

# Hon Grant Robertson, Minister of Finance

## Hon Stuart Nash, Minister of Revenue

### Information Release

#### Options for taxing the digital economy

#### Policy papers, Cabinet paper, and Cabinet minute

April 2019

#### Availability

This information release is available on Inland Revenue's Tax Policy website at <http://taxpolicy.ird.govt.nz/publications/2019-ir-cab-19-sub-0041/overview>.

#### Documents in this information release

1. IR2018/801|T2018/3710 – Tax policy report: Options for taxing the digital economy (13 December 2018)
2. IR2019/038|T2019/171 – Tax policy report: Options for taxing the digital economy - Cabinet paper (29 January 2019)
3. CAB-19-SUB-0041 – Cabinet paper: Options for taxing the digital economy
4. CAB-19-MIN-0041 – Minute: Options for taxing the digital economy

#### Additional information

The Cabinet paper was considered by Cabinet on 18 February 2019.

#### Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

- |             |   |
|-------------|---|
| 6(a)        | to prevent prejudice to the security or defence of New Zealand or the international relations of the government                 |
| 9(2)(a)     | to protect the privacy of natural persons, including deceased people  |
| 9(2)(f)(iv) | to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials |
| 9(2)(h)     | to maintain legal professional privilege  |
| 18(d)       | information is already publicly available or will be publicly available soon  |

## Copyright and licensing

Cabinet material and advice to Ministers from the Inland Revenue Department and other agencies are © Crown copyright but are licensed for re-use under the Creative Commons Attribution 4.0 International (CC BY 4.0) licence (<https://creativecommons.org/licenses/by/4.0/>).





POLICY AND STRATEGY


**Tax policy report: Options for taxing the digital economy**


---

<b>Date:</b>	13 December 2018	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	T2018/3710 IR2018/801

**Action sought**


---

	<b>Action sought</b>	<b>Deadline</b>
Minister of Finance	<b>Agree</b> to recommendations <b>Note</b> the contents of this report	18 December 2018
Minister of Revenue	<b>Agree</b> to recommendations <b>Note</b> the contents of this report	18 December 2018

**Contact for telephone discussion (if required)**


---

<b>Name</b>	<b>Position</b>	<b>Telephone</b>
Carmel Peters	Policy Manager, Inland Revenue	Withheld under section 9(2)(a) of the Official Information Act 1982
Sam Rowe	Senior Policy Advisor, Inland Revenue	
Matthew Gan	Tax Specialist, The Treasury	

13 December 2018

Minister of Finance  
Minister of Revenue

## **Options for taxing the digital economy**

---

### **Executive summary**

---

1. The purpose of this report is to advise Ministers on options for taxing the digital economy, and in particular, whether New Zealand should adopt a digital services tax (DST).
2. There has been significant international concern over the ability of highly digitalised companies to derive significant income from a country without being liable for income tax there. This is mostly caused by deficiencies in the current international tax framework, which has not kept up with digitalisation and other modern business developments. This under-taxation of the digital economy threatens the sustainability of Government revenues and public perceptions of the fairness of the tax system. It also provides a competitive advantage to overseas digital companies compared to local businesses, which are subject to full income tax.
3. We currently consider that changing the international tax framework is the best option for taxing the digital economy in the long-term. Accordingly, New Zealand should continue to participate in the OECD discussions on this, with a view to supporting an agreed solution (bearing in mind its effect on our exporters). There are 3 proposals being considered at the OECD:
  - A limited proposal for digital services only, focussing on social media, digital advertising, multi-sided platforms and data. This is the European Union (EU) and the United Kingdom (UK) proposal.
  - A broader proposal, which would allow greater taxing rights to market countries (such as New Zealand) based on certain "market intangibles" created there by multinationals (including brands and trade names used in the country, customer data and customer relationships). This is the United States proposal and would apply beyond the digital economy.
  - A minimum tax proposal suggested by France and Germany. This proposal would apply beyond the digital economy and would be targeted at a multinational's transactions with related parties in low tax jurisdictions.
4. The OECD is aiming to get G20 approval of its preferred proposals in June 2019 (we attach an article which has a good description of the OECD's approach). We consider it more likely than not that the OECD will be successful in achieving an international solution, but there is no guarantee of this. Accordingly, we recommend the Government also consider whether a digital services tax (DST) might be appropriate as an interim measure. This DST would be like the one proposed by the UK and would apply to online advertising, social media, intermediation platforms (like Uber, eBay and Airbnb) and the sale of data. We note a DST does have significant downsides, which would need to be carefully assessed and explored.
5. To commence, we recommend the Government publishes a discussion document in the first half of 2019 to get public feedback on the options for taxing the digital economy (being the international solution discussed at the OECD and a DST). We recommend the discussion document make it clear that:

- the Government has not yet decided whether it wants to introduce a DST, but is considering this as an option;
  - any DST would only be introduced if the OECD is unable to arrive at an international solution in a reasonable time-frame and a critical mass of other countries also adopt DSTs; and
  - the DST would be an interim measure that would cease to apply once an international solution was fully implemented.
6. The Australian Government has also issued a discussion document on options for taxing the digital economy, which takes a similar approach.
7. If you agree with this approach, we would aim to release a discussion document to seek public feedback in the first half of 2019 (following approval by Cabinet). We would report back to you on this feedback in the second half of 2019, together with final policy recommendations. At that stage we will be in a better position to provide a timeline for further steps, including legislation if the decision is made to proceed with a DST.
8. The current problem with taxing the digital economy only relates to income tax. The Government has already acted to ensure that the digital economy will be fully subject to New Zealand GST. GST has been applied to 'remote' services since 2016 (including digital services), and the Government has announced its intention to charge GST on low-value imported goods from 1 October 2019.

### **Recommended action**

---

9. We recommend that you:
- (a) **Agree** that New Zealand should continue to participate in the OECD discussions, with a view to supporting a long-term solution to the taxation of the digital economy (bearing in mind its effect on our exporters).

Agreed/Not agreed

Agreed/Not agreed

- (b) **Agree** that the Government should also start considering a possible DST as an option for taxing the digital economy, in case the OECD are unable to achieve an international solution in a reasonable timeframe.

Agreed/Not agreed

Agreed/Not agreed

- (c) **Direct** officials to draft a discussion document for release in the first half of 2019 to get public feedback on these options for taxing the digital economy (the international solution and the DST). In relation to the DST, the discussion document should state that:
- the DST would be like the one proposed by the UK;
  - the Government has not yet decided whether it wants to introduce a DST but is considering it as an option;

- any DST would only be introduced if the OECD is unable to arrive at an international solution in a reasonable timeframe and a critical mass of other countries also adopt DSTs; and
- the DST would be an interim measure that would cease to apply if an international solution was fully implemented.

Agreed/Not agreed

Agreed/Not agreed

**Matt Cowan**

Team Leader, Tax Strategy Team  
The Treasury

**Carmel Peters**

Manager, Policy and Strategy  
Inland Revenue

**Hon Grant Robertson**

Minister of Finance  
/ /2018

**Hon Stuart Nash**

Minister of Revenue  
/ /2018

## **Background**

---

10. There has been significant international concern recently over the ability of highly digitalised companies to derive significant income from a country without being liable for income tax there. This is also an issue for New Zealand.
11. The value of cross border digital services provided to New Zealand consumers is estimated to be approximately \$2.7 billion in 2018, and this market is expected to continue growing. For online advertising, the New Zealand market for 2017 was \$923 million, which was 36% of New Zealand's advertising market. The total size of New Zealand's e-commerce market is hard to ascertain, but a rough estimate is \$26 billion in total, with supplies from offshore worth \$11.5 billion.
12. The current problem with taxing the digital economy relates to income tax, rather than GST. GST has been applied to 'remote' services since 2016 (including digital services), and the Government has announced its intention to charge GST on low-value imported goods from 1 October 2019.
13. We previously reported on the digital economy in IR2017/657 and IR 2018/200.

## **The problem**

---

14. The main problem is that the current international tax framework has not kept up with modern business practices, particularly digitalisation. In particular:
  - Digital companies can transact with customers over the internet without having the physical presence required by double tax agreements (DTAs) for income tax to be charged in the country.
  - Even if a digital company does have a taxable presence in a country, the profit allocation rules do not recognise the new kinds of value that are generated by digital companies in that country.
  - Much of the value of digital companies is attributable to intangible assets. These intangibles are hard to value. They are also mobile, meaning the income attributable to them can be easily moved to low tax jurisdictions. We note this is also an issue for the taxation of some non-digital companies.
15. The result of this is that digital companies can participate significantly in the economic life of a country, without being liable for any income tax there.
16. This under-taxation of the digital economy threatens the sustainability of Government revenues and public perceptions of the fairness of the tax system. It also provides a competitive advantage to overseas digital companies compared to local businesses, which are subject to full income tax.

## **Options for solving the problem**

---

17. There are two options for solving the problem. One is to change the current international income tax framework. The other is to apply a separate tax (usually called an equalisation tax, or a digital services tax) to digital transactions.

## **Changing the international framework**

18. Changing the international framework is generally agreed by countries to be the best long-term solution to the taxation of the digital economy. However, it requires changes to existing DTAs and international standards. Accordingly, New Zealand cannot change this framework by itself - it requires multilateral agreement.

19. Countries are currently discussing possible changes to address the problems with the international framework at the OECD. There are 3 proposals being considered:
- A limited proposal for digital services only, focussing on social media, digital advertising, multi-sided platforms and data. This is consistent with how the European Union (EU) and the United Kingdom (UK) have proposed addressing the issue.
  - A broader proposal, which would allow greater taxing rights to market countries (such as, New Zealand) based on certain "market intangibles" created there by multinationals. These are intangibles that relate to marketing activities in the country, or which aid in the commercial exploitation of a product or service or have an important promotional value (such as brands and trade names used in a country, customer data, customer relationships and customer lists). This is how the United States (US) has proposed addressing the issue. This approach would apply beyond the digital economy, but we expect it to be targeted at large companies with significant intangible value in market jurisdictions. [Redacted]  
[Redacted] Withheld under section 6(a) of the Official Information Act 1982 [Redacted]
  - A minimum tax proposal suggested by France and Germany. This proposal would apply beyond the digital economy and would be targeted at a multinational's transactions with related parties in low tax jurisdictions. This proposal addresses some remaining base erosion and profit shifting (BEPS) issues and is not specifically directed at the digital economy (although it would also apply to digital companies). This proposal is independent of the first two, and so could apply in addition to one of them
20. Neither of the first two proposals would require a digital company to have a physical presence in a market country. Accordingly, both proposals should allow New Zealand to tax highly digitalised companies on their sales income here (with the second proposal also allowing us to tax other multinationals with significant local marketing intangibles). The OECD is also discussing whether the first two proposals could be combined.
21. The OECD's proposals would potentially apply to the 124 countries forming part of its wider Inclusive Framework (which includes China and India), plus any other countries which elected to adopt them.
22. There is still disagreement at the OECD on what should be done. However, countries have committed to reaching consensus on an international solution by 2020 and the OECD is putting a significant amount of effort into achieving this. Progress is being made and there is a real possibility that the OECD will be successful, [Redacted] s 6(a) [Redacted]. But it is still too early to tell.
23. The OECD is aiming for G20 approval of its preferred proposals in June 2019 [Redacted] [Redacted] Withheld under section 6(a) of the Official Information Act 1982 [Redacted]. If this occurs, it is likely that an international solution can be achieved in 2020. Accordingly, we should have a better idea of the likelihood of an international solution after the June G20 meeting. Even if an international solution is achieved in 2020, it could still take 3-4 years for the solution to be designed in detail at the OECD and implemented.

### **A digital services tax**

24. The other option for taxing the digital economy is to introduce a special tax, called a "digital services tax", or DST. A DST is targeted at certain digital companies and is not an "income tax" for DTA purposes. This means a DST is not subject to the current international tax framework, and so it can be charged to digital companies regardless of whether they have a physical presence in a country. Consequently,



countries can introduce a DST unilaterally, without the need for international agreement.

25. The UK recently announced it would introduce a separate 2% DST on the profits of certain digital companies that would apply from April 2020. Spain, Italy and India have also enacted or announced DSTs (although India's has a much narrower scope than the others). The EU Commission has proposed a 3% DST for Europe, however it has not been able to achieve the support of all EU members. The EU's original proposal has recently been replaced with a narrower DST only targeting online advertising, which EU members will consider early in 2019. This narrower DST is proposed to apply only in the event that an international solution cannot be achieved at the OECD.
26. The DST is quite controversial (it was not recommended by the OECD due to a lack of consensus), but we expect at least some additional EU countries to enact one even if the EU as a whole does not. In addition, Australia issued a consultation paper on taxing the digital economy in October 2018, which included discussion of a possible DST (among other options for taxing the digital economy).
27. The DSTs proposed so far (other than India's, which was introduced before the recent international interest in taxing the digital economy) share a set of common features. They are flat taxes charged at a low rate (2%-3%) on gross revenues from certain digital platforms. These are digital platforms whose value is dependent on the size and active contribution of their user base – for example, intermediation platforms like Uber and eBay; social media platforms like Facebook; and content sharing sites like YouTube or Instagram (although the EU's latest proposal only targets online advertising).
28. This means a DST is narrowly targeted at certain highly digitalised business models. It would not apply to sales of goods or services (other than advertising or data) over the internet. So, it would not apply to Netflix for example, or to goods sold online by Apple or Amazon. It also would not apply to the kinds of digital services typically exported by New Zealand (such as accountancy services).
29. A DST is levied by reference to where the users of the digital platform are located rather than where payments are made. To achieve this, an affected digital company's consolidated global gross revenues are apportioned between the relevant country and the rest of the world by reference to the proportion of global users in that country. The revenue attributable to that country is then subject to the DST.
30. For example, suppose a digital company had \$10 billion of total gross global revenue and 5% of its total global users in State A. The revenue attributable to State A would be \$10 billion x 5% = \$500 million. State A would then charge 3% tax on its allocated \$500 million of revenues, for total tax of \$15 million. In calculating this tax, it is only the location of the users that is relevant, not the location of the customers paying the digital company for its services. Therefore the \$15 million DST would still be charged even if no actual payments were made to the digital company from State A.
31. For New Zealand, a DST would be a way of collecting some tax from some digital companies (but not all of them) that have been paying little tax either here or overseas. As a rough estimate, we expect a 3% DST would raise between \$30m and \$80m of tax<sup>1</sup>, depending in part on its scope and design. A DST would also significantly improve public confidence in the fairness of the tax system, which is an important factor underlying voluntary compliance. In addition, the size of the

<sup>1</sup> This is based on a rough bottom-up estimate of what we think a DST would raise in New Zealand, combined with top down estimates based on what the EU and UK have forecast their DSTs to raise, adjusted for differences in GDP and exchange rates.

digital economy is growing as a proportion of the total economy. Consequently, it will become increasingly important for New Zealand to tax it appropriately.

32. However, there are issues with a DST. These include:

- The consistency of the tax with other tax settings. The DST may not mesh well with other elements of our tax system. This might result in some double taxation of compliant firms (including possibly some domestic firms) and taxation of businesses with losses.

Withheld under section 9(2)(h) of the Official Information Act 1982

- The economic incidence of the tax. The issue here is whether the tax would be passed along by the non-resident suppliers to New Zealand customers. We expect around half of the cost of the tax could be passed on to customers, based on the limited evidence available.
- The effect on New Zealand's reputation as a good place to do business. New Zealand is a small open economy and we compete for capital with the rest of the world. That means we want New Zealand to be an attractive place for non-residents to do business.
- The potential effect on our export sector. The implications of adopting a DST for our export sector would need to be considered. Some trading partners, s 6(a), might raise concerns should New Zealand introduce a DST. Members of the US Congress and US technology industry have previously claimed DST proposals by the UK and the European Commission would lead to double taxation, and that proposed turnover thresholds would amount to discrimination against US companies in breach of World Trade Organization national treatment provisions.

Withheld under section 6(a) of the Official Information Act 1982

- The period of time for which a DST would be applicable. The OECD expects that any DSTs would be repealed once a multilateral solution is achieved. Other countries that have recently proposed DSTs have also agreed with this. Accordingly, if agreement was reached quickly at the OECD, then it may not be worth designing a DST that would only apply for a short period of time.
- The administration and compliance costs of introducing a new tax. This is particularly an issue given that a DST is not expected to raise significant revenue. In addition, given a DST would be expected to (at least predominantly) apply to companies outside of New Zealand, there are fewer tools available to Inland Revenue to enforce the tax.

## **What should New Zealand do?**

---

### **Continue participating in the OECD discussions**

33. We currently consider that changing the international tax framework, if possible, would be the best option for taxing the digital economy in the long term. It would integrate the taxation of these companies into the income tax system, and so avoid the need for a separate DST with all its attendant issues (as discussed above). At this stage, we also expect this option to benefit New Zealand overall. This is because New Zealand imports more highly digitalised services than it exports. [REDACTED] [REDACTED] However, we will need to wait until the proposals are developed in more detail before we can come to any firm conclusions about this.
34. Therefore, we recommend New Zealand continue to participate in the OECD discussions, with a view to supporting an international solution (bearing in mind its effect on our export sector).

### **Commence formal consideration of a DST in the interim**

35. There may be benefits in adopting a DST in the following circumstances:
- the OECD cannot achieve an international solution in a reasonable timeframe (as any DST would need to be repealed once that solution was achieved);
  - a critical mass of other countries also adopts a DST, particularly Australia (to reduce the reputational risks of adopting a DST);
  - New Zealand companies are not unduly affected by the DST; and
  - the DST will not just be passed on to New Zealand consumers.
36. This evaluation is also consistent with the Tax Working Group's recommendations on a DST in their interim report.
37. We recommend that the Government start considering a DST as another option for taxing the digital economy. To commence, we recommend publishing a discussion document. This will also help to identify some of the advantages and disadvantages of a DST, and so will put the Government in a better position to subsequently decide whether it should introduce one.

### **Contents of the discussion document**

---

38. The discussion document should broadly outline the two options for taxing the digital economy – namely an OECD led international solution, and a unilateral DST. The DST proposed should include the common features discussed above. In addition, we understand that the OECD is planning to publicly consult on its proposed international solutions in February 2019. Accordingly, the discussion document can also describe the OECD's proposed options in detail and invite feedback to the Government on them. We suggest the discussion document be framed as exploring the options (as with the Australian discussion document on the digital economy), rather than consulting on a preferred approach.
39. We also recommend that the discussion document make it clear that:
- the Government has not yet decided to whether to introduce a DST, but is considering it as an option;

- the DST would only be introduced in the event the OCED is unable to reach an international solution in a reasonable timeframe and a critical mass of other countries also adopt DSTs; and
- The tax would be repealed when an international solution was fully implemented.

## Consultation

---

40. We consulted with the Ministry of Foreign Affairs and Trade on this report.

41. Withheld under section 9(2)(h) of the Official Information Act 1982

42.

## Next steps

---

43. If you agree, we would aim to publish a discussion document for public consultation in the first half of 2019 (following Cabinet approval). We would report back to you on the consultation, together with final policy recommendations, in the second half of 2019.

44. The subsequent steps will depend in part on developments at the OECD (particularly whether the G20 endorse the OECD's preferred proposals in June 2019), and on the work programme adopted by the Government following the Tax Working Group's final report. We will be in a better position to provide you with a timeline for these subsequent steps when we report back in the second half of 2019.

**Annex – article from Tax Notes International**

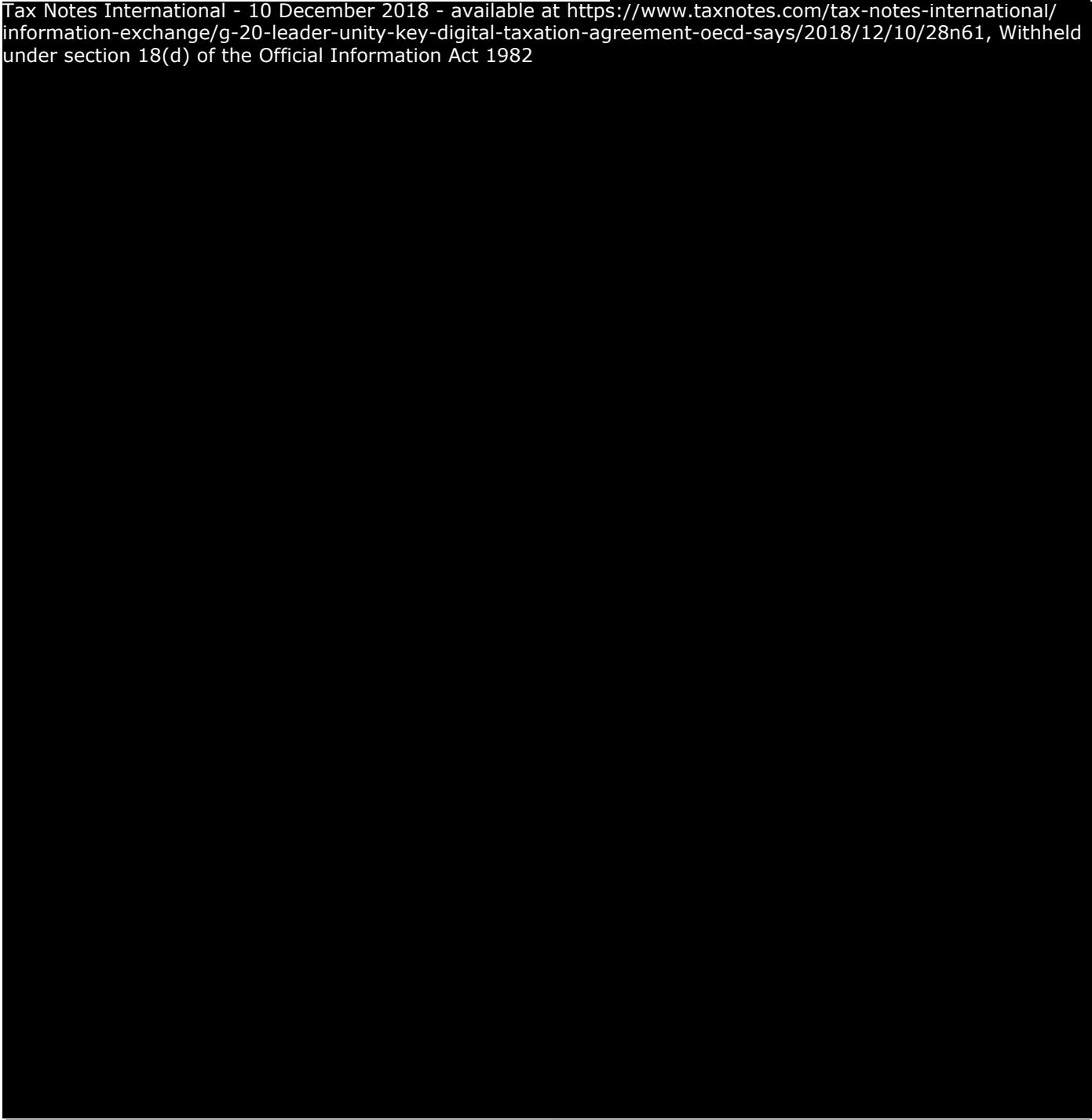
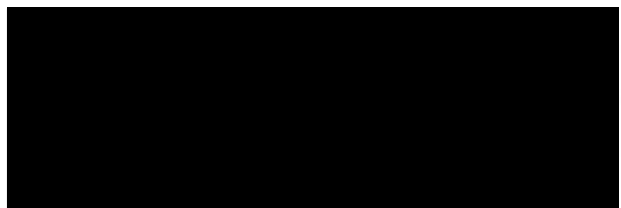
OECD

---

**G-20 Leader Unity Key to Digital Taxation Agreement, OECD Says**

by Stephanie Soong Johnston

Tax Notes International - 10 December 2018 - available at <https://www.taxnotes.com/tax-notes-international/information-exchange/g-20-leader-unity-key-digital-taxation-agreement-oecd-says/2018/12/10/28n61>, Withheld under section 18(d) of the Official Information Act 1982







POLICY AND STRATEGY



## **Tax policy report: Options for taxing the digital economy – Cabinet paper**

<b>Date:</b>	29 January 2018	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	T2019/171 IR2019/038

### **Action sought**

	<b>Action sought</b>	<b>Deadline</b>
Minister of Finance	<b>Advise</b> officials of any desired changes to the Cabinet paper or the proposed redactions	1 February 2019
Minister of Revenue	<b>Advise</b> officials of any desired changes to the Cabinet paper or the proposed redactions	1 February 2019

### **Contact for telephone discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>
Sam Rowe	Senior Policy Advisor, Inland Revenue	Withheld under section 9(2)(a) of the Official Information Act 1982
Matthew Gan	Tax Specialist, The Treasury	

29 January 2019

Minister of Finance  
Minister of Revenue

## **Options for taxing the digital economy – Cabinet paper**

---

1. On 13 December 2018 we provided you with a tax policy report on options for taxing the digital economy (T2018/3710, IR2018/801). That report recommended the preparation of a Government discussion document on the different options, including a digital services tax. The recommendation to prepare a discussion document requires approval by Cabinet.
2. We provided you with a first draft of the Cabinet paper requesting approval to prepare the discussion document on 25 January. Following feedback from you and your offices, we now attach an updated draft of the Cabinet paper. We also attach a version of the Cabinet paper showing the redactions we propose to make to it for its proactive release. Please let us know by Friday 1 February 2019 if you would like any changes made to this draft or the proposed redactions.
3. Since we reported to you in December, the OECD has agreed to consider another proposal for taxing the digital economy. This proposal seems to provide for formulary apportionment of a multinational's profit to market countries, based on certain metrics such as sales and user participation. The proposal would require the multinational to have a significant economic presence in the country (which need not be physical) and could involve withholding taxes. [REDACTED]  
Withheld under section 6(a) of the Official Information Act 1982 We have included this proposal in the Cabinet paper.
4. The next steps are set out in the table below.

<b>Step</b>	<b>Date</b>
Your directions on any changes you would like made to the Cabinet paper or the proposed redactions	1 February 2019
Cabinet paper lodged	7 February 2019
Cabinet paper to DEV Committee	13 February 2019
Cabinet paper to Cabinet	18 February 2019
Draft discussion document provided to you for approval	<span style="background-color: black; color: black;">Withheld under section 9(2)(f)(iv) of the Official Information Act 1982</span>
Draft discussion document provided to Cabinet for approval	<span style="background-color: black; color: black;">[REDACTED]</span>
Discussion document released to public	<span style="background-color: black; color: black;">[REDACTED]</span>



**Recommended action**

---

- 5. We recommend that you:
  - (a) **Review** the attached Cabinet paper and advise us if you would like any changes made prior 1 February 2019.

Agreed/Not agreed

Agreed/Not agreed

- (b) **Review** the proposed redactions to the Cabinet paper and advise us if you would like any changes made prior 1 February 2019.

Agreed/Not agreed

Agreed/Not agreed

**Matt Cowan**  
Team Leader  
Tax Strategy Team  
The Treasury

**Sam Rowe**  
Senior Policy Advisor  
Policy and Strategy  
Inland Revenue

**Hon Grant Robertson**  
Minister of Finance  
/ /2019

**Hon Stuart Nash**  
Minister of Revenue  
/ /2019



In Confidence

Office of the Minister of Finance

Office of the Minister of Revenue

Chair, Cabinet

## OPTIONS FOR TAXING THE DIGITAL ECONOMY

### Proposal

1. This paper seeks Cabinet agreement to prepare a Government discussion document on options for taxing the digital economy, including a digital services tax (DST). This discussion document could be released together with the Government's response to the Tax Working Group's final report, s 9(2)(f)(iv). Feedback from the discussion document will be used to help formulate the best policy for taxing the digital economy.

### Executive Summary

2. The Government will consider several measures recommended by the Tax Working Group (TWG) to improve the structure, fairness, and sustainability of the tax system. This includes a broad extension of capital income taxation, which will primarily affect New Zealand businesses and investments. However, it is important to also ensure that multinational companies pay their fair share of tax in New Zealand.
3. A major issue with the taxation of multinationals is the ability of highly digitalised companies to derive significant income from a country without being liable for income tax there. This is an issue both globally and in New Zealand. This issue is mostly caused by deficiencies in the current international tax rules, which have not kept up with digitalisation and other modern business developments. This under-taxation of the digital economy threatens the sustainability of Government revenues and the fairness of the tax system. It also provides a competitive advantage to overseas digital multinationals compared to local businesses, which are subject to full income tax.
4. We currently consider that changing the international income tax rules is the best option for taxing the digital economy in the long-term. These rules are contained in New Zealand's double tax agreements and in various internationally agreed standards. This means New Zealand cannot change the international tax rules on its own – it requires international agreement. Accordingly, New Zealand should continue to participate in the OECD discussions on this, with a view to supporting an agreed solution (bearing in mind its effect on our exporters). There are two broad measures being considered at the OECD:
  - A measure to allocate greater taxing rights over a multinational's profits to market countries. The measure would not require the multinational to have a

physical presence in the country. There are 3 proposals being considered for this purpose (only one of which would be adopted):

- A limited proposal for digital services only, focussing on social media, digital advertising, multi-sided platforms and data. This is the European Union (EU) and the United Kingdom (UK) proposal.
  - A broader proposal, which would allow greater taxing rights to market countries (such as New Zealand) based on certain “marketing intangibles” created there by multinationals. This is the United States proposal and would apply beyond the digital economy. [REDACTED] s 6(a) [REDACTED]
  - A proposal which seems to provide for apportionment of a multinational’s profit to market countries under an agreed formula, which would be based on certain factors such as sales and user participation. This proposal could extend beyond the digital economy [REDACTED] Withheld under section 6(a) of the Official Information Act 1982 [REDACTED]
- A minimum tax measure suggested by France and Germany. This proposal would apply beyond the digital economy and would ensure that multinationals pay a minimum level of tax on profits earned in low tax jurisdictions.
5. The OECD is aiming to obtain G20 approval of its preferred measures in June 2019. We consider it more likely than not that the OECD will be successful in achieving an international solution, but there is no guarantee of this. Accordingly, we recommend the Government actively consider introducing a DST as an interim measure. This DST should initially be designed to be like the one proposed by the UK (as the UK’s proposed DST is the most advanced and is likely to influence other countries’ DSTs, [REDACTED] s 6(a) [REDACTED]) and would apply to online advertising, social media, intermediation platforms (like Uber, eBay and Airbnb) and the sale of data. We note a DST does have significant downsides, which would need to be carefully assessed and explored. We also see real benefits to aligning New Zealand’s position on a DST with Australia’s.
6. To commence, we recommend the Government publishes a discussion document to obtain public feedback on the options for taxing the digital economy (being the international solution discussed at the OECD and a DST). We recommend the discussion document make it clear that:
- The Government is determined to ensure that multinational companies pay their fair share of tax in New Zealand.
  - The Government is actively considering introducing a DST in advance of an international solution. While New Zealand is committed to finding a solution at the OECD, if sufficient progress is not made this year, a DST is a credible option.
  - The DST would be an interim measure that would cease to apply once an international solution was adopted.
  - We would aim to design the DST so it is fully consistent with New Zealand’s international obligations (which we expect to be possible).

- The Government sees real benefits in aligning New Zealand's position on a DST with Australia's.
7. The Australian Government has also issued a discussion document on options for taxing the digital economy, which takes a similar approach. Consultation closed for this on 30 November 2018.
  8. We consider that measures to address this issue should be combined with the TWG measures adopted by the Government, so that the Government can present a comprehensive package of reforms to improve the New Zealand tax system. To this end, the digital economy discussion document could be released together with the Government's response to the Tax Working Group's final report, <sup>s 9(2)(f)(iv)</sup> [REDACTED]. We would report back to Cabinet on this feedback in the second half of 2019, together with final policy recommendations. At that stage we will be in a better position to provide a timeline for further steps, including legislation if the decision is made to proceed with a DST.

## Background

9. The Government commissioned the TWG to recommend measures to improve the structure, fairness, balance and sustainability of the tax system. The TWG provided its final report in January 2019. We are also reporting to Cabinet on the TWG report contemporaneously with this paper.
10. The concrete measures recommended by the TWG report are mostly focussed on the taxation of New Zealanders. However, the Government must also ensure that multinationals pay a fair share of tax in New Zealand. The Taxation (Neutralising Base Erosion and Profit Shifting) Act (BEPS Act) we enacted in 2018 prevented multinationals from using various strategies to avoid paying their fair share of tax in New Zealand. However, a significant outstanding issue is the taxation of digital multinationals operating in New Zealand.
11. The digital economy in New Zealand is significant and growing, with non-residents making up a large portion. The value of cross border digital services provided to New Zealand consumers was estimated to be approximately \$2.7 billion in 2018, and this market is expected to continue growing. For online advertising, the New Zealand market for 2017 was \$923 million, which was 36% of New Zealand's advertising market. It is not clear exactly what proportion of online advertising is supplied by non-residents, but it is likely to be between 60% - 75%. The total size of New Zealand's e-commerce market is hard to ascertain, but a rough estimate for 2018 is \$26 billion in total, with supplies from offshore worth \$11.5 billion.

## Analysis

### *The problem*

12. The main problem is that the current international tax framework has not kept up with modern business practices, particularly digitalisation. In particular:
  - Digital companies can deal with customers over the internet without having the physical presence required by double tax agreements (DTAs) for income tax to be charged in the country.

- Even if a digital company does have a taxable presence in a country, the current internationally agreed rules for attributing the digital company's profit to the country do not recognise the new kinds of value that are generated by digital companies in that country.
  - Much of the value of digital companies is attributable to non-physical, intangible assets, like patents and trademarks. These assets are hard to value. They are also mobile, meaning they can be used to shift income to low tax jurisdictions. This is also an issue for the taxation of some non-digital companies.
13. The result of this is that digital companies can participate significantly in the economic life of a country, without being liable for any income tax there.
  14. This under-taxation of the digital economy is a significant problem. It threatens the sustainability of Government revenues and public perceptions of the fairness of the tax system. It also provides a competitive advantage to overseas digital companies compared to local businesses, which are subject to full income tax.
  15. The current problem with taxing the digital economy relates to income tax, rather than GST. GST has been applied to 'remote' services since 2016 (including digital services), and the Government has announced its intention to charge GST on low-value imported goods from 1 October 2019.
  16. A diverted profits tax, of the kind adopted by Australia and the UK, would not solve the current problems with taxing the digital economy. This is because a diverted profits tax (like our recent BEPS Act) basically prevents multinationals from avoiding a country's existing income tax rules. However, taxing the digital economy requires a fundamental change to those rules.

### ***Options for solving the problem***

17. There are two options for solving the problem. One is to change the current international income tax rules, which have been agreed to by countries. The other is to apply a separate DST to digital transactions.

### ***Changing the internationally agreed income tax rules***

18. Changing the internationally agreed income tax rules is generally agreed by countries to be the best long-term solution to the taxation of the digital economy. However, it requires changes to existing DTAs and international standards. Accordingly, New Zealand cannot change this framework by itself - it requires multilateral agreement.
19. Countries are currently discussing possible changes to address the problems with the international income tax rules at the OECD. There are two measures being considered:
  - A measure to allocate greater taxing rights over a multinational's profits to market countries. The measure would not require the multinational to have a physical presence in the country. There are 3 proposals being considered for this purpose (only one of which would be adopted):

- A limited proposal for digital services only, focussing on social media, digital advertising, multi-sided platforms and data. This is consistent with how the European Union (EU) and the United Kingdom (UK) have proposed addressing the issue multilaterally.
- A broader proposal, which would allow greater taxing rights to market countries (such as, New Zealand) based on certain “marketing intangibles” created there by multinationals. These are non-physical intangible assets that relate to marketing activities in the country, or which aid in the commercial exploitation of a product or service or have an important promotional value (such as brands and trade names used in a country, customer data, customer relationships and customer lists). This is how the United States (US) has proposed addressing the issue. This approach would apply beyond the digital economy, but we expect it to be targeted at large companies with significant intangible assets in market jurisdictions. Withheld under section 6(a) of the Official Information Act 1982
- A proposal which seems to provide for apportionment of a multinational’s profit to market countries, based on a formula that would take into account factors like sales and user participation. The measure would require the multinational to have a significant economic presence in the country (which need not be physical) and could involve withholding taxes. This proposal could apply beyond the digital economy s 6(a)
- A minimum tax proposal suggested by France and Germany. This proposal would apply beyond the digital economy and would ensure that multinationals pay a minimum level of tax on profits earned in low tax jurisdictions. This proposal addresses some remaining base erosion and profit shifting (BEPS) issues and is not specifically directed at the digital economy (although it would also apply to digital companies).

20. These measures should address the current problems with taxing the digital economy.
21. There is still disagreement at the OECD on what should be done. However, countries have committed to reaching consensus on an international solution by 2020 and the OECD is putting a significant amount of effort into achieving this. Progress is being made and there is a real possibility that the OECD will be successful, especially now that the US supports a solution. But it is still too early to tell.
22. The OECD is aiming for G20 approval of its preferred measures in June 2019 Withheld under section 6(a) of the Official Information Act 1982 If this occurs, it is likely that an international solution can be achieved in 2020. Accordingly, we should have a better idea of the likelihood of an international solution after the June G20 meeting. If an international solution is achieved in 2020, it could take 3-4 years for the solution to be designed in detail at the OECD and implemented.

## *A digital services tax*

23. The other option for taxing the digital economy is to introduce a separate DST. A DST is targeted at certain highly digitalised companies and is not an “income tax” for DTA purposes. This means countries can introduce a DST unilaterally, without the need for international agreement. A DST applies even if the digital company does not have a physical presence in the country.
24. The UK recently announced it would introduce a 2% DST from April 2020. Spain, Italy, France, Austria, and India have also enacted or announced DSTs (although India’s has a narrower scope than the others). The EU Commission has proposed a 3% DST for Europe, however it has not been able to achieve the support of all EU members. In addition, Australia issued a consultation paper on taxing the digital economy in October 2018, which included discussion of a possible DST (among other options for taxing the digital economy).
25. The DSTs proposed so far generally share a set of common features. They are flat taxes charged at a low rate (2%-3%) on gross revenues from certain digital platforms that are attributable to the users in the relevant country. The DSTs apply to digital platforms whose value is dependent on the size and active contribution of their user base – for example, intermediation platforms like Uber and eBay; social media platforms like Facebook; and content sharing sites like YouTube or Instagram (although the EU’s latest proposal only targets online advertising).
26. This means a DST is narrowly targeted at certain highly digitalised business models. It would not apply to sales of goods or services (other than advertising or data) over the internet. So, it would not apply to Netflix for example, or to goods sold online by Apple or Amazon. It also would not apply to the kinds of digital services typically exported by New Zealand (such as accountancy services).
27. For New Zealand, a DST would be a way of collecting some tax from some digital multinationals (but not all of them) that have been paying little tax either here or overseas. As a rough estimate, we expect a 3% DST would raise between \$30m and \$80m of tax, depending in part on its scope and design. The small size of this figure compared to the size of New Zealand’s digital economy as a whole (as discussed in paragraph 11) reflects the narrow scope of a DST – it is targeted at certain highly digitalised business models, and so does not apply to a large portion of the digital economy.
28. A DST may also improve public confidence in the fairness of the tax system, which is an important factor supporting voluntary compliance. In addition, the size of the digital economy is growing as a proportion of the total economy. Consequently, it will become increasingly important for New Zealand to tax it appropriately. Therefore, we consider a DST to be a credible option for taxing the digital economy. We also see real benefits in aligning New Zealand’s position on a DST with Australia’s.
29. However, there are issues with a DST that would need to be carefully worked through in deciding whether to adopt one, including consideration of consistency with New Zealand’s international trade obligations and double tax agreements as well as the potential reactions of trading partners, including with respect to treatment of New Zealand exporters under their domestic tax and other laws.



## **The Tax Working Group**

30. The TWG also considered the taxation of the digital economy. In its final report, the TWG concluded that New Zealand should continue to participate in the OECD discussions on changing the internationally agreed income tax rules, but should also stand ready to implement a DST if a critical mass of other countries move in that direction, and it is reasonably certain the New Zealand's export industries will not be materially impacted by any retaliatory measures.

### **What should New Zealand do?**

#### *Continue participating in the OECD discussions*

31. We currently consider that changing the internationally agreed income tax rules, if possible, would be the best option for taxing the digital economy in the long term. It would integrate the taxation of these companies into the income tax system, and so avoid the need for a separate DST with all its attendant issues. We also expect this option to benefit New Zealand overall, however, we will need to wait until the OECD's proposals are developed in more detail before we can come to any firm conclusions about this. Therefore, we recommend New Zealand continue to participate in the OECD discussions, with a view to supporting an international solution (bearing in mind its effect on our export sector). This was also the recommendation of the TWG in its interim report.

#### *Commence formal consideration of a DST in the interim*

32. We need to ensure that multinationals are fairly-taxed in New Zealand. Therefore, while we prefer an international solution, we need to consider a DST as an option in case this cannot be achieved in a reasonable time frame. In this regard, there may be benefits in adopting a DST as an interim measure in advance of an OECD solution if:
- the OECD cannot make sufficient progress on an international solution this year;
  - a critical mass of other countries also adopts a DST, particularly Australia (to reduce the reputational risks of adopting a DST);
  - New Zealand companies are not unduly affected by the DST; and
  - the DST will not just be passed on to New Zealand consumers.
33. This is broadly consistent with the TWG's analysis of a DST.
34. We recommend that the Government publish a discussion document to commence its formal consideration of a DST (as Australia has done). This will also help to identify some of the advantages and disadvantages of a DST, and so will put the Government in a better position to subsequently decide whether it should introduce one.
35. The discussion document could be released together with the Government's response to the TWG's final report later in 2019.

## **Contents of the discussion document**

36. The discussion document should broadly outline the two options for taxing the digital economy – namely an OECD led international solution, and a unilateral DST. The DST proposed should include the common features discussed above. In addition, the OECD issued a public consultation document on its proposed international solutions on 13 February 2019. Accordingly, the discussion document can also describe the OECD's proposed options in detail and invite feedback to the Government on them.
37. Although the OECD is consulting on its proposals, we recommend that the discussion document also seek feedback from stakeholders on them. This is so that the Government can understand the effect of the OECD's proposals on New Zealand in particular (which is unlikely to be apparent from the OECD's worldwide consultation). This understanding can be used to develop New Zealand's own position on the OECD proposals, which we can then advance at subsequent OECD discussions, and on any potential unilateral options the Government might want to pursue in the face of insufficient progress on a multilateral solution.
38. The discussion document should be presented as part of a package of comprehensive tax reforms that includes any TWG recommendations adopted by the Government.
39. We also recommend that the discussion document make it clear that:
  - The Government is determined to ensure that multinational companies pay their fair share of tax in New Zealand.
  - The Government is actively considering introducing a DST in advance of an international solution. While New Zealand is committed to finding a solution at the OECD, if sufficient progress is not made this year, a DST is a credible option.
  - The DST would be an interim measure that would cease to apply once an international solution was adopted.
  - We would aim to design the DST so it was consistent with New Zealand's international obligations (which we expect to be possible).
  - The Government sees real benefits in aligning New Zealand's position on a DST with Australia's.

## **Consultation**

40. Inland Revenue, the Treasury and the Ministry of Foreign Affairs and Trade were consulted on the Cabinet paper and support the preparation of the discussion document. The discussion document will be used as a basis for consultation with the public. Inland Revenue and the Treasury will consult with other interested Government agencies in preparing the discussion document, such as the Ministry of Foreign Affairs and Trade. We will report back to Cabinet with a draft of the proposed discussion document prior to its release.

## **Financial Implications**

41. There are no financial implications for the release of the discussion document. The introduction of new measures to tax the digital economy would be fiscally positive, although by how much depends on what options are selected and how they are designed (whether by New Zealand or the OECD). Advice on financial implications will be provided when approval on the finalised package is sought.

## **Administrative impacts**

42. Officials will consider administrative impacts when they draft the discussion document. Advice on administrative impacts will be provided when approval on the finalised package is sought.

## **Legislative Implications**

43. The publication of the discussion document does not have any legislative implications. However legislative change will be necessary if Cabinet subsequently decides to implement the policy recommendations developed out of the discussion document.

## **Impact Analysis**

44. Elements of the regulatory impact analysis will be included in the discussion document at a level that is appropriate given the stage of policy development. A full regulatory impact analysis will be carried out later in the policy process, once officials have finalised their policy recommendations.

## **Human Rights**

45. There are no human rights implications associated with the release of the discussion document.

## **Publicity**

46. We will arrange the appropriate publicity for the release of the discussion document. This publicity could be combined with the publicity for the Government's response to the TWG's final report, so that together they form a comprehensive package to improve the New Zealand tax system.

## **Proactive Release**

47. We propose to proactively release this Cabinet paper in part, together with the associated Ministerial reports. These could be released at the same time as the papers for the Government's response to the TWG's final report.
48. Some parts of the Cabinet paper and associated Ministers' reports will be redacted under the grounds contained in the Official Information Act, for example where it is necessary to prevent prejudice to New Zealand's international relations.

## Recommendations

The Minister of Finance and the Minister of Revenue recommend that Cabinet:

1. **Note** that the Government is considering measures recommended by the Tax Working Group to improve the New Zealand tax system.
2. **Note** that there is a problem with the current taxation of the digital economy, both in New Zealand and internationally.
3. **Note** that a number of countries, including Australia, are investigating or implementing digital services taxes (DSTs).
4. **Agree** that New Zealand should continue to participate in the OECD discussions on the taxation of the digital economy, with a view to supporting a long-term solution (bearing in mind its effect on our exporters).
5. **Agree** that the Government should also actively consider a possible DST as an option for taxing the digital economy, in case the OECD are unable to achieve sufficient progress this year.
6. **Direct** officials to draft a discussion document to get public feedback on the options for taxing the digital economy (being the international solution and the DST). In relation to the DST, the discussion document should state that:
  - The Government is determined to ensure that multinational companies pay their fair share of tax in New Zealand.
  - The Government is actively considering introducing a DST in advance of an international solution. While New Zealand is committed to finding a solution at the OECD, if sufficient progress is not made this year, a DST is a credible option.
  - The Government sees real benefits in aligning New Zealand's position on a DST with Australia's.
  - The DST initially proposed would be like the one proposed by the UK.
  - The DST would be an interim measure that would cease to apply once an international solution was adopted.
  - We would aim to design the DST so it was consistent with New Zealand's international obligations (which we expect to be possible).
7. **Delegate** authority to the Minister of Finance and the Minister of Revenue to decide when the discussion document will be released.
8. **Note** that we will report back to Cabinet with a draft of the discussion document prior to its release.
9. **Note** that this Cabinet paper, the associated Cabinet minute, and key advice papers will be proactively released on Inland Revenue's website.

Authorised for lodgement

Hon Grant Robertson  
Minister of Finance

Hon Stuart Nash  
Minister of Revenue





# Cabinet

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

### Options for Taxing the Digital Economy

**Portfolios**                      **Finance / Revenue**

On 18 February 2019, Cabinet:

- 1        **noted** that the government is considering measures recommended by the Tax Working Group to improve the New Zealand tax system;
- 2        **noted** that there is a problem with the current taxation of the digital economy, both in New Zealand and internationally;
- 3        **noted** that a number of countries, including Australia, are investigating or implementing digital services taxes (DSTs);
- 4        **agreed** that New Zealand should continue to participate in the OECD discussions on the taxation of the digital economy, with a view to supporting a long-term solution (bearing in mind its effect on New Zealand exporters);
- 5        **agreed** that the government should also actively consider a possible DST as an option for taxing the digital economy, in case the OECD are unable to achieve sufficient progress in 2019;
- 6        **directed** officials to draft a discussion document to get public feedback on the options for taxing the digital economy (being the international solution and the DST);
- 7        **agreed** that the discussion document should state that:
  - 7.1      the government is determined to ensure that multinational companies pay their fair share of tax in New Zealand;
  - 7.2      the government is actively considering introducing a DST in advance of an international solution. While New Zealand is committed to finding a solution at the OECD, if sufficient progress is not made in 2019, a DST is a credible option;
  - 7.3      the government sees real benefits in aligning New Zealand's position on a DST with Australia;
  - 7.4      the DST initially proposed would be like the one proposed by the United Kingdom;
  - 7.5      the DST would be an interim measure that would cease to apply once an international solution was adopted;

- 7.6 the government would aim to design the DST so that it was consistent with New Zealand's international obligations (which is expected to be possible);
- 8 **authorised** the Prime Minister, Minister of Finance and the Minister of Revenue to decide when the discussion document will be released;
- 9 **noted** that the Minister of Finance and the Minister of Revenue, in consultation with the Prime Minister, will report back to Cabinet with a draft of the discussion document prior to its release.

Michael Webster  
Secretary of the Cabinet

---

**Hard-copy distribution:**

Prime Minister  
Deputy Prime Minister  
Minister of Finance  
Minister of Revenue