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30 November 2018

Dear Brendan,

Discussion Paper: The digital economy and Australia's corporate tax system

carsales.com Limited (**carsales**) welcomes the opportunity to make a submission in relation to the Treasury Discussion Paper entitled "The digital economy and Australia's corporate tax system" (the **Discussion Paper**) released for comment on 2 October 2018.

We note that in preparing this submission we have had the advantage of meeting with your team at Treasury's Canberra offices on 21 November 2018.

carsales is making this submission to highlight some of the adverse impacts that an interim measure could have on Australian businesses and on Australia's technology eco-system.

We have set out our detailed comments in respect of some of the questions raised in the Discussion Paper and in respect of these adverse impacts. These comments are set out in the attached Appendices, however, in summary the key points are as follows:

- We acknowledge the importance of having a fair and sustainable tax system and a level playing field for all participants in the Australian economy.
- We also acknowledge that global digitalisation has presented some unique challenges for tax systems and tax regulators worldwide, including in Australia.
- We understand and agree with the desire for Australia to implement an adequate legislative mechanism to counteract behaviours that may erode the Australian tax base.
- We strongly encourage the Government to continue to work with other countries, through the G20 and the OECD, to develop sustainable, multilateral responses to address the challenges to our tax systems arising from digitalisation and to ensure Australia's tax base is not eroded.
- We believe the only way of achieving a globally fair, consistent and sustainable outcome is to target multilateral consensus in respect of taxing the digital economy.
- A unilateral approach will potentially put Australia at risk of falling further behind other leading OECD countries in the development of its technology eco-system.

- From a policy perspective, it is imperative that the Government implements policies that:
 - Support new ideas and new technologies;
 - Encourages and fuels startup enterprises, particularly tech starts ups;
 - Does not stymie innovation and does not drive start-ups offshore; and
 - Does not undermine Australia's competitiveness as a destination for investment in digital technology.

- The past decade has seen dramatic advances in science and technology. Advances in technologies (and what society does with them) will continue to drive the world forward, and we must all play our part in ensuring these advances continue.

- Before introducing an interim Digital Services Tax (DST), it is important to understand the various dynamics and macro-economic issues impacting digital businesses in Australia. These issues are set out in Appendix A.

- We are concerned Australian businesses (that are already paying a fair and equitable amount of tax in Australia) will be unfairly penalised and adversely impacted disproportionately to their global competitors or potential competitors if an interim DST is adopted.

- As the Government would appreciate, the purpose of any rules (whether interim or permanent) would be to capture income that may otherwise be escaping the Australian tax net. carsales and other comparable Australian technology businesses do not have any revenue currently escaping that net and in the absence of a full Australian tax offset or credit for the DST, Australian businesses (such as carsales) would be subject to double taxation.

- Whilst we categorically do not support the introduction of an interim DST, either here in Australia or in any other jurisdiction, if Treasury were to introduce such a tax, we are strongly of the view that it should contain a number of key features (including deferred introduction, a hardcoded sunset date and a high de-minimis threshold) and these recommended features are succinctly discussed at Appendix B.

We welcome the opportunity to discuss our submission with you and to engage in further consultation as any specific measures are designed and refined. If you have any questions concerning our submission please do not hesitate to contact myself or Matthew Guy, Head of Tax & Treasury on 03 9093 4581 or 0402 319 736.

Yours sincerely



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About carsales

Founded in 1997, carsales.com Limited (ASX: CAR) operates the largest online automotive classifieds business in Australia. The carsales network is the number one online destination for buying and selling cars, motorbikes, trucks, boats, caravans and machinery equipment. In addition to providing the number 1 online automotive marketplace, carsales also offers advertising solutions and data services. Employing over 1200 people around the world, carsales develops world leading technology and advertising solutions from its head office in Melbourne, Victoria.

Appendix A

The Broader Context

Overview

We acknowledge the importance of having a fair and sustainable tax system and a level playing field for all participants in the Australian economy.

We also strongly believe that all businesses in Australia must meet their tax obligations and do so in a transparent and responsible way.

Whilst a robust tax system, and adequate legislative mechanisms to counteract behaviours that may erode the Australian tax base, are vital, importantly our tax system must ensure that the Australian economy (including the technology eco-system) remains strong and continues to grow, particularly as the world becomes more and more reliant on the internet of things and new technologies. Given that, it is critical that government policy does not hinder trade and investment and must not stymie innovation and growth.

We also acknowledge that global digitalisation has presented some unique challenges for tax systems and tax regulators worldwide, including in Australia.

To effectively and equitably deal with these challenges, International Tax Reform is necessary and particularly necessary so as to ensure Australia is competitive in comparison to other international markets and is an attractive place to invest.

We must not create disincentives for start-ups, growth companies and loss making enterprises (particularly technology starts ups) to remain and grow in Australia.

The past decade has seen dramatic advances in science and technology. Advances in technologies (and what society does with them) will continue to drive the world forward, and we must all play our part in ensuring these advances continue and Australia is at the forefront of the same.

The importance of a strong Australian digital economy

The digital economy is developing rapidly worldwide and opening up new opportunities for traditional industries, driving competition, innovation and productivity, fuelling job opportunities and promoting economic growth.

The Australian economy has traditionally been based around physical industries such as manufacturing, construction, mining and agriculture. With the rise in digitalisation, innovation and growth in new technologies are creating opportunities and disrupting business models across all sectors of the Australian economy.

Investment in the digital economy is therefore critical to help fuel Australia's economic growth. By embracing the digital economy, Australia can improve its competitive positioning and accelerate productivity. This shift has the potential to create jobs and improve economic growth, provided adequate investment into the digital sector can be generated in future.

Whilst compared to other OECD countries, our digital and technology eco-system is small, carsales has been encouraged by the growth in the digital eco-system over the last 5-7 years. Leaders in our business (and in our online peers) are mentoring the next wave of digital and technology entrepreneurs. There are now a number of focus groups for like-minded people to discuss digital topics and problems, universities are jumping in and there are more VC funds supporting new ideas and new technologies than ever before.

The continued growth and evolution of this eco-system is imperative and Government must implement policies that encourage and fuel further progression and expansion in this sector. A healthy and vibrant ecosystem helps in the attraction, retention and motivation of employees, with positive employment outcomes helping to stimulate economic growth.

Australian digital success stories are very small in global terms

To date, Australia has a handful of digital platform successes, including carsales, REA Group and SEEK.

Collectively, carsales, REA Group and SEEK represent Australia's largest and leading digital platform organisations, representing approximately 48% of the total market capitalisation of the top 100 Australian Stock Exchange (ASX) listed companies in the Information Technology sector¹.

Although carsales, REA Group and SEEK are some of Australia's largest technology companies, in comparison to the world's largest technology companies they are relatively small. The foreign based multinationals have access to significant financial resources, have significantly bigger R&D budgets and have revenue levels that dramatically exceed those of carsales and its online peers. For contrast, the aggregate investment in R&D of American e-commerce and cloud computing company Amazon.com is approximately 40 times more than the current global revenue of carsales.

With the rapid growth and expansion of digitalisation, Australian businesses are increasingly competing in the same global marketplace as other international companies. The nature of the digital economy means that there are generally reduced geographical barriers to market entry. Low barriers to entry to the Australian market have allowed foreign competitors to disrupt many Australian companies and erode market share.

Larger foreign multinational companies have the ability to seamlessly leverage their size and scale advantages. For example, some foreign multinational companies are able to participate in Australia as a loss leader for a sustained period to ensure market share is captured.

Lastly and importantly, consumer expectations are benchmarked against the experience provided by these foreign multinational companies and it is critical that Australian businesses have the resources, financial support and capability to complete.

Australian Digital Businesses already paying a fair and equitable amount of tax in Australia

carsales and other comparable Australian technology businesses are already paying a fair and equitable amount of tax in Australia.

Tax reforms would generally be pursued to counteract behaviour that has the potential to erode tax base.

Tax reforms for the digital economy would have the purpose of capturing income that may otherwise be escaping the Australian tax net.

carsales and other comparable Australian technology businesses do not have any revenue currently escaping that net and in the absence of a full Australian tax offset or credit for the DST, Australian businesses (such as carsales) would be subject to double taxation.

Our reported effective tax rate (ETR)² has been in the range of 30-31% for the last two financial years and based on our entity tax information published by the ATO for the 2016-17 financial year, Tax Payable as a percentage of Taxable/Net Income was 26.85% (noting FITO's and R&D Tax Concession drive this number lower than our reporting ETR)³.

¹ S&P/ASX 100 Index (1 November 2018)

² Reported ETR adjusted for non-taxable associate gains and losses and impairment losses

³ Sourced from Annual Returns and other publicly available documents

In the absence of appropriate safeguards, if an interim DST were to be implemented, businesses that are already paying Australian corporate income tax at a rate of 30% could be subjected to a second layer of tax on the same income, in the form of the DST. This double layer of taxation would have a punitive effect and could adversely impact carsales and other comparable Australian technology businesses disproportionately to their global competitors or potential competitors.

Features of the carsales business model

The current international corporate tax system essentially determines taxing points by reference to the existence of an entity's physical presence in a country.

Given global economies have evolved and are becoming highly digitalised, the value created from user participation is not necessarily being captured by the current international corporate tax system. This is because digital business models generally do not require any physical presence in a country in order to achieve revenue generation or value creation in that country.

Nonetheless, there is a common misconception that all companies which operate digital platforms derive revenue from similar sources and operate identical business models. The business models of carsales, REA Group and SEEK are fundamentally different from many of the large foreign multinational digital businesses.

Carsales derives value from the inherent nature of its platforms. Revenue is derived from the listing of goods and services (similar to traditional advertising). The majority of revenues are derived from being the intermediary between a buyer and a seller as has been the case in print media for many years. In other words, a customer lists their motor vehicle on our website and consumers subsequently browse the website in search of this commodity. Our goal is to ensure buyers, sellers and owners have a rewarding outcome.

Revenues are predominantly impacted by the demand of consumers rather than from any user generated content.

The intrinsic value of our revenues are inextricably linked to our self-generated intangible assets, for example our technology stack, our customer relationships and importantly our brand. We invest heavily in product and technology development and marketing in order to remain competitive globally.

carsales registers and locate its intellectual property (IP), being the source of its revenues, in Australia. All of the IP associated with carsales' Australian digital portals was originated, developed, held and is owned in Australia by Australian companies. However, IP owned by large foreign multinational digital businesses and relating to user generated content is often located offshore in a lower tax jurisdiction.

With the increase and growth of highly digitalised businesses in the global economy, the current international tax rules may not be able to capture business models that profit from digital services in a country without being physically present. However, without a deep understanding and thorough analysis of the various business models used globally, how value is created and the role of data and users, we believe the imposition of interim measures via a DST will unduly penalise and burden Australian companies that are already paying their fair share of tax and are very small in global terms.

Potential Impact of a Digital Tax

As already highlighted in our submission, if an interim DST were to be adopted without appropriate safeguards, Australian businesses (such as carsales) would be subject to double taxation. Depending on definition of in scope revenue, this could result in a substantial increase in reported effective tax rate.

If the definition of in-scope revenues were to include all Australian marketplace revenue (including commission revenues), it is forecast⁴ that carsales' ETR would increase from 30.9% to 36.0% (an increase of circa 5%) and we anticipate other comparable Australian technology businesses would be similarly impacted.

These forecast increases in ETR of over 5% are excessive and would result in the creation of competitive disadvantages for Australian headquartered digital companies that already have the vast majority of their total group income subjected to Australian income tax.

This would be inappropriate and appears to be at odds with the underlying objectives of the DST, which is to ensure a fair and sustainable tax system and capture income not already captured by the Australian tax net.

In the event of double taxation, the Board of carsales would be faced with a difficult (and somewhat unpalatable) decision as to whether this additional tax is ultimately borne by shareholders, is explicitly passed onto our customers in the form of a price rise (or levy) or whether carsales would need to reposition cost base (including contemplating reducing investment in R&D and jobs) to counter the adverse impact of the DST (or a combination of all three).

In any scenario, this will have negative downstream impacts. A reduction in group profits would impact Australian based super funds, investment funds and retail shareholders through reduced dividends. Price rises or levies or changes to R&D investment or jobs will obviously impact labour markets, job creation, attracting talent, innovation, the digital eco-system and to the economy in general, at a time when Australia's economy is currently facing high household debt, high energy costs, stagnation in real wages growth and lower productivity growth.

We are also concerned that this double taxation could:

- Illicit behaviour that is inconsistent with the core principle of having a fair and sustainable tax system;
- Result in the restructuring of operations to mitigate (or avoid) the adverse impacts of the tax;
- Have a detrimental effect on the technology eco-system, at a time when investment in the digital economy in Australia is absolutely critical to help fuel economic growth; and
- Have a comparably harsher impact on Australian based technology companies than foreign based international technology companies given significant differences in business model and size.

carsales, REA Group and Seek are all leaders in online classifieds in their respective segments. It is important that these companies continue to represent Australia as a country in which technology businesses can thrive, are encouraged and are not disadvantaged compared to their international competitors.

⁴ Modelling of the impact of in-scope revenue is based on the FY18 financial data of carsales and assumes a 3% rate and that the DST is not creditable and not deductible.

The Australian tax landscape

Australia now has one of the highest corporate tax rates in the OECD. Whilst almost every other OECD country has lowered its headline corporate tax rate in recent years, Australia continues to impose tax at a rate of 30% on all companies with aggregated turnover of more than A\$50 million.

In addition, Australia has recently introduced a number of integrity measures in response to the OECD's Base Erosion and Profit Shifting (BEPS) project, such as the Multinational Anti-Avoidance Law (MAAL), the Diverted Profits Tax (DPT) and, most recently, the anti-hybrid rules. These new rules, combined with the range of pre-existing integrity measures such as Part IVA, transfer pricing rules, thin capitalisation rules, and controlled foreign company rules mean that Australia has some of the most robust tax rules applicable to companies globally.

It is arguable that further attempts to broaden and deepen the income tax base in Australia, such as through the imposition of a DST will provide a disincentive to establish or maintain a digital business in Australia. This is particularly relevant given digital businesses generally rely on intangible assets to generate their value, rather than physical attributes, and therefore they are highly portable and mobile.

It is critical that Australia does not undermine its attractiveness and competitiveness as a destination for investment, and particularly for investment in digital technology. Otherwise, Australia is at risk that investment (and/or incubation of new ideas) will move offshore as organisations prioritise other countries that have lower labour costs, better incentivise R&D and innovation and offer lower corporate tax rates.

Longer Term Reforms

We also acknowledge that global digitalisation has presented some unique challenges for tax systems and tax regulators worldwide, including in Australia.

We are concerned however that unilateral action, countries acting alone, and/or countries acting in haste, will almost certainly result in unintended consequences.

The introduction of an interim DST in Australia will result in double taxation to Australian businesses and potentially risks reducing competitiveness and deterring investment in Australia.

Consequently, we strongly encourage the Government to continue to work with other countries, through the G20 and the OECD, to develop sustainable, multilateral responses to address the challenges to our tax systems arising from digitalisation and to ensure Australia's tax base is not eroded, and not introduce an interim DST.

Complex issues such as changing taxing rights, attribution and deeming presence need to be thoroughly explored and analysed and a deep understanding of the value chain in the digital economy, and the role of data and users in this value chain, must be obtained before any reforms could or should be considered and effected.

The fairest and most optimal approach would be to work towards international co-operation and agreement.

Appendix B

The proposed features of any interim measure

Whilst we strongly believe an interim measure should not be introduced, should Treasury proceed with the introduction of an interim measure, we believe the following key features should be included:

1. *Deferred introduction and hardcoded sunset date*

Sunset Date

- An interim measure, if adopted, should only apply until such time as a global consensus-based solution is developed.
- Any interim measure should therefore have a clearly defined and hardcoded sunset date to avoid it becoming a de facto permanent solution.
- A sunset clause of no later than 3 years from introduction should be included in any measure or, if that is not possible, a rolling review period of 12 months after each of which the Australian Government could assess the impact of the measures and whether they should be kept in force.

Introduction

- It is critical that the Government provides certainty in relation to the application of any interim measures well before the effective date of application.
- The effective commencement date for any interim measures should be set far enough in advance to give taxpayers sufficient time to determine the likely impact of the rules and to implement suitable systems and processes that will ensure compliance.
- For these reasons, we strongly recommend that, should interim measures be pursued, the Government implement the rules to take effect no earlier than 12 months after the relevant Bill receives Royal Assent, to provide taxpayers enough time to address any systems and compliance requirements arising from the measures.

2. *Basis of taxation*

We understand that Treasury does not wish to impose a DST in the form of an income tax, as such a tax would become subject to double tax agreements, which would limit the impact of such a tax in practice. Therefore, we understand that any interim measure introduced in Australia is likely to be turnover based tax (i.e. an indirect tax, levy or excise). Whilst this is understandable at a policy level, the levying of an impost on the basis of revenue demands an exercise of caution. In particular, we note:

- It can be difficult in a digital environment to identify the jurisdictional nexus of income and the appropriate attribution of such income to a particular jurisdiction. Any interim measure must, therefore, carefully define the concept of in-scope revenue in a way that is fair and reasonable to taxpayers. This is discussed further in section 3 below.
- Thresholds should be available for small, low profit or no profit taxpayers to ensure that start-ups, growth companies and loss making enterprises are given relief from the measures and, therefore are not impeded from developing and innovating new digital services to Australian customers. These parameters are discussed further in sections 4 and 6 below.
- A tax rate applicable to revenues translates into a higher effective rate on profits. Australian companies are already subject to 30% income tax on their digitally generated profits, and any additional tax on revenues will impact the competitiveness of Australian businesses to international markets. The concept of rate is discussed further in section 5 below.
- Wherever possible, the design features of any interim DST should eliminate the potential for any double taxation of income or profits. Ideally, this should be in the form of an offset or credit mechanism. The absence of such a measure will disproportionately impact Australian headquartered groups relative to foreign controlled groups. This is discussed further in Section 7 below and in Appendix A.

3. Definition of “in-scope” revenue

Defining the concept of in-scope revenue is one of the most important issues in the design of an interim DST because this sets the extent to which technology companies and the broader Australian economy are impacted by these measures.

We recommend that the definition of in-scope revenue be limited to third party revenues from advertising directed to Australian consumers and to the related sale of consumer data. An example of such revenue would be revenue derived by a digital business every time a consumer based in Australia clicks on a third party advertisement on their website. An example of revenue that should not be in-scope would be revenue derived from the listing of goods and services or specific assets such as cars, boats and bikes, real estate and job vacancies. In our view this approach is consistent with the stated policy intent of taxing the value that a company derives from a jurisdiction due to its user base.

To define in-scope revenues more broadly (e.g. to include all revenues arising from a marketplace, including commission income from marketplace sales) would capture a disproportionately high proportion of revenues of carsales and its online peers, when compared with some of the largest foreign multinational digital companies. This would be inappropriate and at odds with the underlying objectives of the DST, which is to ensure a fair and sustainable tax system.

4. Threshold(s)

We are strongly of the view that a high *de minimus* threshold should apply to limit the types of organisations that are subject to any interim measures.

Start-ups, growth companies, loss making enterprises and small businesses that are at an earlier stage in their business lifecycle should not be subject to the same taxation measures that are intended to apply to larger businesses in a stronger financial position.

Importantly, any threshold imposed should apply equally to both domestic and foreign businesses to avoid discrimination.

Any such threshold should also be calculated by reference to in-scope digital revenues only, and not by reference to all revenues, so to appropriately target the imposition of the DST and avoid unfairly capturing entities with significant activities outside the scope of the DST.

The turnover threshold needs to be significant enough that it only applies to substantial entities with substantial in-scope revenue.

The Australian tax framework contains a number of different threshold tests, which apply in different contexts and these generally rely on an annual turnover test. For example, a A\$1bn turnover threshold applies to “Significant Global Entities” (SGE) which is a concept that is now used for a number of purposes including marking the threshold for companies that need to prepare Country by Country (CbC) reports for the Australian Taxation Office.

We submit that a high *de minimus* threshold of A\$1bn should apply to determine those taxpayers that are subject to any interim DST. Only in-scope revenues generated from digital sources should be considered when measuring whether an entity exceeds the *de minimus* threshold.

We note that in the proposed measures announced in the UK recently, UK authorities are proposing that their digital services tax will only apply to groups that generate global revenues from in-scope business activities in excess of GBP£500 million per annum.

To the extent the grouping measures are used to calculate turnover thresholds, we strongly recommend that “independently operated” start-ups are carved out of the application of the rules, even if they are partially or fully owned by corporate groups that exceed the *de minimus* threshold (subject to appropriate integrity measures). It would not be appropriate for such start-ups to be subject to the DST merely because they are wholly or partly owned by a large multinational group rather than positioned as a standalone entity.

5. Rate to be applied

Only a very limited group of countries have already imposed a DST or have explicitly outlined their plans to impose a DST. Of the jurisdictions that have already progressed down this path, the features of a significant sample of the proposed regimes are outlined below, including the applicable rates that have been proposed: -

- The European Commission has proposed a 3% DST on taxable revenues;
- The United Kingdom has proposed a 2% DST on annual in-scope UK revenues;
- Italy has introduced a new 3% tax on digital services provided to Italian companies and permanent establishments;
- Indonesia has proposed to introduce a 0.5% tax on digital economy transactions; and
- India applies a 6% equalisation levy on specified services.

We submit that India is an outlier in the rates listed above.

Should any interim DST be seen as necessary in Australia, a realistic rate would be in the range of 2-3% and this range is consistent with most of the precedents listed above including the rate of 2% as proposed by the UK.

A higher rate of tax on revenues will translate into a much higher effective rate on profits (and is highly dependent upon the margin of the business). Accordingly, an interim DST rate exceeding this 2-3% range would be inappropriate for a country like Australia which already features a comparably high headline rate of corporate income tax.

6. Exclusions / carve outs

The DST architecture should be consistent with a fair and sustainable tax system, and should not create any adverse impacts for start-ups, growth companies, loss makers or small businesses.

To the extent the *de minimus* threshold discussed above (see section 4) does not have the effect of limiting the DST to its intended targets, specific exclusions or carve out provisions should be incorporated into the rules for start-ups, small businesses, unprofitable companies, low profit companies and independently run subsidiaries of larger multinational groups that are inadvertently exceed the *de minimus* threshold.

Such exclusions and carve outs should ensure that small entities or entities with relatively low profitability do not bear an unfair economic burden by being unfairly taxed.

7. Mechanisms for avoidance of tax

Unless appropriate safeguards are implemented, businesses that are already paying Australian corporate income tax at a rate of 30% could be subjected to a second layer of tax on the same income, in the form of the DST. This double layer of taxation would have a punitive effect and would erode the international competitiveness of companies like carsales and its online peers that already pay Australian income tax on the majority of their total group income.

Therefore, we strongly recommend that any DST paid should give rise to a non-refundable offset or credit against the Australian income tax otherwise payable (and should be available for carry forward where the amount of offset/credit exceeds the income tax payable), provided the revenue subjected to the DST is also included in the calculation of the entity's taxable income in Australia.

If the entity that is subject to the DST does not pay income tax in Australia on the income that is subject to the DST, then no credit or offset should be available in Australia for the DST paid (as there is no risk of double taxation).

This mechanism should ensure that Australia would raise additional revenue from digitalised businesses that generate value from Australia but do not already subject a proportionate component of their global revenues to income tax in Australia to reflect that value generation.

8. Systems and process issues

In designing any interim measure, Treasury should be mindful of administrative burden and not requiring taxpayers to dedicate significant levels of resourcing on the development of systems and processes.

Ideally any DST architecture should leverage existing systems, processes and filings that are already undertaken by taxpayers (for example, through the business activity statement / GST process).

