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Retail Council of Canada

Pre-Budget Consultations Consultation

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Conseil canadien du commerce de détail

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Retail Council of Canada Submission
Standing Committee on Finance Pre-Budget Consultation

Thank you for the opportunity to participate in pre-budget consultations for the 2017 Federal Budget.

Responding to the Committee's identified priorities, RCC's recommendations support the goal of "***helping Canadians to maximize their contributions to the country's economic growth*** *and* ***assisting Canada's businesses to meet their expansion, innovation and prosperity goals."***

RCC is calling on the government to take action in three areas:

1. Eliminate import tariffs where domestic manufacturing is limited and where there is a duty delta between Canada and the United States;
2. Maintain a *de minimis* threshold of $20 for duties and taxes on imported shipments; and
3. Regulate credit card interchange fees.

Who We Are

The Retail Council of Canada (RCC) has been the Voice of Retail in Canada since 1963. We are an industry that touches the daily lives of Canadians in every corner of the country by providing jobs, career opportunities and investing in our communities.

RCC is a not-for-profit, industry-funded association representing more than 45,000 store fronts of all retail formats, including department, general merchandise, grocery, specialty, discount, independent stores and online merchants of all sizes.

Collectively, retail is the largest private sector employer in Canada, providing jobs for more than 2 million Canadians and generating sales in excess of $340 billion dollars a year.[i]

Elimination of Import Tariffs

The Prime Minister's Mandate Letter to the Minister of International Trade states:

"As Minister of International Trade, your overarching goal will be to increase Canada's trade and attract job-creating investment to Canada, focusing on expanding trade with large fast-growing markets, including China and India, and deepening our trade links with traditional partners."

RCC is a strong supporter of free trade, particularly as it relates to tariff application at our borders. In this regard, RCC applauds the government's commitment to continue to expand and explore free trade agreements with Canada's largest sourcing partners.

It must be acknowledged, however, that multilateral trade agreements are long-term projects. Canadians are years away from receiving the benefit of tariff elimination from even our most imminent agreements, CETA and the TPP, both of which may also be impacted by political currents in Europe and the U.S. Consequently, the government's trade strategy must include an action plan to rapidly eliminate tariffs on product categories that will make life more affordable for Canadians.

Tariffs were originally applied on imported goods to protect domestic production. But with domestic production for retail products in Canada having narrowed significantly in recent years, most of these tariffs no longer serve the purpose for which they were intended and have simply become a tax on the consumer.

This means, for example, that a pair of shoes coming into Canada are first subject to 18% duty at the border and then federal and provincial sales taxes at point of sale. Assuming that the landed price of the shoes is marked-up 50% at retail and the tariff is simply passed through, the effective tax rate for a Maritimer would be 28.8%. For comparison purposes, a Quebecer would also pay a tax rate of 28.8%, an Ontarian 25.6% and even in Alberta, with no provincial sales tax, the rate would be 17.6%.

Retail is a hyper-competitive environment. Where retailers can cut costs and provide consumers with better pricing, they will. A realized savings in tariff elimination would allow retailers to provide more competitive prices, and to re-invest in their businesses. This will stimulate growth and economic activity which is in line with the government's priority "***to assist Canada's businesses to meet their expansion, innovation and prosperity goals."***

RCC is recommending that the government target specific product categories that are subject to the highest tariff rates in the *Customs Tariff* and are deemed necessities for every Canadian. In this regard, we have identified footwear, clothing, and outerwear (jackets, gloves, hats) for both children and adults. If the government takes action to lower the costs of these necessities, it would directly assist all Canadians, especially low and modest income earners - many of whom may be struggling to afford these basic purchases.

The criteria used to determine our focus on footwear, clothing and outerwear included the following components:

1. Product categories with limited domestic manufacturing;
2. Products that are subject to high import tariff rates; and
3. Products that are considered necessities for Canadian families.

Product	Customs Tariff Chapter	MFN Rate Applied by Canada
Footwear	Footwear – Chapter 64	18%
Children's Clothing (up to size 16)	Textiles – Chapter 61, 62	18%
Adult Apparel	Textiles – Chapter 61	18%
Outerwear (jackets, gloves, hats)	Textiles – Chapter 61	18%

The government needs to act immediately to cut back on government-imposed tariffs that do not exist for a useful purpose, and drive up costs for consumers.

De Minimis

RCC is deeply concerned by efforts to eliminate the level playing field between retailers operating in Canada, whether in stores or online, and those who sell online from outside Canada and ship goods cross-border by post or courier. In a nutshell, that lobbying effort by foreign online sellers is asking our government to provide a tax incentive to shop anywhere *but* Canada.

U.S.-based online vendors (Amazon and eBay), couriers (UPS) and mailing houses (Pitney Bowes) are pushing for an increase in the *de minimis* level, below which shipments into Canada are exempt from sales taxes and duties. An increase to the *de minimis* level could be devastating to Canadian retail operations, to our investment plans and to our industry's two million+ employees.

They are asking that we raise the current $20 threshold to $200, which would mean that *any* parcel costing under $200 could enter Canada free of federal and provincial sales taxes. Meanwhile, merchants operating here would be required to collect sales taxes on the same or competing products. U.S. and offshore online merchants would thereby have an average tax advantage of 12.3% (ranging from 5% in Alberta to 15% in Atlantic Canada). In addition, foreign online sellers would be exempt from the customs duties that we pay on imported goods.

De minimis at anything like the $200 level would lead to major increases in cross-border purchases, with the obvious negative consequences for retailers in Canada and their employees. This would be particularly true in apparel, footwear, books, toys, consumer electronics and housewares, most of which are priced below $200 and easily shipped. Of course, these are the very areas in which many small and medium-sized Canadian retailers specialize.

The U.S. online lobby always neglects to mention the tax advantage they would gain and points instead to the *de minimis* level of $800 in the United States. But there is no real comparison between the U.S. and Canada. First, the U.S. does not have a federal sales tax and does not collect state or local sales taxes at the border, so there is no advantage created for inbound goods.

Second, the United States dominates its online retail space and the global online space, with only 22% of U.S. customers reporting having made a purchase from a non-U.S. seller. By contrast, 67% of Canadians report having made online cross-border purchases[ii]. The scale of U.S. warehouse operations and absence of federal sales tax is such that the U.S. can easily afford to offer a high *de minimis* level, while pushing other countries to raise their own levels.

To be clear, it is not the fact of cross-border purchases that we object to. Customers may have valid reasons to buy from vendors outside Canada. What concerns us is the prospect that foreign sellers would be given a huge price advantage over Canadian retailers by being tax-exempt and duty-exempt.

Why give a tax advantage to foreign online vendors, who employ few if any people here, at the cost of those who do create jobs and economic activity? We should note that one of the first victims of a hike in *de minimis* is apt to be Canadian investment in online technology, including high-wage jobs in IT and design. This would affect not only Canadian-based retailers but also transnationals, as there would be little incentive for HQs elsewhere to invest in Canadian online offerings if they can service Canadian consumers from existing websites south of the border with a tax advantage.

Lastly, we question why governments (federal and provincial) would want to forgo the revenues that would be lost as taxable Canadian sales shift to tax-free foreign sales with the inevitable change in consumer behaviour.

Once all the facts are presented, we think the decision will be a straightforward one and hope that you will support this fight for fairness for Canadian-based businesses.

Credit Card Fees

RCC is calling on the Minister of Finance to limit the fees that merchants may be charged for accepting credit cards.

By way of explanation, every time a merchant accepts a credit card for payment, that merchant takes a "haircut" and receives less than the face value of the transaction. This reduction in the face value is due to *interchange*, a compulsory fee paid to the credit cardholder's bank. Interchange rates are set by two credit card payment networks, *Visa* and *MasterCard* and are non-negotiable for merchants. In effect, this allows the credit card duopoly to dictate the reductions that merchants face.

Retail merchants do not object to interchange as such. Our concern is with the *level* of interchange, which averages 1.5% in Canada. By contrast, the average interchange rate sits at 0.3% in the UK and through most of Europe, 0.28% in France, and 0.5% in Australia, with no difference whatsoever in the services provided to merchants. Public authorities (legislatures, central banks and competition regulators) in over 30 countries have already intervened to lessen the power of the credit card duopoly in this relationship[iii]. Retailers are calling upon our policymakers to support legislation that would allow for a re-balancing of the relationship here in Canada.

While the issue might appear at first glance to be a business-to-business one, the main impact of high interchange rates is that they drive up the prices paid by consumers. This has been recognized worldwide and in studies by Canada's Competition Bureau. In a nutshell, high interchange rates raise prices for everyone, including on necessities like groceries, pharmacy products, and fuel. In total, these interchange fees cost Canadian consumers close to $5 billion annually.

As operators of retail businesses, merchants do not call for regulation lightly. Our own industry is fiercely competitive and we prefer that pricing be a function of open competition, with a level playing field. In this case however, the card networks' market dominance is such that there is a failure of competition – how else to explain that the same services are offered to merchants by the same companies in two different markets at pricing that varies by 400% and more.

In this type of market failure, due to oligopoly pricing, policymakers should intervene in the public interest. This empowerment is an important step toward a more balanced relationship and one that should be supported by parliamentarians of all stripes.

While these three issues might appear to be disparate threads, they are in fact intimately bound together. Both tariffs on consumer goods and high interchange fees drive up the prices that Canadians pay at retail, together to the tune of $9 billion annually. These unnecessary costs also constrain our industry's ability to invest in our communities.

The *de minimis* issue is one of basic fairness at one level, i.e., why would Canadian policymakers incentivize Canadians to shop anywhere *but* Canada, especially given our industry's importance to the economy, including serving as our country's largest private sector employer. But that is primarily on the tax fairness front. It is also true that if tariffs were eliminated or even if tariff differentials were eliminated, the playing field could remain level, while allowing for a higher *de minimis* threshold on the duty portion.

On behalf of the retail sector, RCC wishes to thank the Finance Committee for the opportunity to present our views.

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[i] $337.4 billion in seasonally unadjusted sales for the rolling 12-months to May 2016. Excludes vehicles, parts and gas station sales. Source: CANSIM table 080-0020 and *Retail Fast Facts, May 2016.*

[ii] PayPal Cross-Border Consumer Research 2015 GLOBAL SNAPSHOT, https://www.paypalobjects.com/digitalassets/c/website/marketing/global/pages/jobs/paypal-insights-2015-global-report-appendix-added.pdf

[iii] *Public Authority Involvement in Payment Card Markets: Various Countries August 2015 Update*. Prepared by Fumiko Hayashi and Jesse Leigh Maniff, Payments System Research Department Federal Reserve Bank of Kansas City, https://www.kansascityfed.org/~/media/files/publicat/psr/dataset/pub-auth_payments_var_countries_august2015.pdf