

Australia's framework questions for a possible digital tax

2 October 2018

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In brief

As foreshadowed in the 2018-19 Federal Budget, on the 2 October 2018 the Government released a discussion paper “[*The digital economy and Australia's corporate tax system*](#)” (the Discussion Paper) that explores options for taxing digital businesses in Australia.

The Discussion Paper raises 13 questions which invite views on topics such as taxing user created content, taxing marketing intangibles, potential changes to profit attribution rules, and the appropriate nexus for imposing Australian taxes on the digital economy, along with considerations for interim measures to be adopted in Australia.

The closing date for submissions is 30 November 2018.

In detail

The pace at which new business models are evolving through the use of technology and data (through social media, search engines, online media, online shopping, sharing economy platforms, and the like) and across jurisdictions is growing exponentially.

The release of the Discussion Paper is confirmation from the Australian Government that the digital economy will be subject to increasing and industry-specific policy scrutiny.

The Discussion Paper is only a guide as to how Australian tax principles concerning the digital economy might operate. In particular, the Discussion Paper aims to explore options to move towards a fairer and more sustainable tax system for the digitalised economy. With the opportunity to comment on the issues posed in the Discussion Paper before 30 November 2018, any principles flagged in the Paper have not received Government approval at this time.

In addition to raising questions about how Australian tax policy could be pursued, the Paper also includes much broader questions, such as whether the digitalised economy is actually something that can be distinguished from the traditional economy, and whether tax reforms in this area can and should be ring-fenced to highly digitalised businesses.

One of the major questions that is posed in the Discussion Paper is whether or not Australia should be acting unilaterally and ahead of the Organisation for Economic Cooperation and Development (OECD) led, consensus-based solution to address the impacts of digitalisation on the economy.

This was acknowledged a number of years ago as part of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, and specifically in the 2015 BEPS Action 1 Report, *Addressing the Tax Challenges of the*

Digital Economy, which recognised that digitalisation and some of the business models that it facilitates present important challenges for international taxation.

The challenge in this area of tax policy comes from the need to identify the nexus of profits (or income) and then determine the appropriate attribution of profit to a particular jurisdiction. This nexus issue represents a departure from the long-standing tax principles of residency and source, which have informed relief from double tax under bilateral treaties for decades.

Although there is a general expectation internationally that a long-term global solution is needed, some countries have been considering an interim solution such as an “equalisation tax”.

Currently, Australia is not alone in pursuing or contemplating this agenda. Other countries are at least considering some form of digital tax. For example, the United Kingdom has previously released discussion documents setting out the challenges and possible solutions, and India has adopted an equalisation levy. Earlier this year the European Commission foreshadowed the introduction of a 'digital turnover tax', which would have levied a three per cent tax on the revenue of certain internet service providers.

The effect of such reforms would have been to drastically redefine the scope of what constitutes a taxable presence, thereby impacting the global supply chains for digital businesses.

Discussion questions

Included below are the 13 questions that have been raised throughout the Discussion Paper:

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?
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?
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?
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?
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?

A double-edged sword?

The Treasurer, in his media release announcing the release of the Discussion Paper, has stated that "Australia is committed to working with other countries, through the G20 and the Organisation for Economic Co-operation and Development (OECD), to develop sustainable, multilateral responses to address the challenges to our tax systems arising from digitalisation."

Unilateral and interim measures aimed at the digital economy represents part of a significant and ongoing conceptual shift in how various nations view the allocation of value across the supply chain of a multinational enterprise. Particularly, it has the potential to alter tax principles such that jurisdictions that 'consume' rather than 'generate' value are asserting taxation rights in respect of that value.

It will be important that any proposed changes consider any risk of retaliation by other territories whose companies may be unilaterally impacted if the changes are seen as unfair and inequitable. Australia should be careful before deciding that it has the right to tax the proceeds of services and technology that it neither performs nor creates.

The takeaway

While there is a broader recognition for the need to ensure our cross-border laws keep pace with the growth of digital commerce, it is also important that we do not propose unilateral digital taxation laws which are damaging to Australian investment in this critical sector.

Importantly, digital businesses have the flexibility as to where they develop their intellectual property, host their services and base their regional or global headquarters, so it is critical that any domestic reforms consider the competitive global environment Australia faces for foreign and local investment - particularly given the comparative tax rates offered by countries such as the United Kingdom, Singapore and most recently, the United States.

Even though the Discussion Paper raises questions about broader policy considerations, it is notable that practical questions have not been raised about how any potential reforms could be implemented and adopted by the taxpayers which are likely to be impacted.

The OECD is yet to reach agreement on any single approach to taxing digital businesses and on that basis it is important that we do not overlay unique unilateral tax measures that discourage or hamper this critical part of our economy. The Treasurer has indicated that the Australian Government has written to the Secretary-General of the OECD offering assistance on finding a better way to allocate taxing rights in the increasingly digitalised economy. In addition, Australia will host the fifth meeting of the OECD Global Forum on Value Added Taxes in March 2019.

The Discussion Paper has a 60 day period of consultation, with 30 November 2018 set as the closing date for submission.

Let's talk

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