PITCHER PARTNERS

Pitcher Partners Advisors Proprietary Limited
ACN 052 920 206

Level 13, 664 Collins Street
Docklands, Victoria 3008

Level 1, 80 Monash Drive
Dandenong South, Victoria 3175

Postal Address
GPO Box 5193
Melbourne, Victoria 3001

Tel +61 3 8610 5000
Fax +61 3 8610 5999
www.pitcher.com.au

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Principal Adviser
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By Email: *corporatetax@treasury.gov.au*

Dear Principal Adviser

THE DIGITAL ECONOMY AND AUSTRALIA'S CORPORATE TAX SYSTEM

1. Thank you for the opportunity to provide comments on the Treasury Discussion Paper titled The Digital Economy and Australia's Corporate Tax System ("**Discussion Paper**").

2. Pitcher Partners specialises in advising taxpayers in what is commonly referred to as the middle market. Accordingly, we service many taxpayers that would be impacted by any changes the Australian corporate tax system.

3. Our submission contains high-level comments in response to certain proposals contained in the Discussion Paper, rather than providing answers to specific questions posed therein.

4. We believe that Australia should wait until a broader international consensus is reached whereby a significant number of jurisdictions agree on how to allocate taxing rights in relation to enterprises that have a sufficient economic (but not physical) presence in another country. Therefore, if any unilateral interim measures are adopted, these should be limited in scope and be designed in a manner that can be easily transitioned once international consensus on a longer-term solution is reached in a manner that would not create significant costs of compliance and administration.

5. We share Treasury's concerns that any interim measures that were to apply to all businesses would impose an undue cost on small businesses in Australia who would bear the burden of collecting the tax and/or face higher pricing for digital services.

6. It is our view that the value of intangible assets is appropriately taken into account by the current domestic and international corporate income tax system through the

current transfer pricing rules. Consequently, we believe the arm's length principle underpinning our transfer pricing rules for determining the value attributable to intangible assets is more appropriate than a "formulary apportionment" approach or any deemed source rule that would allocate value to the jurisdiction where the consumers are located rather than where the intellectual property is created.

INTERIM OPTIONS

General Comments

7. We recognise that there has been a focus in recent years to ensure non-resident enterprises importing goods and services to Australian users were not benefitting from an advantage not available to their Australian competitors by not paying their fair share of tax. Measures have since been implemented from a GST perspective that capture revenue on business-to-consumer transactions with further proposed measures that will expand the scope of GST to offshore accommodation booking services. Therefore, we believe that any new measures should only apply to business-to-business transactions.

8. As a general principle, we believe that any new interim measure should be a direct tax on the income of the non-resident enterprise that fits within the current income tax framework as this would most likely allow the provider to claim an income tax credit or exemption in their country of residence in relation to the particular item of income. This should minimise the risk of the cost being passed on to Australian businesses and consumers if the measure merely shifts the allocation of taxing rights rather than levying additional overall tax. This is a critical impact of any interim measure, as noted by Treasury in section 5 of the Discussion Paper.

9. It is our view that Australia should be careful in unilaterally pursuing interim options ahead of an OECD-led consensus-based solution to address the impacts of the digitalisation of the economy on the international tax system. There is a high risk that implementing measures too early could erode the competitiveness of the Australian economy by raising the costs borne by large number of Australian businesses who rely on digital products and services provided by offshore enterprises.

10. We would recommend that, if not already done so, Treasury consults with its counterparts in other countries to understand the practical impact of such a unilateral measure. For example, Treasury should consult with their colleagues in India in relation to India's recently introduced "equalisation levy". We understand the Indian equalisation levy imposes a significant compliance burden on Indian customers and has likely impacted start-ups who bear the true cost of the levy through higher pricing (e.g. through gross-up clauses), while ultimately not generating a substantial amount of revenue.

Nexus

11. As a general principle, we believe that, for digitalised businesses, the rules that determine whether a jurisdiction has rights to tax foreign resident enterprises should be where internet activity happens.

12. We believe that any interim measures that have the effect of expanding the current nexus rules (i.e. beyond the current source rules as complemented by Australia's tax treaties) should only relate to income earned from digital advertising that is paid for by Australian businesses and fees received for platform services from an Australian supplier.

13. Due to the difficulty in identifying where users are and the ability for users to easily mask this, it may be easier for any interim measure to concentrate on Australian businesses that are paying for the advertising services or fees to digital intermediation platforms where the supplier is located in Australia. An option would be a final income tax similar to the recent web tax that has been introduced in Italy. To minimise compliance costs, this could be levied at a rate based on gross payments made to the non-resident unless a more appropriate rate is agreed to by the Commissioner (i.e. similar to the regime for taxing non-resident insurers in Division 15 of Part III of the *Income Tax Assessment Act 1936*). We reiterate our above comments that a tax in a form creditable in the residence country would have the least impact on Australian consumers.

14. This could require the business paying the advertising to withhold (or lodge a tax return as agent), and remit to the ATO, an amount from any payment to non-resident enterprises that provide the advertising services. However, in our view a withholding mechanism is not the right approach as it will impose the compliance burden on Australian businesses. We would suggest instead that it is the foreign entity that is deriving the revenue that should carry the compliance burden through an obligation to lodge a tax return in Australia.

15. While we believe that an income tax is the best option available, it still raises the problem that any measure that expands the current income tax framework by, for instance, expanding the definition of royalties, deeming the source of certain royalties or disregarding the permanent establishment attribution rules has the potential to breach Australia's existing tax treaty obligations with our major trading partners.

16. Additionally, if Australia is to be the next country that adopts unilateral measures, there would be a high risk of double or even triple taxation of the revenues earned by digital service providers given the lack of synchronicity in both the scope of the form of the tax by the various countries.

Applicable thresholds

17. Therefore, if unilateral action is taken, our preference is for any interim measure to be limited to significant global entities ("**SGE**s") who are deriving material revenue with the appropriate nexus to Australia. We would suggest that the revenue threshold should be $25m to be consistent with the Diverted Profits Tax. Our suggestion to limit to SGEs is on the basis that SGEs would have the financial means to fund any compliance costs associated with implementing interim measures and then transitioning to a longer-term solution. Our suggestion would be that such SGEs lodge an income tax return in Australia and pay tax on the relevant income in this way.

18. This would ensure that the compliance burden is not borne directly by Australian businesses and is limited to entities who will have the resources and internal risk management policies in place to ensure that any necessary compliance is undertaken.

19. We note that this would require amendments to the *International Tax Agreement Act 1953* as it would be contrary to Australia's existing treaty obligations.

If you would like to discuss any aspect of this advice, please contact either Leo Gouzenfiter on (03) 8612 9674 or me on (03) 8610 5503.

Yours sincerely

THEO SAKELL
Executive Director