



**NEW ZEALAND INSTITUTE FOR THE STUDY
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A Proposed Pathway towards future reform of New Zealand's de minimis threshold.

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Abstract:

Imports into New Zealand are tax-free if the duty and GST payable is less than \$60. This has resulted in an effective value threshold of between \$226 and \$399, significantly higher than many of our trading partners. We examine other nations' thresholds and border practices with a view to whether NZ should lower its de minimis threshold. We further examine other options, strongly recommending changing to a minimum customs value definition. However, we do not support collection of duties/GST through financial intermediaries, instead proposing the establishment of a multilateral system. Finally, we outline shortcomings in Customs' cost-benefit analysis and accordingly present three alternative methodologies for future assessment of the de minimis threshold.

1. Introduction:

As a signing bonus at their new job, Tom and Richard had both been given a \$300 clothing allowance. Needing new shirts, Tom discovered that English online retailers were significantly cheaper than stores on Lambton Quay. He decided to buy three shirts for the special price of \$250, telling Richard about the bargain he had found. However, Richard knew that shirts faced a 10% tariff. Taking advantage of the online retailer's free shipping offer, Richard bought his three shirts separately for \$90 each (\$270 total). Whilst Richard's shirts arrived without any issue, Tom received a letter from NZ Customs informing him that he had \$104.32 in duty, GST and customs fees payable.

This story emphasises the inherent flaw of a de minimis system. As an exception to ordinary tax legislation, it will always be possible 'to game the system'. With an effective threshold of \$400 for many goods, New Zealand stands to lose significant revenue through legal tax avoidance. As e-commerce becomes increasingly popular, fears of systematic avoidance are not unfounded. This report examines issues with the current operation of New Zealand's de minimis threshold.

E-commerce creates substantial consumer welfare. For residents of a small country, the internet dramatically expands consumers' horizons. Goods that were previously unavailable or difficult to find are now only a mouse click away. In many cases, online prices are substantially lower than in traditional stores. Moreover, consumers are assured of delivery when purchasing from (trustworthy) online retailers. In contrast, physical stores may be out of stock, or unable to find the desired product. Lower prices and increases in product availability and selection over the internet have driven significant increases in consumer welfare.

Nevertheless, some of this growth is attributable to the operation of the de minimis threshold. Currently, imports are tax free if the duty and GST payable is less than \$60. An examination of the academic literature suggests strong tax-effects have influenced the growth of e-commerce. If New Zealand were to abolish the de minimis threshold, Einav et al's (2012) study of eBay data predicts a 45-60% fall in purchases from offshore internet retailers, offset by a 27% increase in demand at domestic online retailers. This indicates that consumers are actively avoiding GST by purchasing goods offshore. Moreover, offshore retailers are, to a certain extent, discouraged from establishing a physical store in New Zealand. As a result, we believe that the de minimis threshold is distortionary, provides adverse incentives and unnecessarily disadvantages domestic retailers.

This report examines the current rationale behind the de minimis threshold in New Zealand. In 2011, following a review of the de minimis threshold, the New Zealand Customs Service declared that “the de minimis appears to be set at about the right level, based on the costs of revenue collection and compliance in the airfreight sector” (NZCS, 2011). We respectfully disagree.

As a signatory to the International Convention on the Simplification and Harmonization of Customs Procedures, New Zealand defines its de minimis threshold in terms of a minimum amount of duties/GST payable. Duties and GST are only payable if they exceed \$60. This has created a variable threshold. Depending on whether a good attracts a tariff, the threshold varies between \$226 and \$399. The operation of this system is confusing and difficult to understand. Moreover, it is out-of-line with many other countries such as Australia, the US and Canada which all operate a minimum value threshold.

This report investigates the different processes and reporting standards required when importing goods into New Zealand through international parcel post or express airfreight. We find that Customs is required to manually screen all incoming mail at New Zealand Post’s International Mail Centre. This manual screening process differs substantially from the streamlined process observed in the express airfreight sector. Moreover, we find that significantly different reporting standards are applied depending on the import consignment’s value.

The growth of e-commerce and its effect upon sales tax revenues is a global phenomenon. As a result, we compare New Zealand’s system to the UK, Canada and Australia. We find that the operation of New Zealand’s de minimis threshold is, in many respects, very similar to Australia’s system. Both countries operate relatively high thresholds (NZ\$400 and A\$1,000). Moreover, parcels sent through the international parcel post are held at the border until all duties and GST are paid. In contrast, the UK and Canada both operate relatively low thresholds (£15 and C\$20). Furthermore, sales taxes and duties are collected through postal authorities – rather than Customs.

However, in the absence of publically available data, we have been unable to assess the efficiency of overseas regimes. We recommend that future reviews of New Zealand’s de minimis threshold attempt to gain information surrounding the administrative costs of these systems.

Although country comparisons provide some suggestions for improving efficiency at the border, we consider three potential solutions. We strongly recommend a change of the de minimis definition. Moving from a minimum duty payable to a minimum customs value will bring New Zealand into line with the rest of the world. Minimum customs value thresholds are “easy to comprehend and apply” (NZCS, 2011). Such a change is likely to increase public awareness of the de minimis threshold whilst also reducing Customs administrative costs.

However, we do not recommend the collection of duties/GST through financial intermediaries. Although conceptually attractive, it is not feasible for credit card companies to assess and collect duties and GST payable. Moreover, even if the establishment of such a scheme were possible, it is likely to result in large administrative costs for financial intermediaries, society and the government.

Looking towards the future, we believe the most promising long-term solution is the establishment of a multilateral agreement through APEC or other international organisations designed to encourage, rather than force, online firms to collect and remit sales taxes to the respective nations. Although political obstacles will be inevitable, we believe the establishment of such a system is feasible, given the worldwide nature of this issue.

Finally, we have serious concerns with the methodology employed by Customs in their 2011 review of the de minimis threshold. In many respects, the cost-benefit analysis is the most important aspect of any review. Accordingly, we establish and explain three alternative methodologies which can be used to assess the appropriate de minimis threshold.

2. Findings of the literature review:

The growth of e-commerce over the past two decades is phenomenal. In 2012, New Zealanders spent more than \$3.19 billion online. This spending is expected to grow at 14.3% per annum, to reach \$5.37 billion by 2016 (Harker, 2012). This growth has led to substantial increases in consumer welfare. However, the literature also finds considerable tax effects, indicating that many consumers purchase goods online in a deliberate attempt to avoid paying GST.

For a small, geographically isolated country, the internet provides a window to the world. Consumers are exposed to a vast array of goods often at lower prices than at their local store. Many goods that were previously unavailable or difficult to find, are now readily accessible over the internet. A prime example can be seen in sales of obscure books on Amazon.com.¹ Brynjolfsson, Hu and Smith (2010) estimated that the consumer welfare gain from sales of obscure books was between US\$3.94 to US\$5.04 billion. For an industry with total sales of US\$37.3 billion, growth in consumer welfare was equivalent to between 10.5% - 13.5% of the industry. This clearly demonstrates the value consumers place on an increased product range.

Consumers derive further welfare gains from the increase in product availability provided by the internet (Gallino and Moreno, 2012). When consumers purchase goods from a (trustworthy) online retailer, they are assured of their delivery. Consumers can avoid the disappointment of driving to the local store only to be told that the good is out of stock or no longer available.

Finally, a recent study of the online retail market found that the key driver of e-commerce in New Zealand was lower prices.² As search costs reduce, the online retail market has become increasingly integrated (Brynjolfsson, Dick and Smith 2010). Search engines such as Google, Yahoo! and Ask.com allow consumers to be directly connected to manufacturers throughout the world. 'Shopbots' such as pricespy.co.nz or webjet allow consumers to rapidly search and compare retailers' prices and shipping times. Nevertheless, although prices remain important, studies of e-commerce find a substantial dispersion in prices between retailers. Consumers display clear preferences for branded

¹ Obscure books are defined as books that are no longer in-print, and are therefore, only likely to be found at second-hand book stores.

² In the recent survey conducted by PricewaterhouseCoopers, 51% of New Zealand respondents concluded that lower online prices were the most important reason for shopping online (Harker, 2012).

retailers such as Amazon or Barnes and Noble. This suggests that consumers use store branding as a proxy for credibility.

The current effect of New Zealand's de minimis threshold is to provide a 15% implicit subsidy for offshore retailers. From a theoretical perspective, the only rationale behind a de minimis threshold for offshore internet purchases is an infant industry argument (Goolsbee and Zittrain, 1999). Essentially, the government should help to establish a fledgling market, rather than stifle its growth in an attempt to bolster flagging tax revenues. Imposing GST may lead to social underprovision through information problems and a loss of network benefits. This loss of e-commerce has the potential to materially lower consumer welfare throughout the economy.

This argument is no longer valid. As noted above, New Zealand consumers spent over \$3.19 billion online in 2012. This is predicted to grow at 14.3% per annum to reach \$5.27 billion by 2015 (Harker, 2012). E-commerce has become sufficiently entrenched. With the rise of smartphones and internet-capable tablets, clear network benefits have already been established. There is no theoretical reason to maintain an implicit 15% subsidy for offshore online purchases.

In our view, the current de minimis threshold is distortionary, provides adverse incentives and unnecessarily disadvantages domestic retailers to the detriment of society.³ A review of the academic literature surrounding the effects of de minimis levels found that many consumers actively purchase goods from offshore/out-of-state retailers where no sales tax is payable. For example, Einav et al's (2012) recent year-long study of e-Bay sales data found substantial tax effects. For every 1% rise in state sales taxes, the volume of sales at in-state online retailers falls by 3 - 4 per cent. Moreover, purchases at out-of-state online retailers rose by 1.8% for every 1% rise in in-state sales taxes.

Such a finding illustrates the distortionary effect of the current de minimis threshold. Consumers are increasingly purchasing goods offshore for the primary reason of avoiding GST. If the government were to remove the de minimis loop-hole, Einav et al's study predicts a 45 -60% decline in demand for offshore online retailers offset by a 27% increase in demand for domestic internet retailers. Not only would government revenue rise, but domestic retailers would be revitalised, resulting in increased employment and higher company and PAYE tax revenues.

The literature further suggests that the de minimis threshold provides a significant deterrent to many offshore retailers contemplating a physical presence in New Zealand (Anderson et al., 2010). Once consumers associate a business with New Zealand, they will be less willing to purchase goods from an offshore website. Accordingly, retailers will be forced to collect GST on all purchases from a New Zealand based website. This entails a loss of the implicit 15% subsidy.

We believe these findings provide clear evidence for a review of the current de minimis threshold. Although we recognise that there remains a practical need for a de minimis, this report seeks to provide methods to reduce Customs' enforcement costs with a view to lowering the threshold.

³ For further information see the accompanying literature review: *E-Commerce and its effect upon the Retail Industry and Government Revenue*.

Nevertheless, we accept that any suggestions must “balance the need to maintain the revenue yield without placing unrealistic compliance burdens on the taxpayer or collector” (McQueen et al., 2012).

3. New Zealand’s current system:

3.1 Legislative environment:

The *International Convention on The Simplification and Harmonization of Customs Procedures* requires governments to define de minimis thresholds in one of two fashions. As a signatory to this convention, New Zealand can either define a minimum customs value below which no taxes are collected or define the threshold in terms of a minimum amount of duties/taxes payable. New Zealand uses this latter method.

In New Zealand, import duties and GST are assessed differently. Duties are based solely upon the customs value of the consignment. That is, the duty only applies to the value of the underlying good excluding any freight and insurance costs. In contrast, GST of 15% is levied upon the sum of the customs value, import duties and freight/insurance costs. Since 2010, import tariffs and GST are only collected if the amount owing exceeds \$60.⁴ This system “can be complex to apply, especially for infrequent private importers” (NZCS, 2011). Its operation is best illustrated by the following examples:

Table 1 – Good subject to a 10% import tariff

	Shirts imported from Vietnam	Value in NZ\$	Duty Payable (NZ\$)
A	Customs Value (i.e. Value in NZ\$)	\$240	
B	Import duty (10% on Customs Value)	\$24	\$24
C	International Freight and Insurance	\$15	
	Value for GST purposes (sum of A to C)	\$279	
D	GST at 15%	\$41.85	\$41.85
Total GST and duty payable			\$65.85 (Collected)

Table 2 – Good with no import duty payable

	A box of books imported from the USA	Value in NZ\$	Duty Payable (NZ\$)
A	Customs Value (i.e. Value in NZ\$)	\$240	
B	Import duty (Not applicable)		\$0
C	International Freight and Insurance	\$15	
	Value for GST purposes (sum of A to C)	\$255	
D	GST at 15%	\$38.25	\$38.25
Total GST and duty payable			\$38.25 (Not Collected)

The only difference is the type of goods being imported. Shirts from Vietnam attract a 10% tariff, whilst books from America do not. Although both goods have the same underlying customs value (\$240) and insurance/freight costs (\$15), taxes are only payable on the imported shirts. The \$38.25 of duties and GST payable on the books will not be collected as it falls under the \$60 de minimis

⁴ Customs and Excise Regulations 1996, reg 70(1).

threshold. Although Customs has established an online calculator enabling importers to accurately work out the duties payable, the system remains confusing to many.

3.2 Application in practice.⁵

Although the legislative framework is, for the most part standardised, different reporting standards apply depending upon the value of the consignment being imported into New Zealand.

Full customs formalities must be followed when importing goods with a value of NZ\$1000 or more – regardless of the import channel. Importers are required to complete a standard import declaration. This form provides detailed information surrounding the classification, origin and valuation of the goods being imported, allowing Customs to accurately assess the amount of GST and duty payable.

However, standard import declarations are complex and difficult to complete. Due to the need to classify imported products accurately most importers employ customs brokers. This results in significant administrative costs. Consequently, Customs prescribes a simpler process for consignments with a value between \$400 to \$999. Commercial importers must complete a Simplified Import Entry, whilst private importers must provide a Personal Import Declaration. These forms are easier to complete, and the services of a customs broker are generally not required. Nevertheless, they allow Customs to assess the GST and duty payable accurately.

Most pertinently for this report, however, are the procedures for consignments falling below the de minimis threshold. The reporting requirements for these low value consignments differ depending upon the mode of entry. There are two common avenues. Goods may either enter the country through international parcel post (i.e. mail), or through international express airfreight (i.e. via courier companies).⁶ The reporting requirements and procedures differ across categories – as can be seen below.

3.2.1 *Express airfreight (Courier):*

Express airfreight describes consignments imported into New Zealand via courier companies such as DHL, FedEx and UPS. Courier companies transport time sensitive consignments. Goods are flown into New Zealand and quickly shipped to their destination. As Customs notes “the express airfreight sector’s business model is based on servicing low weight, time sensitive international consignments.”⁷ As a result, the reporting process is extremely streamlined, designed to allow goods to pass rapidly through the border.

As e-commerce grows, demand for courier companies has increased rapidly. DHL recently announced that inbound deliveries in the first quarter of 2012 rose by 30%. This has been attributed to increasing deliveries from websites based in the US and Europe (Infometrics, 2012). During

⁵ Unless stated otherwise, all data in this section comes from New Zealand Customs Service, 2011.

⁶ Goods can also enter New Zealand through alternative methods e.g. shipping. However, of the 40.8 million consignments imported into New Zealand in 2009/10, less than 0.01% of consignments that fell under the de minimis threshold were imported through shipping. New Zealand Customs Service, 2011.

⁷ New Zealand Customs Service, 2011.

2009/10 express couriers imported around 2.4 million consignments into New Zealand. The breakdown by value can be seen in Table 3.

Table 3 - Breakdown of Express Courier deliveries by value during 2009/10. Data from NZCS, 2011.

Value	Reporting requirements	Volume of Consignments	% of total consignments imported by express airfreight
<\$400 ⁸	Cleared through electronic cargo information (ECI)	2.0 million	83.33%
\$400 – \$1000	Simplified Import Entry	126,000	5.25%
>\$1000	Standard Import Entry	275,000	11.46%
Total Consignments		2.4 million	100%

As can be seen from the table above, the import requirements differ, depending upon the value of the consignment. However, the importer may not notice the difference. This is due to the fact that the courier companies manage the entire import process. By employing in-house customs brokers, courier companies complete standard or simplified import entries on behalf of their clients. In 2007 the Conference of Asia Pacific Express Couriers (CAPEC) estimated that this service costs their members approximately \$30 to process each consignment (once overheads are accounted for).⁹ The courier companies also pay the \$22 (GST exclusive) processing fee charged by Customs for each standard and simplified import entry. All of these costs are then passed on to the importer by the courier company (NZCS, 2011).

Consignments that fall below the \$60 de minimis threshold simply require the courier company to provide electronic cargo information (ECI). An ECI is “an electronic version of an aircraft’s manifest that is used to carry out the Customs clearance of low value airfreight that falls within the de minimis” (NZCS, 2011). Customs uses the information provided by the report to risk assess the incoming consignment and then clears it through the border via return electronic message. Customs charges a \$30 processing fee for each manifest submitted. Nevertheless, as precise tariff clarifications are not required for an ECI, in-house courier costs are lower. Once again, the courier pays the \$30 processing fee, recovering its cost from the importer (NZCS, 2011).

As can be seen, this process is relatively costly. For consignments exceeding the de minimis threshold, the combined Customs and courier costs are in excess of \$50. Nevertheless, the process is streamlined and assures rapid Customs clearance.

3.2.2 International Parcel Post (mail):

All mail entering New Zealand passes through New Zealand Post’s International Mail Centre (IMC) in Auckland. As no advance electronic information is provided about parcels sent through post,

⁸ This category describes imports that fall under the de minimis threshold. If import duties are payable, the de minimis threshold will be lower – in which case a simplified import entry will have to be completed for consignments over the threshold, but under \$1,000.

⁹ CAPEC’s members include DHL, FedEx, TNT and UPS. This estimate was referred to in the New Zealand Customs Service’s 2011 review of the de minimis threshold.

Customs must manually screen all parcels entering New Zealand. This process is facilitated through the use of internationally standardised CN22 and CN23 forms. These forms provide brief details surrounding the goods' origin, classification and customs value. If a parcel exceeds the de minimis threshold it is held at the border. All other parcels are immediately released for delivery (NZCS, 2011).

Parcels stopped by Customs at the border will only be released if the importer submits a PID or standard/simplified import entry. This results in significant administrative costs. In 2011, it was estimated that Customs incurred administrative fees of \$26 for every package exceeding the de minimis threshold. Of this, \$22 is recovered through the processing fee charged by Customs. However, it would appear that Customs overstated their revenue collection costs. Their estimate includes costs associated with risk assessment and clearance processes. As these costs are quite separate from revenue collection costs, they should not have been included. This would suggest that the actual costs of collection may be materially lower than \$26.¹⁰

In an initiative to modernise border security and efficiency, Customs and the Ministry of Primary Industries (MPI) jointly invested in the new \$75.9 million Joint Border Management System (JBMS).¹¹ Designed to replace the existing 15 year old computer systems used by Customs and MPI, the JBMS is desperately needed. However, in an effort to recover 50% of JBMS's operating costs from industry participants, Cabinet recently approved the following fee increases for goods entering New Zealand:

Table 4 - Revised Customs costs¹²

Fee name	Current fee (GST excl.)	New fee (GST excl.)
Biosecurity (System Entry Levy) Order 2010		
MPI Biosecurity levy	\$11.10	\$15.33
Customs and Excise Regulations 1996		
Import entry transaction fee (IETF)	\$22.00	\$25.44
Inward cargo transaction fee (air)	\$26.67	\$27.54
Inward cargo transaction fee (sea)	\$312.89	\$363.27

3.3 Summary:

New Zealand's use of a minimum duty/GST payable definition has resulted in a roving de minimis threshold. Depending on whether the good attracts a tariff, the effective value threshold ranges from \$226 to \$399. Customs processes differ significantly across import channels. Due to the lack of information about packages travelling through international parcel post, all packages must be

¹⁰ For more information, see section 6.2.

¹¹ Regulatory Impact Statement: Cost Recovery for Tranche 1 of the Joint Border Management System, 2012.

¹² <http://www.customs.govt.nz/news/updates/Pages/summary-of-customs-and-biosecurity-fee-changes-for-jbms.aspx>

manually screened. This is in stark contrast to the mainly automated process that occurs in the express airfreight channel.

4. Customs processes across the world:

Although the growth of e-commerce is a worldwide phenomenon, countries have not adopted a co-ordinated response. As a result, de minimis thresholds around the world remain wildly divergent, as can be seen in the table below:

Table 5 – De minimis thresholds for some of New Zealand’s trading partners

Customs Administration	Value Threshold for GST/Sales Tax (except New Zealand)	Threshold in NZ\$ (as at 13/2/2013)
Australia	A\$1000	NZ\$1,229.32
Canada	C\$20	NZ\$23.73
People’s Republic of China	CNY500	NZ\$95.32
Republic of Korea	KRW150,000	NZ\$164.28
New Zealand	\$60 in duty/GST payable	Between \$226 and \$399
United Kingdom	£15 (excl. the Channel Islands)	NZ\$27.96
United States	US\$200	NZ\$237.74

In particular, we consider the customs procedures and de minimis thresholds of Australia, Canada and the United Kingdom. Given New Zealand’s close historical ties and similar legal system, a comparison of these countries thresholds is particularly illuminating.

4.1 United Kingdom:

The United Kingdom defines its de minimis threshold in terms of a minimum customs value. Different thresholds exist for VAT and customs duties. VAT of 20% is payable as soon as the goods value (including postage, insurance and any customs or excise duties payable) exceeds £15. In contrast, customs duties are not levied until the value of the imported good (including postage and insurance) exceeds £135.¹³

However, as the UK is a member of the European Union, different criteria apply to packages originating in the EU. Although these packages are still liable for VAT and excise duties, no customs duties are payable on imports across the EU. In contrast, packages from outside the EU are subject to customs duties, as well as VAT and excise. Nevertheless, the screening process remains the same across both categories.

All packages entering the UK are examined by the U.K. Border Force (UKBF). As part of the broader screening process, the UKBF assesses the amount of VAT and customs and excise duties due (using data from CN22 and CN23 declarations). Packages exceeding the de minimis threshold are entered into a database which allows duty and VAT owing to be accurately assessed. A label setting out all

¹³ Note: Customs duties are waived, if the amount of duties due is less than £9. Her Majesty’s Revenue and Customs, January 2013. *Notice 143: A guide for international post users.*

the duties and VAT payable is then attached to the package. This label contains a barcode which is read by Royal Mail/Parcelforce.

Unlike New Zealand, Royal Mail/Parcelforce pays the amount of VAT and duty owing on behalf of the consumer. The addressee is then sent a letter advising them of the taxes payable. Until the consumer pays the VAT and duties owing, along with a clearance fee of £8 (or £13.50 for express packages), Royal Mail/Parcelforce withholds the package from delivery. Consumers can pay these taxes and fees online, via the phone or at a Royal Mail/Parcelforce depot. Upon receipt of payment, Royal Mail/Parcelforce releases the packages for delivery.

This system has allowed the UK to operate a de minimis threshold significantly lower than New Zealand's. The current thresholds are set out in the table below:

Goods Value (£)	Value in NZ\$ (at £1/\$0.523)	Customs Charges Applicable
≤£15	\$0.01 to \$28.70	<ul style="list-style-type: none"> • No customs duty • No import VAT (excl. imports from Channel Islands)
£15.01 to £135	\$28.71 to \$258.30	<ul style="list-style-type: none"> • No customs duty • Import VAT due
>£135	\$258.31 and greater	<ul style="list-style-type: none"> • Customs duty due, but waived if the amount of duties is less than £9 (\$17.22) • Import VAT due

The election of the coalition government in May 2010 has seen significant reductions in the UK de minimis thresholds. In the 2011 Budget, the Chancellor of the Exchequer, George Osborne, announced the reduction in the VAT threshold from a customs value of £18 to a customs value of just £15. This change, designed to level the playing field between internet and bricks and mortar stores, was implemented in November 2011.¹⁴ Most recently, the VAT exemption for personal gifts was lowered from a customs value of £40 to £36, effective 1 January 2013.¹⁵

Nevertheless, the most significant change has been in relation to the Channel Islands. The Channel Islands are a group of self-governing islands that are historically linked to the United Kingdom. Referred to as 'special territories' they "are part of the EU for customs purposes, but not for fiscal purposes. Goods imported from these countries therefore are free of customs duty, but subject to excise duty and import VAT."¹⁶

In November 2011, the Exchequer Secretary to the Treasury, David Gauke, announced that from 1 April 2012, all commercial imports from the Channel Islands would be subject to VAT – no matter how small the value of the package.¹⁷ This policy was implemented for two reasons. First, in 2011 the UK Treasury estimated "75 per cent of all international parcel post to the UK from outside the EU

¹⁴ (23 March 2011) 525 GBPD HC 962.

¹⁵ HMRC, January 2013. *Notice 143: A guide for international post users.*

¹⁶ HMRC January 2013. *Notice 143: A guide for international post users.*

¹⁷ (9 November 2011) 535 GBPD HC 15WS.

... originate[d] in the Channel Islands.”¹⁸ Taking advantage of the VAT exception for low value consignments, retailers based in the Channel Islands were undercutting bricks and mortar stores throughout the UK. This measure was designed to level the playing field between domestic and foreign retailers. Secondly, the U.K. hoped to raise an additional £100 million per annum in tax revenue as a result of this measure.¹⁹

Finally, the U.K. has established Memoranda of Understanding between the customs and postal authorities of New Zealand, Hong Kong, Singapore and the Channel Islands.²⁰ Businesses within any of these countries may register with HMRC and collect customs duties and tax on behalf of the U.K. In return, they are provided with a unique authorisation number. All packages showing this number along with the statement “Import VAT Prepaid” are immediately released through Customs, thereby ensuring rapid delivery of the parcel. Additionally, importers are not charged a RoyalMail/Parcelforce handling fee.²¹

The U.K.’s approach towards e-commerce and its detrimental tax effects is extraordinarily proactive. The combination of low thresholds and the removal of the Channel Islands loophole has allowed the UK to reduce the import of VAT-free goods into the UK substantially. Moreover, RoyalMail/Parcelforce’s collection fees are significantly lower than the fees charged by New Zealand Customs and MAF, suggesting a more efficient process.

Nevertheless, the U.K.’s system is far from perfect. Many deliveries are delayed due to tax collection purposes. Consumers are often forced to pick up their packages/mail from their local post office rather than receive them by home delivery. The low threshold catches a large number of goods, with the result that many consumers are ‘stung’ with fees, taxes and duties that can be almost as expensive as the underlying good itself. This causes large inefficiencies and resentment.

Unfortunately, data surrounding the cost of the UK’s border policy is not publically available. As a result, it is impossible to assess its efficiency. It may be that the administrative cost of such a low threshold outweighs the revenue collected. Alternatively, the scheme may be sufficiently efficient that tax revenues equal or exceed administrative costs. Any future review of the current NZ system should attempt to gain information surrounding the administrative costs of this scheme.

4.2 Canada:

The Canadian system is very similar to the UK’s system. Canada defines its de minimis threshold in terms of a minimum value. Customs duties, Goods and Services tax and provincial sales tax (PST) are all payable once the value of the good being imported exceeds C\$20. There are, however, several exceptions. All taxes and duties are payable upon books, periodicals and magazines entering Canada – regardless of value. Moreover, like the UK, tobacco and alcohol products are not covered by the de minimis threshold. All excise duties are payable regardless of the value of alcohol or tobacco products being imported.

¹⁸ <http://www.hmrc.gov.uk/news/removal-lvcr.htm>

¹⁹ (9 November 2011) 535 GBPD HC 15WS.

²⁰ HMRC, January 2013. *Notice 143: A guide for international post users.*

²¹ *Ibid.*

A higher de minimis threshold also exists for packages being sent as gifts. No duty or taxes are payable on gifts with a value of less than C\$60.²² This is equivalent to the £36 exemption for gifts entering the UK.

As with New Zealand, the UK and Australia, the process by which duty and taxes are assessed and paid differs according to the method of entry.

4.2.1 *International Parcel Post:*

All international mail entering Canada is diverted to one of three CBSA screening facilities located in Toronto, Montreal and Vancouver.²³ Using CN22 and CN23 forms, the CBSA manually assesses the amount of duties and taxes payable. If a package is worth more than C\$20 (or C\$60 if marked as a gift), the CBSA enters the information into a computer database, creating a Customs Invoice. Unlike New Zealand, the collection of these duties and taxes is outsourced to Canada Post.

Canada Post charges a C\$9.95 handling fee, payable on top of all duties and taxes owing. These fees, duties and taxes can be paid at any Canada Post outlet, by cheque or via credit card. Once the fees, duties and taxes have been paid, Canada Post releases the items for delivery. This system is very similar to the United Kingdom's system.

4.2.2 *Express Airfreight (Courier):*

In December 2011, US President, Barak Obama, and Canadian Prime Minister, Stephen Harper, released their "Beyond the Border" Action Plan. This plan sought to create a long-term partnership between the United States and Canada, with a view to increasing border security and facilitating trade.²⁴ One of the areas addressed was harmonisation of the thresholds for expedited customs clearance across both countries. Effective 8 January 2013, Canada increased the Low Value Shipment threshold from C\$1,600 to C\$2,500.²⁵ This change roughly equated to the US's US\$2,500 threshold.

Under the LVS scheme, registered couriers provide CBSA with an inventory of goods passing through the border. The CBSA uses this information to remotely risk assess the packages entering Canada. Packages with a value of less than C\$2500 can be cleared remotely. All customs duties and taxes are then paid by the courier companies who later recover this cost from the importers.²⁶ This has allowed for rapid border clearance across the US/Canada land border resulting in expedited delivery across Canada and the US.

²² Note: In order to qualify as a gift, the package must be sent from a private home to another private person and must contain a gift card. It cannot be sent directly from the manufacturer.

²³ Canada Border Services Agency, 2009. *Importing Non-Commercial Goods by Mail*.

²⁴ "This action plan sets out joint priorities for achieving that vision within the four areas of cooperation identified in the Beyond the Border Declaration: addressing threats early; trade facilitation, economic growth and jobs; cross-border law enforcement; and critical infrastructure and cyber-security." Beyond the Border, 2011.

²⁵ Customs Notice 13-001. Available at: <http://www.cbsa.gc.ca/publications/cn-ad/cn13-001-eng.html>

²⁶ For more information see Memorandum D17-4-0. Available at: <http://www.cbsa-asfc.gc.ca/publications/dm-md/d17/d17-4-0-eng.pdf>

As with the UK, the Canadian system has allowed the maintenance of a very low de minimis threshold. This is perhaps surprising given the additional administrative costs incurred by the CBSA arising from the different provincial tax regimes throughout Canada. The \$2500 exclusion provided for couriers is particularly important given the land border with the United States. This has the advantage of retaining rapid delivery of parcels throughout Canada. This alignment with the US further illustrates the efficiency gains created by joint border management processes. In this respect, the Canadian system may provide a benchmark for co-operation between nations.

However, the lack of public data surrounding the maintenance of Canada's de minimis level precludes any attempt to assess the efficiency of this system. Future reviews of the de minimis level in New Zealand should seek to gain estimates of the administrative costs involved in maintaining the Canadian system.

4.3 Australia:

In many respects Australia operates a comparable border management system to New Zealand. All goods entering the country must be inspected by Customs and the Department of Agriculture, Fisheries and Forestry (DAFF) Biosecurity. Moreover, like New Zealand, Australia is experiencing a massive increase in the volume of low value parcels entering Australia. Between 2006/07 and 2010/11 there was a 104% increase in the volume of Express Mail Service (EMS) items entering Australia (Low Value Parcel Processing Taskforce (LVPP), 2012). As with New Zealand, this increase has been attributed to the rise of e-commerce.

Currently, Australia operates one of the world's highest de minimis thresholds. In line with the U.K. and Canada, this threshold is defined in terms of a minimum value. All goods with a value of less than A\$1,000 are exempt from GST and import duties.²⁷ GST of 10% is imposed upon the value of taxable importation (VoTi). The VoTi consists of the sum of the customs duty, insurance and transport costs, as well as any customs fees and wine equalisation taxes payable (LVPP, 2012). In many respects this is very similar to New Zealand in that GST is charged upon the cost of the whole import – not simply the goods' customs value.

GST provides substantial revenue for State and Territory governments in Australia.²⁸ Currently, all GST is collected by a federal agency – the Australian Tax Office. State and territorial governments then reimburse the ATO for its costs of collection. In return, the ATO distributes this GST revenue. The potential for e-commerce to undermine this revenue base is significant. As a result, several state governments have expressed displeasure with the current threshold. For example, the New South Wales treasurer, Mike Baird, recently called on the federal government to lower the threshold to just A\$30.²⁹ Although several reports have been commissioned to investigate the appropriate limit, the federal government has not altered the A\$1,000 threshold.

²⁷ With the exception of goods such as alcohol and tobacco.

²⁸ As a percentage of state revenue, GST amounted to 24% in Victoria, 60% for the Northern Territories, 11% for Western Australia and 30% in South Australia. (All data from 2012/13 State Budgets).

²⁹ See for example, <http://www.abc.net.au/news/2012-09-07/gst-deal---lower-online-threshold-scrap-stamp-duty/4248226>

4.3.1 *Customs Procedure:*

Section 68 of the Customs Act 1901 distinguishes between imports requiring a full import declaration (FID), and imports that do not. Currently, all goods with a value in excess of A\$1,000 are required to complete an FID. This threshold is defined according to a customs value. Insurance, shipping costs and duties are all excluded when calculating a good's value.

Importers can submit a full import declaration either electronically, or through a physical document. However, processing fees are substantially lower for FIDs filed electronically, reflecting Customs' lower costs for electronic submissions. The fees also differ depending upon the goods' mode of entry. FID's for goods imported via sea cargo are around A\$12 more expensive than FIDs filed for goods imported via air or international post (LVPP, 2012).

The information required for a FID is similar to New Zealand's standard import declaration. Importers must provide detailed information on the goods' origin, transport costs and Australian dollar value. This information is used to accurately classify the duty and GST payable on the imported goods. Given the complexity of the forms, most importers are required to retain a Customs broker.

4.3.2 *International Parcel Post (Mail):*

All goods entering Australia as international mail must pass through one of the four international mail centres located in Sydney, Melbourne, Brisbane and Perth. As the Universal Postal Union's designated operator, Australia Post is responsible for the delivery of all international mail throughout Australia. As with other countries, the volume of international mail entering Australia has been growing rapidly. Between 2010 and 2011, inbound international mail increased over 56% (Productivity Commission, 2011).

Unlike all other import channels, no advance information is provided to Customs Australia regarding the value and types of goods being imported through parcel post. The only information that Customs can use is contained on the CN22 and CN23 labels attached to the parcels. Accordingly, parcels must be manually screened for revenue collection purposes. This screening process is part of Customs' wider border risk management responsibilities.

If a good is found to have a value in excess of A\$1,000, it is withheld from delivery (Productivity Commission, 2011). The consumer/importer is sent a letter from Australia Post advising them that a full import declaration is required before the good is released. This FID can be returned to Customs and Border protection via email, mail, fax or in person. Once the full import declaration is received, Customs accurately calculates the amount of GST and import duties payable. The goods will only be released for delivery once the consumer/importer pays the duty and tax along with the A\$48.85 cost recovery fee charged by Customs.³⁰ This is an extremely time consuming and costly process.

³⁰ Australian Customs Notice No. 2006/21. Available at:
<http://www.customs.gov.au/webdata/resources/notices/ACN0621.pdf>

Unlike all other import channels, there are no customs formalities that are required to be completed if the good has a value less than A\$1000. This is equivalent to New Zealand. Once a parcel passes its risk assessment (x-ray etc.), the parcel is immediately released for delivery.

4.3.3 *Express Airfreight (Courier):*

Using in-house customs brokers, courier companies complete all customs formalities on behalf of their clients. This allows rapid transit through the border. Courier companies recover this cost through a fee for taxes and services (Productivity Commission, 2011).

All packages with a customs value in excess of A\$1000 must complete a full import declaration.³¹ This form allows Customs to assess accurately the amount of taxes and duties payable. These forms can be submitted either electronically or physically. However, the fee rises from A\$40.20 for an electronic submission to A\$48.85 for a physical submission.

Unlike parcel post, the courier companies must report all imports to Customs – regardless of their value. This allows Customs to accurately measure the volume of packages crossing the border for statistical purposes. Packages that fall under the A\$1000 threshold must be accompanied by a Self Assessed Clearance (SAC).³² This form is filed electronically and allows Customs to carry out a risk assessment on the package whilst it remains in transit. Customs and Border protection do not charge for this service. As a result, there is a clear cross-subsidisation between imports that are above the threshold and imports that are below (LVPP, 2012). Importers are only required to provide their details, a declaration that the good's value does not exceed A\$1000 and the method of entry into the country.

4.4 Summary:

Although the four systems reviewed differ in several respects, several common characteristics can be observed. All four countries are required to screen international mail manually. This is due to the fact that the rules governing treatment of international mail are set by the Universal Postal Union. Established in 1874, the UPU regulates international mail arrangements between 192 member states. As the UPU does not require any electronic information to be transmitted by postal authorities, countries are forced to inspect CN22 or CN23 forms manually. Moreover, all four countries prescribe streamlined processes for express airfreight. Courier companies complete all border formalities on behalf of consumers allowing for rapid border transit.

Nevertheless, the UK and Canadian thresholds and customs fees suggest that it would be possible for New Zealand and Australia to lower their de minimis thresholds dramatically. Any future review of New Zealand's threshold must investigate the efficiency of these systems.

³¹ Customs Act 1901 (Australia Cth), s 86.

³² Customs Act 1901 (Australia Cth), s 64AB and s 71.

5. Suggestions for future change:

As noted earlier, the primary purpose of this report is to provide a starting point for any future review of the de minimis threshold. In this light, all the suggestions outlined below will be required to be assessed for cost and efficiency. They are by no means comprehensive.

5.1 Changing from a minimum duty to minimum value threshold:

“A de minimis based on a [minimum] customs value for a consignment may be simpler to administer and apply given the complex interaction of the rules for tariff duty and GST that face infrequent private importers in applying NZ’s current de minimis” (NZCS, 2011)

We strongly recommend changing to a minimum value threshold. Changing the threshold’s definition is relatively simple and inexpensive. A simple legislative amendment to the Customs and Excise Act 1996 and its accompanying regulations would be required. In our view, this change would produce the following benefits.

First, a minimum value definition is “easy to comprehend and apply” (NZCS, 2011). The current de minimis level is confusing and often difficult to understand. Depending upon the type of good being imported, the threshold can range from \$226 to \$399.³³ From anecdotal evidence it is clear that many private, infrequent importers are ‘stung’ with duties and GST, having mistakenly believed that the de minimis threshold is a minimum value threshold set at \$399 for all goods. As e-commerce becomes increasingly popular, this issue is likely to grow.

Secondly, storage costs for New Zealand Post are likely to fall. Currently many consumers may be unwilling to pay the customs duty and GST, especially if they had purchased the goods thinking that they would fall under the threshold. By implementing a minimum value definition, storage costs are likely to fall as consumers are more likely to be aware of any customs duty and GST payable.

Finally, Customs administrative costs are likely to fall, especially in the international mail stream. All packages entering the country clearly display a customs value upon the CN22 or CN23 forms. Customs officers would simply be required to convert the currency to New Zealand dollars when assessing if duty or GST is payable. As officers grow increasingly accustomed to international exchange rates, the identification of packages exceeding the de minimis threshold will be significantly quicker. In contrast, the current system requires a two-step test. First, Customs must convert the consignment’s value into New Zealand dollars. They must then identify any duties payable along with freight and insurance costs in an attempt to work out the duties/taxes payable. This is a time consuming process that would be considerably streamlined by adopting a minimum value threshold.

³³ If the assessed duties and tax payable are less than \$60, they are not collected. If a good is subject to a 10% tariff, this is equivalent to a customs value threshold of \$226. If the good is not subject to any tariffs, this translates to a \$399 customs value threshold. It must be remembered that duties are only calculated on the customs value of the good, whilst GST is calculated on the sum of the customs value, freight and insurance. See table 1 for more information.

However, it is important to be aware that by changing to a minimum value definition, the de minimis threshold may actually widen. Freight and insurance costs along with customs duties will not be included in the initial calculation. Depending on the mode of entry, freight and insurance costs can be substantial – pushing a consignment above the current de minimis threshold. In the 2011 Issues paper, Customs estimated that a change to a \$400 customs value threshold would have resulted in 22,000 previously taxed consignments falling under the de minimis threshold. This issue is easily addressed by lowering the customs value threshold.

5.2 Collection of duty/GST through financial intermediaries:

Consumption taxes are levied on the principle of taxation at the place of consumption and according to rates set in individual countries ... Historically, the generation of income depended on the physical presence of assets and activities. This physical presence, or permanent establishment, generally determined which jurisdiction had the primary right to tax the income generated. [With] the growth of electronic commerce, new e-business models ([such as] digital marketplaces, online catalogues, virtual communities, subscription based information services, online auctions, and portals) have emerged. Each allows taxpayers to conduct business and generate income in a country with little or no physical presence in that country. Th[is] separation of assets and activities from the source of the income represents a significant departure from historic business models. (Basu, 2008)

E-commerce has clearly illuminated the shortcomings of an indirect tax based upon the place of consumption. Under this solution, financial intermediaries such as Visa, MasterCard, American Express and PayPal would be required to assess and collect taxes on behalf of the government. It is exceptionally unlikely that these intermediaries would voluntarily agree to levy all taxes on offshore purchases. Accordingly, legislation, backed by extensive regulation, would be required to force compliance.

Nevertheless, the attraction of this proposal is immediately apparent. All offshore purchases, regardless of value, would be subject to the same taxation rules as goods purchased and consumed domestically. This scheme has the further advantage of catching all transactions made over the internet. As electronic ‘goods’ such as computer programs, music and movies do not pass through a physical border they are currently tax-free. Using financial intermediaries to collect GST revenue on these purchases would remove a ‘black hole’ for the government, providing a substantial revenue stream.

Moreover, collection of duties and GST through financial intermediaries will allow the government to remove the de minimis threshold entirely. As offshore firms will not be required to register with the IRD, the establishment of this scheme is unlikely to cause any additional costs for non-financial intermediary firms. As a result, it is unlikely that offshore firms will ‘retaliate’ and refuse to ship to New Zealand.

In essence, collection of duties and GST by financial intermediaries would facilitate the abolition of the de minimis level for commercial imports into New Zealand. However, whilst conceptually attractive, we do not believe this is currently feasible.

It is simply not possible for credit card companies to calculate import duties. Information regarding the goods classification, origin, and location of the recipient are all required when assessing the appropriate duty payable. At present, credit card companies “do not transfer data on the detailed break-down of a purchase” (LVPP, 2012). The Australian Taskforce concluded that this technology will not be available in the short to medium term. Although PayPal may be able to collect this data, the targeting of only one payment mechanism would simply provide an incentive to purchase goods through a credit card (LVPP, 2012).

Alternatively, legislation could be enacted requiring financial intermediaries to collect GST only. New Zealand’s GST regime is extraordinarily uniform, providing few exceptions or exclusions (Alley, 2011). Accordingly, detailed information regarding the nature and location of the good would not be required. Financial intermediaries would simply be required to add a 15% ‘surcharge’ to all purchases made from offshore retailers. Nevertheless, even this simpler scheme faces several issues.

First, under the current scheme, GST is levied upon the sum of the customs value, duty payable and freight/insurance costs. Implementing a scheme whereby GST is automatically collected at point of sale would reduce the importance of duties. Moreover, insurance and freight may be arranged separately to the purchase of the good. In many cases, it is unlikely that all the GST owing would be collected.

Secondly, many offshore firms will sell their goods at a sales tax inclusive price. If the good is being consumed in New Zealand, the underlying purchase must be tax free before New Zealand GST can be added. For example, shirts bought from UK retailers may have a 20% VAT tax already included. Financial intermediaries would be required to identify, and exclude all foreign sales taxes when calculating the New Zealand GST payable. This is simply infeasible.

Thirdly, purchases designed for offshore consumption are exempt from all New Zealand based GST and duty. Hotel bookings, airline tickets for travel outside of New Zealand and gifts for friends and relatives overseas would all be (incorrectly) subject to GST. In both the second and third situations consumers would be required to provide evidence to the IRD to get a partial refund. This process is likely to be time consuming for both the IRD and individual consumers, creating significant administrative costs.

Fourthly, the establishment and operation of a point-of-sale system is likely to be very expensive. It would be unjustifiable to expect financial intermediaries to bear these costs, for what is, essentially, a tax collection burden. This cost would have to be recovered either through increased annual credit card fees, or through an IRD subsidy. Nevertheless, it must be noted that one would expect that averaged over online offshore purchases, this would represent a relatively small collection cost.

Finally, there is nothing to prevent a New Zealand based consumer from purchasing goods at an offshore internet retailer with a credit card issued by a foreign bank. There is a risk of creating a two-tiered financial system whereby consumers may use a credit card issued by a domestic bank for every day, domestic purchases and by an offshore bank when purchasing goods at online retailers. This incentive would disadvantage domestic banks and credit card issuers.

Whilst the establishment of a point of sale collection system is conceptually attractive, it appears currently infeasible. Even if the implementation of such a system were possible, its operation would be fraught with difficulties. Customs would have to devise a system to automatically identify packages with pre-paid duty and GST. As online retailers would not be involved in the tax collection, they would have no incentive to identify pre-paid packages. Accordingly, society would be forced to absorb significant administrative costs.

5.3 Multinational agreement promoting voluntary registration for taxation purposes:

The growth of e-commerce has serious implications for all countries reliant upon sales taxes. As a worldwide problem, we believe the most effective long-term solution is the development of a multilateral agreement between affected countries.

Our preferred solution is the establishment of a system which encourages, rather than forces, online retailers to collect and remit sales taxes to the respective nations. Although aspirational, we believe the establishment of such a system is feasible. Faced with declining sales tax revenues, countries may be prepared to invest resources to ensure this scheme's long-term success.

As a small country, New Zealand's ability to impose requirements upon foreign retailers unilaterally is extremely limited. For example, we believe that most, if not all, offshore retailers would cease selling goods into New Zealand if the government only allowed GST registered retailers to ship to New Zealand. The creation of a multilateral agreement circumvents many of these issues.³⁴ The greatest issue lies in creating a system which provides sufficient incentives for firms to voluntarily collect and remit sales taxes on behalf of a myriad of countries.

Several international organisations could be used as a vehicle for developing such a system. Although organisations such as the Universal Postal Union and the World Trade Organisation have a broad scope and large country membership we do not believe these are the appropriate organisations which could be used to facilitate the development of such a system. This is primarily due to the difficulties in obtaining a consensus amongst large numbers of countries.³⁵

Instead, we believe that APEC would provide a more efficient forum. With only 21 members, achieving consensus is likely to be significantly easier than at the WTO or UPU. Moreover, with a number of large economies such as Russia, Canada, China, the US, Japan and Australia as members, large amounts of incoming trade will be potentially taxable. The biggest issue with APEC is the absence of the European Union. Nevertheless, it may be possible to incorporate the EU in these discussions.³⁶

³⁴ The benefit to online retailers of a multilateral agreement through APEC or other international body will come from large nations like the US, UK, Canada and Australia. In essence, New Zealand will be able to 'piggyback' on a solution developed by large nations who have sufficient market power to make voluntary registration worthwhile for online retailers.

³⁵ For example, the WTO's Doha round of negotiations which began in May 2001 are still being debated nearly 12 years after they began.

³⁶ Alternatively, it may simply be easier for countries to engage in bilateral negotiations – for example Australia and New Zealand.

The most promising method for attracting voluntary compliance is fast-tracked processing of goods through the border.³⁷ If countries could guarantee rapid border transit and reduced consumer compliance costs for packages sent by registered companies, we believe many companies would register. Customers, recognising the potential cost savings and faster delivery times, are likely to switch to registered companies – providing additional incentives for other companies to register.

The greatest advantage of a multilateral agreement from New Zealand's perspective is that companies are likely to derive the most value from large economies. Expedited border processing in countries with low thresholds such as Canada and the UK will provide a significant motivation for companies to voluntarily register. As more and more companies sign up under this system, New Zealand could slowly lower its de minimis level. Over time, it may be possible for New Zealand to match the low threshold observed overseas, without incurring significant administrative costs.

Moreover, even if New Zealand's de minimis threshold remained at its current level, consumers will derive significant benefits from this scheme.³⁸ Most countries operate some variety of a user pays system. In Canada and the U.K. consumers are charged a processing fee representing the costs incurred by Royal Mail and Canada Post. In Australia and New Zealand, consumers are required to pay a Customs handling fee. These fees are charged on the grounds that customs and postal authorities incur additional costs in the identification and processing of consignments with duty and GST owing. However, pre-paid parcels will not require any revenue assessment. Accordingly, they should be exempt from all customs and postal handling costs. When the new Customs and MPI fees are introduced, consumers receiving goods through international parcel post will save \$46.89 (incl. GST).

In addition, consumers will benefit from rapid border transit. Currently, packages exceeding the de minimis threshold sent through international parcel post are withheld from delivery. Under this scheme, these packages would be immediately released. This is likely to lead to efficiency gains throughout the economy as businesses (and consumers) receive valuable consignments in a more timely fashion. Storage costs for New Zealand Post will also decline rapidly.

The government would also derive significant benefits from the establishment of this system. Currently, all packages entering New Zealand via international parcel post must be manually screened for revenue assessment. Given the enormous volumes passing through the International Mail Centre, it is inevitable that packages exceeding the de minimis threshold routinely pass through the border undetected. Under this scheme, however, all duty and GST is collected from participating retailers as soon as the good exceeds the de minimis threshold. The risk of a package slipping through the border undetected, will accordingly, decrease significantly.

Moreover, the border is likely to become more secure. As fewer packages will require revenue assessment, Customs officers that were previously required for revenue assessment and collection

³⁷ Such a system could be based upon the UK's Memoranda of Understanding with New Zealand, Hong Kong, Singapore and the Channel Islands.

³⁸ Nevertheless, one would expect New Zealand to lower its de minimis threshold substantially so as to increase the incentives for retailer's to enter the scheme.

purposes could be reassigned to routine risk screening. This will enable Customs to more effectively uphold its primary objective of preventing illegal and unwanted items from entering New Zealand.

Finally, physical goods only represent the tip of the iceberg of goods purchased online. Tax revenue lost on purchases of electronic goods are far greater than losses on physical goods imported through the border. The advantage of creating a voluntary system for offshore companies exporting physical goods is that countries could use this as a model for future multilateral action on electronically consumed goods and services such as music, movies and computer programmes. Given the predicted rise in e-commerce, the early establishment of an effective tax system is vital.

Nevertheless, the establishment of such a system is likely to be fraught with issues. Although this report is not intended to be comprehensive, we set out the four largest barriers that will need to be overcome.

First, countries must be able to ensure that the duties and sales taxes are correctly assessed. This is not an insurmountable issue. Participating countries could easily create a free database, available in a variety of formats, detailing each nation's duties/GST rates and exemptions. Online retailers would then face a single fixed cost when incorporating this database into their sales platform. As many online retailers already face varying sales taxes within nations, the incorporation of such a database should not prove insurmountable.³⁹

Secondly, the system must ensure that the assessed duties/GST are actually remitted to the respective nations. Given the potential for fraud, bankruptcy or other issues, countries are unlikely to agree to a system whereby companies are required to remit all taxes on a monthly basis. Accordingly, a retailer's entry into this scheme could be predicated on the lodgement of a bond at participating nations. Alternatively, companies may be required to ensure instantaneous electronic payment and remittance through their internet platform at time of sale. We do not have an easy solution.

Thirdly, Customs must be able to identify pre-paid packages and confirm, at the border, whether the appropriate duties and taxes have been paid. Once again, this is not an insurmountable issue. Firms registered for GST purposes at an international organisation or with various countries could be issued with a secure identification tool, such as holographic barcodes. As soon as border protection agencies receive confirmation that taxes/duties have been assessed and remitted, companies would be issued with a code allowing labels to be affixed. This uniform barcoding system would reduce compliance costs for companies significantly. Moreover, Customs would be able to scan incoming packages to ensure GST/duties have been collected.

Finally, consumers must be able to derive security from their pre-payment to an online retailer. As noted earlier, the potential for fraud is large. Although participating online retailers may be able to be easily identified, unsuspecting consumers will inevitably 'pay taxes' to unregistered firms. The system must be able to cope with such eventualities.

³⁹ For example, Amazon calculates, collects and remits varying sales taxes on purchases made across different states in the US.

Summary:

Although the implementation of such a system may prove costly and time consuming, especially given the political hurdles all multilateral agreements are subject to, we believe the benefits will far exceed these costs. Government revenue will increase as all purchases above the threshold from registered suppliers will be subject to sales taxes.⁴⁰ Moreover, for goods that currently attract attention, consumer welfare is likely to be enhanced through the reduced administrative costs resulting from the rapid transit through the border. Furthermore, costs for consumers should fall dramatically as Customs will no longer incur any revenue assessment costs (except for routine compliance checks). Finally, the border is likely to become more secure. As more officers are diverted from revenue assessment, greater emphasis can be placed upon Customs' primary objective of protecting New Zealand from illicit and contraband items.

6. Revised methodology for future analysis of the de minimis threshold:

Having accepted that "the de minimis is intended to achieve a balance between the costs of assessing and collecting duty and revenue received"⁴¹ the big question then becomes: how does one conduct an appropriate cost-benefit analysis? Although different approaches focus upon different segments of the economy, we believe that two methods are worth pursuing. In particular, we believe that the cost benefit analysis can be analysed in terms of society or the government. Our proposed methodologies, along with Customs' are set out in the table below:

	Benefit	Cost
Customs Issues Paper	Tax revenue collected	Administrative costs throughout society
Government orientated	Tax revenue collected	Government expenses less costs recouped from importers
Social welfare maximising	Rise in NZ producer surplus along with the tax revenue collected	Decline in consumer surplus along with increased administrative costs

6.1 Customs' current methodology:

Underlying Customs' 2011 assessment of the de minimis level was, from our perspective, a flawed methodology. Customs sought to balance the collection and administrative costs faced by Customs, private importers and courier companies, against the tax revenue collected. In doing so, they concluded that "the de minimis appears to be set at about the right level, based on the costs of revenue collection and compliance in the airfreight sector" (NZCS, 2011). Such a calculation fails to recognise that the costs and benefits being compared are not 'alike'.

⁴⁰ Given the manual screening process that occurs at the IMC, it is inevitable that packages exceeding the de minimis threshold will pass through undetected.

⁴¹ New Zealand Customs Service, 2011.

All cost-benefit analyses must be conducted using the same common denominator. In other words, the costs and benefits must have the same characteristics. Apples cannot be compared with oranges. Customs' analysis fails this standard. Whilst the costs of the de minimis level are calculated across society, the benefits are only measured in terms of the government. The two are not compatible.

Customs assesses the validity of the de minimis threshold for a marginal good, across both the express airfreight and international parcels post channels.⁴² In 2011, Customs incurred collection and processing costs of approximately \$24.20 for every parcel exceeding the de minimis threshold imported through the express airfreight channel. In addition, packages that exceeded the threshold created administrative costs of around \$30 (including overheads) for courier companies. On this basis, Customs concluded that the \$61 of revenue collected was roughly offset by the \$54.20 of costs borne by society.

Using the same analysis, Customs acknowledged that there was a case for lowering the de minimis threshold in relation to the international parcels post channel. Although the government collects \$61 in GST and duty, Customs collection costs, including overheads, are only \$26. Nevertheless, as the threshold applies across both channels, Customs took the view that it was appropriately set.

From our perspective this is a flawed analysis. Accordingly, we suggest the development of the following methodologies.

6.2 Government based approach:

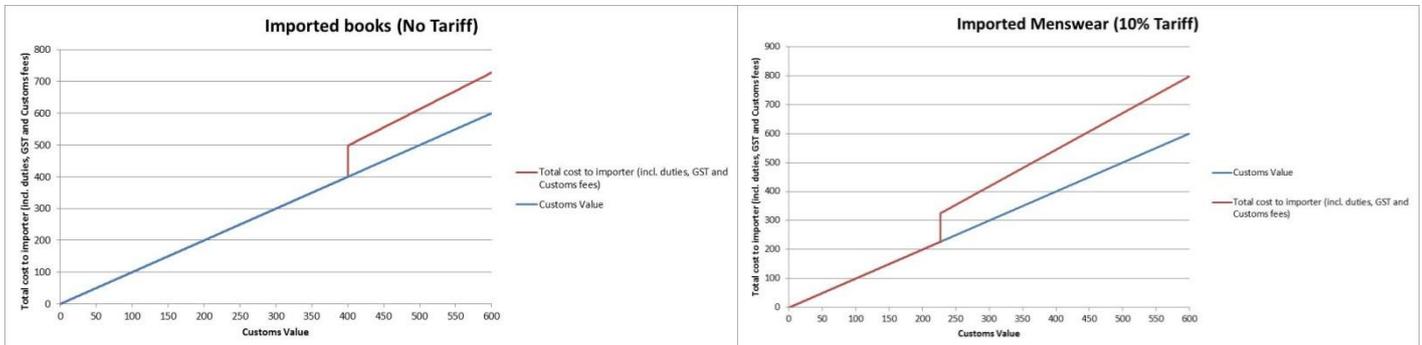
This approach seeks to compare the tax revenue collected with the Government's costs of collection. As with all methodologies underlying the de minimis threshold, the aim is to find an equilibrium whereby the government's costs of collection equals the revenue it receives. Adopting such an approach has the advantage of being easy to calculate, and explain, to the public.

Customs' primary objective is to prevent contraband and other prohibited items from entering New Zealand. In the international mail environment, all packages, regardless of their value, are screened by Customs as part of the wider border risk management process. In the express airfreight sector, courier companies provide Customs with an electronic manifest of the goods entering New Zealand. This allows for an intelligence-driven risk management process. As the initial risk screening process must be carried out on all consignments, regardless of their value, these costs should not be included when assessing Customs' costs of collection and assessment.

However, in the 2011 Issues Paper, Customs insufficiently delineated the costs of risk assessment from the routine risk screening process through which all imports, regardless of their value are subjected. Instead, they acknowledged that [Customs' processing costs] *"do not just relate to Customs revenue collection function but encompass all aspects of the risk assessment and clearance process."* Given that New Zealand operates a user pays system for consignments exceeding the

⁴² That is a good which just crosses the de minimis threshold. For the sake of their analysis they compare the costs of collection to the \$61 of duty and GST collected on a marginal good.

threshold, this is simply intolerable. Importers should not be cross-subsidising Customs' routine risk screening procedures. As can be seen in the graph below, as soon as a consignment crosses the threshold, the total cost to the importer jumps substantially. It is not feasible to suggest that a package worth \$400 costs Customs \$98.07 more than a package worth \$399.99.



In its most basic form, a government based cost-benefit analysis must balance the government's cost of collection, less any costs recovered from consumers with the tax revenue it receives. Accordingly, all administrative costs incurred by importers (e.g. customs brokers or processing fees from courier companies) must be disregarded. Additional costs incurred by consumers in the express airfreight channel simply represent the cost of employing couriers, rather than international parcel post. From a government perspective, these costs are incidental, and must be ignored.

We believe the appropriate method of 'costing' a reduction in the de minimis threshold is by considering Customs' costs of identifying and collecting revenue. Unlike the current de minimis issues paper, these revenue assessment costs must be sufficiently isolated from other risk screening processes. A user pays system should not attempt to cross subsidise universal risk-screening procedures that must occur regardless of value. Currently, importers pay a \$22 (GST excl.) processing fee for consignments exceeding the de minimis threshold. Given that a large component of this fee represents a cross-subsidisation for general Customs processes, it is likely that this processing fee could drop substantially.

Against these costs, the government must balance the customs duty and GST revenue received. The lower the threshold, the smaller the revenue recovered on each parcel. For example, if the threshold was reduced to a minimum customs value of \$50, goods that do not attract customs duties would generate just \$7.50 in GST. Nevertheless, as New Zealand operates a user pays system, it will be possible to lower the threshold substantially, whilst still balancing the costs of collection with the tax revenue received. This can be clearly seen in the 2011 Issues paper, where Customs incurred costs of around \$26 for packages exceeding the threshold. However, \$22 of this was offset by the Customs processing fee. On this simple calculation, one could argue that the de minimis threshold could be lowered down to a point whereby only \$4 of revenue was collected – suggesting a minimum customs value of around \$27.

6.3 Social welfare orientated approach:

Our preferred approach seeks to lower the de minimis threshold so as to maximise social welfare throughout the economy. Such a calculation is by no means trivial, and requires extensive research of tax changes throughout the economy. Nevertheless, by employing a nation-wide methodology, economic distortions will be minimised, leading to a more fair and equitable de minimis threshold.

With the government's adoption of many of the Tax Working Group's suggestions in 2010, New Zealand's tax base shifted from direct to indirect taxation. Lower company and income taxes were offset by a 2.5% increase in GST. As offshore e-commerce grows increasingly popular, the future viability of a GST based tax system is increasingly jeopardised. Any government contemplating a reduced de minimis threshold will face one of two motivations.

The decision to lower the de minimis threshold may be a reaction to declining tax revenues. In the aftermath of the global financial crisis, increased GST revenues from a lower threshold will help the current government's stated goal of achieving a surplus by 2014/2015. Alternatively, tax revenue from a lower de minimis may be used to further reduce our reliance on direct taxes. The revenue raised may enable the government to further lower income or corporate taxes, reducing distortions throughout society.

6.3.1 *Enhanced government revenue:*

By employing a societal approach, it is still possible for the government to lower the de minimis threshold with a view to raising previously foregone tax revenues. This approach seeks to balance the social welfare gains with the social costs generated by a reduction in the de minimis threshold, as can be seen in the table below:

Social welfare gain	Social costs
<ul style="list-style-type: none">• Rise in New Zealand producer surplus• Tax revenue raised	<ul style="list-style-type: none">• Decline in consumer surplus (including tax effects)• Administrative costs (Customs, courier companies and private importers)

A lower de minimis threshold creates several avenues for increased social welfare. As imported goods lose their tax advantage, domestic bricks and mortar and online firms become increasingly competitive. If the government were to completely remove the de minimis loop-hole, Einav et al's study predicts a 45 – 60% decline in demand for offshore internet retailers offset by a 27% increase in demand for domestic internet retailers. Although this study cannot be directly applied to New Zealand, it clearly indicates strong tax effects resulting from the current de minimis level. Given that consumers exhibit strong home biases, a reduction in the de minimis threshold is likely to lead to substantial increases in demand at domestic firms as the price differentials reduce.⁴³

⁴³ Although one would have to take into account the reduced demand that New Zealand online retailers may face if other countries lowered their de minimis thresholds in response, we are unlikely to be significantly affected given that our four biggest export commodities by value in 2011 were dairy, meat, forestry and oil.

This enhanced demand at domestic retailers translates into larger producer surpluses. Currently, offshore retailers such as Amazon, ASOS and the Book Depository derive significant producer surpluses from sales made in New Zealand. As consumers repatriate their purchases, this welfare will be shifted from offshore to New Zealand retailers. Given the size of the e-commerce market, and its predicted growth, the repatriation of sales to New Zealand is likely to dramatically enhance domestic producer surpluses, to the benefit of the economy.

This enhanced demand at domestic retailers not only results in increased producer surpluses, but firm growth leading to increased employment. Jobs created by a reduction in the de minimis threshold increase the economy's productive capacity, clearly benefiting the rest of the country. Enhanced domestic employment results in increased consumer spending, and through the multiplier effect, enhanced growth throughout the economy.

Finally, there is some evidence to suggest that offshore retailers are reluctant to establish a physical store in New Zealand if it would entail a loss of the implicit 15% subsidy they currently receive. By removing the incentive to remain outside New Zealand's tax jurisdiction, offshore retailers may be increasingly willing to open physical retail stores.

These changes have positive taxation effects. In the US, state sales taxes simply provide an incentive to engage in out-of-state purchases. Whilst the state misses out on sales tax revenue, the purchase remains in the US and is accordingly subject to a myriad of corporate and income taxes. In contrast, the incentive in New Zealand is to purchase goods overseas. Company and PAYE taxes, in addition to GST are all forfeited through the government's current policy. A lower de minimis threshold will not only raise previously foregone GST revenue, but will also result in higher company and PAYE tax receipts as purchases are repatriated to New Zealand.

However, the benefits created by a lower de minimis threshold must be measured against the social costs created by such a change. The most notable cost lies in the reduction of consumer surpluses throughout the economy.

Consumers derive substantial welfare gains from e-commerce. The internet allows consumers to purchase an enormous variety of goods from retailers across the world, often at lower prices than are available domestically. Although online retailers often face lower costs and are able to offer goods at a reduced price compared to bricks and mortar retailers, they are further helped by the implicit 15% surplus provided by the government's current de minimis threshold.

Any reduction or removal of the de minimis threshold will cause prices at most offshore online retailers to rise by 15%. Although some companies may choose to offer a reduced price for New Zealand consumers (in order to mitigate the loss of demand caused by the application of GST), prices at offshore retailers will inevitably rise. According to PricewaterhouseCoopers (2012), 51% of New Zealanders stated that lower prices online were the main reason for engaging in e-commerce. As the price of a good rises, this will result in fewer purchases, at higher prices. This will cause an immediate and large reduction in consumer surplus.

Moreover, a reduction in the de minimis level is likely to create significant administrative costs throughout society. Unlike the government based approach, all administrative costs must be accounted for under this methodology. Imports requiring duties and GST to be paid incur significantly higher administrative costs than goods that pass under the threshold. Importers who previously faced no administrative costs will be forced to complete Simplified (or Personal) Import Declarations (SID or PID respectively). Consumers may be forced to deal with customs brokers, whilst courier companies will be required to employ additional brokers to handle the increasing volumes requiring customs clearance. Customs are also likely to face increasing administrative costs as a result of this change.

Finally, under the current system, a lowering of the de minimis threshold is likely to increase delivery times of goods sent through international parcel post dramatically. Packages that exceed the new threshold will be withheld from delivery until a PID or SID is submitted and the duty and GST is paid. This delay in delivery is likely to have negative effects throughout the economy as goods are held at the border.

Detailed modelling of any changes will allow an approximation of the social welfare gains and costs accruing to New Zealand as a result of this change. Although the costs are likely to be significant, we anticipate that they will be initially offset by the gains resulting from a reduction in the de minimis threshold. The optimal threshold will then be set at a level where the marginal social welfare gains are offset by the marginal social costs. We believe that this will result in increased demand and employment at domestic firms along with higher government revenue, offset by an increase in administrative costs and a loss of consumer surplus.

6.3.2 Tax base redistribution:

The government may, alternatively, seek to diversify the tax base. Increased GST revenue derived from a reduction in the de minimis threshold could be used to lower income or corporate taxes, thereby reducing the distortionary effects created by these taxes. The approach seeks to balance the following social costs and benefits:

Social welfare gain	Social costs
<ul style="list-style-type: none"> • Rise in New Zealand producer surplus • Reduction in distortions as other taxes are lowered 	<ul style="list-style-type: none"> • Decline in consumer surplus (including tax effects) • Administrative costs (Customs, courier companies and private importers)

This methodology is predicated on the grounds that all tax effects are neutral. As a result, increases in government revenue derived from a lower de minimis threshold are irrelevant. Any increase in GST revenue will be used to reduce taxes in another area. That is, the government simply uses the gains from a lower de minimis threshold to diversify the tax base.

Unlike the previous social welfare approach, the main benefit (outside of increased domestic producer surpluses) lies in the reduced distortion as other taxes are lowered. All taxes create unwanted distortionary effects. The de minimis threshold creates an incentive to purchase goods

offshore. High personal income taxes create incentives to shelter income behind trusts or companies. If these acts are being done for the primary purpose of avoiding taxes, they are undesirable and distortionary. By lowering the de minimis threshold, the government will be able to reduce tax rates in other areas, such as PAYE or company taxes. Any distortions removed through this process provide a benefit to society.

The reduction of tax rates in other areas may also result in reduced compliance or administrative costs. For example, the increase in GST from a lower de minimis threshold could be used to create a tax-free income bracket of, say, up to \$5,000. If the first \$5,000 of income were to be tax free, individuals who were previously unwilling to work may be tempted to join the labour force. Moreover, very lower earners may fail to cross the \$5,000 threshold. In this case, they would not be required to file income tax returns – reducing compliance costs for both individuals and the IRD. Across the economy, these benefits may be substantial.

The attraction of this methodology is that it enables the government to create a fair and equitable tax system, designed to enhance productive capacity throughout the economy. Aside from the welfare gains through reduced distortions in the tax system, the cost-benefit analysis is conducted in the same manner as the above methodology.

7. Conclusion:

E-commerce has revolutionised the retail industry. What was traditionally bought in stores is now increasingly purchased online. Through the internet, consumers are directly connected to retailers around the world. The lower prices and increased product selection available online have driven substantial consumer welfare gains.

However, due to the operation of the de minimis threshold, consumer benefits have come at the expense of lower government revenue and reduced demand at domestic retailers. Imports are currently tax free if the duty and GST payable is less than \$60. Depending on whether the good attracts a tariff, the effective de minimis threshold ranges from \$226 to \$399. This high threshold is distortionary, providing adverse incentives for consumers to avoid GST by purchasing goods from offshore retailers.

Although e-commerce's tax effects are a worldwide issue, countries have failed to adopt a coordinated response. An examination of the UK, Australia and Canada's border processes and thresholds reveals substantial differences across nations. In the absence of publically available data, we have been unable to examine the efficiency of overseas jurisdictions. Future reviews should seek to obtain this data.

We strongly recommended a change in the de minimis' definition. Currently, New Zealand's threshold is defined in terms of a minimum duties/GST payable. For infrequent, private importers, this policy is confusing and difficult to understand. In contrast, changing to a threshold defined in terms of a minimum customs value would bring us in line with the UK, Canada, Australia and the US. This quick and easy change will significantly improve public awareness of the threshold, whilst reducing Customs' administrative costs in the international mail environment.

Whilst collection of duties and GST through financial intermediaries is conceptually attractive, we do not recommend its adoption. Even if the establishment of such a system were possible, it is likely to result in substantial administrative costs for financial intermediaries, society and the government.

Instead, our preferred long-term approach is the creation of a multilateral agreement designed to encourage, rather than force, offshore retailers to collect and remit sales taxes to participating nations. If countries could guarantee rapid border transit and reduced consumer compliance costs, we believe many retailers will register. As retailer participation rises, New Zealand would be able to progressively lower its threshold in line with reducing Customs costs. Whilst we acknowledge that the creation of such a system is aspirational, we believe that many countries, recognising its potential, will be prepared to invest resources in ensuring its success.

Finally, we propose three alternative methodologies for assessing the de minimis threshold. These are designed to replace the flawed methodology employed in the 2011 Customs review of the de minimis threshold. They have the further advantage of allowing a cost-benefit examination to be conducted across society, or limited solely to the government.

Importantly, this report is not intended to be comprehensive. Instead, we envisage it as a springboard for future research aimed at developing a cost-effective method for lowering New Zealand's de minimis threshold.

Report written by William Steel in consultation with Toby Darglish, Lisa Marriott, Norman Gemmell and Bronwyn Howell for Booksellers New Zealand.

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