ASIA INTERNET COALITION

18 July 2019

To
Options for taxing the digital economy
C/- Deputy Commissioner, Policy and Strategy Inland Revenue Department
PO Box 2198, Wellington 6140

Subject: Industry Submission on Options for Taxing the Digital Economy

On behalf of the Asia Internet Coalition (AIC) and its members, I am writing to express our sincere gratitude to the Ministry of Finance, The Ministry of Revenue, and the Government of New Zealand Personal for the opportunity to submit comments on the **Government Discussion Document on Options for taxing the digital economy ("Discussion Document")**. AIC is an industry association comprised of leading Internet and technology companies in the Asia Pacific region with an objective to promote the understanding and resolution of Internet and ICT policy issues. Our current members are Airbnb, Amazon, Apple, Expedia Group, Facebook, Google, Grab, LinkedIn, LINE, Rakuten, Twitter and Yahoo (Oath), and Booking.com.

We commend the government's efforts on developing the **Discussion Document**, with an aim to build a productive, sustainable and inclusive economy, while at the same time supporting a sustainable revenue base to fund improvements to the wellbeing of New Zealanders and their families. This means it is important for everyone to pay their fair share of tax in New Zealand.

We understand that there has been significant international concern over the perceived under-taxation of the digital economy, and digital multinationals in particular. It has been argued that this under-taxation is mostly caused by deficiencies in the current international tax rules, which have not kept up with digitalisation and other modern business developments. While the **Discussion Document** canvases the possibility of an interim digital services tax (DST) that will apply to certain digital transactions, in our view the Government of New Zealand would be better served devoting its efforts to formulating an internationally agreed solution at the OECD to update international tax rules to account for the challenges presented by the rapid digitalization of the economy. Further, the OECD and the EU Expert Group have both looked at the idea of a tax targeted at digital and agree that it is the wrong approach. We therefore believe that the wider impacts, in terms of reputational damage of the New Zealand as an open digital economy, and the chilling effect the tax may have on investment and the risk of retaliatory measures from other countries, will have long term negative consequences for the country's tech sector.

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This public consultation is critical, particularly at a time when cross-border trade and data flows has taken a centre stage in the digital economy ecosystem. As responsible stakeholders in the developmental progress, we appreciate the ability to participate in this discussion and the opportunity to provide input into the policy-making process. As such, please find appended to this letter detailed comments and recommendations, which we would like to respectfully request the Government of New Zealand to consider and which could be a useful feedback for future consultations to determine an optimal approach to implementing a digital taxation framework.

Should you have any questions or need clarification on any of the recommendations, please do not hesitate to contact our Secretariat Mr. Sarthak Luthra at Secretariat@aicasia.org or at +65 8739 1490. Importantly, we would also be happy to offer our inputs and insights on industry best practices directly through meetings and discussions to help shape the dialogue around effective options for taxing the digitalized economy.

Sincerely,

Jeff Paine
Managing Director
Asia Internet Coalition (AIC)

Detailed Comments and Recommendations*

***Detailed Comments and Recommendations**

1. How governments allocate the taxes paid by multinational companies is a matter that must be worked out between governments - and it is important that a rules-based approach is agreed on a multilateral basis. Unilateral taxes, even on an interim basis, undermine the international rules-based system. This submission offers our perspective on the questions and issues raised in the Discussion Paper. Our key points are:

    a. We agree that the international tax framework need to be reformed in response to the rapid digitalization of the economy, and believe that countries should work on this together through the OECD. We do not support the unilateral interim digital services tax proposed in the Discussion Document.

    b. New Zealand should stick with the OECD process - the OECD is moving quickly and a unilateral DST, even on an interim basis, diverts resources and undermines the group process.

    c. This raises trade issues - a new tax targeting the revenue of foreign firms is a tariff on trade.

    d. It will increase costs to small business and exporters - this is based on Discussion Paper's own estimates of pass through.

    e. It will be complex to administer, the cost of which is magnified relative to the small amount of revenue estimated to be collected - the definitions are not clear on what would/would not be in scope.

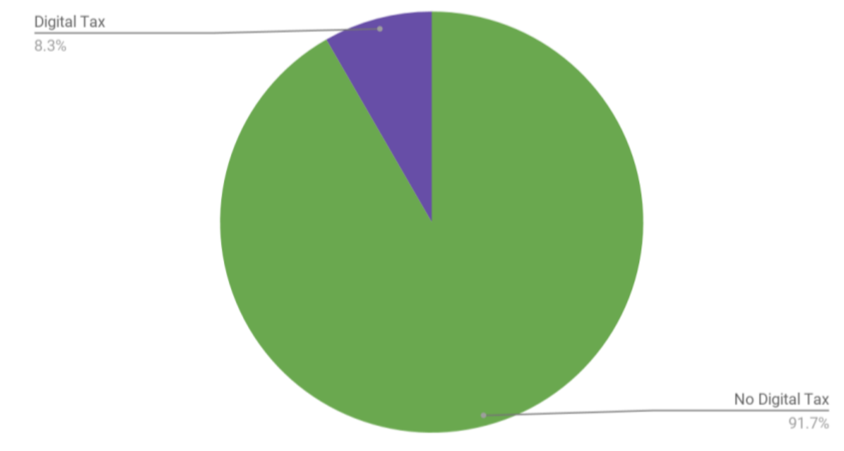
    f. One of the big problems with DST proposals is the presence of double taxation, since DST is not relieved by tax treaties. We suggest that this concern in clearly highlighted in the discussion document and associated regulatory framework.

    g. OECD and the EU Expert Tax Group are of the view that it is inappropriate to try and make a distinction between digital and non- digital businesses. The DST goes against this expert advice and risks making arbitrary distinctions between types of business. Further, the DST proposals could actually slow progress towards a long term agreement to reform multinational taxation at OECD level, because it incentivise countries taking unilaterally approaches rather than seeking collective agreement.

2. **No OECD country has actually imposed or applied a digital services tax.** While, the UK is moving toward with DST introduction from 1 April 2020, but with a scheduled review by UK Treasury in 2025. iIt seems likely that the UK will withdraw the same in later years once the OECD proposals have progressed and agreed upon. Other economies similar to the UK, such as Japan and Germany are already working at the OECD level to propose concrete reform proposals. France is isolated as the only OECD country planning to 'go it alone' with DST.As New Zealand has already proven it can be a uniting force on a global scale, it should be leading collective discussions with other OECD members to bring consensus and consistency to a global approach..

3. New Zealand has a small domestic market and relies on exports to drive its economy. Therefore, it is worth considering which of New Zealand's top twenty export markets[1] have developed a DST. China, Australia, United States, South Korea, Singapore, Hong Kong, Germany, Taiwan, Malaysia, Indonesia, Canada, Thailand, Netherlands, United Arab Emirates, the Philippines and Vietnam have not developed a DST. The UK, India and France have. The chart below sets this out in terms of the value of those markets for New Zealand exports.

New Zealand Top 20 Export Markets by Value



We also suggest referring to the case in point from Australia that held a consultation on DST, post which the government decided not to introduce one. One of the key reasons for not going forward with DST included concerns emanating from DST region, particularly those that discourage innovation, and adversely affect small businesses.

4. We recommend New Zealand **instead focus its efforts on helping develop and advocate for a consensus-based solution at the OECD.** The Discussion Paper suggests that the

[1] https://www.stats.govt.nz/information-releases/goods-and-services-trade-by-country-year-ended-march-2018

OECD progress is taking too long. However, New Zealand did not bring any new proposals to the OECD, and only a few other countries did so at the end of 2018. Prior to this, OECD countries including New Zealand, had agreed to assess in 2020the impact of other BEPS measures agreed in 2015.

5. In less than a year, the OECD has progressed a large programme of work. As seen in the Discussion Paper, these are important issues for countries to work together on and where accuracy and coherence is required. The OECD is working at speed to get consensus and is expected to make significant progress over the coming year. The OECD/G20 Inclusive Framework on BEPS (IF) took a major step forward with an agreement on the **Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy**.[2] The Programme of Work provides detailed instructions to the IF and its technical working groups to deliver a solution to the tax challenges brought by digitalisation. This work focuses on two pillars. The first pillar is about the allocation of taxing rights, and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules. The second pillar focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation. While exploring these two pillars, the Programme of Work also planned an economic analysis and impact assessment that will be carried out over the next few months. This step forward is essential as it shows the willingness of the IF members to agree on a global and sustainable solution by the agreed timeline of 2020, and the process for reaching a new global agreement for taxing multinational enterprises is expected to not take long.

6. DST, even on an interim basis, will divert resources and focus from the OECD. This undermines the multilateral process and may impede progress. Alternatively, progress may still be achieved but without the input normally provided by New Zealand officials whose efforts will be diverted to enacting an interim DST.

7. Applying a digital tax for an interim period also means that the costs of designing, implementing and applying the tax are spread across a short period of time. Considering the significant up-front costs to both businesses (stemming from the need to design and implement new processes and systems for compliance) and revenue authorities (stemming from the need to design and implement new processes and systems for collection and audit) that would result from the enactment of a revenue-based digital tax, strong consideration should be given as to whether these significant up-front costs would be offset by the revenue collected during the short period of time before the OECD issues its long-term, consensus based solution.

[2] https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf

8. **Unilateral taxes raise trade issues.** The proposed digital tax targets foreign digital businesses in both intent and scope. This means it raises a new tariff on trade and will raise trade issues. By arbitrarily and unilaterally changing tax principles on foreign businesses who trade with New Zealand, the country inevitably exposes itself to the risk of retaliation. In support of this argument, we would like to stress on the statement by US Treasury Secretary:

> *"I highlight again our strong concern with countries' consideration of a unilateral and unfair gross sales tax that targets our technology and internet companies. A tax should be based on income, not sales, and should not single out a specific industry for taxation under a different standard. We urge our partners to finish the OECD process with us rather than taking unilateral action in this area".*[3]

9. And in a rare bipartisan statement, Democrats and Republicans from both the US Senate and House of Representatives further said:

> *"Even on an interim basis, unilateral actions, such as digital services taxes proposed by some countries, can adversely affect U.S. businesses and have negative economic and diplomatic effects".*[4]

10. More recently, in response to the France digital services tax proposal, Democrats and Republicans from the US Senate Finance Committee further called on the US Treasury in a bipartisan letter to "consider all available tools under US law to address such targeted, discriminatory taxation", even going so far as to ask the US Treasury to consider the use of IRC Section 891, under which a double rate of US tax could be imposed on citizens and corporations of foreign countries "engaging in discriminatory taxation of Americans".[5]

11. Further, on July 10, 2019, an announcement was made confirming the United States Trade Representative (USTR) has initiated an investigation to explore whether the French law unfairly targets certain U.S.-based technology companies, noting the role OECD can play in reaching a "multilateral agreement", stating:

> *The United States will continue its efforts with other countries at the OECD to reach a multilateral agreement to address the challenges to the international tax system posed by an increasingly digitized global economy.*[6]

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[3] https://home.treasury.gov/news/press-releases/sm534
[4] Grassley, Neal, Wyden, Brady Joint Statement on Unilateral Digital Services Taxes, OECD Negotiations to Address the Tax Challenges of the Digitalization of the Economy, April 10, 2019.
[5] https://www.finance.senate.gov/chairmans-news/grassley-wyden-press-mnuchin-over-french-governments-proposed-digital-services-tax
[6] https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/july/ustr-announces-initiation-section-301

12. Given the current challenges with global trade, particularly between the US and China, it is unusual that New Zealand would expose its exports to heightened risk, and potentially to regulatory tarrifs (being a reported, potential outcome of the French DST tax) by the U.S.[7].. A unilateral approach is even more unusual when considered against New Zealand's long-standing support for a multilateral rules-based trading system. Departing from this approach and introducing a new non-tariff barrier to trade, may also affect New Zealand's trade negotiations. For further discussion on trade implications please see *The Cost of Fiscal Unilateralism*.[8] From the perspective of trade law, the DST is also an indirect tax on services imports and is effectively a customs duty. New Zealand is committed to market access and national treatment on digital services and must prove that the DST (and particularly its quantitative thresholds) are not arbitrarily set to discriminate imported online services. The WTO e-commerce moratorium also prohibits such customs duties.

13. **A digital tax will cost small businesses and exporters.** The Discussion Paper states that "*we expect between thirty and fifty percent of the costs of a DST to be passed on to New Zealand consumers.*"[9] Assuming this is correct and that further costs are not passed through[10] (and that a digital tax applies as described), then it will cost small businesses more to advertise online and exporters more to advertise in other markets. In 2017, 72 percent of New Zealand small businesses had internet sales[11], so it is probable that in 2019 this would be a higher percentage. Most of these small businesses will use online advertising to attract customers. Therefore, based on this and the Discussion Paper's estimate, most small businesses will bear the cost of the new tax when they face increased costs to attract customers. Where New Zealand small businesses are not able to absorb the additional costs, they will be forced to increase prices which will either pass the cost onto New Zealand consumers or make the pricing of their products/services less competitive, potentially impacting New Zealand jobs and overall economic activity.

14. More broadly, the New Zealand Government also seeks to build a productive, sustainable and inclusive economy. The digitalization of the economy has been a key driver of growth and adopting new technologies helps businesses become more productive and lift exports. The Productivity Commission has noted that New Zealand has a productivity challenge and that "[t]*he development and adoption of technologies is a fundamental driver of productivity growth, which in turn can lead to higher wages and living standards.*"[12] It is important that

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[7] https://www.bbc.com/news/world-europe-48945828

[8] The Cost of Fiscal Unilateralism: Potential Retaliation Against the EU Digital Services Tax (DST), European Centre for International Political Economy, November 2018.

[9] Para 3.89.

[10] See also https://itif.org/publications/2019/05/13/digital-services-taxes-bad-idea-whose-time-should-never-come

[11] https://www.mbie.govt.nz/assets/30e852cf56/small-business-factsheet-2017.pdf

[12] https://www.productivity.govt.nz/sites/default/files/Technological%20change%20and%20the%20future%20of%20work_Issues%20paper%20FINAL.pdf, p9.

new taxes do not discriminate against a particular mode of delivery as this has the effect of distorting economic activity, making investments less productive and acting as a disincentive to digital innovation. This is especially important to avoid in a sector such as advertising, which as a service that connects buyers and sellers is a key driver of growth across the economy.

15. **A digital tax is complex to administer**. Defining the scope and application of any new tax is complex - developing definitions with both legal and technological precision is even more complex. A lack of clarity risks "creating inequities between companies competing for similar customers via different methods of delivering a service." For example, what is 'social media', what is a 'content sharing site'?

16. Please refer to techUK submission in the UK that sets out these practical challenges, in particular ***pages 3-10***.[13] The submission sets a premise that the Government's approach to taxation should treat companies equally and should not undermine the digital economy. The submission further states that "Government should avoid any attempt to single out the digital sector for new taxation measures. Such an approach risks not only seriously damaging the reputation of the country as an open and welcoming digital economy, but would create a further fragmented business environment at a time when the wider economy is digitising and using data. The country therefore should act as a leader in driving inclusive reform at an international level to improve transparency for all businesses, rather than seeking short term measures that will create new barriers to investment".

    Key challenges:
    - DST risks making investing in the New Zealand less attractive, increasing costs for consumers and will likely hinder progress towards a long-term global solution.
    - DST risks creating new non-tariff barriers to trade, and there is a real risk that the Government is putting the New Zealand at risk of retaliation from the other Governments that would hurt New Zealand's businesses and consumers.
    - The tax could very likely lead to some unintended outcomes, including increasing costs being passed onto consumers, dis-incentivising investment in R&D and reducing competition.

17. The principle upon which the Discussion Paper seeks to define the scope of the DST, appears to be set out in paragraph 3.22 which refers to those services that "derive much of their value from active user participation." This raises several questions, particularly as broad definitions, such as 'social media', do not reflect whether the business is actually generating value as described. For example:

[13] https://gallery.mailchimp.com/3db897db1506081dc74dd704d/files/df691fd4-2ae1-414b-b858-95cfe4305d8e/Corporate_Tax_and_the_Digital_Economy_Position_Paper_Update_techUK_response.01.pdf

a. How does it apply to people who follow Twitter and Facebook but do not post?
b. How does it apply to people who use a Search engine without signing in?
c. How does it apply to developer sites like GitHub, where software developers engage?
d. How would it apply to a service such as Flybuys where people participate in a points-based scheme, including shopping online?
e. As traditional media shift on online and build payment models based on user engagement including with specific articles, when should the tax apply?

18. **Incorrect Evidence** - ***Para 2.12*** states that "[i]*n Europe, the traditional international business model has an average tax rate of 23.2%, whereas the average tax rate for a digital company is 9.5%.*" This statement is incorrect and should be removed from the analysis along with any views that rely upon it. The authors of the study on which this number was based have dismissed that conclusion and issued this press release. Please note, this was the only evidence supporting the claim of a digital "problem" in the EU DST consultation. For a further discussion, please see *Digital Companies and Their Fair Share of Taxes*.[14]

CONCLUSION

Over the last several decades, a number of developments have allowed multinationals to create globally integrated companies in which cross-border transactions are both more numerous and less tangible. The rise of information technology, including the Internet, has challenged the consensus even further by making it much easier for companies to earn revenue from a country's consumers without having a physical presence there.

Since 2012, the international community has made significant progress addressing the legitimate problems of base erosion and profit shifting. The basic agreements emerged within three years, and over the last three years, countries have made good progress implementing them. The result is a wide consensus that the most serious problems have been addressed.

The growing digitalisation of the economy has raised questions about whether the current international tax framework is "fit for purpose". We encourage the New Zealand Government to continue engaging in the OECD led process for responding to the digitalisation of the economy in order to find a way of restoring the consensus around how to treat multinationals. In our view, interim DSTs are not the answer. Policymakers advocating for DSTs rely on unconvincing explanations of how users in a few business models create value. As such, DSTs are not only capricious and unfair, they introduce a number of destructive distortions into the economy. The net effect of these distortions will likely be a reduction in consumer surplus, economic growth, and innovation. We therefore believe it is economically damaging for countries to impose unilateral taxes on foreign companies simply

[14] Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions, European Centre of Political Economy, February 2018.

because they think the current rules need reform. Instead, we urge the New Zealand Government to continue to engage constructively through the OECD.