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30 November 2018

By email: corporatetax@treasury.gov.au

Dear Sir/Madam,

The digital economy and Australia's corporate tax system

PricewaterhouseCoopers (**PwC**) Australia welcomes the opportunity to make a submission to the Treasury (the **Treasury**) in relation to the digital economy and Australia's corporate tax system discussion paper (the **Discussion Paper**) released for comment in October 2018.

In contrast to ad-hoc and sector-specific tax policy changes, PwC remains of the view that Australia should be engaging in a process of comprehensive tax reform (covering both direct and indirect taxes). Unilateral measures which introduce inefficient taxes, trigger international concerns over taxing rights, risk double taxation, and reduce the purchasing power of Australian consumers are likely to adversely impact the Australian economy and should be avoided.

Executive Summary

- The digitalisation that is occurring across businesses, tax administrations and economies is a global phenomenon and in our view, any approaches to deal with the impact of digitalisation need to be developed by the OECD, then endorsed and implemented in a coordinated way globally.
- However, if recommendations for a consensus approach are not followed and an interim unilateral measure is instead pursued by the Australian Government (**the Government**), then the following points should be considered in its design:
 - We believe that any short-term measures should not be developed in a piecemeal manner. Initiatives should be informed by a clear medium-term policy framework which

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recognises the need to attract investment (given Australia's position as a capital importer);

- Interim rules should seek to avoid uncertainty for taxpayers. Rules should address digitalisation concerns in a way that is limited, proportionate, effective and in a manner that is consistent with the framework laid out by the OECD for evaluating taxation options for the digital economy;¹
- Any interim measure should be just that, and include both review periods and a sunset date mechanism so that it is removed once consensus is achieved at the OECD level. It is unacceptable to introduce interim measures that are based on a mere proxy of the type of revenue or profits at issue, and then leave such rules in place in perpetuity;
- The complexity and the cost of complying with an interim measure should be minimised. The systems/compliance issues that are expected to arise in implementing any interim measure, especially one unique to Australia, will need to be considered carefully;
- An interim measure should be limited and consistent with other similar global initiatives, taking into account its application, the compliance burden and the data required to comply;
- Any additional taxation or costs imposed on businesses operating in Australia (already imposing one of the highest corporate tax rates amongst our trading partners) should be minimised;
- The broad impact on the Australian economy and the incidence of taxation on both consumers and businesses should be analysed. This needs to take into account the context of the varying business models adopted by highly digitalised businesses. This should include detailed modelling of the impacts to ensure that the likely outcomes are consistent with policy aims and expectations, and do not result in adverse implications for Australia's economy;
- The impact on start-ups, business creation and small businesses more generally;
- Compliance with Australia's international obligations needs to be carefully assessed, including with respect to our tax treaty network and international trade agreements; and
- Consideration should be given to the potential impacts of the proposals, in particular on our major trading partners and the potential responses by those economies.

1. Comments on the broader topics raised in the Discussion Paper

The digitalisation of businesses, tax administrations and economies is a global phenomenon and in our view, any new approach in this area needs to be developed, endorsed and implemented in a globally consistent manner.

PwC considers that the digital economy is not a sector that can be identified clearly and taxed separately. Digitalisation is an accelerator for growth, and taxation should not inhibit that more than it does with traditional business. This view is consistent with the findings of the OECD in the 2015 Final Report Addressing the Tax Challenges of the Digital Economy:

*"because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes."*²

¹ OECD (2014), Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing. <http://dx.doi.org/10.1787/9789264218789-en> p 149

² OECD (2015), Addressing the Tax Challenges of the Digital Economy ACTION 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

This position is restated in Tax Challenges Arising from Digitalisation – Interim Report 2018 / The Inclusive Framework on BEPS³.

PwC appreciates the desire of Treasury and the Government to develop a long term comprehensive framework. In our view, policy makers should focus on achieving outcomes under the OECD Inclusive Framework. Measures outside of the OECD process, such as those described in the Appendix to the Discussion Paper, should not be pursued.

1.1 Allocating profits in the digital economy

Global profits of multinational companies are generated through many activities and by many legal entities in many countries. Synergy-related profits are also realised. Allocating profits, based on functions, assets, and risks, in the various countries, has become an extremely complicated matter.

Digitalisation (both through a host of new products/services, and through impact on more traditional functions) is further altering value chains within multinational companies. Questions arise from policy makers about where value is generated and whether that should impact the allocation of profits.

PwC acknowledges the analysis of the OECD International Framework in its Interim report. In order to design global, sustainable, long term approaches, a deep understanding of the various business models, how value is created, and the role of data and users is essential. Any such approach needs to appropriately reflect the effort and investment that takes place outside of the end user or consumer jurisdiction.

Additional time and consultation is needed to identify approaches that appropriately address concerns in a way that will be effective in the long-term, and aligned to the interests of Australian citizens by driving innovation, growth and investment. This particularly applies to identifying the appropriate way in which different factors (including, but not limited to, users) create value for digital businesses, and how this should be attributed consistently and fairly.

1.2 A consensus approach

The modern activities of multinational enterprises (MNEs) continue to blur the boundary between domestic and international aspects of tax. This means that domestic tax reform should be considered within the context of international tax frameworks and international tax reform to avoid the potential for creating local tax-related distortions to international economic activity.

Domestic tax reform has consequences for the decisions that MNEs make about their structure and operations, including investment decisions (the international flow of capital) and the way they access their market (international trade).

<https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1543487908&id=id&accname=guest&checksum=C3FA39391C14B65A939D3CD58DB14E86> p 11

³ OECD (2018), Tax Challenges Arising from Digitalisation – Interim Report 2018, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

<https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1543487808&id=id&accname=guest&checksum=F6F53B3BFD8353D8B8E5CF1D69D6C2D8> paragraph 15

Therefore the preference must be for an approach which is based on consensus amongst stakeholders (in this case, most, if not all, nation-states). Efforts to achieve a coordinated, consistent approach by national governments as part of the OECD BEPS process have already made progress in this regard. Any attempt by Australia to adopt additional unilateral measures and break away from this process risks further undermining the goal of convergence that arose during the BEPS process.

Furthermore, the adoption of unilateral international tax measures in isolation, without consideration of a balanced approach to Australian and global tax reform, means that Australia may be a relatively less attractive market. This could be detrimental to the Australian economy, impacting decisions on foreign direct investment and potentially encouraging Australian business to seek access to capital overseas by commencing activities elsewhere.

A multilateral approach is crucial to resolving issues identified in the Discussion Paper in a way that reduces the distortions to investment and growth. It is expected that a consensus approach also reduces complexity, minimises double taxation, supports innovation and achieves a fairer, more efficient and simpler tax system for firms operating across the globe.

2. Comments that are specific to the concept of an interim measure, raised in the Appendix to the Discussion Paper

Our view is that Treasury should continue to make a significant contribution to the ongoing multilateral discussions on this topic. We believe that resources should not be diverted to the design and implementation of a potentially harmful unilateral measure.

However, if Treasury proceeds to examine an interim measure then both the design considerations addressed in the OECD's interim report published 16 March 2018⁴ (**the OECD Report**) and certain additional matters should be considered.

Any unilateral measure should:			
1	comply with international obligations	5	minimise impact on start-ups, business creation and small businesses generally
2	be temporary	6	minimise cost and complexity
3	be limited	7	not negatively impact the Australian economy, businesses or consumers
4	minimise over-taxation	8	not invite or risk retaliatory actions

Each of these are considered with respect to a potential Australian interim measure below.

⁴ OECD (2018), Tax Challenges Arising from Digitalisation –Interim Report 2018, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.
<https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1543487808&id=id&accname=guest&checksum=F6F53B3BFD8353D8B8E5CF1D69D6C2D8> p 178

2.1 *Be compliant with a country's international obligations*

An interim measure should not be inconsistent with, or contrary to, any of Australia's international obligations. Two broad areas to consider are:

- The impact of existing tax treaties on an interim measure; and
- Australia's obligations under its trade agreements, including through membership of the World Trade Organisation (**WTO**).

2.1.1 The impact of existing tax treaties on an interim measure

The design of any measure will largely determine whether it is to be generally a covered tax under Australia's tax treaty network or some other form of revenue collection which falls outside of Australia's tax treaties.

Whether an interim measure falls within the scope of a particular tax treaty is a determination based on the precise features of the interim measure and wording in the relevant tax treaty. Accordingly, Treasury will need to consider the wording of each bilateral treaty to determine whether, and to what extent, this might impact on the design of any interim measure.

A greater risk of double taxation clearly arises where the measure is not a covered tax. Multiple unilateral measures may result in multiple country taxation of the same income streams. Initiatives agreed within the treaty framework could rely on the framework to manage this risk of multiple taxation, and also rely on the dispute resolution mechanisms agreed under the treaty. The same is not true for other initiatives (such as turnover taxes, trade excises or levies).

In cases where companies face double taxation outcomes it is reasonable to expect that costs are passed onto consumers in whole or in part. An Australian digital services tax which is not a covered tax under Australia's double tax treaty is anticipated to be passed through to consumers more often than not.

2.1.2 Australia's obligations under its trade agreements including through membership of the World Trade Organisation

The Discussion Paper notes that an interim measure would need to be consistent with Australia's commitments under its free trade agreements and in respect of our membership of the WTO in relation to the setting of thresholds and its application to both domestic and international businesses.

This is a complex issue to manage, particularly given that Australia has e-commerce clauses in ten of its twelve bilateral free trade agreements (including, notably, the US-Australia Free Trade Agreement (**AUS FTA**), as well as under additional multilateral instruments such as the General Agreement on Trade in Services (**GATS**) and the General Agreement on Tariffs and Trade (**GATT**). See, for example, *Article II: Most-Favoured-Nation Treatment*⁵ and *Article XVII: National Treatment*⁶ of GATS.

⁵ General Agreement on Trade in Services, Article II.

⁶ General Agreement on Trade in Services, Article XVII.

Our view is that the WTO-compatibility of any proposed Australian measure should be considered in light of Australia's obligations under WTO law and also work within the program of work which is ongoing at the WTO, e.g. in the context of its e-commerce program.

It is worth noting that other jurisdictions have considered similar issues. For instance, there was concern in Europe that the proposed interim digital services tax (**EU DST**) may not be compatible with WTO law, particularly the EU's obligations under the GATS⁷, and similar EU obligations found in its free trade agreements.

However, the WTO and FTA compliance impact for Australia may not necessarily be the same as those faced in, say the EU or the UK, simply because the nature of our particular commitments under Australia's FTAs may be different to those of other nations.

A useful case in point in this regard is to consider how an interim measure could be interpreted in the context of our e-commerce commitments made under the AUSFTA, which represents perhaps our most onerous e-commerce commitment of all of our international obligations in this space. It is also pertinent to consider the AUSFTA given that the particular companies listed by name on page 1 of the Discussion Paper are, without exception, US headquartered multinationals.

To this end, Australia's non-discrimination and most favoured nation commitments for e-commerce are found in Article 16.4 of the AUSFTA.⁸ This article confirms that Australia and the United States must not discriminate and distinguish between digital products, either directly or indirectly, of either nation.

This clearly means, as Treasury has rightfully pointed out, that any measure would need to apply equally to both foreign and domestic participants, and that its thresholds would also need to be assessed in this context.

For instance, an Australian measure with a high revenue threshold, designed to capture a particular group, such as large US digital multinational corporations, could potentially be (or perceived to be) discriminatory in character. Similarly, 'taxable revenues' subject to the Australian measure should not specifically target and capture the business models of a specific group, such as large US digital multinational firms. For instance, digital advertising, digital platforms and marketplaces to sell goods and services, and transmission of users' data to other users, are key characteristics of large US multinational digital firms.

However, given the breadth of our commitments under Article 16.4, Treasury might also need to consider other, possibly less apparent, potential conflicts, such as (among others):

- Do the thresholds or in-scope business models or revenues capture a particular profile of business more likely to be located offshore rather than onshore?
- Does the calculation of the tax base unfairly impact certain businesses (the deductibility of GST in calculating the tax base for example may not be helpful to offshore businesses)?
- Would an entitlement to an Australian income tax deduction be discriminatory to offshore businesses not currently within the Australian tax system?

⁷ <https://piie.com/system/files/documents/pb18-15.pdf> (written by Gary Clyde Hufbauer and Zhiyao (Lucy) Lu for the Peterson Institute for International Economics), <https://www.pwc.com/gx/en/about/assets/reponse-ec-proposals-digital-tax-package.pdf> (PwC's response to the European Commission proposals)

⁸ Australia-United States Free Trade Agreement, Article 16.4.

In any case, regardless of whether there is an actual inconsistency with our AUSFTA or any other international e-commerce commitments, there is clearly a perception in the US that a unilateral interim measure focussing on digital companies is unfair and discriminatory towards the foreign headquartered technology sector. To illustrate the sentiment in the US on this issue, it is useful to note House Ways and Means Committee Chair Kevin Brady's, short and pointed statement made on October 31:

“Singling out a key global industry dominated by American companies for taxation that is inconsistent with international norms is a blatant revenue grab.....If the United Kingdom or other countries proceed, that will prompt a review of our U.S. tax and regulatory approach to determine what actions are appropriate to ensure a level playing field in global markets.”

The Government should also fully consider, and be prepared for, the potential impact of any retaliatory measures to the preference currently afforded to Australian industry under the AUSFTA and Australia's trade relationship with the US more generally, such as the preference recently granted to the Australian steel industry.⁹

In a climate of increasing uncertainty and heightened trade protectionism, Treasury and Government need to ensure that any interim measure is wholly consistent with our foreign trade agreement obligations.

2.2 Temporary

The consensus among Inclusive Framework members is that a comprehensive global solution is preferred to the adoption of unilateral measures¹⁰. However, certain countries believe there is a strong imperative to act immediately to ensure that the tax paid by certain businesses is commensurate with the value they consider is being generated in their jurisdictions.

Unlike the BEPS process which was focussed on issues concerning double non-taxation, the likely motivating factor in relation to taxing digitised businesses concerns the broader topic of taxing rights between two or more countries. Accordingly, any unilateral measures should only ever be temporary, ceasing to apply once a global response to the tax challenges raised by digitalisation has been agreed.

It is, in our view, critical that any interim measure that is considered by Australia in advance of the 2020 recommendations by the OECD on this matter should be analysed as a temporary measure only. To provide the business community and stakeholders certainty in respect of this point, the Government should commit to cancel any interim measure if an international approach is agreed, similar to the commitment made in the recent UK Budget announcement:

A review clause – this means that the DST will be subject to formal review in 2025 to ensure it is still required following further international discussions. This underlines the government's commitment to continue seeking a global solution to ultimately replace the DST. In addition, the

⁹ <https://www.abc.net.au/news/2018-05-01/australia-avoids-steel-tariffs/9714330>

¹⁰ OECD (2018), Tax Challenges Arising from Digitalisation – Interim Report 2018, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.
<https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1543487808&id=id&accname=guest&checksum=F6F53B3BFD8353D8B8E5CF1D69D6C2D8> p 184

*government will dis-apply the DST if an appropriate international solution is in place prior to 2025.*¹¹

Political, budgetary and other pressures are also likely to impact the feasibility of removing a legislated ‘tax’ or measure in the future¹². This adds to the case to consider a sunset clause which ensures any measure should cease to apply after say only one or two years from its commencement and should be removed before that end date in the event that OECD consensus is reached.

Any interim Australian measure should be combined with a periodic review so that the Government could analyse the impact and determine whether the progress of global negotiations means the measure remains valid against the stated policy objectives at the outset, as opposed to remaining in place because of being merely opportunistic for the Australian revenue base.

2.3 Limited

Given the potential adverse consequences arising from an interim measure, it is important that any approach is well-defined and limited to minimise the collateral impact of the measure on elements of the tax system or on businesses generally. We recommend that the following points should be examined:

- Noting that an interim measure is not recommended, the complexity arising for global businesses dealing with a variety of inconsistent unilateral measures should be considered. A targeted, simple measure with sufficient carve-outs that are broadly consistent with the international approach would reduce this complexity somewhat.
- Businesses not specifically targeted by an interim measure should not unintentionally be caught. This requires careful consideration of how the relevant criteria is established and documented.
- A broad list of exemptions including those in other international proposals and in the OECD Report¹³ should be considered. Exemptions should be drafted in consultation with stakeholders to ensure they apply as broadly as intended¹⁴. Examples of such exclusions are listed below:
 - Financial and payment services
 - Investment services
 - The provision of online content
 - Sales of software/hardware
 - Television/broadcasting services
 - Cloud computing services
 - Payment, digital content and communication services provided through a digital interface
 - Transmission of data by out of scope businesses
 - Transactions between entities in a consolidated accounting group

¹¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752172/DST_web.pdf

¹² The Multinational Anti-avoidance Law (MAAL) was introduced as a unilateral measure ahead of the conclusion of OECD negotiations in respect of the definition of a permanent establishment. It now seems likely that the MAAL will not be repealed or dis-applied even though consensus has been reached through the Multilateral Instrument: ‘Australia has not adopted Article 12. Australia will consider adopting these rules bilaterally, however, in future treaty negotiations to enable bilateral clarification of their application in practice. Pending this, the MAAL will continue to safeguard Australian revenue from egregious tax avoidance arrangements that rely on a ‘book offshore’ model’: <https://treasury.gov.au/tax-treaties/multilateral-instrument/>.

¹³ OECD (2018), Tax Challenges Arising from Digitalisation –Interim Report 2018, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.
<https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1543487808&id=id&accname=guest&checksum=F6F53B3BFD8353D8B8E5CF1D69D6C2D8> p 184

¹⁴ <https://www.pwc.com.au/tax/taxtalk/assets/alerts/pwc-bcm-ec-dig-tx-pkg.pdf>

- It is relevant to consider how the measure should apply to businesses providing various services to customers across multiple business units.
- The digitalised business models that derive advertising revenues have potentially common characteristics. Marketplaces are arguably different. The following factors need to be considered carefully before imposing a tax on intermediation services such as online marketplaces.
 - The value derived from user contributions (if any) varies across platforms and business models. That is, it may not be correct to assume that all interaction with users leads to the same levels of net revenues for each business, nor that there is necessarily a correlation between this interaction and the net profits of a business.
 - The reliance on direct and indirect network effects may vary across marketplaces. This impacts the consideration of how value is created on different platforms, by whom and when and ultimately the consideration of whether and how this value, however created, should be taxed.
 - Any measure that impacts the feasibility or profitability of current business models may encourage platforms to adopt response effects or change their business model and terms of service.
 - The impact on small businesses making use of platforms to get goods and services to market (i.e. without the level of investment to develop an online platform themselves).

We recommend that Treasury continues to monitor the development of the European and UK proposals and the related debate as it considers the merits of any Australian interim measure.

2.4 Minimise over-taxation

The Coalition Government acknowledged in promoting its Enterprise Tax Plan that the Australian corporate tax rate must be reduced (and the after tax return to business increased) if we are to remain competitive. Scott Morrison stated:

“The Government understands the imperative of having an internationally competitive corporate tax rate. Unlike Bill Shorten, we won’t sell our future short through higher taxes on businesses¹⁵.”

The tax discussion paper released on 30 March 2015¹⁶ discussed the impact of corporate tax on economic growth and living standards:

“Tax on investments can influence decisions about where to invest, what to invest in, and how much to invest. Higher taxes on investment generally mean that fewer investments will be viable. This effect is more pronounced where the rate of corporate tax is higher than in other countries offering comparable investment opportunities.”

It is important that the economic impact of introducing additional costs to businesses operating in or considering investing in Australia is fully considered before any interim measure is pursued (see further commentary on the impacts on the Australian economy below).

¹⁵ Media Release: Turnbull Government committed to driving jobs and higher wages for Australians through business tax relief, 27 April 2017

¹⁶ <http://bettertax.gov.au/publications/discussion-paper/>

We recommend that the following be considered:

- The 30% Australian corporate tax rate is higher than many countries we compete with for investment. An incremental increase is expected to deter investment in Australia.
- An additional tax such as an excise tax which is not creditable against corporate taxes will cause double taxation of the revenue derived in Australia by Australian taxpayers.
- Treasury should consider whether an offset against Australian income taxes should be provided (instead of a deduction against/reduction of assessable income) to ensure Australian taxpayers are not penalised further.
- The risk of double or multiple taxation where an interim measure imposes a charge outside of our tax treaty framework.
- The margins and general profitability of the businesses targeted should be considered in determining the tax base and the tax rate applied in any measure.
- A safe harbour could be considered (similar to UK proposals¹⁷) to ensure any measure is proportionate and does not impact loss making businesses or business units.
- In the case of an ‘in-scope’ business unit, consideration should be given to how it might exclude business unit revenues where, although profitable at an entity, consolidated group (accounting and tax) or taxpayer level, the innovative business unit may not itself be profitable.
- Similarly, the impact of applying any interim measure based on income or other data reported by an accounting or tax consolidated group (which may include multiple entities and multiple businesses), should be considered carefully.
- The incremental impact on a local Australian headquartered business subject to a higher corporate tax should be compared to the incremental impact for a foreign business (with little or no Australian presence) subject to lower corporate taxes and potentially different proportions of in-scope versus out of scope revenues.
- If an interim turnover based measure is pursued then the merits of a lower rate than the 3% rate proposed in the European Commission proposals should be considered, noting that the UK (with a current corporate tax rate of 19%) has announced a lower 2% rate.

2.5 Minimise impact on start-ups, business creation and small businesses more generally

As set out in the OECD Report, an interim measure which is essentially a tax (however described) on the supply of particular services will increase the cost of capital, reducing the incentive to invest with a resulting negative effect on growth¹⁸. A measure targeting local and global digitalised businesses may act as a deterrent to continuing investment in innovation.

An interim measure has the potential to be contrary to Australia’s commitment to fostering an environment and ecosystem conducive to innovation (and related investment) in Australia as we transition from the prior mining boom to a more diversified economy.

¹⁷ The UK Budget announcement included a safe harbour: “this means that businesses can elect to calculate their liability on alternative basis, which will be of benefit to those with very low profit margins. The outcome is that those making losses under this calculation will not have to pay the DST and those with very low profit margins will pay a reduced rate of tax”. - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752172/DST_web.pdf

¹⁸ OECD (2018), Tax Challenges Arising from Digitalisation –Interim Report 2018, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing. <https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1543487808&id=id&accname=guest&checksum=F6F53B3BFD8353D8B8E5CF1D69D6C2D8> p 178

For example, the recent National Innovation and Science Agenda set a focus on science, research and innovation as long-term drivers of economic prosperity, jobs and growth to transform Australia's economy and drive prosperity and competitiveness.

A number of positive measures have been introduced since¹⁹ including tax incentives for early stage investors (where the Australian Government sought “to encourage innovation by aligning our tax system and business laws with a culture of entrepreneurship and risk-taking”), making improvements to the Early Stage Venture Capital Limited Partnership (ESVCLP) and Venture Capital Limited Partnership (VCLP) regime, a continued focus on building and maintaining world-leading data science research capability through Data61 and establishing the CSIRO Innovation Fund.

Measures designed to back innovation in fintech in Australia²⁰ provide further evidence of a commitment to engage in and capitalise on digitalisation, data and innovation in Australia.

If an interim measure is pursued, it is critical that an exemption applies for start-ups and growth businesses (regardless of whether they are independent, or partially or wholly owned by larger corporate groups). Any interim measure should not inhibit innovation and entrepreneurship or create further barriers to entry where markets are dominated by established, mature, profitable businesses that can either pass on the cost to consumers or absorb the additional cost in their business. A threshold has been considered in other jurisdictions²¹ to, in part, manage this challenge. Those thresholds and related challenges²² should be considered if the Government pursues an interim measure in Australia.

2.6 Minimise cost and complexity

The Discussion Paper has noted that there may be challenges with compliance, collection and administration of any potential interim measure. These challenges cannot be underestimated, particularly if the measure pushes into new and uncharted territory of attempting to identify, capture and calculate “user created value” in Australia.

This concept stretches well beyond traditional direct tax (e.g. source and residency) and indirect tax (e.g. destination principle) nexus concepts, and would potentially require impacted taxpayers to collect data that before now may not generally have been needed for tax compliance, or indeed financial reporting, purposes.

For example, consider an interim measure which applies to digital advertising campaigns aimed at Australian viewers, a scenario contemplated in the Discussion Paper. In this case, the interim measure would require the advertiser to be able to identify not only where its client is located (necessary for GST and VAT purposes under most countries' electronic services rules), but also where its *client's potential customers* (i.e. the viewers) are located. In some cases, this information might be located somewhere within the organisation, possibly in data centre usage metrics etc. However, if such information has not

¹⁹ The government committed over \$1.1 billion over four years to 24 measures - <https://www.industry.gov.au/strategies-for-the-future/boosting-innovation-and-science>

²⁰ <https://fintech.treasury.gov.au/>

²¹ The EU proposal for a Digital Services Tax entails a 3% tax on revenues for groups with more than €750M global revenues, including €50M of EU taxable revenues. Under the proposed UK DST measure businesses will need to generate revenues from in-scope business models of at least £500m globally to become taxable under the DST. The first £25m of relevant UK revenues are also not taxable.

²² Australia's obligations under international trade agreements or as a member of the World Trade Organisation will need to be addressed together with any potential retaliatory actions by our trading partners.

typically been required for tax or finance purposes previously, new systems and processes would need to be implemented to collect and integrate this information into the billing systems.

An apportionment methodology would also be needed to identify the part of the advertising revenue which should be attributed to Australian viewership based on that data. Add to that the related pricing, invoicing and contractual changes which may also be required. Then consider how this complexity might be compounded if advertisers who operate in multiple jurisdictions are required to comply with slightly different nexus and valuation requirements for similar measures in place in other countries.

Another example, possibly even more challenging than the advertising scenario above, is calculating the value to be attributed to the network effects for social media platforms, travel booking sites and other websites which benefit from user contributions and reviews. How should a “like” be valued? How should a favourable review of a hotel be valued? What about an unfavourable review? Many of these platforms do not earn revenue directly from such user participation. An interim measure seeking to apply to such activities would need to determine the relevant revenue stream identified as benefitting from the user’s actions, collect the data points needed to track that revenue stream and then devise a method for apportioning the value to the relevant action. Not a simple task and certainly not one many taxpayers have needed to pursue before.

Any requirement imposed by an interim measure to identify and track the location of users on a platform also needs to be considered in the context of the global trend toward the strengthening of data privacy laws (see, for example, the recently introduced EU General Data Protection Regulations (**GDPR**)), which might prohibit or restrict businesses’ ability to capture the information needed to comply with the measure. Even if privacy law issues can be addressed, tracking of user location is often imprecise and is made even more difficult with the increasing use of Virtual Private Networks (**VPNs**) in Australia and overseas.

What these examples highlight is that an interim measure which seeks to capture value created in Australia may be complex and there will be a number of system and operational changes needed to allow taxpayers to comply. This is where the OECD framework for evaluating taxation options for the digital economy,²³ derived from the Ottawa Taxation Framework Conditions,²⁴ becomes relevant. In particular, the framework provides that digital taxation measures should be (among other things):

- **Efficient:** Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.
- **Certain and Simple:** The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.
- **Effective and Fair:** Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to the risks involved.

²³ OECD (2014), Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing. <http://dx.doi.org/10.1787/9789264218789-en> p 149

²⁴ 1998 CFA Report “Electronic Commerce: Taxation Framework Conditions”

As the Discussion Paper notes, careful consideration will need to be taken to ensure that the scope and nexus requirements of any interim measure are not so complex that they put strain on these guiding principles. Care also needs to be taken to ensure that the cost of compliance for taxpayers and tax authorities does not end up being disproportionate to the revenue collected by the measure.

This is particularly the case for an *interim* measure - a temporary measure which is not intended to apply long term should not require taxpayers to have to undertake extensive system and operation redesign to be undertaken in order to comply.

With these principles in mind, we therefore believe that if an interim measure is to proceed (which, as stated above, we do not recommend should occur), it must, at a minimum:

- Align with other territories in terms of scope, nexus and the data points required to account for the measure. Harmony at a practical and operational level with other territories could allow taxpayers to achieve efficiencies from required system changes, as they could be developed with the purpose of streamlining compliance for multiple jurisdictions. Given the relative size of the Australian market compared with other parts of the world, an approach which standardises data collection requirements could also improve overall compliance levels in Australia. In contrast, an approach which is unique to Australia might adversely impact levels of compliance and, by extension the extent of revenue collected from the measure. Harmonisation and consistency with other jurisdictions should ultimately also assist Australian digital businesses operating overseas to comply with the same or similar measures being introduced elsewhere.

This is perhaps best illustrated through the contrasting experiences to date with the two most recent GST legislative changes impacting the digital sector. For example:

- The GST Inbound Intangibles measures²⁵ introduced GST on the supply of digital products and services to Australian consumers from 1 July 2017. Unlike the GST low value goods measures²⁶ (discussed below), similar measures had been introduced in other jurisdictions prior to Australia (referred to generally as Electronically Supplied Services or “ESS” provisions). Therefore, impacted taxpayers had already largely introduced systems to capture information such as the location of the consumer. While Australia did introduce some additional requirements which meant additional systems changes were required (ie obtaining an Australian Business Number and GST information) many taxpayers did not need to make significant additional systems changes for the Australian GST digital products and services measures.
- However, in contrast, the GST low value goods measures which commenced 1 July 2018 required unique systems changes required only for Australia. As noted above, this impacted compliance and also perceptions of compliance. In addition, Australia introduced a particularly complex design which required marketplaces to account for GST on sales made by sellers on their marketplaces where the goods are offshore low value goods. This required substantial systems changes for many marketplaces in order to comply. For example, the measures require marketplaces to be able to identify the location of goods sold by third party sellers at the time of sale in order to determine the

²⁵ *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016 (No. 52, 2016)*

²⁶ *Treasury Laws Amendment (GST Low Value Goods) Act 2017 (No. 77, 2017)*

GST position for the sale when sold, information which a marketplace would not normally know. This complexity was the subject of many submissions made to the Senate Estimates Committee on the measures and noted in its report tabled 7 May 2017. As a result of these complexities the measures were delayed by 12 months and the committee noted: *“The committee notes the concerns expressed about the proposed implementation date, and the complexity of implementation and enforcement. It accepts that businesses may need more time and assistance to develop their systems to implement the measure²⁷.”*

There have been reports that compliance levels are supposedly below what was expected by the ATO and even allegations of “widespread avoidance” in relation to these measures during their first few months of operation.²⁸ Retailers have also been reported to suffer declining sales and declining share prices and blame has been placed, at least in part, on differing levels of compliance with the GST measures across different platforms.²⁹

- Be designed in collaboration with industry, specifically on the question of how to identify the revenue stream to be subject to the measure and, importantly, determine the system fields, data points and calculation methodologies required to calculate the amount payable under the interim measure.
- Leverage other existing revenue collection mechanisms, such as the simplified GST registration regime for the ESS and low value goods measures, to reduce the need for new compliance processes and additional taxation filings. A simple and well understood compliance mechanism may also have a heightened importance from an enforcement perspective, simply because if any measure falls outside of the multilateral and bilateral treaty framework, the provisions ensuring mutual assistance between countries for the collection of tax debts (the 'assistance in collection articles') may not apply.³⁰ This may impact the ability of the Government and the ATO to effectively enforce compliance offshore. So a simple and easy filing and reporting process might be useful to encourage and promote compliance by offshore businesses.
- Be introduced with an appropriate implementation period, possibly in line with the two year implementation period afforded in recent GST electronic services and low value goods measures, to give taxpayers sufficient time to implement the systems changes needed to comply with the interim measure.

2.7 Impact on the Australian economy

The economic impact of an interim measure should be considered, particularly in respect of Australian consumers, businesses and the Government.

²⁷ Paragraph 2.39 of the Senate Economic Legislation Committee report into *Treasury Laws Amendment (GST Low Value Goods) Bill 2017* [Provisions] tabled 7 May 2017.

²⁸<https://www.smartcompany.com.au/industries/retail/widespread-avoidance-multiple-retailers-appear-not-to-be-not-charging-gst-despite-new-laws/>

²⁹ Sue Mitchel, AFR. 'Kogan.com shares fall 23pc as global sales, margins come under pressure' (29 October 2018)

<https://www.afr.com/business/retail/kogancom-shares-fall-23pc-as-global-sales-margins-come-under-pressure-20181028-h177wu>

³⁰ See Part D of PS LA 2011/13 Cross border recovery of taxation debts for a discussion regarding the assistance in collection articles.

2.7.1 *Australian consumers*

The Discussion Paper identifies some key benefits which digitalisation has delivered to Australian consumers. These are:³¹

- Choice and convenience
- Competition (i.e. lower prices)
- Innovation (i.e. new offerings, greater choice and the potential to develop the source of future exports)
- Productivity

An interim measure which is poorly attuned to the design considerations outlined above could be detrimental to the continued enjoyment of these benefits. For example, where an interim measure makes Australia a less attractive jurisdiction to do business, it reduces choice, convenience and competition, reduces the potential for innovation and risks negative impacts on productivity.

Furthermore, a cost imposed by any interim measure may be passed on to Australian consumers, increasing the cost of in-scope products and services. To this end, PwC has held initial meetings with numerous large providers who may potentially fall within the scope of an interim measure. There was a near unanimous view amongst those businesses that any interim measure would be passed through to customers in the form of increased prices. As discussed in more detail below, increased prices will ultimately hurt Australian consumers, making many of the digital services highlighted in the Discussion Paper as integral to Australians' everyday lives more expensive.

In addition, the relative market strength of Australian businesses, foreign headquartered businesses and the start-up sector may also influence how many different businesses react to and re-price the sale of digital products as a result of any interim measure. This could impact economic activity and job creation for Australian digital businesses.

2.7.2 *Australian businesses*

The impact of an interim measure will be different for different businesses. We consider Australian headquartered businesses, foreign headquartered businesses and Australian start-ups below.

2.7.2.1 *Australian headquartered businesses*

Australian headquartered businesses may experience different impacts from any interim measure. These businesses are already subject to one of the highest headline corporate income tax rates applicable amongst the OECD countries³² across the majority and in some cases all of their value chain. Introducing an additional cost or 'tax', particularly where it is not fully creditable, increases this burden on Australian businesses.

Moreover, the characteristics of the digital economy identified in the Discussion Paper, such as cross-jurisdictional scale without mass, reliance on intangible assets, data, user participation and network

³¹ Discussion Paper, page 3.

³² Statutory Corporate Income Tax Rate (last accessed 28 November 2018)
https://stats.oecd.org/index.aspx?DataSetCode=Table_III1

effects³³ means that businesses targeted by interim measures are more capable of responding than other businesses which may have been the target of specific Australian taxation regimes in the past (i.e. the Mineral Resource Rent Tax). However, Australian headquartered businesses may not yet have the globally diversified revenue and customer bases of their foreign counterparts and may lack a dominant market position. This in turn may mean that Australian headquartered businesses are not be in a position to pass on or absorb the additional cost of a digital tax. This would likely have a negative impact on growth, further innovation and investment by this sector in Australia.

2.7.2.2 Foreign headquartered businesses

Businesses with their base of operations outside the jurisdiction in question have been a concern when setting the parameters of a domestic tax regime in recent years (see, for example, Australia's MAAL).

However, when a specific industry or type of business is targeted (highly digitalised businesses), broad generalisations about the economy are no longer sufficient and a further investigation of the industry or sector(s) to be impacted is instead required.

Foreign headquartered highly digitalised companies with a presence in Australia can be mature businesses that operate across various jurisdictions and markets and often have diversified revenue bases. Policy setting issues could arise if foreign headquartered businesses have lower corporate tax rates in their home jurisdictions, have inelastic demand for their products and are better placed to either absorb in part or otherwise pass on these costs to consumers.

2.7.2.3 Australian startups

Australian early stage ventures generally exist in two forms, those funded by founders or 'venture capital' and those funded by established businesses. The first of these, the founder/'venture capital' category can largely be protected by including appropriate turnover thresholds in any interim/final measures. However it is crucial that the second category is similarly insulated from any digital gross turnover tax. This is because these investment operations are generally established as separate businesses. A loss-making subsidiary of an established business may be stifled by further costs, thus placing barriers on further innovation and the development of the Australian tech sector.

We recommend that Treasury review how the UK proposes to implement the 'safe harbour' concept referred to above. Broadly, the intention of this measure is to protect loss-making businesses or businesses with low profit margins from additional taxes.

2.7.3 The Australian Government

We consider that detailed modelling is required by Treasury in advance of any decision to ensure that the economic impact of introducing any measure is understood and is consistent with clearly articulated policy aims. The effect of various approaches on the cost of capital for Australian taxpayers, including possible consequences in particular sectors should be estimated, drawing on both modelling and dedicated consultation with businesses that are expected to be impacted. We consider it necessary to understand the effects that these potential rules would have on the relative competitiveness of our tax system and accordingly the long-term impact on our economy.

³³ Discussion Paper, page 2.

2.8 Potential for retaliatory action

Careful consideration of the scope and thresholds that could apply to an interim measure (and the methodology for determining any liability) is required to ensure Australia does not act in a way that is contrary to any of its international trade obligations. However, even where an interim measure is not strictly contrary to our international obligations, it may still attract retaliatory measures where the measure is considered to target particular businesses from outside of Australia.

The US commentary on the EU and UK measures is instructive in this regard.

In addition to the statement by House Ways and Means Committee Chair Kevin Brady, R-Texas (outlined earlier in this submission), the US Senate Committee on Finance has also criticised the EU's plans to introduce a 'digital tax,' describing the measures as discriminating 'against US companies' in a letter sent³⁴ to European Council president Donald Tusk and Commission President Jean-Claude Juncker, and explaining that:

"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,"

"We urge the EU to abandon this proposal, urge the member states to delay unilateral action and instead refocus efforts on reaching consensus with other leading economies within the OECD on any new digital taxation models."

These communications highlight the fact that many stakeholders in certain jurisdictions feel that they may be unfairly targeted by unilateral measures similar to those proposed by the European Commission and the UK Government, and are prepared to take measures to protect their local companies.

In relation to trade tariffs and excise taxes, Alan Greenspan (former US Federal Reserve chairman from 1987 to 2006) has recently observed that excise taxes clearly impact purchasing power and that:

"[Tariffs] are exactly the same as an excise tax. If you think you are going to raise the excise taxes in your country to beat the country over here ... you are shooting yourself in the foot."³⁵

3. Conclusion

Our view is that Treasury and the Government should continue to play a significant role in the consensus-based OECD process considering the complex issues discussed above. An interim measure should not be pursued.

We acknowledge the difficulty of the subject matter and encourage continued stakeholder engagement.

* * * * *

³⁴ The letter is jointly signed by Republican chairman Orrin Hatch and his Democratic counterpart Ron Wyden.

³⁵ <https://www.barrons.com/articles/alan-greenspan-interview-1539635388>

If you have any further questions regarding our submission, please do not hesitate to contact us.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Paul McNab', with a long, sweeping horizontal stroke extending to the right.

Paul McNab
Legal Partner

A handwritten signature in black ink, appearing to be 'Jonathan Malone', with a large, stylized 'J' and a horizontal line extending to the right.

Jonathan Malone
Partner, Global Tax

A handwritten signature in blue ink, appearing to be 'Brady Dever', with a stylized 'B' and a horizontal line extending to the right.

Brady Dever
Partner, Indirect Tax