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Principal Adviser
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The Treasury
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Dear Sir/Madam,

The digital economy and Australia's corporate tax system

Ai Group appreciates the opportunity to comment on the Treasury October 2018 Discussion Paper *The digital economy and Australia's corporate tax system*.

We also appreciate the potential challenges presented to traditional approaches to taxation presented by increased globalisation and the growing intensity of the digitisation of economic activity.

While others will have much more useful input into more detailed issues relating to the more specific proposals put forward in the Discussion Paper, Ai Group would like to make some more general observations about the approach of the Discussion Paper and some of the issues it raises.

Evidence of the Threats and their Severity

Our first general point is that, while positing threats to the integrity of the Australian tax system, no evidence is presented in the Discussion Paper about whether Australia's tax system is currently being impacted by the range of issues raised in the paper. We are well into the digital age and the extent to which the threats posed by the digital economy are real rather than hypothetical would appear to be fundamental to questions of whether, at what pace, and in what directions Australia's tax system should evolve to mitigate the risks raised in the Discussion Paper.

As a starting point, Ai Group points to the already relatively high proportion of Australian tax that is collected from income tax bases in general and from investment income bases in particular. While this may make Australia more vulnerable to tax base erosion arising from the digitisation of economic activity, the current strength of corporate tax revenues and other taxes on investment income itself is certainly a reason to question whether there is any need for haste on Australia's part.

It may well be the case that part of the explanation of Australia's continuing success at collecting revenue from investment income is due to what the Discussion Paper characterises (at page 12) as "some of the most robust tax integrity rules in the world." This would suggest that our corporate tax system is already comparatively well-fortified and would further call into question the need for haste on our part.

More discussion about the evidence of the proximity of threats is fundamental to the range of issues raised by the Discussion Paper for a range of reasons not the least of which are the potential costs associated with disruption, of system changes and of deterring investment that could, as acknowledged in the Discussion Paper, occur if Australia were to move further ahead of the international community in relation to many of the potential directions raised in the Discussion Paper.

As a point of reference, generally a risk matrix would map the severity of the impact of an event against the probability of it occurring. This would then inform a discussion of appropriate and proportionate mitigation. In omitting a discussion of the proximity of the threats under discussion, the Discussion Paper does not assist in this sort of evaluation.

A Broader Context for the Discussion

As a second general point, we think there is a strong case to consider the tax system implications of increasing digitisation in a much broader context than is examined in the Discussion Paper. The Discussion Paper is limited to the possible impacts on the corporate tax system. While these impacts are no doubt an important part of the overall story, a more fundamental issue concerns the impacts arising from the broader structure of the Australian tax system.

Thus, while the Discussion Paper (at page 6) makes the point that "[f]or countries with substantial consumption taxes the problems associated with allocating corporate income taxing rights between countries can be less significant for the overall revenue base", neither this point nor its potentially important implications are explored further.

We think the discussion on the tax-related implications of digitisation should have a greater emphasis on the potential vulnerabilities to tax system-wide impacts of the digitisation of economic activity rather than only focussing on the corporate tax system. This is particularly the case given the relatively low emphasis we have on consumption taxation in Australia together with the structural forces at work that are eroding the coverage of existing consumption taxes and therefore potentially lifting the vulnerability of the existing tax system to the growing digitisation of economic activity.

Given that actions to further fortify the corporate tax base would have costs, a broader (i.e. system-wide) approach would enable a wider consideration of alternative, and in many cases less costly means of achieving an equivalent lift in integrity and resilience.

General Concerns raised by Members

Ai Group members have raised several general issues of concern with aspects of the Discussion Paper.

- One was the risk of Australia adopting measures that would penalise businesses based on their place of residence. Some were concerned that domestically-based businesses would be disadvantaged relative to foreign-based businesses and others saw measures that would make it more difficult for them to compete with businesses that were domestically based.
- Another set of risks revolved around the prospect of new tax arrangements applying to a subset of businesses for example “highly digitised businesses”. Members raised fears of uncertainty about the classification of businesses and discrimination of tax treatment between competitors (both in their product or service markets and in the markets for inputs);
- Another area concerned the risks of disproportionate action by Australia’s tax authorities and the heightened risks of disproportionality associated with unilateral action and action taken ahead of greater international consensus being achieved.

Comments on Specific Questions

User value creation

While the discussion of the user value creation raises a range of interesting issues, there would appear to be substantial difficulties in valuing and taxing these, generally unpriced, contributions to end-value creation.

The digital economy

Rather than think of a “digital economy” in some sense distinguishable from the rest of the economy, Ai Group’s perspective on the phenomenon is that economic activity is becoming increasingly digitised. This is occurring at different paces in different firms and in different industries.

We do not find the juxtaposition between a “digital economy” and a “traditional economy” useful for two reasons:

- There is a high degree of digitisation of economic activity in what would usually be seen as traditional industries (including mining, agriculture; manufacturing, logistics and construction);
- In industries in transition (and which are not) there is often a wide disparity of digitisation between individual businesses.

Highly digitised businesses

The Paper seeks input on whether Australia's tax system should be changed so that some measures only apply to "highly digitised businesses".

Our firm starting position is that the risk of eroding principles of consistency, efficiency and horizontal equity make us extremely wary of ringfencing in this manner. In the absence of any evidence of benefits that would flow from such a ringfencing we see no reason to shift from this view.

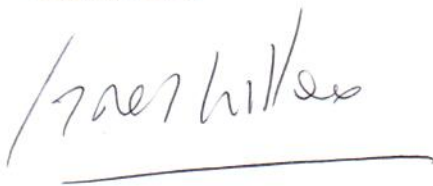
Interim options

Ai Group does not think that a case has been made in the Discussion Paper for Australia to move further ahead of general international practice by pre-empting the direction of a complex international debate and imposing interim measures. In part this is due to what we see as the lack of a convincing case for hasty action. We look at revenue collections and we find it difficult to be convinced that there is a substantial erosion of the corporate tax base at work.

That said, Ai Group supports Australia taking an active role in international discussions and initiatives on these issues and remaining alert to threats to the integrity of our taxation arrangements. We think this should be accompanied by a close watch on the facts at hand and on careful and transparent assessment of the actual and potential impacts of the intensification of globalisation and the increasing digitisation of economic activity.

If you would like to follow up on the issues raised in this submission please contact Ai Group's Head of Influence and Policy, Peter Burn on 02 9466 5503 or at peter.burn@aigroup.com.au

Yours sincerely



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