

Domain

Treasury Discussion Paper

Submission by
Domain Holdings Australia Limited

The digital economy
and
Australia's corporate tax system

30 November 2018

1 Introduction

Domain Holdings Australia Limited (“Domain”) welcomes the opportunity to comment on the Discussion Paper: *The digital economy and Australia’s corporate tax system* published by Treasury on 2 October 2018.

We also note that, following the UK Treasury paper “*Corporate Tax and the digital economy*” in March 2018, the UK announced the introduction of a digital services tax (“DST”) in late October 2018, being a 2% tax on the gross revenue of certain in-scope digital revenues. Given Australia typically follows the lead of the UK on tax matters (and the need for global consistency of a DST), we have made reference to the proposed UK DST where relevant.

We also note the comments in Section 4.1 of the Australian discussion paper which provides some useful background as to why countries like the UK and Australia are considering the introduction of a DST on certain gross digital revenue as an interim solution.

“The rapid growth of the digitalised economy in recent years has prompted international debate about whether there is a need to change the way that taxing rights over business profits are allocated between countries under the existing international corporate tax framework.

The concern for some countries is that the current tax framework does not properly capture the value to digitalised businesses of the participation of users, the provision of personal data or user-created content. For some countries with large numbers of users but few highly digitalised domestic businesses, there is an increasing prospect of tax revenues diminishing as foreign, highly digitalised businesses replace traditional business activities.

A number of countries are considering imposing a tax on the turnover of highly digitalised businesses as an interim response. Some countries are also considering expanding nexus rules in order to tax highly digitalised non-resident businesses that have a significant economic presence in their country.”

In particular, from a political perspective, we understand that there is a push to ensure that countries such as Australia can collect a “fair amount of tax” from certain foreign technology companies, and that this could be achieved via a DST as an interim solution (noting a global, long term solution through the income tax treaty framework may take many years to achieve).

We also acknowledge that the consideration of a DST in Australia is likely to give rise to a variety of political and other economic ramifications which need to be taken into account, including ensuring Australia meets its international trade obligations (eg such that any DST is not seen, in substance, as discriminatory).

2 Background on Domain

In order to understand the potential impact of a DST on Domain, we note the following background information on Domain.

- Domain is an Australian Stock Exchange listed company that operates 100% within Australia. That is, all of Domain’s employees and technology development activities are based in Australia; and all of its revenue is assessable in Australia and subject to the 30% corporate tax rate.
- Domain earns its revenue from
 - selling digital advertising to residential and commercial real estate agents and owners, and to property developers (around 63% of revenue);
 - selling print advertising to the same client base (around 22% of revenue);
 - providing real estate data to agents (around 8% of revenue); and
 - commissions on loans and insurance and other services purchased through its websites (around 7% of revenue).
- The market in which Domain operates is competitive, with its major competitor being REA Group Limited, which is also listed on the ASX, albeit is majority owned by News Corp Australia Limited.
- Whilst Domain’s annual digital revenue was around \$280M in the 30 June 2018 year, the intention is to grow the business rapidly in future years.
- Domain is 60% owned by Fairfax Media Limited (“Fairfax”) (and is consolidated in Fairfax’s accounts) and is classified as a “significant global entity” for Australian tax purposes given the gross revenue of the consolidated Fairfax Group which exceeds \$1B. Fairfax is also in the process of merging with Nine Entertainment Co Holdings Limited (“Nine Entertainment”).
- Domain’s business is inextricably linked to Australian real estate transactions (which is neither moveable nor transportable). As such, its customers and users are almost completely based in Australia (with all of Domain’s revenue derived in Australia and subject to GST and corporate tax in Australia).
- Domain invests in a number of Australian start-up companies that are generating future innovation of Australian revenue streams. A lot of the start up’s have turnovers that are within the small business entity definition.

3 The potential impact of a DST on Domain

Based on the discussions in the Australian Treasury paper and the UK DST announcements, Domain is concerned that a potential Australian DST could apply to a large proportion of Domain’s revenue. If, for example, a 2% turnover style tax was imposed on Domain’s digital revenue, we note the following:

- This would result in double taxation for Domain, given that 100% of its revenue is already subject to Australian corporate tax at the 30% rate. Given that the primary intention of a DST would be to collect tax on foreign technology companies not treating certain digital revenue as taxable in Australia, the imposition of a DST on Domain would be “collateral damage”. Indeed, this is acknowledged in section 5 of the Australian discussion paper. It is simply unfair to impose an additional “double” tax burden on domestic businesses that are already fully subject to tax on such revenue in Australia.

On the basis that the proposed DST is imposed on digital revenue, similar to the UK’s proposal, the impact on EBITDA for Domain is shown below¹:

Proforma	FY18
Gross Digital Revenue	278.9
EBITDA	98.2
Assumed DST @ 2%	5.6
Adjusted EBITDA	92.6

- Thus, if Australia was to proceed with a DST, significant attention should be given to designing the DST (and the relevant thresholds) such that it did not result in an additional burden for domestic businesses like Domain. We are concerned that this may be difficult given Australia’s desire to honour its WTO and FTA non-discrimination obligations.
- Moreover, the compliance costs associated with calculating a DST liability becomes greater as the design of the DST becomes more complicated.
- The imposition of a DST on Domain would be a significant taxation burden which would be expected to result in the following:
 - Domain would endeavour to try to pass on the DST to its customers, which would effectively be a de facto property tax for Australians wishing to sell their house and participate in the Australian property market;

¹ Calculations based on Domain’s 2018 Full Year results Investor Presentation per <https://shareholders.domain.com.au>

- In order to remain competitive, Domain would need to consider other avenues to reduce costs, for instance, “offshoring” the development of new technologies, or limiting investment in Australian start-up companies, which would reduce employment in Australia (and the associated employee taxes generated), and stifle technical innovation in Australia. This would inhibit economic growth in the Australian digital economy sector;
- From a competitor perspective, a DST would disadvantage Australian businesses like Domain more than the large dominant foreign technology companies, which can more easily pass on the cost of a DST, and already have lower offshore development costs.
- If a longer term solution was introduced (eg the amendment of international income for rules on a global basis), then it is expected that there would be no additional tax burden on Domain given it is already subject to 30% corporate tax in Australia on all of its revenue. Thus, it would seem unfair to impose a DST on a business like Domain as part of an interim solution (giving rise to double tax), when it is expected that no such additional tax would arise under a longer term solution. Moreover, we are concerned that the interim, DST solution may actually become a permanent tax if a global, multilateral solution cannot be agreed upon.

4 Thresholds

In terms of designing appropriate thresholds for a DST in Australia, we note:

- The UK have announced a revenue threshold of £500m from in-scope digital services.
- The Australian discussion paper raises the possibility of only applying the DST to “SGE’s”, given Australia’s WTO and FTA obligations, and the desire to ensure that a DST does not, in substance, apply on a discriminatory basis
- Domain is concerned that a DST could apply to the majority of its digital revenue given it is classified as an SGE (as its 60% ownership by Fairfax and Nine Entertainment).

In light of the above, significant attention should be given to the Australian DST thresholds such that the DST would not apply to an Australian business like Domain (given the double taxation, collateral damage outcomes etc). For example, this could be achieved in a number of ways:

- Having a separate threshold for all domestic and foreign listed companies which does not rely on the SGE rules. This would ensure that Domain is not aggregated with Fairfax (and Nine Entertainment post the merger)
- Having a threshold which is based purely on digital in-scope revenue (such as \$750M or even higher) which would be similar to the UK. This should be considered in the context that the UK corporate tax rate is 17%; whereas the Australian corporate tax rate is 30%
- Having a threshold for start-ups like the £25m threshold in the UK and not grouping them in an SGE-like rule
- An exclusion for the DST to be applied to the revenues generated by investments in Australian incorporated and unincorporated joint ventures where they have a turnover of less than a small business entity
- Basing the threshold on a net profitability type basis (rather than a gross revenue basis, which does not take into account the higher cost of operating in Australia). This could, for example, introduce an alternative calculation methodology such that businesses earning a low profit margin on digital services would be excluded from a DST. Another alternative would be to base a DST on net positive cash flow (ie revenue after taking into account cash development costs).

5 Other concerns

The introduction of DST as an interim solution in Australia would also have the following consequences:

- A DST imposed on gross revenue would be a blunt excise/turnover tax that did not take into account the profitability of a business. Such a DST would be more disadvantageous to Australian businesses like Domain who employ people locally to undertake all elements of business operations. Whereas the dominant foreign technology companies' local presence is limited largely to sales employees.
- A unilateral DST is likely to lead to piecemeal, country-by-country measures. This is likely to lead to complexity, double taxation and a significant compliance burden for all technology companies (eg working out what digital revenue is in-scope on a product by product basis). This is not sustainable and supports the view that Australia should pursue a longer term solution, rather than an interim, unilateral DST.
- A DST could lead to retaliatory counter-measures by other countries which may well outweigh the expected revenue benefit from an interim measure. The US Senate Committee on Finance has written a letter to the European Commission in regards to its proposal for a Digital Services Tax, strongly urging the European Union against implementing the measure:

The EU DST Proposal violates the long-held principle that taxes on multinationals should be profit-based, not revenue-based. The EU already has a revenue tax based on the location of the customer – the VAT. Consequently the DST will undoubtedly lead to double taxation of multinational companies.

...

The turnover thresholds ... are discriminatory, putting in-scope companies at a competitive disadvantage without objective justification. This raises concerns about the EU DST Proposal's compliance with the EU's national treaty commitments under the World Trade Organization General Agreement on Trade in Services.

Moreover, we note the following statement by US Treasury Secretary, Steven T Minchin on 25 October:

“Treasury is working very closely with the OECD and our counterparts there to address issues of base erosion and fair taxation. We believe the issue is not unique to technology companies but also relate to other companies, particularly those with valuable intangibles. I have instructed our team to continue their efforts in the OECD so that we can make progress on these issues quickly. I highlight again our strong concern with countries’ consideration of a unilateral and unfair gross sales tax that targets our technology and internet companies. A tax should be based on income, not sales, and should not single out a specific industry for taxation under a

different standard. We urge our partners to finish the OECD process with us rather than taking unilateral action in this area.”

The very fact of such a range of uncertain and potentially problematic outcomes is itself key to the experience of announcing or implementing interim measures.”

- It would also be expected that technology companies would change their contractual arrangements with customers to minimise the impact of a DST, which would distort the natural underlying arrangements such that the DST would not apply as intended. For example, digital businesses earning commissions as an agent would endeavour to be considered to be a principal in a transaction; there could be a redesign of the way that discounts and rebates are offered to customers to minimise the gross revenue earned.

6 Other comments

There is little prospect of being able to introduce a unilateral, interim measure (which is compliant with Australia's international trade obligations), that does not apply to increase the cost base of Australian digital businesses that are already paying tax on all of their profits in Australia like Domain.

Accordingly, Australia should pursue a multilateral, longer term solution, rather than a unilateral interim DST type solution.

In the event that Australia does intend to introduce a DST, the DST should be creditable against corporate tax; or give rise to franking credits.

In terms of "in-scope" digital services revenue, it should be made explicit that this does not include:

- Revenue from a customer when data/service/content are provided directly to that customer, even in digital form
- Revenue from advertising, where the advertising is provided in hard copy print such as a newspaper or magazine (for example, the Domain print material in the Sydney Morning Herald or the Australian Financial Review, which is published by Fairfax).