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30 November 2018

Dear Brendan,

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

REA Group Ltd (**REA**) 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 to give effect to the Government's commitment to ensuring digital businesses pay their fair share of tax, as announced in the 2018-19 Federal Budget.

The intention of this submission is to document REA's position in relation to the technical features of any tax reform in this area and to highlight a number of other issues, as outlined below.

REA is not in favour of implementing an interim Digital Services Tax (**DST**). Overall, we believe the Federal Government should seek a multilateral consensus in respect of taxing the digital economy as this is the only way of achieving a fair, consistent and sustainable outcome on a global scale.

However, if Treasury were to consider the application of DST:

- It is important to understand the various dynamics and macro-economic issues impacting digital businesses in Australia. A summary of these is set out in Appendix A;
- A DST should contain particular features to ensure such a tax results in a fair outcome for both domestic and international companies, whilst ensuring investment into the Australian economy continues to be incentivised. These features are outlined further in Appendix B;
- An interim DST should not result in Australian digital companies paying an additional tax on revenues which are already subject to the Australian headline corporate tax rate of 30%. Such a measure would arguably further widen the competitive advantage currently held by larger foreign multinational digital companies as these companies have a larger diversified revenue base to fund any additional tax levied under any proposed DST; and
- Digital businesses are not all the same. Therefore, it is critical that a thorough understanding of the various digital business models (and their unique nuances) is first obtained by Treasury before any interim DST is considered. In particular, it is

necessary to establish a framework that evaluates value creation within different digital businesses in order to develop a fair and sustainable tax system that ensures parity of taxation approaches across the entire economy and not to a separate industry. We are happy to work with your team to provide Treasury with this understanding.

Equally, there are several economic impacts which require careful consideration before an interim DST is contemplated. These are as follows:

- A unilateral approach will put Australia at risk of falling further behind other Organisation for Economic Co-operation & Development (**OECD**) countries in the development of its technology sector, as an interim DST will provide an impediment to corporate investment in the technology sector in Australia. International tax reform is therefore necessary to ensure Australia is competitive in comparison to other international markets and an attractive place to invest;
- The introduction of an interim DST could have a detrimental 'multiplier' effect on the real estate industry, which is currently operating in a challenging economic environment. This is due to several government policy changes and macro-economic factors which has resulted in a contraction in real estate market activity. A detailed explanation of these specific factors is outlined in Appendix C;
- Should Australia seek to unilaterally introduce a DST, it will be acting in a manner that is inconsistent with its commitment to develop and endorse consensus based international tax reform and, for the reasons that we have outlined in this paper, it is Australian resident taxpayers that will be most adversely affected by those measures.

We acknowledge the importance of having a fair and sustainable tax system and a level playing field for all participants in the Australian economy. Global digitalisation has presented some unique challenges for tax systems and tax regulators worldwide, including in Australia.

We also understand and agree with the desire for Australia to possess an adequate legislative mechanism to counteract behaviours that have the potential to erode the Australian tax base. Whilst some companies are opposed to changes to the current tax regime which applies to the digital industry, REA is supportive of reform to the Australian and international tax system. This is because we believe the current tax landscape provides a significant unfair competitive advantage to foreign based multinational digital companies.

We have set out REA's detailed comments in respect of some of the questions raised in the Discussion Paper in the attached Appendices.

We welcome the opportunity to discuss REA's submission with you and to engage in further consultation as the specific measures are designed and refined. If you have any questions, please contact me by phone on (03) 8486 5198 or at [clint.collins@rea-group.com](mailto:clint.collins@rea-group.com).

Yours sincerely



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Treasury Discussion Paper

# The digital economy and Australia's corporate tax system

Feedback & Comments

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## Appendix A

### 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. Digitalisation is creating benefits and efficiencies as new digital technologies drive innovation, fuel job opportunities and act as catalysts for economic growth.

However, Australia is entering the digital economy at somewhat of a disadvantage due to a number of factors which reduce REA's international competitiveness. These include the following:

- Australia's investment in research and development (**R&D**) is falling behind other leading OECD countries. Although Australia's R&D tax incentive aims to encourage innovative activity by Australian companies, R&D expenditure as a percentage of gross domestic product is below the OECD and European Union (**EU**) averages<sup>1</sup>. Further, the benefits of the Australian R&D tax incentive are expected to reduce further under a proposed "R&D intensity" threshold as announced by the Australian Government in the 2018-19 Budget;
- Australia is facing a widening competitiveness gap when compared to other developed digital economies due to lower levels of investment in digital infrastructure and the digital technology workforce. Although Australia is committed to embracing innovation and science through funding of early learning and science, technology, engineering and mathematics (**STEM**) initiatives in order to improve future productivity, it is lagging behind other OECD countries. Australia was ranked below the OECD average for tertiary education graduates in natural sciences and engineering as a percentage of all tertiary graduates<sup>2</sup>;
- Compared to other OECD countries, Australia lacks a strong supply of highly skilled digital workers. Other countries such as the United States and China have a strong supply of skilled workers, both from a current workforce perspective and when factoring in the impact of existing investment in STEM on skill development and supply to the industry. According to research undertaken by Hays Recruitment, there is a large supply gap in the market for Information & Communications Technology (**ICT**) roles such as UX/UI Designers and Developers, Front-end JavaScript Developers, Full Stack Java Developers, Full Stack .Net Developers and Infrastructure Engineers<sup>3</sup>; and
- Deloitte Access Economics forecasts that the demand for the number of ICT workers is set to grow by almost 100,000 to 758,700 workers by 2023<sup>4</sup>. Consequently, ICT resources are highly sought after by REA and industry competitors. To the extent that investment in the Australian digital industry is not incentivised comparatively to its geographical neighbours, there is a risk the Australian economy will lose these workers to overseas competitors, resulting in a 'brain drain' to the Australian digital economy.

Consequently, there are early warning signs that Australia could end up a passenger in the digital journey, with other countries in the driver's seat. As an economy grappling with the

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<sup>1</sup> OECD Science, Technology and Industry Scoreboard 2017 – The digital transformation report, page 146.

<sup>2</sup> Science, Technology and Industry Scoreboard 2017 report, page 102.

<sup>3</sup> Hays Quarterly Report – Information Technology (October – December 2018), Hays Recruitment.

<sup>4</sup> ACS Australia's Digital Pulse Driving Australia's international ICT competitiveness and digital growth, 2018, Deloitte Access Economics, page 3.

transition away from its mining boom, Australia risks falling behind our international peers, which could have flow-on effects on productivity and living standards<sup>5</sup>.

It is noteworthy to add that the youngest company in the 5 largest companies by market capitalisation listed on the Australian Stock Exchange (**ASX**) is the Commonwealth Bank, which was founded in 1911. In contrast, most of the top 5 companies listed on the New York Stock Exchange are relatively young technology companies, such as Google, Amazon and Facebook.

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. However, Australia's economy is currently facing high household debt, a decline in real wages and low productivity growth. Australia's place in the global economy is set to fall from 19<sup>th</sup> to 28<sup>th</sup> by 2050.<sup>6</sup> We have also fallen down the ladder on rankings of global resilience<sup>7</sup> and we currently rank below other leading OECD countries in the Global Innovation Index<sup>8</sup>.

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.

## Australian digital success stories are very small in global terms

Australia has a handful of digital platform successes, including REA, SEEK and Carsales, and a variety of other online digital platforms owned and operated by Australian companies.

REA is an Australian business which traces its founding origins back to a garage based in the eastern Melbourne suburb of Doncaster. The company was founded by Karl Sabljak, along with his wife Carmel, brother Steve and co-founder Marty Howell. Since its launch in 1995, the REA business has grown exponentially, operating a global headquarters based in Richmond, Victoria and employing over 1,000 people in Australia and an additional 400 employees throughout the greater Asian region. REA's Australian residential property platform, realestate.com.au, provides the gateway for more than 1 million Australians each day to search for their ideal home.

Collectively, REA, Carsales and SEEK are 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 sector<sup>9</sup>.

Although REA, Carsales, and SEEK are some of Australia's largest technology companies, in comparison to the world's largest technology companies, the revenues of these domestic companies are relatively small in comparison. For example, the global revenues<sup>10</sup> of Alphabet Inc, Amazon and Apple range from approximately US\$111.9BN to US\$267.6BN, compared to

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<sup>5</sup> ACS Australia's Digital Pulse Driving Australia's international ICT competitiveness and digital growth, 2018, Deloitte Access Economics, page 3.

<sup>6</sup> The Long View How will the global economic order change by 2050?, The World in 2050, PwC, February 2017.

<sup>7</sup> FM Global Resilience Index, <https://www.fmglobal.com/research-and-resources/tools-and-resources/resilienceindex/explore-the-data/?cr=AUS&sn=ex&cd=AUS>.

<sup>8</sup> The Global Innovation Index 2018 is a leading measure of innovation across more than 80 indicators.

<sup>9</sup> S&P/ASX 100 Index (1 November 2018).

<sup>10</sup> Global revenues referred to have been sourced from Annual Reports filed for the years ended 31 December 2017 and 29 September 2018.

the global revenues of REA, Carsales and SEEK, which range from US\$327.9M to US\$1.0BN<sup>11</sup>.

Businesses and governments worldwide are moving quickly to build new and advanced digital technology capabilities. R&D expenditure provides insight into what businesses see as important to their future growth, with the world's largest publicly listed technology companies investing heavily in R&D. Australia's current investment in R&D is well below the OECD average. For example, Australia's aggregate investment in R&D for the year ended 30 June 2016 was AU\$31.1BN<sup>12</sup>, with the majority of R&D expenditure borne by traditional businesses. In contrast, a single US company (Google) incurred R&D expenditure of US\$16.6BN for the 31 December 2017 year<sup>13</sup>.

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

Whilst REA invests heavily in product and technology development in order to remain globally competitive, larger foreign multinational companies have the ability to leverage their scale advantages. For example, some foreign multinational companies are able to participate in Australia as a 'loss leader' to ensure market share is captured. 'Freemium' models are also creating significant competitive pressure on Australian digital platforms that are unable to participate due to high costs.

The significant financial resources available to large foreign multinational companies means that innovation and new technologies are able to be diverted to countries conducive to their growth and development. R&D activities and assets (which are increasingly intangible in nature) have never been more portable.

## 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 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 are highly portable.

It is critical that Australia remains globally competitive and attractive to investors. Otherwise, Australia is at risk that investment will move offshore as organisations prioritise other

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<sup>11</sup> Global revenues referred to have been sourced from Annual Reports filed for the year ended 30 June 2018.

<sup>12</sup> 8104.0 - Research and Experimental Development, Businesses, Australia, 2015-16, Australian Bureau of Statistics (ABS). More recent data is not publicly available from the ABS.

<sup>13</sup> Alphabet Inc. Form 10K, 31 December 2017.

countries that have lower labour costs, better incentivise R&D and innovation and offer lower corporate tax rates. Countries such as Singapore, which boast a significantly lower corporate tax rate (17%) and lucrative R&D incentives, have become a favoured destination for multinational companies to establish hubs to conduct 'cutting-edge' digital R&D activities. This has led to several digital and software multinational companies such as Netflix and Hewlett-Packard to establish regional headquarters based out of Singapore.

Australia's ability to attract and retain highly skilled and experienced ICT workers will be an important driver of future digital success.

## Features of the REA business model and impact of a digital tax

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.

There is a common misconception that all companies which operate digital platforms derive revenue from similar sources and operate identical business models. The REA business model is fundamentally different from many of the large foreign multinational digital businesses:

- REA derives value from the inherent nature of its platforms. Revenue is derived from the listing of goods and services (similar to traditional advertising) under a 'fee for listing' service model;
- The majority of revenues are derived through an intermediary and separate from the consumer (e.g. a customer lists a house on the website). Consumers subsequently browse the website in search of this commodity or opportunity;
- Revenues are predominantly impacted by the demand of consumers wanting to purchase or sell a property (rather than from any user generated content), the number of users on the website or from the execution of the transaction itself. More importantly, the revenues derived by REA's businesses are not contingent on the transaction being executed as REA operates under a fee for listing service model and does not receive a commission;
- Consumers contribute minimal content to the website. Accordingly, where there is no demand for REA's product and therefore no listings, REA would not generate revenue. This can be contrasted with other foreign multinational digital companies which derive a significant proportion of their revenue base from sale of digital data;
- Whilst REA does retain data from the listing of properties by real estate agents on its website (e.g. pictures of houses, property information etc), the data is not monetised. Consequently, there are negligible revenues derived from REA's intangible assets which are not captured under the Australian tax net.

In contrast, intellectual property (**IP**) for user generated content for foreign multinational digital companies is often located offshore in a low tax jurisdiction.

The intrinsic value of REA's revenues are inextricably linked to its self-generated intangible assets (e.g. the technology stack which powers its websites, REA's customer relationships and its local brand). REA registers and locates this IP, being the source of its revenues, in



Australia. The majority of IP associated with REA's Australian digital portals is originated, developed, held and owned by Australian companies.

## Uncertainty in defining the concept of 'user created value'

There is currently no global consensus on the relevance and importance of the location of value creation and the identity of the value creator. There are ways in which different factors (including, but not limited to users) create value for digital businesses. The role that users play in generating value for digital companies varies depending on the digital models used by businesses, as outlined in the previous section.

The value of user participation and how certain digital activities create value is also not widely understood. This position has been reiterated on several instances by a Nordic diplomat integral to the EU's negotiations on digital tax:

*"For us, the problem is the whole concept of taxing user value creation. Ultimately, this favors large countries over small countries and especially ones with exports.....The issue user value creation concept needs much more consideration. That is a key reason why we believe the OECD is the right place to resolve this issue and find a global agreement on the issue of digital taxation<sup>14</sup>."*

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 of the various business models used globally, how value is created and the role of data and users, REA believes the imposition of interim measures via a DST will unduly penalise and burden Australian companies that are currently paying their fair share of tax.

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<sup>14</sup> EU Banking Industry Calls for Blanket Exemption From Digital Tax, Bloomberg Law News, 23 November 2018.

## Appendix B

### The proposed features of any interim measure

REA have set out below a number of areas that should be considered by Treasury in developing a longer term digital tax solution. While REA strongly believe an interim measure should not be introduced, should Treasury proceed with the introduction of an interim measure, REA submits that the following matters be considered.

#### *1. Deferred introduction and hardcoded sunset date*

In its Interim Report, *Tax Challenges Arising from Digitalisation*, the OECD notes that a global DST solution is preferred over the adoption of unilateral measures. The OECD also states that, to the extent countries impose interim measures, these should only apply until such time as a consensus-based solution is developed.

REA agrees that any interim measure should be temporary and should cease to apply once a global solution is developed and endorsed. In this respect, in acknowledgement of the OECD's work and Australia's leadership within the OECD in this area, the application of an interim DST should be subject to a sunrise date such that if a global multilateral solution has not been agreed by, say 31 December 2020, Australia will implement a DST measure. By having the interim DST measure subject to a sunrise date, it provides the OECD with sufficient time (and potentially, pressure) to develop a global solution but does provide certainty to Australian businesses that if a multilateral measure isn't developed within a reasonable time, an interim measure will be enacted. The lead time will also give taxpayers sufficient time to determine the likely impact of the rules and to implement suitable systems and processes that will ensure compliance.

In addition, any interim measure should therefore have a clearly defined sunset date to avoid it becoming a de facto permanent solution. A sunset clause of no later than say 30 June 2024 should be included in any potential interim measure. If that is not possible, a rolling review period of 12 months would allow the Australian Government and industry participants to assess the impact of the measures and whether they should be kept in force.

#### *2. Basis of taxation*

REA acknowledges 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 the tax in practice. Therefore, REA understands that any proposed interim measure in Australia is likely to be a 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, it is noted:

- 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 apply and relief should be available for small, low profit or no profit taxpayers to ensure that start-ups and scale-ups continue to grow and 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 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. This is discussed further in section 5 below; and

- 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 businesses such as REA relative to foreign headquartered groups. This is discussed further in section 7 below.

### 3. Definition of “in-scope” revenue

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

It is recommended that Treasury consider adopting a more targeted definition of in-scope revenue, so as to avoid impacting businesses for which the application of a DST is unintended. This could include defining in-scope revenues as:

- “pay per click” revenues derived from Australian consumers (i.e. revenue derived by a digital business every time a consumer based in Australia clicks on a third party ad on their website); or
- banner advertising directed to Australian consumers; or
- download of applications from websites.

Similar to the proposals submitted by the EU, REA also advocates excluding all revenues from financial services from the operation of a DST<sup>22</sup>.

Whilst this method of taxation may not be a long-term global solution, it is arguably a reasonable proxy for taxing the value generated by the Australian user base, which is consistent with the stated policy intent.

To define in-scope revenues 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 REA, 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.

This is illustrated in the example below, which sets out the impact an interim tax would have on REA’s Effective Tax Rate (ETR):

<u>Scenario A:</u>	if in-scope revenue was defined to include advertising from banner revenues only, it is forecast <sup>23</sup> REA’s ETR would increase from 31.9% <sup>24</sup> to 32.6%;
<u>Scenario B:</u>	if in-scope revenues included all Australian revenue (including all listing revenues), it is forecast <sup>25</sup> REA’s ETR would increase from 31.9% to 37.4%;

<sup>22</sup> *EU Banking Industry Calls for Blanket Exemption From Digital Tax*, Bloomberg Law News, 23 November 2018.

<sup>23</sup> Modelling of the impact of in-scope revenue including advertising from banner revenues assumes a 3% rate and that the DST is not creditable and not deductible.

<sup>24</sup> REA Group Limited Annual Report, 30 June 2018.

<sup>25</sup> Modelling of the impact of in-scope revenue including all Australian marketplace revenue assumes a 3% rate and that the DST is not creditable not deduct ble.

In Scenario B, an increase in ETR by 5.5% is excessive and unwarranted. This would result in the creation of a competitive disadvantage for REA as an Australian headquartered digital company due to the risk that the vast majority of its income would be subjected to double tax.

#### 4. *Threshold(s)*

REA is strongly of the view that a *de minimus* threshold should apply to limit the types of organisations that are subject to any interim measures. Smaller companies and start-ups 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. This position is consistent with the position advocated by the European Banking Federation in relation to the EU's proposed DST.

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

Only in-scope revenues generated from digital sources should be considered when measuring whether an entity exceeds the *de minimus* threshold.

To the extent the grouping measures are used to calculate turnover thresholds, it is strongly recommended that start-ups and scale-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. It would also not be appropriate for independently operated businesses to be subject to the DST merely because they are owned by a large multinational group rather than positioned as a standalone entity.

REA would also consider it equally inappropriate for a grouping threshold to apply which practically discriminated between individual domestic companies competing in the same Australian online real estate advertising market.

#### 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.

It is submitted that India is an outlier in the rates listed above. A realistic rate for any interim DST in Australia would be no higher than 2%, which is consistent with most of the precedents listed above. A higher rate of tax on revenues will translate into a much higher ETR on profits and is highly dependent upon the margin of the business. Accordingly, an interim DST rate exceeding 2% would be inappropriate for a country like Australia which already features a comparably high headline rate of corporate income tax alongside robust measures to combat tax avoidance (e.g. the MAAL and DPT laws).

## 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 small businesses or independently run subsidiaries.

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 (e.g. REA) that 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 unreasonable economic burden by being unfairly taxed.

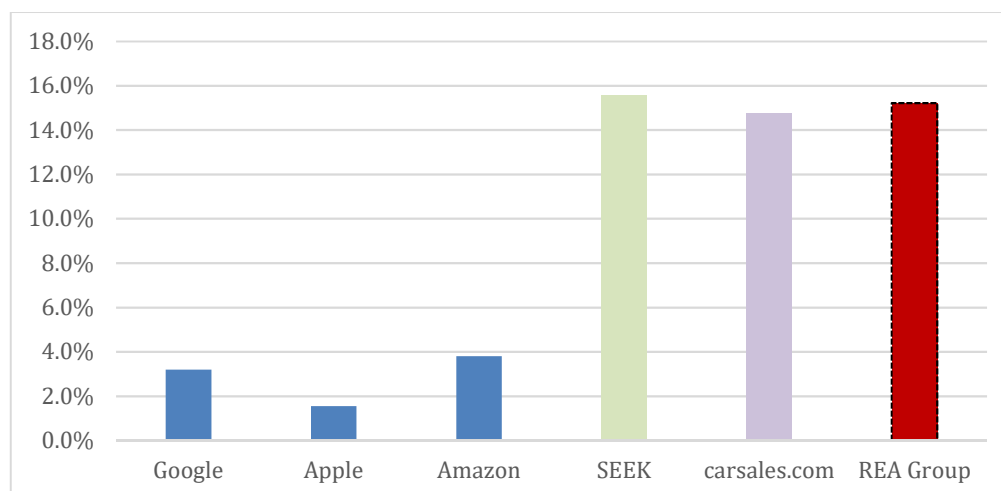
Consideration should also be given to preventing the application of the DST in situations where the underlying IP of a company is located in Australia.

## 7. Mechanisms for the 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 REA that already pay Australian income tax on the majority of their total income.

The table below outlines the comparative amounts of income tax as a proportion of Australian revenues paid by Australia's leading digital platform operators in comparison to several of the key global digital businesses operated abroad.

**Table 4: Australian Income Tax Paid as a Proportion of Australian Revenues<sup>27</sup>**



<sup>27</sup> The data for this graph has been sourced from information in the 2015-16 Report of Entity Tax Information, Corporate Tax Transparency, ATO, and the relevant company's 10-K filings or Annual Reports.

Therefore, REA strongly recommends that any DST paid should give rise to a non-refundable offset or credit against the Australian income tax otherwise paid or payable (or should be available for carry forward where the amount of offset/credit exceeds the income tax paid or payable), provided the revenue subjected to the DST is 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.

By way of precedents, there are several countries that permit a tax credit for indirect / non-income based taxes to be applied against income tax liabilities. For example, the Peru tax system provides a specific concession which allows certain Peruvian companies to offset VAT credits against its corporate income tax liabilities.

Alternatively, the provision of an income tax deduction for any DST paid is not sufficient to relieve taxpayers from double tax. A deduction mechanism will still result in 70% double taxation where a company's income is prima facie subject to both Australian income tax (at a rate of 30%) and DST. This level of double taxation is unacceptable and will, in practice, be disproportionately borne by Australian resident entities.

## ***8. Systems and process issues***

The challenge of complying with any interim measure should not be overlooked. It is critical that if an interim measure is implemented, it is simple to manage and comply with, without creating an unnecessary impost on a business' limited resources. It must be recognised that there will be challenges of complying with interim measures, as most businesses do not readily track or collect the data that would be required to ascertain in-scope revenue and, accordingly, calculate the taxes payable.

In designing any interim measure, Treasury should be mindful not to require taxpayers to dedicate significant levels of resourcing on the development of systems and processes. Resources should be spent on product and technological development as opposed to finance related resources/systems required to comply with the proposals. Ideally, the architecture of a multilateral DST should leverage from the existing systems, processes and filings that are already undertaken by taxpayers (for example, through the business activity statement / GST process).

## Appendix C

### Significant headwinds faced by property sector

As an owner and operator of digital online real estate portals, the viability of REA's business model is highly dependent on a stable property sector which promotes investment in the Australian real estate market. Historically, the growth in value experienced in the Australian property market has been driven primarily by the following factors:

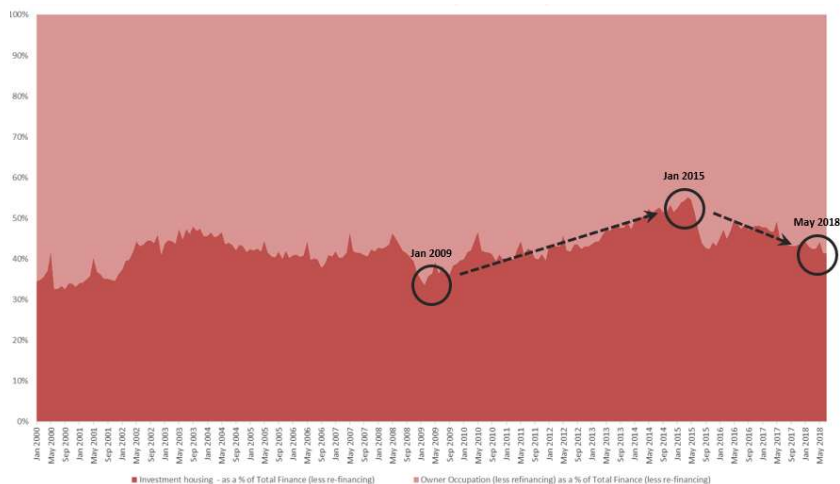
- Government policy which incentivises Australian consumers to invest in Australian property, which subsequently leads to a healthy balance between the demand and supply of Australian housing for both owner occupier and investors alike;
- Historically low interest rates making property investment attractive to aspirational buyers (i.e. low cost of borrowing, higher rental yields); and
- Negative gearing providing attractive tax benefits to help fund investment in property.

Despite the Australian property sector experiencing significant growth over the past decade, there are considerable economic headwinds currently being faced by the real estate industry. These are summarised below.

#### *Impact of Royal Commission & tightening of credit availability*

There has been a significant contraction in lending markets for property over the past 12 months, resulting in a significant decrease in property turnover levels. Based on data released by the Australian Bureau of Statistics (**ABS**), financing levels in 2018 dropped by 10.1% in comparison to 2017<sup>28</sup>. Whilst there has been a drop in owner-occupier financing made available to borrowers (down 3.9%, year on year), investor finance has plummeted with financing levels decreasing by up to 20.1% year on year.<sup>29</sup> The drop in overall finance levels and split between investors and owner-occupiers is outlined in the graph below. This trend has been further exacerbated by an out of cycle interest rate rise enacted by financial institutions in August 2018.

Table 2: Investment v Owner Occupier – Lending Split (excluding re-finance)



<sup>28</sup> *Housing finance falls to lowest level since Jan 2016*, Alex Ritchie, RateCity, 12 October 2018.

<sup>29</sup> *Ibid.*

## Potential impact of negative gearing & Capital Gains Tax (CGT) changes

Proposed reforms to negative gearing and the CGT discount are likely to further increase financial pressure on the real estate industry. RiskWise Property Research and Wargent Advisory co-authored the *Impact Analysis: Negative Gearing, CGT & Australia's Residential Property Markets Report*<sup>30</sup>, which has assessed the impacts of proposed negative gearing and CGT reforms. These include:

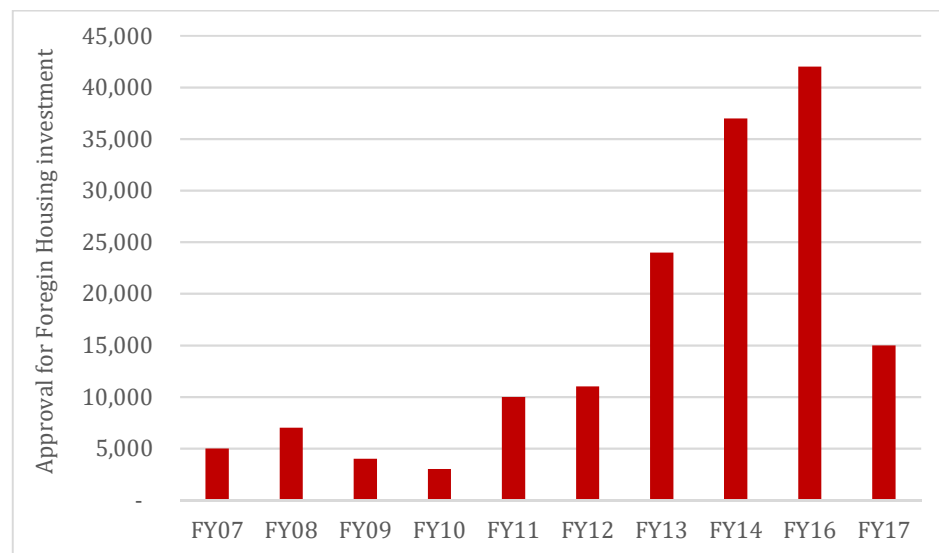
- The proposed changes would be the equivalent to a sudden 1.15% increase in interest rates in the Sydney unit market;
- Negative gearing and CGT reforms having potential unintended consequences, and some geographical areas, especially those with weak or fragile property markets, would be adversely impacted more than others. i.e., Darwin, Mackay, inner-city Perth and Townsville; and
- Declining dwelling prices (or price deceleration in some regions), a reduction in dwelling commencements and deteriorating rental affordability.

## Slump in foreign buying demand

The value and number of approvals for foreign investment in Australia's housing market has dropped significantly since 2016. A total of 13,198 residential real estate applications were approved in the 2016/17 financial year, totaling \$25.2 billion, down from 40,149 approvals worth \$72.4 billion in 2015/16 (see Table 3 below).

The decrease in foreign demand for Australian property has been driven primarily by higher charges (e.g. increase in stamp duties imposed by state governments), tighter lending restrictions and the introduction of capital controls in China<sup>31</sup>.

Table 3: Approvals for Foreign Investment in Australia's Real Estate Market<sup>32</sup>



<sup>30</sup> *Impact Analysis: Negative Gearing, CGT & Australia's Residential Property Markets Report*, WargentAdvisory, 19 June 2018

<sup>31</sup> *Official data reveals the collapse in foreign investment activity in Australia's housing market*, Business Insider Australia, 29 May 2018.

<sup>32</sup> Ibid.



### *Housing turnover is actually declining*

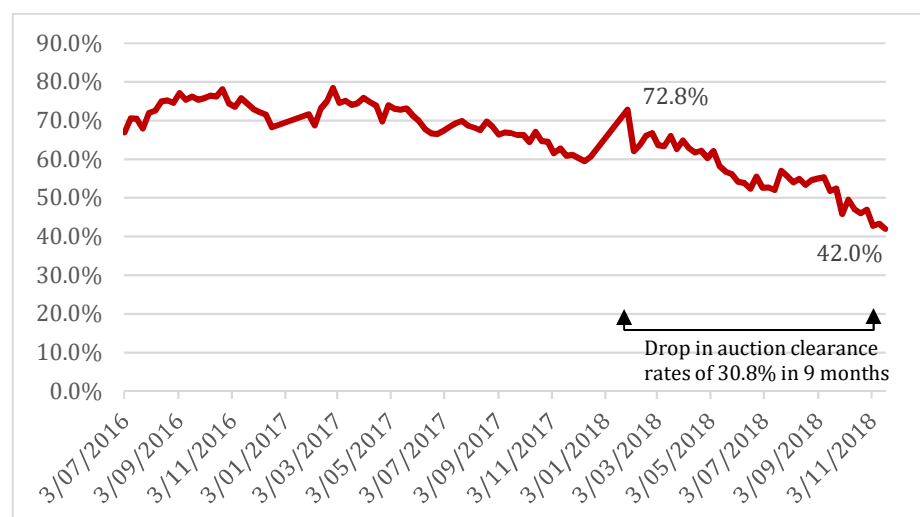
Based on statistics released by the Reserve Bank of Australia (**RBA**), the rate of housing market turnover, an important indicator of housing market conditions, has trended lower since the early 2000s. This is partly because households are moving less often and fewer Australians owning their own homes. Among the potential reasons for this could be lower rates of home ownership, particularly for younger households, and migration trends<sup>33</sup>. A lower turnover can result in a smaller direct contribution to aggregate economic activity in the future.

### *Auction clearance levels & housing turnover is declining*

Property sales have experienced a sharp decline during the 2018 year, with auction clearance rates for the 2019 financial year currently averaging 50.7% (2017: 63.7%)<sup>34</sup>. This is resulting in REA's customers experiencing higher levels of financial distress, due to a significant fall in commission revenues derived from property sales.

Further, auction clearance rates have dropped 30.8% from its peak in January 2018, down from 72.8% to 42%. The sudden decline in clearance rates is outlined in the table below:

Table 4: Weighted Average Auction Clearance Rates – Australian Properties<sup>35</sup>



### **How does this impact the implementation of a proposed DST?**

Should an interim DST be implemented, it could result in an additional cost which could be passed onto customers (i.e. real estate agents) or consumers (i.e. house buyers/sellers). Given the considerable financial duress faced by the real estate industry due to the factors outlined above, the additional 'pass on' cost arising from a potential DST would further exacerbate the financial duress currently experienced by real estate agencies. In particular, these costs could have a significant impact on the financial viability of small to medium sized real estate agencies, particularly in remote areas where the quantum of property turnover is comparatively lower than city centres.

The real estate industry currently employs approximately 45,000 people Australia wide.

<sup>33</sup> *Housing Market Turnover*, Hannah Leal, Stephanie Parsons, Graham White and Andrew Zurawski, March Quarter 2017 Bulletin, RBA.

<sup>34</sup> CoreLogic Auction Results, CoreLogic, 25 November 2018.

<sup>35</sup> CoreLogic Auction Results, CoreLogic, 25 November 2018.