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Attention: Natasha McNamara

Dear Natasha

### Submission on the digital economy and Australia's corporate tax system

Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ) appreciates the opportunity to provide our submission to The Treasury on 'The digital economy and Australia's corporate tax system' Discussion Paper (the Discussion paper). We apologise for missing Treasury's deadline but as you would know, there have been many submissions for us to do lately.

We welcome the Government initiating public consultation on this important Australian and global issue, in response to a mandate from the G20 Finance Ministers to work on the implications of digitalisation for taxation. As set out in the [Interim Report on the Tax Challenges Arising from Digitalisation](#), released in March 2018, the members of the OECD/G20 Inclusive Framework on BEPS agreed to work towards a consensus-based solution by 2020.

Australia is one of more than 110 countries and jurisdictions who agreed, as part of the next phase of the OECD work, to undertake "a coherent and concurrent review" of two key concepts of the international tax system - the 'nexus' and 'profit allocation' rules - fundamental concepts relating to the allocation of taxing rights between jurisdictions, and the determination of the relevant share of the multinational enterprise's profits to be subject to taxation in a particular jurisdiction. A central consideration in this process is the impact of digitalisation on the economy, in terms of how best to align profits with underlying economic activities and value creation in an increasingly digital world.

## Introductory comments

Chartered Accountants ANZ believes that the present moment is a critical juncture for the worlds' collective future, where it is vital for countries to work *together* to develop the next era of international taxation principles that will be fit for purpose throughout the coming decades of digitalisation.

While we don't know exactly what it will look like, we do know that the coming decades will be a period of rapid economic transformation because of technologies and innovations, many of which have not even been conceived, let alone invented and adopted in the mainstream. This will happen in the context of a carbon-constrained world, facing climate breakdown and other environmental, social and economic challenges that will require the world to work together to completely and rapidly metamorphasise if we are to move to more sustainable economic trajectories, and survive and prosper longer term.<sup>1</sup> Technologies offering data-based remote services and solutions with transnational reach will be common place.

Income taxation has long been a truly international issue, but for all the reasons above, it will become increasingly global and transnational in the decades to come. High-performing income tax frameworks depend upon the quality of global dialogue, unity, consistency, and consensus. For this reason, we believe that it is imperative for nations to co-operatively co-design rules that are fit for purpose in the 21<sup>st</sup> century economy.

We must also look forward with vision, aspiration and mutual respect for each other's needs, to ensure that the next generation of international taxation laws developed are robust, and operate fairly, efficiently and equitably so that the appropriate tax is collected by each nation.

From Australia's individual perspective, we see an even broader set of interests to consider, and that is understanding how any changes to the settled order and design of international tax laws may play out for the Australian economy and its sectoral composition over the longer term. These implications should be well-considered ahead of making any knee-jerk, reactionary law changes that are designed with the short term in mind, without a vision for the long run. Having said that, should the Government decide that an interim measure is necessary to serve Australia's national interests, there are a number of design considerations for any such measure that we believe should be taken into account.

It is from these various perspectives that we have contextualized, considered, and developed our high level views expressed in this submission, and our responses to the specific consultation questions.

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<sup>1</sup> IPCC, 2018: Summary for Policymakers. In: *Global warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty*, V. Masson-Delmotte, et al, World Meteorological Organization, Geneva, Switzerland, 32 pp.

## Key comments and recommendations

- As a member of the OECD's Inclusive Framework, Australia would recognise that we share a common interest in maintaining a single, relevant set of international tax rules.
- While it may be an option for Australia to introduce an interim income tax measure, such a measure could give rise to more risks and adverse consequences than the benefits to be gained. Although it may be possible to manage or limit some of the adverse side-effects, there may be inherent issues that could have a detrimental longer-term impact on Australia's tax revenue if the wrong short-term measures are implemented, related to our economic composition.
- The challenge from an international income tax perspective is to strike the right balance between:
  - protecting the revenue base and avoiding distortions to competition (in terms of a level tax playing field);
  - achieving consistency of the international tax rules, with tie-breakers and tax credits to enable relief from double taxation;
  - adopting tax rules that will achieve a fair, reasonable, and equitable allocation of profits between countries;
  - avoiding double taxation of the same revenue base domestically, and in turn cascading tax being borne by consumers; and
  - avoiding the costs and downside considerations of income tax measures that could be disproportionate to the income collected, i.e. ensuring that any changes have a net benefit that is in the long-term interest of Australia.
- Chartered Accountants ANZ recommends that the Government stay the course with the Inclusive Framework, and carefully considers the costs and benefits to Australia before introducing any interim tax measure. The OECD has recognised that “the digital economy is increasingly becoming the economy itself”, and as such, “it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes”. We agree with both these propositions, and therefore recommend that the tax rules adopted now should preferably be those that will be adopted as the new set of rules for the newly emerging globalized, digitalised economy going forward.
- We believe that an interim measure that moves us into the “turnover” territory for the taxation of digital services income within Australia would:
  - risk creating different principles from the internationally accepted tax rules that are currently undergoing a considered review process. This could create a risk of international double taxation and in turn, even economic / tariff retaliation;
  - create domestic double taxation of digital services supplied to consumers, as GST has now been imposed on those inbound services. To apply income tax on those services based on “turnover” (which is now GST-inclusive for those services) would impose income tax on the GST component of the turnover. This double taxation would need to be addressed. The cost incidence of this cascading taxation may be borne by consumers; and come at a resourcing, training and enforcement cost which could be significant given the completely new approach that would not easily fit with the existing tax compliance system. The Government would need to conduct a cost-benefit analysis to confirm that the revenue collections outweigh the downside risks.

# Response to Specific Consultation Questions

## 1. ***Is user participation appropriately recognised by the current international corporate tax system? If not, how should value created by users be quantified and how should it be taxed?***

Based on the international work undertaken to date, there appears to be consensus with the following propositions:

- There are tax challenges arising from the modern economy that need to be addressed; and
- International tax systems need to be put on a more sustainable footing.

However, the more controversial conclusion proffered by many (albeit not all) from the above propositions is that the division of the global tax base, when it comes to profits arising from the economic activity associated with digitalisation, needs to be rebalanced. In short, the more controversial conclusion is that a greater allocation of the digital economy's profit pool should be going to the jurisdictions where the buyers reside, not the supplier's production base.

That is, existing international taxation principles based around residence, supplemented by the concept of a permanent establishment requiring some form of physical presence in a jurisdiction, are not necessarily flawed for many business models, but they need modification or supplementary rules, particularly in regard to the income streams generated from relatively mobile and interactive intangible assets/platforms.

However, in Chartered Accountants ANZ's opinion it is less clear that the current problem resides primarily in the failure to appropriately value 'user participation'. Moreover, even if this is the root of the current problem, the suggested answers to the questions of what 'user value' is created and how it should be fairly taxed in each jurisdiction are far from settled. In addition, as the Discussion Paper already acknowledges, if solutions are implemented now which address the alleged failure to appropriately tax local user value, the emergence of other digital technologies may well result in the solutions developed becoming obsolete very quickly.

Accordingly, Chartered Accountants ANZ is of the opinion that the answers to both the above questions are still a global 'work in progress'. They are best left to be debated and determined via existing consultation processes aimed at reaching a broad global consensus on a future international tax framework.

## 2. ***Is the value of intangible assets including 'marketing intangibles' appropriately recognised by the current international corporate tax system? If not, how should value associated with intangibles be quantified and how should it be taxed?***

Chartered Accountants ANZ's response to question 1 is equally applicable here, other than to add the following points:

- There appears to be no broad consensus that a focus on the problems associated with the taxation of intangibles concludes that 'formulary apportionment' is the optimal solution; and
- Even the more limited proposal that advocates the source rules for income derived from marketing intangibles (such as trademarks and brand names) should diverge from the source

rules associated with patents and copyrights (and presumably other intangibles), appears to lack both the empirical evidence to support such propositions and/or the detailed design work to confirm they could be implemented in an equitable and compliance-friendly way.

3. ***Are the current profit attribution rules ‘fit for purpose’? If not, how should profits be attributed?***
4. ***What are your views on allocating taxing rights over residual profits associated with: (i) user contribution to ‘user’ countries, or (ii) ‘marketing intangibles’ to market countries?***
5. ***Should existing nexus rules for determining which countries have the right to tax foreign resident companies be changed? If so, how?***

Chartered Accountants ANZ’s response to question 1 acknowledges what appears to be broad international consensus, that the adequacy of the current international framework for profit attribution rules and nexus are not ‘broken’ but may be deficient in some business models.

Similarly, our views on: (i) what local activity or ‘virtual permanent establishment’ needs to be targeted; (ii) when such activities should and should not be taxable in the buyer’s location; and (iii) how the local profits should be quantified, all require a global solution, not an Australian-centric tax policy decision.

6. ***From a tax perspective, do you consider that the digitalised economy is distinguishable from traditional economy? If yes, are there economic features of the digitalised economy that present special challenges in the context of taxation? How are these features relevant for assessing the costs and benefits of various models of taxation?***
7. ***Can and should any changes to the international nexus and profit attribution rules be ring-fenced to apply only to highly digitalised businesses? If so, how?***
8. ***Are there changes other than to nexus and profit attribution rules that should be made to the existing international corporate tax framework and/or Australia’s tax mix to address the challenges presented by globalisation and digitalisation?***

We concur with the OECD views that it is difficult to ring-fence what are, and are not, ‘digitalised economy activities’ particularly given the rapid changes in technological developments. Moreover, attempts to do so inevitably lead to accusations of creating taxes just for specific businesses, rather than any real attempt to create a level playing field in international taxation rules.

On the question of whether other changes might be made to the international corporate tax framework and/or the Australian tax mix to address the challenges of globalisation and digitalisation, we question why Australia would contemplate:

- investing time and energy on untested international tax policy theories; or even
- seek to be an early adopter of such theories,

while at the same time, Australia appears content to defer action on some of our more obvious tax mix dependency issues already highlighted to us by the Henry Review.

9. ***What does the experience of other countries that have introduced interim measures or that are contemplating them mean for Australia?***

10. ***Should Australia pursue interim options ahead of an OECD-led, consensus-based solution to address the impacts of the digitalisation of the economy on the international tax system?***
11. ***What indicators could be used to identify businesses that benefit most from user-created value? Would an interim measure applied to digital advertising and/or intermediation services accurately target that value? How broadly or narrowly should 'digital advertising' and 'intermediation services' be defined?***
12. ***The choice of 'nexus' for an interim measure (or a longer-term 'virtual' PE proposal) involves significant trade-offs between ease of administration and the risk of avoidance. Which nexus option strikes the best balance between these considerations?***
13. ***What are your views on thresholds for an interim measure, taking into account the need to meet Australia's international trade obligations?***

Chartered Accountants ANZ's first preference would be for an OECD-led, consensus-based solution to form the basis of any digital taxation response by Australia.

Having said that, we acknowledge the following:

- A global, principles-based solution still appears to be some way off, and detailed global design parameters even more so;
- Based on the Government's recent track record of embracing international tax developments early, plus the overseas developments thus far on digital services taxes, realistically the Government may not be willing or able to accept a 'wait and see' approach;
- An interim decision in Australia to consult on the detailed design of a 'back-up plan' in the event of no global consensus by say 2020, is a legitimate tax policy response in the circumstances;
- This is merely facilitating both options being considered in tandem, rather than sequentially (albeit there is unfortunately a duplication of effort); and
- Any domestic measure actually implemented post-2020 should be compatible with Australia's existing trade obligations and should have a sunset date linked to an ultimate global solution (albeit there is still the prospect of a duplication of implementation costs for both taxpayers and the ATO).

Accordingly, assuming the Government proceeds to the interim design phase, the past experience of other countries that have pre-empted a global solution suggests:

- The OECD's interim framework guidance is a good starting point, but invariably domestic nuances proliferate in these interim measures;
- When it comes to implementation, an approach of 'the end justifies the means' is regrettably often adopted and we anticipate any Australian interim measure may fall into the same category. That is, for all the theories about correctly capturing user participation value, the source of marketing intangible value, or more appropriate profit splits in the digital supply chain, the actual interim digital tax regimes that have been adopted are very simple (and very

blunt) revenue raising measures, practically payable by only a few taxpayers (mainly non-residents in an unmentioned but generally clearly identifiable country – the United States of America<sup>2</sup>). Politically, such taxes may also be seen as an easy “sell” to citizens even though they are not costless in terms of passing on effects;

- As the global discussions on digital taxation have developed, there have been incremental changes adopted in digital tax regimes subsequently announced, that leverage off the most recent learnings;
- Given the United Kingdom (UK) has the most recent iteration of an interim digital tax (and Australia has tended to follow in the international tax footsteps of the UK), we suspect the UK proposals would be a useful place for Australia to start in designing any digital services tax that we are proposing to implement. France has reportedly also indicated a “go it alone” strategy in the absence of a uniform European Union approach by March 2019<sup>3</sup>.

In designing a digital services tax for Australia, however, the potential for domestic double taxation of digital services supplied to consumers must be considered. This is because Australian GST has now been imposed on those business to consumer (B2C) inbound digital products and services. To apply Australian income tax on those products and services based on “turnover” (which is now GST-inclusive) would impose income tax on the GST component of the turnover. This double taxation would need to be addressed. The cost incidence of this cascading taxation may also be passed on to and borne by consumers.

We note that the current approach to income taxation principles is well-integrated with the GST base. One is mutually exclusive of the other. The GST component of the consideration received for a supply is excluded from the revenue on which income tax is payable. Similarly, if a GST input tax credit is available on a purchase, the GST component is excluded from the expense for determining deductibility from assessable income.

By contrast, if a digital services tax were imposed based on “turnover”, then this income would include both revenue + GST component, and accordingly would constitute double taxation within our own domestic tax base. This in turn would mean that Australian consumers would bear double taxation on their digital products and services, unless the two policies were carefully designed and modelled to ensure that they are neatly dove-tailed, without overlap in the tax bases. That would likely involve complexity.

Adopting different principles from the internationally accepted tax rules that are undergoing a considered review process could also create a risk of international double taxation, in turn even economic / tariff retaliation. There is increasing concern that an un-coordinated approach to taxing the digital economy may have ramifications for taxing intangibles and physical goods.

A new, unfamiliar interim digital services tax on turnover would also have to be administered. This will come at a resourcing, training and enforcement cost which could be significant given the

<sup>2</sup> We note however that China – with its rapidly emerging digital economy and large diaspora – may well be another target and may find one-off, country specific digital services taxes just as objectionable as the USA.

<sup>3</sup> Refer: [https://www.cnbc.com/2018/12/06/france-will-tax-digital-giants-from-2019-even-if-no-eu-wide-agreement.html?mkt\\_tok=eyJpIjoiWkdOaU1XTmtPR0ZrWVRsbSlzInQiOiJvStZUnhVS3VOY2JHYWJWVFFmU2FMVHcyT1h6Z2dObWp5XC9PaDhuNIVGZVdhcjR3VkQ4dGgzZmZlSldxejZRCdDhXcjZ3VkR1UkXUURNbkJiTdkyRDhiakZENnY3UnpyMDFleEVqZk1lbU5iTUhMWUNsSnpkeksrMkpzelgifQ%3D%3D](https://www.cnbc.com/2018/12/06/france-will-tax-digital-giants-from-2019-even-if-no-eu-wide-agreement.html?mkt_tok=eyJpIjoiWkdOaU1XTmtPR0ZrWVRsbSlzInQiOiJvStZUnhVS3VOY2JHYWJWVFFmU2FMVHcyT1h6Z2dObWp5XC9PaDhuNIVGZVdhcjR3VkQ4dGgzZmZlSldxejZRCdDhXcjZ3VkR1UkXUURNbkJiTdkyRDhiakZENnY3UnpyMDFleEVqZk1lbU5iTUhMWUNsSnpkeksrMkpzelgifQ%3D%3D)

completely new approach would not necessarily easily fit with the existing income tax compliance system. The Government would need to conduct a cost-benefit analysis of the revenue collection costs.

We trust that the comments in this submission are of assistance to the Treasury. We would welcome the opportunity to discuss our submission with you in further detail should this assist.

In the meantime, if you have any questions about any aspect of our submission, please contact either Ms Donna Bagnall on (02) 9290 5761 or [donna.bagnall@charteredaccountantsanz.com](mailto:donna.bagnall@charteredaccountantsanz.com), or myself on (02) 9290 5609 or [michael.croker@charteredaccountantsanz.com](mailto:michael.croker@charteredaccountantsanz.com).

Yours sincerely



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