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29 November 2018

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## EY Submission on the Treasury Discussion Paper on the Digital Economy and Corporate Taxation

Dear Treasury team

EY values the opportunity to comment on the Australian Treasury Discussion Paper on the Digital Economy and Corporate Taxation (**DP**).

We note that the DP is issued in the context of a framework of global multilateral policy discussions that include the G20 and the OECD Task Force on the Digital Economy (**TFDE**) in which the Australian Government with Treasury are proactive participants. Those discussions continue to work towards a long-term consensus based approach to updating international tax norms as the digital economy effectively becomes the global economy.

The TFDE interim OECD March 2018 report "Tax Challenges Arising from Digitalisation - Interim Report 2018" (**OECD interim report)** outlined the complex issues, different views and work continuing to seek a consensus solution. These approaches proceed consistent with the Ottawa Taxation Framework developed by the OECD, that the same principles that apply to the taxation of conventional commerce should equally apply to e-commerce, namely neutrality (taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce), efficiency, certainty and simplicity, effectiveness and fairness, and flexibility.

U.S. Treasury Secretary Steven Mnuchin stated on 25 October 2018 concerning digital tax proposals that the U.S. "Treasury is working very closely with the OECD and our counterparts there to address issues of base erosion and fair taxation. We believe the issues are not unique to technology companies but also relate to other companies, particularly those with valuable intangibles. I have instructed our team to continue their efforts in the OECD so that we can make progress on these issues quickly" [i].

The December 2018 meeting of the TFDE will discuss proposals which are being developed, to put proposals to governments and the G20 in the next Interim Report due in June 2019.

We note that the DP acknowledges the "enormous benefits" that digitalised businesses provide to Australia (para 1.2) and it is in this context that we fully understand and support the significant progress apparently being made to improve the taxation framework for the global digital economy that would apply broadly without the negative economic impact of taxes that seek to discriminate against specific activities. The OECD's Director for Tax Policy, Pascal Saint-Amans, stated in an article published in the lead up to the G20 Meeting in Buenos Aires on 30 November 2018, the OECD is now "confident the 2020 final report should bring a common position"[ii].

The OECD interim report: *Tax Challenges Arising from Digitalisation* issued in March 2018 noted that while the work towards a consensus and rules based response to such challenges continues, various countries might be driven by domestic political pressures to consider implementing unilateral interim taxing measures. These include imposing digital services excise-type taxes in relation to digital transactions (**DSE**). The OECD interim report identified that these create risks. Similarly, we see interim taxes as a risk for Australia and its economy.

As an overall observation we believe that Australia should resist moves for unilateral imposition of expedient and inefficient new taxes and should instead remain focused on working towards meaningful improvement of international tax rules to make them fit for purpose in a digital economy.

Based on this concern our submission focuses on the impact of interim measures.

We note that discriminatory indirect tax regimes targeting a particular form of consumption can be directed at activities which are perceived to give rise to a societal cost. Such taxes are generally justified to curb consumption and/or to fund responses to consequences of consumption (eg tobacco, liquor, fossil fuels, gambling, carbon emissions). A DSE would be unusual in targeting activities that are generally perceived as making a positive contribution to the economy.

We welcome that page 23 of the DP clearly identifies some of the potential adverse outcomes of any interim measure:

> *"The OECD has also indicated that the policy responses to these challenges are likely to be imperfect. Accordingly, any interim measure:*
>
> - *would need to apply to both domestic and foreign businesses (to comply with WTO and other international obligations), and so could result in over-taxation where an interim measure applies to Australian businesses in addition to corporate tax;*
> - *may increase the cost to Australian businesses and consumers of digital products and services that are covered by the interim measure;*
> - *may have an adverse impact on investment, innovation and welfare, for example by distorting the choices of Australian consumers and businesses, or by changing the way in which digital products and services are provided; and*
> - *may have relatively high compliance and administrative costs."*

The DP suggests for discussion that "[u]nilateral action may be the only way to address concerns regarding the taxation of digital businesses in the near term." For the reasons set out below we do not agree. We believe it would achieve few if any of the stated objectives and come at a cost to consumers, targeted Australian taxpayers and the economy generally.

Our feedback is provided in summary form. We would be happy to expand upon and discuss our views as part of any ongoing consultative process in relation to the matters raised by the DP.

**EY feedback**

- A DSE would not be expected to be an interim measure. Based on previous experience, if such a tax were to be introduced, implemented by taxpayers, absorbed by the market, and become a contributor to Government revenues the likelihood of it being repealed should be regarded as low. Its efficacy should therefore be tested on the basis that it would become a long-term feature of the Australian tax system, including the abovementioned impact on costs to businesses and consumers, adverse impact on investment, innovation and welfare, compliance and administrative costs.

- Any move by Australia to impose a DSE as a form of taxation that clearly conflicts with existing international tax principles designed to prevent double taxation and provide a tax-neutral global investment environment would be a cause for significant concern. A departure from existing norms, especially if done in a non-coordinated manner would be harmful to cross-border investment and economic growth.

- A DSE will be, or will be perceived to be a discriminatory tax targeted at large US companies operating in a narrowly defined sector of economic activity. U.S. Treasury Secretary Mnuchin in

his statement highlighted "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."

The U.S. Senate wrote to the EU to highlight the discriminatory nature of the EC proposals on 18 October, highlighting:

> *"The EU DST Proposal has been designed to discriminate against US companies and undermine the international tax treaty system, creating a significant new transatlantic trade barrier that runs counter to the newly-launched US and EU dialogue to reduce such barriers… non-EU companies with little or no footprint in the EU … would effectively fall outside the proposal's scope, further enhancing the legal problems with the interim proposal... the proposal contains no end date and could conceivably last indefinitely. In the unlikely event the EU DST Proposal is approved as an interim measure, taxpayers and taxing authorities would be required to develop new, complex, and costly tax collection and compliance systems, which would be discarded once international consensus is reached.*
>
> *… Given these many issues, and the potential for long-term harm arising from the EU DST Proposal, the EU should refocus its efforts away from this interim tax measure and back on reaching consensus with other leading economies … for the development of a policy that will guarantee fairness, avoid discrimination, and prevent double taxation."* [iii]

- Australia should be concerned with the risk of contributing to the escalation of current trade conflicts and possibly retaliatory measures.

- The scale of this risk needs to be weighed against the overall low levels of revenue to be realised from non-resident multinational enterprises as a result of a DSE, the potential for punitive non-creditable, non-frankable taxation of Australian based companies that could be subject to such taxes, in addition to their existing income tax obligations.

- A DSE would have potential extra-territorial reach beyond existing norms of international taxation. For example it has the potential to attach to revenue earned by non-resident enterprises from non-resident customers based on a novel concept of 'user-created value' in respect of Australian users. Not only does this depart from taxation based on residence and source, or permanent establishment, it also departs from principles of neutrality as it would be targeted at specifically defined business activities. Such a fundamental departure from existing principles of taxation should only be pursued through a broad consensus approach. This further emphasises why Australia should therefore continue to act as part of the global multilateral initiative to address structural deficiencies in the international tax system in a digital age.

- A DSE would not achieve any objective of making foreign multi-national enterprises 'pay their fair share of tax.' It would not ultimately be likely to be borne by the suppliers of relevant digital services. As a low rate, low transaction value, high transaction volume tax, it would lack transparency and could be expected to be readily and fully passed on to consumers in Australia and elsewhere in the cost of such digital services.

- As well, proposals to allocate taxing rights based on user location or local market participation create a risk to Australia's export revenue base. Destination based taxation need not be limited to digital services. If taxes based on gross revenues become a global norm that do not offend WTO principles because they are levied comprehensively with thresholds drawn to effectively give relief to domestic taxpayers their scope can easily be expanded. The DSE scope expansion is not just domestic. A DSE could also contribute to creating a precedent for other

countries that harms Australian exporters.

- Departing as it would from the existing framework for cross-border taxation the DSE, and the proliferation of similar taxes in other jurisdictions, will result in cascading over-taxation. Over-taxation would include:
  - Over-taxation of domestic companies with some additional form of tax on turnover on top of Australian corporate tax, with the potential for punitive 'non-creditable', 'non-frankable' taxation of Australian based companies which are already subject to Australian income tax rules and that could be subject to the tax.
  - The UK has proposed a DSE and has identified it is not integrated with international transfer pricing law and practice, and has raised many issues for development.
  - Over-taxation would arise as multiple jurisdictions seek to tax the same revenue but without the allocation constraints of existing tax treaty based norms.

- Similarly, a DSE could in some cases apply to taxes covered by agreements concluded between the ATO and taxpayers as a result of tax audit settlements and Advanced Pricing Agreements. This would undermine both any revenue projections to be attributed to a DSE and Australia's tax compliance settlement processes.

- A DSE does not account for the fact that many enterprises within scope could have very different margins and as such it would be inherently unfair. The UK's discussion paper on a proposed DSE recognises that taxation must be based on value creation – net income not merely turnover.

- A DSE would require a major investment of time and resources to create certainty for businesses, for consumers and for the tax administration, including extensive law development processes including dispute resolution processes. All of these would add compliance cost and complexity to businesses that would be passed on to consumers. This cost would be significant relative to the modest amounts of tax likely to be raised under the measure. The concept of 'user created value' contemplated as a basis for a DSE is not one that would be expected to currently be reported in product line, service line, market segment, or geography based financial reporting and would be expected to require costly changes to existing enterprise financial systems. This cost is amplified where countries consider instituting differing DSE models. Such cost would seem to be even more difficult to justify if the DSE actually were to be an interim measure.

- While depending on the rate, the defined scope, the existence of safe harbours, and the application of thresholds, the tax collected under a DSE regime is unlikely to have a material impact on Australian revenue. This also gives greater weight to the issues of increased compliance costs, increased costs to consumers, and the potential tax cost to domestic companies that would shift part of their tax burden from frankable corporate income taxes to an excise tax.

- Further, an additional tax burden on domestic companies through the introduction of a DSE in addition to their existing income tax obligations will significantly impact their ability to continue to compete within a global market.

In summary we believe that targeted taxation regimes such as a DSE or similar regimes will be perceived as being selective and discriminatory; will lead to cascading over-taxation; will not promote growth and equality in the global economy; will undermine Australia's reputation as an attractive market in which to invest; and have a significant impact on domestic companies subject to the DSE. These are

at odds with the Ottawa principles which the international community adopted, and conflict with and distract from the development of adjusted multilateral income tax principles.

We stress the importance of:

- A thorough and principled analysis of the tax policy options notwithstanding any political imperative to be seen to be tough on taxing multinational enterprises. Australia already has a justifiably robust reputation in this regard;
- Australia continuing to participate in a measured and coordinated approach to the evolution of the global tax system through the existing OECD/G20 Framework to develop a tax framework that continues to apply long-established international tax principles; and
- A recognition of the negative aspects of discriminatory, sector or business model specific tax regimes.

Please contact Alf Capito on (02) 8295 6473 in the first instance to discuss this further.

Yours sincerely

Alf Capito

Oceania Tax Policy Leader

Copy to: The Hon Josh Frydenberg MP, Treasurer

The Hon Stuart Robert MP, Assistant Treasurer

[i] Secretary Mnuchin, Statement on Digital Economy Taxation Efforts, 25 October 2018 https://home.treasury.gov/news/press-releases/sm534

[ii] G20 meeting booklet to be distributed to all meeting participants ahead of the 30 November G20 meeting in Buenos Aires, Argentina at page 130 - https://bit.ly/G20BuenosAires

[iii] Letter by the United States Senate Committee on Finance dated 18 October 2018 to The Hon Donald Tusk, President of the European Council and The Hon Jean-Claude Junker, President of the European Commission, https://www.finance.senate.gov/imo/media/doc/2018-10-18%20OGH%20RW%20to%20Juncker%20Tusk.pdf