissions (Swan 2012; 2014). Driven by media attention on technology companies like Google, Apple, and eBay (Butler and Wilkins 2012), the political focus narrowed during 2012 and 2013 to corporate tax avoidance.

Of particular significance was a report published by Tax Justice Network Australia in 2014 that reported that effective tax rates calculated from annual financial statements substantially deviated from Australia's (then) statutory company tax rate of 30 percent. What was not reported, however, is the fact that every public company has a tax reconciliation note in its annual financial statements. There is no mystery to the "book-tax income gap," either at a company level or from a policy perspective (see Davidson 2014b; 2015a). While the report was severely criticized (see, e.g., McCrann 2014), nonetheless it established in the public mind the *notion* of widespread wrongdoing on the part of business and led to a Parliamentary inquiry into corporate tax avoidance—we discuss this inquiry below.

Australian policymakers were also responsive to developments in the OECD and the G20. OECD work in 2010 on transfer pricing reform led to legislative changes in 2012 ensuring that Australian transfer pricing rules were interpreted according to OECD guidelines.[4] Changes to Australia's general anti-avoidance rule, foreshadowed since March 2012, were introduced into parliament the day after the release of the OECD's BEPS report in March 2013.[5] Two papers on the taxation of multinational enterprises by the Treasury department in May and July 2013 followed, presaging further reform (Treasury 2013a; c). The election of the conservative Abbott government at the end of 2013 coincided with Australia's presidency of the G20, and the new government publicly aligned itself with the intention behind the OECD/G20 program (Abbott 2013; Hockey 2013). Changes to thin capitalization laws were announced in November 2013 and passed in September 2014.[6]

The changes to Australian tax rules were accompanied by reforms to the conditions for 'disclosure' of corporate tax information—*disclosure* used in this manner means the *government* making public tax information about individual corporations, not those corporations disclosing information about themselves. In February 2013, the Labor government announced that "recent events in Australia and around the world call into question whether large and multinational businesses should have the same level of confidentiality about the taxes they have paid" and that "Large multinational companies that use complex arrangements and contrived corporate structures to avoid paying their fair share of tax should not be able to hide behind a veil of secrecy" (Bradbury 2013a). A Treasury paper two months later argued that Australia's "voluntary compliance" tax system required public confidence in the fairness of that system. Perceptions of unfairness might lead to "heightened efforts to avoid tax" (Treasury 2013b, 7). Such efforts would require more intrusive compliance controls, which could also in turn undermine confidence and the tax system's sustainability.

To counter the perception of unfairness, the Treasury proposed that the Commissioner of Taxation be required to disclose to the public limited tax return

4. Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012.
5. Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.
6. Tax and Superannuation Laws Amendment (2014 Measures No. 4) Bill 2014.

information for companies whose total income is AU$100 million or more, as well as any minerals resource rent tax or petroleum resource rent tax payable. The information required was the business number and name, reported total income, taxable income, and corporate income tax payable. For publicly listed companies, this information is already available in annual financial statements, as is a tax reconciliation between financial accounting and tax accounting. Legislation was introduced into parliament to give effect to this proposal in May 2013 and passed in June.[7] In the second half of 2015 the Coalition government modified the threshold to distinguish between publicly listed and foreign-owned companies, who were subject to disclosure if their total income was above $100 million, and private companies, who were subject to disclosure only if their total income was above $200 million.[8] As the Australian Taxation Office (2013) noted, the purpose of disclosure reforms was to "discourage" aggressive tax planning and "encourage public debate about corporate tax policy." Tax disclosure, however, was not a requirement or recommendation of the G20/OECD process. Indeed, the director of the OECD's Centre for Tax Policy and Administration, Pascal Saint-Amans, argued that disclosure "may be misleading and it could do big damage unfairly" (quoted in Khadem 2014). It has been suggested that this disclosure constitutes a 'market mechanism' promoting greater tax compliance. Market mechanisms, however, usually work to reduce information asymmetry. In fact, for publicly listed companies, all the information being 'disclosed' is already publicly available. It is not clear that re-releasing public information and exposing it to a less well-informed audience than the Australian Tax Office could reduce asymmetric information and encourage greater tax compliance.

Public shaming as a revenue strategy

While in opposition the Coalition parties evinced some skepticism about the Labor government's crackdown on corporate tax avoidance, particularly the disclosure reforms. The Coalition won government in 2013. Their period in government coincided with increasing public discussion about corporate tax avoidance. A keyword search of five major Australian newspapers finds over 800 articles referring to corporate tax avoidance between 2013 and 2015, most coming in the third year.[9] The establishment of a Senate committee inquiry into Corporate

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7. Tax Laws Amendment (2013 Measures No. 2) Bill 2013.

8. Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015; Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015.

9. Based on a Factiva search for *"corporate tax" and avoidance*, in *The Age*, *The Sydney Morning Herald*, *The Australian Financial Review*, *The Australian*, and the *Canberra Times*.

Tax Avoidance in October 2014 ensured a steady drip throughout the next year of newspaper reports on tax planning practices among large firms. The inquiry took testimony from more than a dozen technology, mining, and pharmaceutical firms, as well as various non-profit organizations which had campaigned on corporate tax avoidance such as the Uniting Church, the Australia Institute (a progressive think tank), and unions such as United Voice and the Community and Public Sector Union. As one commentator wrote, this inquiry gave a number of Senators the opportunity to "berate local leaders of the world's biggest technology companies" in front of the press (Treadgold 2015).

The committee's first report, released in August 2015, emphasized that the Australian taxation system was "strong and, in many respects, world leading," but noted that a number of multinational companies which derived significant revenue in Australia yet paid little to no corporate tax. The title of that report, *You Cannot Tax What You Cannot See*, characterized the recommendations, which were concerned both with the information sharing efforts driven through the G20/OECD BEPS project, as well as further recommendations for domestic disclosure, including: (1) a mandatory tax reporting code for large Australian and multinational companies operating in Australia, (2) a public register of tax avoidance settlements, (3) an annual report of tax minimization and avoidance include estimates of revenue foregone, (4) an annual report of tax avoidance compliance activities, (5) the publication of country-by-country reports, and (6) a requirement that government tender bids state a firm's country of domicile for tax purposes (Senate Economics References Committee 2015). Should these recommendations be adopted in whole or in part, they would be certain to guarantee the same drip-feed of press reports that had accompanied the inquiry itself. The emphasis placed on public disclosure suggests a limited range of possible public responses and the committee's apparent view that tax avoidance is an issue best addressed through public suasion rather than reform to the tax code.

It is worth exploring this notion in a bit more detail. The problem policymakers face in conceptualizing BEPS is that companies in general and multinationals in particular are generally compliant with domestic tax law. BEPS does not suggest that companies are not paying their legally mandated tax liabilities, but rather that they should be paying more. So it appears that the Senate committee was hoping that companies would 'agree' to pay more tax than they are legally mandated to pay through a process of public shaming. Yet paying money to (foreign) governments in the absence of a clear tax liability or court order is likely to violate norms—if not actual laws—against paying bribes. Soliciting such payments from multinational corporations is also problematic for a country that purports to operate under the rule of law. If the Australian government wishes to raise more revenue from taxation it should pass an appropriate law through the parliament or enforce the existing laws it has previously passed through the parliament, though there may be little scope to increase company tax revenue through more rigorous enforcement of existing laws (Davidson and Heaney 2012).

The committee was unable to come to a conclusion about how significant corporate tax minimization and avoidance was in the Australian context. The lack of conclusion was a reflection of the evidence put to the committee. Treasury officials appearing in front of the committee were asked directly about how much revenue was being lost to multinational tax avoidance. In response, the Deputy Secretary answered that they "really do not know."[10] We address this issue below.

The Coalition government made countering multinational tax avoidance one of the central revenue features of its 2015–16 budget.[11] The government released draft tax legislation intended to "stop multinational entities using artificial or contrived arrangements to avoid a taxable presence in Australia."[12] This legislation, which was introduced to parliament in September, lowered the threshold under which the Australian Tax Office (ATO) could make a claim under the general anti-avoidance law, increased penalties for tax avoidance, and enabled the ATO to judge that profit booked in a foreign jurisdiction was taxable under Australia law. We have argued elsewhere that this places multinational firms operating in Australia under a threat of double taxation, as there is no reason foreign tax authorities would accept the ATO's claim (Berg and Davidson 2015).

While the Coalition government sought to roll back some of the transparency provisions introduced by the previous Labor government, parliamentary negotiation in December 2015 meant that transparency provisions remained relatively unchanged.[13] The first release of this data occurred that month. While it was accompanied with a warning from the taxation commissioner that "No tax paid does not necessarily mean tax avoidance" (Jordan 2015), the data dump was greeted with headlines such as "How our tax take has been royally Scrooged"

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10. Response by Robert Heferen to question from committee chair Sam Dastyari, Official Committee Hansard, Senate Economics References Committee, April 9, 2015, p. 24 (**link**).

11. This was accompanied by a video advertisement (**link**), which stated: "Some multinational companies use Australian businesses and Australian workers to sell products and services to Australian customers every day. But when it comes to sign the contract, the Australian customer is actually signing the contract with a related company in another country. This means Australian income is not being taxed in Australia. To make matters worse, money is then being channelled through to a tax haven, escaping tax worldwide, leaving Australian companies, small businesses, families, and individuals to carry the tax burden. It is unfair and unsustainable for local businesses to pay tax on their profits when their competitors do not. From 1 January next year, this will change. The government will introduce new laws and new penalties to stop this greed, and will consult with the community on further amendments to the Australian tax law. To find out more, visit budget.gov.au."

12. Tax Laws Amendment (Tax Integrity Multinational Anti-Avoidance Law) Bill 2015 (**link**).

13. The Coalition negotiated an increase in the threshold for private company disclosure, from $100 million total income to $200 million, in order to gain Greens support in the Senate.

(Verrender 2015). In December 2016 the second data release occurred. The taxation commissioner made this statement:

> Today's information provides more transparency for the community on the operations of these entities, but it **does not change the level of transparency they have with the ATO**. We already have access to far more detailed information and regularly engage with and assure the tax behaviour of these major players in the Australian economy. (Jordan 2016, emphasis in original)

Not only is the ATO releasing information that it already knows, it is releasing information that is already in the public domain via annual financial statements. Nonetheless, it is worthwhile comparing what the ATO reported with what the media reported. The ATO:

> I should also say we collect, on average, about $2 billion from our compliance activities with these large and private companies each year, which is not reflected in the data released today. (Jordan 2016)

That statement gave rise to the headline "ATO chases multinationals for $2b in unpaid tax" (Mather et al. 2016). The public is left with the impression that multinational tax avoidance amounts to some $2 billion. If correct, that would suggest that multinational tax avoidance constituted some three percent of total company tax revenue. The tax commissioner, however, was referring to *all* compliance matters, not just multinationals. In any event, the ATO still has no clear idea how much revenue is being lost to multinational tax avoidance. An ATO official told the Parliamentary Standing Committee on Tax and Revenue:

> What we have found is that it is very important, if we are to produce a gap, that we are very confident in the underlying methodology, that it is credible and reliable. The superannuation gap, as with a couple of the other income tax gaps, got to a stage where, on external review, they were rated as low or very low reliability.[14]

In short, the transparency policy does not increase tax transparency to the ATO, while it provides the media with an opportunity to report misleading interpretations of information that is already in the public domain. It generates the very misleading impression that the ATO knows how much multinational tax avoidance is occurring, when the ATO in fact has no idea what the extent of

14. Response by Jeremy Hirschhorn to question from committee member Milton Dick, Official Committee Hansard, House of Representatives, Standing Committee on Tax and Revenue, 30 November 2016, p. 15 (**link**).

the problem could be. Overall, this policy assumes that increased exposure, of public information and of information already known to the tax authorities, will lead to less tax avoidance. We are invited to believe that the public has a better understanding of corporate taxation than does the Australian Taxation Office.

The welfare economics of tax competition

Arguments against tax competition often comprise a mixture of declamations with economic argumentation. A domestic political audience with limited economic skills may find such a confused collection of ideas and arguments to be convincing. An example is provided by the former Dutch State Secretary of Finance Wouter Bos, who has argued that while tax competition is all very well in theory, it could never actually work in practice:

> There is nothing wrong with different countries having different tax regimes. Tax policy is a legitimate instrument in improving competitiveness in a global market. A low and competitive tax rate will, among other things, help them to facilitate this goal. In order to pursue and sustain this low tax rate, governments must organise their scarce resources as efficient as possible. From an economic perspective, tax competition therefore leads to efficient governments and the highest possible level of wealth for everybody.
>
> There is only one very important side condition for this last statement to be true, and that is that the global markets are perfect and there are no market failures whatsoever. This is, I am afraid, not the case in real life.
>
> When markets are imperfect, policy goals can not be achieved by market forces alone. The same is true for competing in the field of tax policies. Any competition needs some form of regulation, so does this one. (Bos 2000)

Bos then mentions free-riding and negative externalities. He fails, however, to explain how these problems would manifest in the international taxation system in practice. Finally, he concludes:

> In a perfect world differences between national policy mixes should lead to an optimal mix between the level of taxes and the level of public expenditure on the part of a state. In practice, however, there is a natural tendency to exert pressure to ever lower taxes which could—in turn—threaten the balance between taxes and public expenditures. It is at this point, where fair competition comes close to not just a "race to the bottom" but a "race to public poverty," that fair competition turns into unfair competition and where total tax income of the countries becomes too low for governments to finance a sustainable and sufficient level of public services. (Bos 2000)

Bos frets about tax revenue being "too low" to finance a "sufficient level of public services." A lot rides on the word "sufficient." There is good reason to believe the current size of the public sector has a negative effect on economic growth and productivity (Bergh and Henrekson 2011; Mitchell 2005; Novak 2013). In the British tradition of constitutional government, restraints are needed to keep government from intruding into, and overwhelming, civil society. Just as market competition checks monopolistic abuse, tax competition can exert a healthy check on the 'monopolized' power that is government. Further, Bos suggests that tax competition is not subject to any form of regulation, but that is far from the case. The international tax architecture consists of a complex set of interlocking treaties and conventions that almost amount to an international tax cartel (Edwards and Mitchell 2008). Much like a private-sector cartel, governments have divided up the global tax base and allocated taxing rights over an exclusive domain (see Davidson 2015b). In this view the BEPS debate is simply governments squabbling over prices and market share, as would any private-sector cartel.

Julie Roin (2007a) argues that two chief questions are at the centre of the international tax regime: how much tax should be levied on income generated by transnational transactions, and which government should levy that tax. The international tax architecture establishes which government will levy taxation on income with the overarching principle that income should be taxed only once; governments seldom, if ever, enter into tax sharing agreements. Roin (1995) argues that the international norm is that the source country (i.e., the host economy) has primary taxation jurisdiction over an economic transaction, rather than the home country. The prime objective of most tax treaties is to avoid the problem of double taxation. A chief purpose of these treaties has been to promote international trade and investment.

A consequence of a policy regime designed to avoid double taxation is so-called 'under-taxation.' Roin (2007b) refers to this phenomenon as "double non-taxation." It occurs when the country with primary authority does *not* levy a tax on economic activity. To be clear: Sovereign nations have both the right and the duty to define their own tax bases; in this instance a sovereign nation has chosen to exclude from its own tax base some economic activity over which, by international agreement, it has primary taxation authority.

There are, very often, good reasons why a country may choose to not levy a tax. The most obvious reasons would be to facilitate international trade or encourage foreign direct investment. In other instances, particular income might become tax-exempt due to treaty obligations that have been negotiated between sovereign states. Then, there may well be purely pragmatic reasons related to the mechanics of tax administration. It is important to emphasize that nontaxation by the country with primary taxing authority is a deliberate policy choice, and a design feature of tax systems. Jawboning countries to tax where they otherwise would choose not to tax could be viewed a form of fiscal imperialism. Edward Kleinbard (2011a; b) argues that international tax architecture creates so-called "stateless income." But the very term "stateless" is misleading: Kleinbard's complaint is not that the income is stateless *per se*, but that it is not taxed in the United States (Davidson 2014a). Similarly, the Australian government's complaints about base erosion and profit shifting can be reduced to the fact that income is not taxed in Australia.

Sovereign nations that have taxing authority under the international tax architecture chose their own tax regimes. Many nations have chosen, for example, to tax intellectual property at lower rates than they do physical property. Unsurprisingly, multinational corporations with valuable intellectual property often locate their property in those countries.[15] These so-called tax havens have come under substantial criticism from international organizations such as the OECD and from high-taxing governments. Yet it is well-known that tax havens promote investment and economic activity. Mihir Desai, Fritz Foley, and James Hines (2006) have found that "tax haven activity enhances activity in nearby non-havens." Higher after-tax returns enable multinational corporations to maintain higher levels of foreign investment. A strong case can be made that the impact a tax haven has on economic activity in neighbor countries is positive, not negative. The question of whether governments suffer adverse revenue effects from tax competition is addressed below.

International taxation arrangements are regulated and constrained by international treaties, domestic law, and business conventions. The international tax architecture operates much like a cartel. It is unsurprising if governments dislike obstacles to their taking more wealth from the private economy, and that the Australian government, which has run persistent and growing budget deficits, would want to renegotiate the rules to gain more tax revenue rather than reduce expenditure.

How significant is profit shifting?

The material published by the OECD and the Australian government makes much of popular perceptions of widespread profit shifting. That material has focused on the mechanisms by which profit shifting might occur, and on the vulnerability of tax systems to aggressive tax planning, but mostly unanswered is how widespread or significant profit shifting is. Here we survey the academic

15. *See* Davidson and Potts (forthcoming) for a discussion on this point.

literature on profit shifting and the use of tax havens. Advances in both method and the acquisition of more fine-grained data have allowed a greater understanding of the extent of profit shifting (Dharmapala 2014).

Observing the growth in multinational firms after the Second World War (Kopits 1976b), the first generation of scholarship to study multinational profit shifting was conducted in the late 1970s and early 1980s. These studies asked whether relative tax rates were likely to influence the behavior of multinational corporations. It was understood that differential taxes and tariffs were an important determinant of transfer pricing (Copithorne 1971; Horst 1971), but data was scarce and little quantitative evidence was available. Exploiting research commissioned by the Colombian government between 1966 and 1970 to identify "overpricing" in the foreign subsidiaries of pharmaceutical firms, Sanjaya Lall (1973) and Constantine Vaitsos (1974) found overpricing ranging from 33 percent to 300 percent, possibly driven by Colombian restrictions on profit maximization. Other studies attempted to indirectly estimate transfer pricing through least squares estimation (Kopits 1976a; Müller and Morgenstern 1974), but lacked actual pricing data.

A second generation of scholarship in the 1990s tried to answer that question by subtracting a counterfactual 'true' income of an affiliate from the observed pre-tax income. The 'true' income was determined by an assessment of the affiliate's capital and labor inputs. The result of this calculation was the profits that had been shifted to the affiliate. James Hines and Eric Rice (1994) and Harry Grubert and John Mutti (1991) exploited country-level aggregated data of U.S. affiliate firms from the U.S. Department of Commerce. Hines and Rice (1994) find that a ten percent decrease in a country's tax rate would be associated with an increase in hypothetical reported profits from \$100,000 to \$122,500—implying a very large amount of profit shifting (see Dharmapala 2014, 28, Table 1). However, an alternative approach taken in the accounting literature compares the accounting rates of return across United States and foreign operations to derive an estimate of shifted income. Using this method, Julie Collins, Deen Kemsley, and Mark Lang (1998) found no evidence of income shifting out of the United States between 1984 and 1992.

Such analyses were based on country-level or consolidated worldwide data. Aggregating firms together removes important differences between industries, individual firms within an industry, and the structure of tangible and intangible assets. In recent years, however, researchers have been able to employ highly disaggregated data which break down financial information to the affiliate level, using, for example, the Orbis and Amadeus databases. Employing firm-level data, the literature has seen a steady reduction in the estimates of the magnitude of profit shifting. Similarly, controlling for industry-specific shocks and other factors has reduced estimates further. Table 1, reproduced from Dhammika Dharmapala (2014, 28), demonstrates that studies in the early 1990s reported large estimates of profit shifting but that more recent studies have reported much lower estimates. Dharmapala suggests that a semi-elasticity of 0.8 of pretax income is a consensus estimate, but also points out that a number of more recent studies have reduced that estimate further.

TABLE 1. A summary of BEPS estimates

Study	Data	Period	Semi-Elasticity	Interpretation: a 10% point decrease in a country's tax rate (e.g., from 35% to 25%) is associated with an increase in reported income from $100,000 to:
Hines and Rice (1994)	BEA (country-level)	1982 (cross-section)	2.25	$122,500
Huizinga and Laeven (2008)	Amadeus	1999 (cross-section)	1.3	$113,000
Dischinger (2010)	Amadeus	1995–2005 (panel)	0.7	$107,000
Heckemeyer and Overesch (2013)	Various	Various	0.8 ("consensus" estimate)	$108,000
Lohse and Riedel (2013)	Amadeus	1999–2009 (panel)	0.4	$104,000

Source: Reproduced from Dharmapala (2014, 28, Table 1).

According to the more recent estimates, the extent of profit shifting is quite low. The recent work suggests that multinational firms operating in high-tax jurisdictions shift between 2 percent and 4 percent of their profits to lower tax jurisdictions. Hines (2014) argues that the magnitude is lower again, despite the ample opportunities firms have to exploit tax havens and low tax jurisdictions. Dharmapala (2014) asks whether 2 to 4 percent of income shifted from multinational firms ought to be considered large or small. In our view, a highly relevant policy consideration is the effect that efforts to reduce income shifting would have on the investment climate within the domestic economy. In the OECD BEPS project, the term "base erosion" assumes what needs to be proven: that profit shifting is having a material effect on the domestic tax base.

The evidence for base erosion

The OECD BEPS program is premised on an argument that a country's tax base is, or risks, being eroded by tax avoidance and profit shifting. Such language has been adopted by the Australian government (Australian Taxation Office 2016; Bradbury 2013b). Base erosion is an empirical question. Here we investigate the notion that base erosion has occurred. Peter Birch Sørensen (2007) has provided an analysis where the ratio of company income tax revenue to GDP is decomposed into its component parts:

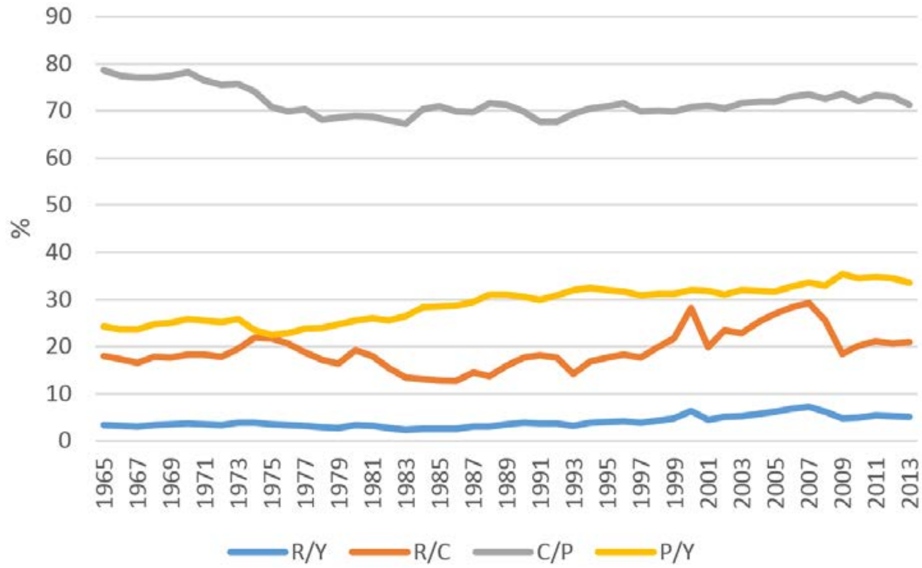
$$\frac{R}{Y} = \frac{R}{C} * \frac{C}{P} * \frac{P}{Y}$$

where R = company income tax revenue, Y is GDP, C is total company profit, and P is total profit earned in the economy. R/C is a proxy for the average effective company income tax rate, C/P is the company share of profits, and P/Y is the profit share of the economy. The decomposition allows us to determine whether any changes in the ratio of company tax revenue to GDP are due to changes in the effective company tax rate or the company tax base (defined as the interaction of the share of company profits and the profit share of the economy).

Following Sørensen (2007), we employ corporate operating surplus as a proxy for corporate profit and total operating surplus as a proxy for total profit. Data for operating surplus and GDP are taken from the Australian Bureau of Statistics and company tax data are taken from the OECD.[16] Sørensen provides the decomposition for several OECD economies over the period 1981 to 2003. In Figure 1, we replicate the decomposition for the period 1965–2013 for Australia. To provide greater clarity we show each of the component series separately in Figure 2.

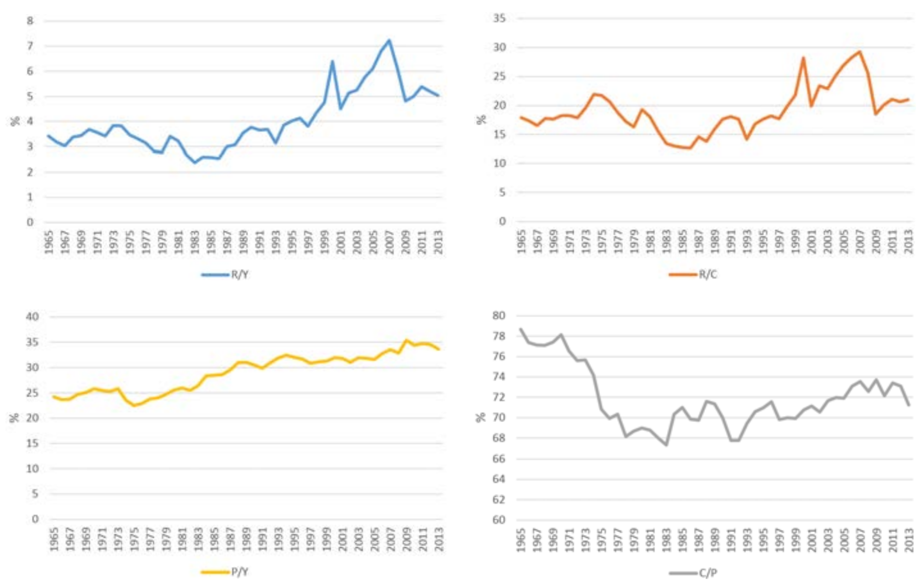
16. Australian Bureau of Statistics, Catalogue 5206.0—Australian National Accounts: National Income, Expenditure and Product (**link**); OECD Tax Database (**link**). There is a question as to whether aggregate time series data can be employed to answer the question we pose. It is always true that aggregate data contain less information than analysts would like. We subscribe, however, to Lord Kelvin's maxim that in the absence of numbers our knowledge is meager and unsatisfactory. Now, *even with numbers* our knowledge may remain meager and unsatisfactory, but this is a problem faced by all participants in the BEPS debate, including the Australian Taxation Office.

Figure 1. Company income tax decomposition for Australia



Source: ABS, OECD iLibrary, and author calculations

Figure 2. Company income tax decomposition for Australia, component series



Source: ABS, OECD iLibrary, and author calculations

As these figures show, the ratio of company tax revenue to GDP has increased since the early and mid-1980s, as has the ratio of company tax revenue to company profits. These changes are largely due to Australia adopting a dividend imputation tax system (see Twite 2001; Cannavan et al. 2004). The profit share of the economy (P/Y) has steadily increased since the mid-1970s while the share of company profits fell until the early 1980s and remained more or less steady after that. The spike in the average effective company tax rate in 2000 is associated with income tax reforms that were introduced to coincide with the imposition of the Goods and Services Tax (the Australian value-added tax on consumption) that was introduced in that year. The decline after 2008 is associated with the global financial crisis and its aftermath. These data do not support the view that the company income tax base in Australia is being eroded. To the contrary, it appears that the Australian company tax base has broadened over time, especially since the early 1980s. This result is consistent with Sørensen's original analysis using a different time period and data source. He too interprets his result as suggesting that the Australian company tax base has broadened, not eroded, over time.

One alternative explanation for our results could be that multinationals have been profit shifting from Australia over several decades, and the problem simply has not gotten any worse since the 1970s and 1980s. We are not convinced by this argument. It invites us to believe that large-scale tax avoidance is occurring while the profit share of the economy is rising. Profit shifting would be consistent with a declining profit share, as 'costs' become inflated. At the same time the company share of profits has been stable since the early 1980s. The decline in the company share of profits over the period of the 1970s is quite consistent with the economic turmoil of those years, and declines also occur during recessions in the early 1980s and early 1990s, and also in the years after the financial crisis of 2007–09. Furthermore the argument that profit shifting was well established by the 1980s and has not changed since then is inconsistent with the argument as to which companies engage in this sort of behavior. BHP Billiton is the largest Australian taxpayer, and in recent years it has been accused of profit shifting through a tax strategy known as a 'Singapore Sling'—but its Singapore hub was established in 2001 (Saunders 2015). Other companies that are regularly singled out for criticism include Amazon, Apple, Adobe, Abbott Laboratories, Facebook, Forest Laboratories, Google, IBM, Johnson & Johnson, LinkedIn, Microsoft, Starbucks, and Yahoo (Chessell 2014). Many of these companies did not exist in the early 1980s. The conditions for the so-called 'Double Irish with a Dutch Sandwich' also were not in place at that time, and many of the companies that have employed that strategy did not exist.

Two other objections might be raised against our approach. It could be claimed that the relevant comparison is not absolute change in the company tax over time but change relative to what it would be been had stronger anti-BEPS policies been in place in that period. This is a plausible argument, but analysis in support of this claim not been forthcoming. The Australian Taxation Office admits that "Company income tax receipts continue to move in line with macroeconomic indicators, reflecting broad compliance by corporates with their income tax obligations" (2015, 34). Our analysis above corroborates that argument. A related claim might be that the long-term stability of company tax revenue reflects a concerted effort to keep Australia's tax laws up to date with business practices. According to Joe Hockey, treasurer in the Abbott government, Australia has some of the "the strongest anti-avoidance laws in the world" (Hockey 2014). Again, the fine-grained analysis that would support such a claim has not been forthcoming, and in that absence, it strikes us as a leap of faith to suggest that individual anti-avoidance reforms have been well-calibrated enough to ensure that company tax revenue is consistent over time.

Conclusion

The corporate tax avoidance debate has many of the hallmarks of a moral panic. A moral panic consists of hyperbolic media and popular claims about threats to the social order, reinforced by political and legislative action that reproduces and amplifies those claims (Krinsky 2013). Moral panics are typically dramatic and sudden, characterized by rhetorical similarity across media and politics, and are "out of all proportion to the actual threat offered" (Hall et al. 1978, 16). This describes the corporate tax debate quite well. It is certainly true that multinational firms seek to minimize their tax liabilities, in Australia as much as anywhere in the world. However, there is little to no evidence consistent with hyperbolic claims about the level of tax paid by multinational firms—often based on misleading or incomplete information—that have been a common feature of Australian news media since the start of the OECD BEPS project. In the context of a federal budget in deficit, with the state of Commonwealth finances being a major political issue, corporate tax avoidance was associated with the constrained fiscal outlook and need for spending reductions. This debate has had a heavily moral dimension. It conveniently locates the source of Australia's budget problems on corporate avarice. An advertisement produced by the Australian government in 2015 accompanying its corporate tax reforms stated that "The government will introduce new laws, and new penalties, to stop this greed."[17] Such language from a right-of-center

17. See note 11 above.

Coalition government echoes that used by left-wing campaigners against corporate tax avoidance.[18]

We have presented an outline of central claims in government discourse about corporate tax avoidance, and evidence that rejects those claims, or at least casts grave doubts on them. Governments of all stripes have a responsibility to maintain a high standard in their discourse about the exercise of their fiscal powers. Corporate taxation is a complex area, and the interaction between domestic tax systems and international taxation architecture is even more so. It is not surprising that there is much public confusion about corporate taxation. It is unfortunate that governments have chosen to exploit, rather than counter, that confusion.

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