

# Hon Grant Robertson, Minister of Finance

## Hon Stuart Nash, Minister of Revenue

### Information Release

#### Options for taxing the digital economy Tax policy report, Cabinet paper and minute

July 2019

#### Availability

This information release is available on Inland Revenue's Tax Policy website at <http://taxpolicy.ird.govt.nz/publications/2019-ir-cab-dev-19-sub-0110/overview>.

#### Documents in this information release

1. IR2019/217 T2019/1187 – Tax policy report: Cabinet paper - options for taxing the digital economy (24 April 2019)
2. DEV-19-SUB-0110 – Cabinet paper: Options for taxing the digital economy (8 May 2019)
3. DEV-19-MIN-0110 – Minute: Options for taxing the digital economy (8 May 2019)

#### Additional information

The Cabinet paper was considered by the Cabinet Economic Development Committee on 8 May 2019 and confirmed by Cabinet on 13 May 2019.

One attachment to the Cabinet paper is not included in this information release as it is publicly available:

- Options for taxing the digital economy – a Government discussion document.

#### 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  |

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## Tax Policy Report: Cabinet Paper - Options for Taxing the Digital Economy

<b>Date:</b>	24 April 2019	<b>Priority:</b>	Medium
<b>Security Level:</b>	In Confidence	<b>Report No:</b>	T2019/1187 IR2019/217

### Action sought

	Action Sought	Deadline
Minister of Finance	<p><b>Sign</b> and <b>refer</b> the attached Cabinet paper and Discussion Document to the Cabinet Office</p> <p><b>Refer</b> a copy of this report to the Prime Minister</p>	10:00 am, 2 May 2019
Minister of Revenue	<p><b>Sign</b> and <b>refer</b> the attached Cabinet paper and Discussion Document to the Cabinet Office</p> <p><b>Refer</b> a copy of this report to the Prime Minister</p>	10:00 am, 2 May 2019

### Contact for telephone discussion (if required)

Name	Position	Telephone
s 9(2)(a)	Senior Policy Advisor, Inland Revenue	s 9(2)(a)
Carmel Peters	Policy Manager, Inland Revenue	
Matthew Gan	Tax Specialist, The Treasury,	

24 April 2019

Minister of Finance  
Minister of Revenue

## **Cabinet Paper - Options for Taxing the Digital Economy**

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1. This paper seeks your agreement to refer the attached Cabinet paper and draft discussion document to the Cabinet Office by 10:00 a.m., Thursday 2 May 2019 for the Cabinet Economic Development Committee (DEV) to consider at its meeting on 8 May 2019.

### **Discussion Document**

2. On 18 February 2019 Cabinet agreed to issue a discussion document to consult on options for taxing the digital economy (CAB-19-MIN-0041). That Cabinet paper noted you would report back to Cabinet with a draft of the discussion document prior to its release. We provided you with a draft of the discussion document on 11 April 2019, together with our policy report IR2019/208, T2019/1045.
3. An updated draft of the discussion document (Discussion Document), entitled *Options for Taxing the Digital Economy*, is **enclosed**, together with a draft Cabinet paper seeking approval to release it. This version is very similar to the version we provided you on 11 April. The main change is to the structure of the document. Chapter 3 and parts of Chapter 2 have been moved to the appendices. Chapter 3 is now concerned with the possible adoption of a digital services tax (DST) as an interim measure, and previous chapter 4 has been merged into it. We attach a marked-up version of the Discussion Document showing the changes we made (other than where we have just moved the text around).
4. If Cabinet approves the Discussion Document, we will issue it on 30 May 2019 (i.e. Budget Night). In consultation with your offices, officials would appreciate the ability to make minor editorial and technical changes to the Discussion Document before its public release.

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

5. We remain of the view that the under-taxation of the digital economy poses risks to the sustainability of Government revenue and the fairness of the tax system. There are two options for addressing this issue:
  - a DST, which could be adopted as an interim measure (i.e. subject to an appropriate international solution being reached at the OECD); or
  - a multilateral solution, which is currently being discussed at the OECD.
6. The advantages and disadvantages of each course of action are set out and explained at length in the Discussion Document. However, for convenience, a brief summary of these is provided below.

## **Advantages and Disadvantages of a DST**

7. Adopting a flat, targeted, low rate DST would result in a tax which is relatively simple to calculate and administer. Most importantly, it would improve the fairness of the tax system by collecting revenue from businesses which have historically paid little tax either in New Zealand, or overseas. A DST could also increase economic efficiency and welfare by helping address the current favourable international tax treatment of the digital sector in comparison to more traditional businesses.
8. A DST does have some disadvantages, however. For example, as a DST would apply in addition to income tax, it could subject firms to double taxation (including possibly some domestic firms). Some of the burden of a DST (we estimate between 30% and 50%) would likely be passed on to New Zealand consumers rather than borne by the digital firms themselves. Internationally, there is the risk that a DST could affect New Zealand's reputation as a place to do business and place pressure on New Zealand's relationships with its trading partners.
9. As a rough estimate, we expect a 3% DST would raise between \$30m and \$80m of tax<sup>1</sup>, depending in part on how it is designed.

## **Advantages and Disadvantages of a Multilateral Solution**

10. A multilateral solution at the OECD would integrate the taxation of the digital economy into the income tax system and would avoid double taxation, by allowing any income tax payable in New Zealand to be creditable overseas. There are two measures under consideration at the OECD for changing the internationally agreed income tax rules. These are:
  - 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 three 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 it would apply beyond the digital economy. s 6(a)
    - A proposal which provides 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 and is supported by a group of 24 developing countries (the G24).

It is possible that the OECD may adopt an option that incorporates elements of more than one of the three proposals, or an alternate proposal not yet considered.

- 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.

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<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.

11. However, there is a risk in waiting for a multilateral solution to emerge from the OECD. Further, even if a common approach could be agreed, there would be some delay between the agreement being reached and its implementation, costing the Government in revenue foregone and leaving multinationals unfairly taxed in the interim.
12. We expect the OECD measures to all raise revenue. However the proposals are not detailed enough for us to estimate the revenue impact yet.

### **Next Steps**

13. As you have agreed to a 30 May 2019 release date, the next steps will be as follows:
  - **2 May 2019:** the Cabinet paper and the Discussion Document is lodged with Cabinet Office
  - **8 May 2019:** the Cabinet paper goes to the Cabinet Economic Development Committee (DEV).
  - **13 May 2019:** the Cabinet paper goes to Cabinet for its approval to issue the Discussion Document.
  - **30 May 2019:** The Discussion Document is released.

## Recommended action

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14. We recommend that you:

- (a) **Sign** and **refer** the attached Cabinet paper and the Discussion Document to the Cabinet Office by 10:00 a.m., Thursday 2 May 2019 for the Cabinet Economic Development Committee to consider at its meeting on 8 May 2019.

Signed and referred

Signed and referred

- (b) **Refer** a copy of this report and its attachments to the Prime Minister.

Referred

Referred

s 9(2)(a)



**Mark Vink**  
Manager  
Tax Strategy  
The Treasury

s 9(2)(a)



Senior Policy Advisor  
Policy and Strategy  
Inland Revenue

**Hon Grant Robertson**  
Minister of Finance

**Hon Stuart Nash**  
Minister of Revenue





## BUDGET-SENSITIVE

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 publish the attached tax policy Government discussion document *Options for taxing the digital economy*. This discussion document will be released as part of Budget 2019. Feedback from the discussion document will be used to help formulate the best policy for taxing the digital economy.

### Executive Summary

2. 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.
3. 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. This option is currently being discussed at the OECD. The other option is to apply a separate digital services tax (DST) to certain revenues earned by highly digitalised multinationals in New Zealand.
4. The Government supports an internationally agreed solution at the OECD, but it will seriously consider a DST if the OECD cannot make sufficient progress this year.
5. On 18 February 2019 Cabinet agreed to issue a discussion document to consult on options for taxing the digital economy (Cabinet Minute CAB-19-MIN-0041 refers). The 18 February Cabinet paper noted that we would report back to Cabinet with a draft of the discussion document prior to its release.
6. We attach a draft of this discussion document (Discussion Document) to this paper for approval by Cabinet.

### Background

7. 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 also an issue for New Zealand. The 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 impacts 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.

8. On 18 February 2019 Cabinet agreed to issue a discussion document to consult on options for taxing the digital economy (Cabinet Minute CAB-19-MIN-0041 refers).

## **Analysis**

### ***Content of the discussion document***

9. We have drafted the Discussion Document as outlined in the February Cabinet paper. The Discussion Document explains the problems with taxing the digital economy. It then outlines the two options for taxing the digital economy – imposing a DST or changing the internationally agreed tax rules at the OECD – and invites public feedback on those options. Some information about the size of the digital economy in New Zealand and globally is included as well.

#### ***Option 1 – imposing a DST***

10. The Discussion Document states that:
  - The Government is determined to ensure that multinational companies pay their fair share of tax in New Zealand.
  - While the Government supports an internationally agreed solution at the OECD, it will seriously consider a DST if the OECD cannot make sufficient progress this year
  - 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.
11. The DST proposed in the Discussion Document is based on the DST announced by the UK, and shares a set of common features with other DSTs. It is a flat tax charged at a low rate (3%) on gross revenues that are attributable to the users in the relevant country. The DST would 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.
12. This means the proposed 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 accountancy services delivered via the cloud.
13. Countries which have introduced or announced DSTs so far are Austria, the Czech Republic, France, India, Italy, Spain and the UK. The European Commission proposed a 3% DST for the EU but it could not achieve the support of all EU members.

14. The Discussion Document explains the benefits of a DST and its issues. These issues include the 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 Discussion Document also considers how much of a DST may be passed on to New Zealand consumers, amongst other things.

*Option 2 - Changing the internationally agreed income tax rules*

15. The Discussion Document describes two measures being considered at the OECD for changing the internationally agreed income tax rules. These are:
- A measure to allocate greater taxing rights over a multinational's profits to market countries (such as New Zealand). The measure would not require the multinational to have a physical presence in the country. There are three 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 based on certain "marketing intangibles" created there by multinationals. This is the United States proposal and it would apply beyond the digital economy. s 6(a)
    - A proposal which provides 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 and is supported by a group of 24 developing countries (the G24).

It is possible that the OECD may adopt an option that incorporates elements of more than one of the three proposals, or an alternate proposal not yet considered.

- 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.
16. The OECD is aiming to obtain G20 approval of its preferred measures in June 2019 and countries have committed to working towards a consensus solution in 2020.

*Conclusion*

17. The Discussion Document concludes that the Government supports an internationally agreed solution at the OECD, but it will seriously consider a DST if the OECD cannot make sufficient progress this year. Factors to be considered in making this decision are:

- whether the OECD can make sufficient progress on an international solution this year;
- whether a critical mass of other countries also adopts DSTs (to reduce the reputational risks of adopting a DST);
- whether New Zealand companies would be unduly affected by a DST; and
- whether the cost of a DST would all be passed on to New Zealand consumers.

18. This is broadly consistent with the Tax Working Group's analysis of a DST.

***Australia's announcement that it would not proceed with a DST at this time***

19. Australia announced on 20 March 2019 that it would not adopt a DST at this time. Instead it will focus on achieving a multilateral solution at the OECD. The announcement follows Australia's recent consultation on options for taxing the digital economy (which included a DST). The announcement noted that:

- the Australian Government firmly believes that digital firms, like all firms, must pay their fair share of tax;
- the submitters overwhelmingly supported Australia continuing to engage in the ongoing multilateral process at the OECD; and
- many submitters raised significant concerns about the potential impact of an Australian DST across a wide range of Australian businesses and consumers.

20. Australia's announcement should not affect New Zealand's decision to consult on a DST. The Government was clear when it announced the Discussion Document in February that it prefers a multilateral solution, but wants to consider a DST now in case the OECD does not make sufficient progress. So the Government shares Australia's preference for an OECD-led multilateral solution, but wants to be ready to implement a DST in case this cannot be achieved in a reasonable time-frame.

***Next steps***

21. If Cabinet approves the Discussion Document, then we would release it as part of Budget 2019. We would report back to Cabinet on the feedback from the Discussion Document 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.

22. Some minor editorial and technical changes may need to be made to the Discussion Document following its approval by Cabinet including changes to reflect any updates to the OECD proposals prior to the release of the Discussion Document. This is because there is a possibility that the OECD will update its proposals before the Discussion Document is released. If this occurs, we will update the description of those proposals in the Discussion Document.

## **Consultation**

23. We consulted with the following on this Discussion Document: Inland Revenue, The Treasury, The Ministry of Foreign Affairs and Trade, The Ministry of Business, Innovation and Enterprise, The Ministry for Culture and Heritage, and The New Zealand Customs Service. We have incorporated their feedback into the Discussion Document and they support the preparation of the Discussion Document.
24. The Discussion Document will be used as a basis for consultation with the public.

## **Financial Implications**

25. There are no financial implications for the release of the Discussion Document. We expect the introduction of new measures to tax the digital economy to 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). As a rough estimate, we expect a 3% DST would raise between \$30m and \$80m of tax, depending in part on how it is designed. Advice on financial implications will be provided when approval for our final policy recommendations is sought.

## **Administrative impacts**

26. There are no administrative impacts from the publication of the Discussion Document. A DST and an OECD solution would have administrative impacts. We have designed the proposed DST in the Discussion Document to minimise these. Advice on administrative impacts will be provided when approval for our final policy recommendations is sought.

## **Legislative Implications**

27. 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**

28. Elements of the regulatory impact analysis have been 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**

29. There are no human rights implications associated with the publication of the Discussion Document.

## **Publicity**

30. We will arrange the appropriate publicity for the release of the Discussion Document. The release of the Discussion Document will also be included in the publicity for the 2019 Budget.

## Proactive Release

31. We propose to proactively release this Cabinet paper in part, together with the associated Ministerial reports.
32. 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 there is a problem with the current taxation of the digital economy, both in New Zealand and internationally.
2. **Note** that a number of countries are investigating or implementing digital services taxes (DSTs).
3. **Agree** that the Ministers of Finance and Revenue may make minor editorial and technical changes to the Discussion Document before its release.
4. **Note** that if the OECD proposals change before the release date, we will update the description of those proposals in the Discussion Document under recommendation three above.
5. **Agree** to publicly release the attached Government discussion document *Options for taxing the digital economy*, subject to any changes made pursuant to recommendation three above.
6. **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 Economic Development Committee

## Minute of Decision

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*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.*

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### Options for Taxing the Digital Economy

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

On 8 May 2019, the Cabinet Economic Development Committee:

- 1        **noted** that on 18 February 2019, Cabinet:
  - 1.1      noted that there is a problem with the current taxation of the digital economy, both in New Zealand and internationally;
  - 1.2      noted that a number of countries, including Australia, are investigating or implement digital services taxes (DSTs);
  - 1.3      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);
  - 1.4      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);
  - 1.5      noted that the Minister of Finance and the Minister of Revenue, in consultation with the Prime Minister, will report back with a draft of the discussion document prior to its release;

[CAB-19-MIN-0041]
- 2        **agreed** to the release of the document *Options for Taxing the Digital Economy: A Government Discussion Document* (the discussion document), attached to the paper under DEV-19-SUB-0110, subject to any changes in accordance with paragraphs 3 and 4 below;
- 3        **authorised** the Minister of Finance and the Minister of Revenue to make minor editorial and technical changes to the discussion document prior to its release;
- 4        **noted** that if the OECD proposals change before the release date, the Minister of Finance and the Minister of Revenue will update the description of those proposals in the discussion document.

Janine Harvey  
Committee Secretary

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**Hard-copy distribution: (see over)**

**Present:**

Rt Hon Winston Peters  
Hon Kelvin Davis  
Hon Phil Twyford  
Hon Dr Megan Woods (Chair)  
Hon Chris Hipkins  
Hon David Parker  
Hon Stuart Nash  
Hon Iain Lees-Galloway  
Hon Jenny Salesa  
Hon Damien O'Connor  
Hon Shane Jones  
Hon Kris Faafoi  
Hon Willie Jackson  
Hon Eugenie Sage

**Officials present from:**

Office of the Prime Minister  
Officials Committee for DEV

**Hard-copy distribution:**

Minister of Finance  
Minister of Revenue