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Taxation of Global Digital Matchmakers: A Tentative Step Forward?

Abstract

Using the example of Google, this article discusses the problem of the 'fiscal absence' (or limited fiscal presence) of global digital matchmakers selling Internet advertising and digital intermediation services in New Zealand remotely over the Internet. The article evaluates the response to this problem found in the Taxation (Neutralising Base Erosion and Profit Shifting) Bill, which was introduced on 6 December 2017, and the OECD's Interim Digitisation Report of 16 March 2018 on the implications of digitalisation for taxation. Building on this analysis, the article suggests New Zealand should introduce an excise tax, as discussed in the OECD's Interim report, to protect its national tax base from erosion, while waiting for a suitable international solution to be developed to the division of the gains generated in the today's integrated and digitalised global economy.

1 INTRODUCTION

On 6 December 2017, the New Zealand Government introduced the Taxation (Neutralising Base Erosion and Profit Shifting) Bill (the Bill)[1] to put an end to some of the practices eroding New Zealand corporate tax base. The Bill does not specifically target tax base eroding activities of global matchmakers – foreign firms[2] that operate a global multisided platform business supplying Internet advertising and digital intermediation services[3] to customers in New Zealand (e.g. Uber, Google, Facebook, Airbnb, Booking.com, Trivago, Amazon Marketplace, Taobao, Apple iTunes, e-Bay).[4] However, a New Zealand subsidiary of one of the largest global matchmakers (Google) has responded to the New Zealand Government's

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1 Taxation (Neutralising Base Erosion and Profit Shifting) Bill 2017 (3-1).

2 In this article, a 'foreign firm' is a unit of organisation for productive activities, incorporated in one country and conducting business in another country through a branch, subsidiary or permanent establishment. See "firm" in John Black, Nigar Hashimzade and Gareth Myles (eds), *A Dictionary of Economics* (4th edn, Oxford University Press 2012, online version 2013).

3 "Digital intermediation services (also referred to as platforms) are websites and mobile applications that facilitate the exchange of goods or services between third parties": see OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [443] at 186.

4 A 'matchmaker' is a firm with a multisided platform business. This firm produces multiple products simultaneously and organises its business activities in such a way that the customers of one product will attract customers for another product produced by the same firm. When this firm is multinational and operates as a global unitary business, its multisided platform will also likely to be global and, therefore, the firm will be a 'global matchmaker'.

initiative in cooperative way. In his submission of 8 February 2018 on the Bill, the Senior Manager for Public Policy and Government Affairs of Google New Zealand Mr Young stated that "[w]e intend to shift our business model from [our] past approach, such that customers will enter into contracts with our New Zealand entity, which will generate revenue from NZ advertising customers, and pay taxes in line with its role in the transaction".[5] Nationally[6] and internationally[7] this statement was seen as a success story of a global campaign run by the OECD and the G20 in the framework of the Base Erosion and Profit Shifting (BEPS) project.[8]

At the first glance, the Google's statement sounds promising for New Zealand. If Google entered into sales contracts in New Zealand, it would pay tax on income from these sales in New Zealand and not somewhere else. However, as sections 4 and 5 of this article conclude, the corporate income tax paid by Google in New Zealand will be likely to remain modest compared to the firm's large and growing economic presence in the country. The reason for this is the general mechanism and model the international tax regime[9] applies to divide gains from cross-border business activities among countries.[10] New Zealand cannot change these mechanism and model unilaterally. However, there are some actions New Zealand, as a

5 Letter of Senior Manager Public Policy and Government Affairs of Google New Zealand Ross Young of 8 February 2018 <http://www.documentcloud.org/documents/4384129-Google-Letter-to-F-amp-E-select-committee.html# document/p3/a405840> accessed 16 March 2018. See also section 4 of this article.

6 Matt Nippert, "Google to cease 'offshoring' local revenue" (*The New Zealand Herald*, 22 February 2018) available at < http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11999548>.

7 OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [262] at 91, [273] at 95, [309] at 107 and footnote 12 at 123.

8 In 2013, the OECD and G20 launched the BEPS project to align the rules for taxation of cross-border economic activities with the location of economic activity and value creation; to improve coherence between domestic tax systems and international rules; and to promote tax transparency: see OECD, "Addressing Base Erosion and Profit Shifting", *BEPS Report* (Paris, 12 February 2013); OECD, "Action Plan on Base Erosion and Profit Shifting (BEPS)", *BEPS Report* (Paris, 19 July 2013). See also OECD, "Global Tax and Transparency: We Have the Tools, Now We Must Make Them Work" <http://www.oecd.org/tax/global-tax-transparency-we-have-the-tools.htm> accessed 20 October 2017.

The BEPS package of fifteen measures developed by forty-four countries through consultations with more than eighty other jurisdictions was announced in October 2015 in the Final BEPS Report: see *2015 Final Report, OECD/G20 Base Erosion and Profit Shifting* Project (5 October 2015). See also OECD, "OECD Secretary-General Report to G20 Leaders" (Hamburg July 2017) <http://www.oecd.org/tax/oecd-secretary-general-tax-report-g20-leaders-july-2017.pdf>.

9 In the context of the current discussion 'the international tax regime' means an instrument of global tax governance.

10 For an overview of the model the international tax regime applies to divide gains from cross-border business activities among countries see section 4 of this article.

market state into which services are sold, can take as interim measures to protect its tax base from erosion through the actions of Google and other global matchmakers.

This article does not address the broad problem of tax base erosion in market states arising out of cross-border direct sales.[11] It also does not have the objective of evaluating the overall anti-BEPS effect of the Taxation (Neutralising Base Erosion and Profit Shifting) Bill. The current discussion focuses on the effects of this Bill on the taxation of global matchmakers supplying Internet advertising and digital intermediation services to customers in New Zealand. According to the OECD, the taxation of this type of activities is very challenging for a country where customers of these services are located and may require the introduction of specific tax measures.[12]

The article is structured as follows. The challenges of taxing global matchmakers are illustrated through a look at the example of Google's economic presence in New Zealand (section 2) and the fiscal outcome of this presence (section 3). Section 4 analyses tax implications of the Google's promise to change a structure of its business operations in New Zealand. Section 5 examines the Taxation (Neutralising Base Erosion and Profit Shifting) Bill and non-tax alternatives available to New Zealand. Section 6 concludes that New Zealand should introduce an excise tax on foreign suppliers of Internet advertising and digital intermediation services.

2 ECONOMIC PRESENCE OF GOOGLE IN NEW ZEALAND[13]

[11] From a tax perspective, the concept of 'cross-border direct sales' are business activities conducted by foreign suppliers through direct interaction with customers in the "market" country. As a result of this interaction customers in the market country make mail, phone or online orders for products and services and receive these products and services directly from a form located abroad. In general terms, 'direct sales', 'direct selling' or 'direct marketing' is the "selling by means of dealing directly with consumers rather than through retailers. Traditional methods include mail order […], cold calling, telephone selling, and door-to-door calling, […] telemarketing, direct radio selling, magazine and TV advertising, and online computer shopping […]": 'direct marketing' in Jonathan Law, *A Dictionary of Business and Management* (5th edn, Oxford University Press 2009).

[12] See Chapter 6 in OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018). See also section 5 in this article.

[13] The analysis is based on data that has been publicly available.

Google was created with the incorporation of Google Inc in California in September 1998.[14] It subsequently became a wholly owned subsidiary of Alphabet Inc in October 2015.[15] Its principal business is selling Internet advertising services and other digital products and intermediation services worldwide.

The “Google segment” is the largest part of Alphabet’s business. The Google entities produce and supply worldwide many different types of digital services (e.g. Internet search), products (e.g. virtual reality headsets) and technical infrastructure (e.g. cloud infrastructure). In 2016, the Google segment generated 99.1 per cent of the consolidated income of Alphabet; 88.7 per cent of which came from Internet advertising.[16]

The Google segment includes two New Zealand subsidiaries: Google New Zealand Ltd[17] and Google Payment New Zealand Ltd.[18] The single shareholder of both subsidiaries is Google International LLC, which is incorporated in the United States. Google New Zealand Ltd and Google Payment New Zealand Ltd support the operations of the Google segment in New Zealand.

Neither of the New Zealand Google subsidiaries are engaged in transactions with local customers; they earn income only through intra-group transactions with other entities of the Google segment, primarily Google Inc, Google Ireland Ltd and Google Asia Pte Ltd.

It follows from the Financial statements filled with the Company’s Office in New Zealand Google New Zealand Ltd provides sales and marketing (S&M) services for Google Ireland Ltd and Google Asia Pte Ltd, as well as research and development (R&D) services for Google Inc.

[14] For the history of Google see <www.google.com/about/company/history/>.

Google Inc was reincorporated in Delaware (the United States) in October 2002. See Fourth Amended and Restated Certificate of Incorporation of Google Inc. See <http://investor.google.com/ corporate/certificate-of-incorporation.html>.

[15] Larry Page’s statement <https://abc.xyz/> accessed 11 April 2016.

[16] See Alphabet Inc, Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 (form 10-K) for the Fiscal Year Ended on December 31 (2016) at 24 <https://abc.xyz/investor/pdf/ 20161231_alphabet_10K.pdf> accessed 10 February 2017.

[17] Google New Zealand Ltd, the Company Extract (<www.business.govt.nz/companies/app/ui/pages/ companies/1786635?backurl=%2Fcompanies%2Fapp%2Fui%2Fpages%2Fcompanies%2Fsearch%3Fmode% 3Dstandard%26type%3Dentities%26q%3DGoogle#> accessed 11 April 2013.

[18] Google Payment New Zealand Ltd, the Company Extract <www.business.govt.nz/companies/app/ui/ pages/companies/1904436?backurl=%2Fcompanies%2Fapp%2Fui%2Fpages%2Fcompanies%2Fsearch%3Fm ode%3Dstandard%26type%3Dentities%26q%3Dgoogle> accessed 11 April 2013.

Google Payment New Zealand Ltd collects payments for digital products sold to customers in New Zealand through the Google Play web platform.

Based on the corporate business structure of the Google segment, it appears that customers of Internet advertising services in New Zealand pay for advertising services directly to Irish or Singaporean subsidiaries of Google Inc (Google Ireland Ltd and Google Asia Pte Ltd).[19] As a result, advertising revenues collected from customers in New Zealand do not pass through the subsidiaries of Google that are incorporated in New Zealand.

3 FISCAL OUTCOME OF GOOGLE'S ECONOMIC PRESENCE IN NEW ZEALAND

Tables 3.1 and 3.2 set out selected financial and fiscal results of the Google segment of Alphabet Inc (and Google Inc prior to October 2015) in New Zealand for the period 2010-2016[20] based on the Financial Statements of Google New Zealand Ltd[21] and Google Payment New Zealand Ltd filed with the Company's Office.[22]

Google New Zealand Ltd (in NZD)							
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**

[19] However, it is possible that all payments from local customers are collected by or paid directly to a Singaporean subsidiary of Google (Google Asia Pte Ltd). The Singaporean subsidiary manages operations of the Google segment in the Asia-Pacific mega-region, which includes New Zealand.

[20] As of the date this article was submitted for publication, Google New Zealand Ltd has not filed its Financial Statements for 2017 year. Google Payment New Zealand Ltd has not been filed its Financial Statements since 2015.

[21] Google New Zealand Ltd, Financial Statements for 2010-2015: (2010) <https://www.business.govt.nz/companies/app/service/services/documents/8C6EC1B99321AC63986CDAF112B352BC>; (2011) <https://www.business.govt.nz/companies/app/service/services/documents/49E6002435E505F500D2AA97A96E4373>; (2012) <https://www.business.govt.nz/companies/app/service/services/documents/ABF3EC4E2F8DC46 F9B723FE6A41F6618>; (2013) <https://www.business.govt.nz/companies/app/service/services/ documents/ 6F0A975FE248A2BA6C7DA4ED1B1AE377>; (2014) <https:// www.business.govt.nz/companies/ app/service/ services/documents/23411216F0B792CE4D05DD4225577957>; (2015) <https://www. business. govt.nz/companies/app/service/services/documents/746996CC976EEF52A020236A741E621A> accessed 15 June 2016.

[22] Google Payment New Zealand Ltd, Financial Statements for 2010-2014: (2010) <https://www.business.govt.nz/companies/app/service/services/documents/094B737426744E80BB69B1899B84BA04>; (2011) <https://www.business.govt.nz/companies/app/service/services/documents/DB996E8A34360E019C6F1DB3F33B7976>; (2012) <https://www.business.govt.nz/companies/app/service/services/documents/633F369BCF5F222CD15C98DB62CD5111>; (2013) <https://www.business.govt.nz/companies/app/service/services/documents/0797E34032C935053DCF1BC4112C6D8A>; (2014) <https://www.business.govt.nz/companies/app/service/services/documents/B18889364E802EA16AE2547C0BD08296> accessed 15 June 2016.

Income[23]	$ 3,982,723	$ 4,447,898	$ 6,823,867	$ 10,131,648	$ 14,925,180	$ 10,729,935	$ 12,593,921
Profit/(loss) for the year (before income tax)	$ 158,260	$ 56,803	$ (193,671)	$ 5,362	$ 521,735	$ (368,067)	$ (298,895)
Income tax expense/ (credit)	$ (203,349)	$ (109,038)	$ 165,526	$ 227,074	$ 361,542	$ 233,396	$ 304,860

Table 3.1 Financial Results of Google New Zealand Ltd between 2010 and 2016

Google Payment New Zealand Ltd (in NZD)						
	2010	**2011**	**2012**	**2013**	**2014**	**2015-2016**
Income[24]	$ 26,516	$ 19,443	$ 15,090	$ 15,773	$ 22,764	unknown[25]
Payments received on behalf of other companies of the Google group	unknown	$ 49,710	$ 530,264	$ 3,183,515	$ 4,670,274	unknown
Profit/(loss) for the year (before income tax)	$ 6,359	$ 1,378	$ 1,151	$ 1,168	$ 906	unknown

Table 3.2 Financial Results of Google Payment New Zealand Ltd between 2010 and 2016

No income from sales of Internet advertising services and digital intermediation services or sales of digital products was attributed to New Zealand subsidiaries of Google in 2010-2016. Accordingly, it appears the national tax base of New Zealand, as the market state for services and products sold by Google to customers in New Zealand, was eroded by Google's decision for its overseas subsidiaries[26] to invoice for sales of Internet advertising services, digital intermediation services and digitals products to customers in New Zealand. It is not possible to measure the size of this erosion because none of the Google subsidiaries in New Zealand have been reporting income the group earns from sales it makes to customers in New Zealand. The author has not found any public data that would provide a basis for an accurate estimate of the business profits of Google from sales of digital intermediation services and digital products to customers in New Zealand. However, some information about Google's

[23] The entire amount of income earned by the entity under intra-group transactions.

[24] The entire amount of income earned by the entity under intra-group transactions.

[25] Since 2015, because of the very low level of its corporate income, Google Payment New Zealand Ltd has legitimately avoided having to file financial statements in New Zealand.

[26] Google Ireland Ltd and Google Asia Pte Ltd.

likely revenue from Internet advertising in New Zealand is available. In 2016, the total interactive advertising[27] spend in New Zealand was NZD 890.86 million.[28] According to PricewaterhouseCoopers (PwC):

> […] the annual value of New Zealand's internet advertising market will grow to $1.58 billion by 2020 from $828 million in 2015. More than half of that revenue is generated by paid searches, of which Google is responsible for 90 percent. The accounting firm estimates paid search ad revenue will be worth $897 million by 2020.[29]

Therefore, it is reasonable to assume that Google has earned about $ 400-500 million per year from sales of Internet advertising to customers in New Zealand in 2015-2016[30] and this amount will likely double by 2020.

Google spends about fifth of its income from Internet advertising on the acquisition of user traffic.[31] Google also pays its New Zealand subsidiaries for research and development and sales and marketing activities conducted in New Zealand. Therefore, the size of the real ‘erosion’ of the corporate tax base in New Zealand as a result of manner in which Google has structured its business is less than the firm’s income generated from sales of Internet

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[27] Interactive advertising is advertising viewed on any screen via an internet connection, 3G, 4G or WIFI. See Interactive Advertising Bureau (IAB) NZ Press Release <http://www.iab. org.nz/news/iabpwc-q4-2015-ad-spend-report/> accessed 19 May 2016. The thesis refers to ‘Internet advertising’ instead of ‘interactive advertising’.

[28] IAB NZ Press Release <http://www.iab.org.nz/news/iabpwc-q4-2016-ad-spend-report/> accessed 2 January 2017.

[29] Paul McBeth, “Google NZ Gets Less Revenue from Parent in 2015; Still Dominates Online Ads” (*The National Business Review*, 10 June 2016) <https://www.nbr.co.nz/article/google-nz-gets-less-revenue-parent-2015-still-dominates-online-ads-b-190231> accessed 10 June 2016.

[30] The New Zealand Herald came to the same conclusion. “Several sources spoken to by the Herald, many declining to be named as they regularly conducted business with Google and Facebook, said the companies appeared to make, respectively, $400 million and $100 million from New Zealand clients”: “Internet Giants Shifting Millions Overseas” (*The New Zealand Herald*, 26 March 2016) available at <http://www.nzherald.co.nz/business/news/ article.cfm?c_id=3&objectid=11611823>.

[31] For instance, in 2016 traffic acquisition costs as a percentage of advertising revenue were 21.2 per cent, including payments made to web publishers participating in the Google AdSense programme for access to their websites and web content and payments to third parties for the distribution of Google’s browser Chrome and for re-directing search queries to Google websites: Alphabet Inc, Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 (form 10-K) for the Fiscal Year Ended on December 31 (2016) at 29 <https://abc.xyz/investor/pdf/ 20161231_alphabet_10K.pdf> accessed 10 February 2017. In 2015, traffic acquisition costs were 21.3 per cent: Alphabet Inc and Google Inc, Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 (form 10-K) for the Fiscal Year Ended on December 31 (2015) at 31<https://abc.xyz/investor/pdf/20151231_ alphabet_10K.pdf> accessed 18 May 2016.

advertising services and digital products to customers in New Zealand. However, even taking into account all costs Google likely incurs to produce and sell Internet advertising services in New Zealand, the 'erosive' effect of the firm's economic presence for the New Zealand tax base is substantial.

4.0 GOOGLE'S PROMISE

The way Google generates its profits is challenging for tax policymakers. Google is an example of a firm that is *economically present* in almost every state, but at the same time, for the purpose of corporate income tax, Google is *fiscally absent*[32] in most of states where its customers[33] or targeted Internet users[34] are located. When it comes to the taxation of Google's business profits derived from cross-border direct sales of digital services and products,[35] in virtually all of the states that are the economic source of these profits, Google, rather than the states, effectively decides whether or not it will have a 'tax presence' and the degree of that presence.

Google's decision to be 'fiscally present' in some states and 'fiscally absent' in others is perfectly legal in most cases, because its practices are designed around the general mechanism and models of the international tax regime and comply with the legislation and treaties of the states participating in this regime. The main elements of the model that the international tax regime applies for the allocation of business profits are the separate entity approach and a physical presence standard for the tax nexus with business profits. Under the separate entity approach, when a firm operates in more than one state, the states where the individual legal or tax entities of the firm are located apply their own laws to these entities and treat them for tax purposes as if they are separate and independent enterprises.[36] The

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[32] The problem of 'avoiding a taxable presence' was identified as a key issue in the framework of the Base Erosion and Profit Shifting (BEPS) project. See OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2014 Deliverable, OECD/G20 Base Erosion and Profit Shifting Project* (16 September 2014) at 102 [5.2.1.1] and 124-129 [7.2-7.3].

[33] In the context of this discussion the concept 'customers' embodies both individuals and businesses.

[34] 'Targeted Internet user' is a recipient of an Internet advertisement.

[35] Digital products have characteristics of both services and goods. The article does not focus on differences between digital services and so-called 'digital products' (apps, electronic books, magazines, films and videos). The discussion in this article concerns digital services. However, most of findings of this discussion are relevant to digital products as well.

[36] OECD *Model Tax Convention on Income and on Capital: Condensed Version* (9th edn, Paris, 15 July 2014), arts 7 (2) and 9 (1). See also Reuven S Avi-Yonah, "National Regulation of Multinational Enterprises: An Essay on

separate entity approach, in particular, underlies transfer pricing rules of states.[37] A physical presence standard for the tax nexus between a state and business income is applied to identify the source of business income in national tax legislation or as a part of the concept of a permanent establishment concept (PE) in national statutory and treaty rules. Both the separate entity approach and the physical presence standard are at odds with the integrated nature of the global economic environment today, the structure of multinational business operations and the production process of many multinational firms.

Many people and governments see fiscal absence of the global matchmakers as immoral and on this basis claim that Google 'does evil'[38] to both states and people by eroding the national tax bases of many states and thereby forcing ordinary people to pay more tax. Almost by definition, the actions of firms are not driven by moral concerns. Profit maximisation, according to Milton Friedman,[39] is the duty of a firm to its shareholders. "Arranging one's affairs to reduce the amounts of tax that has to be paid" or avoiding tax is therefore, apparently, the natural behaviour of rational, profit-maximising economic actors. Google does its duty well. In 2017 Google's total revenue was USD 24,750 billion and its net income was USD 5,426 billion.[40] To some extent, Google has no choice but to use every possible

Comity, Extraterritoriality, and Harmonization (The Regulation of Foreign Direct Investment)" (2003) 42 Columbia Journal of Transnational Law 5 at 8.

[37] "In the area of international taxation, transfer pricing under the "arm's length"- standard serves the role of allocating profits to the different units of a multinational enterprise and of allocating taxing rights to the involved jurisdictions": Wolfgang Schön, "Transfer Pricing – Business Incentives, International Taxation and Corporate Law" in Wolfgang Schön and Kai A Konrad (eds) *Fundamentals of International Transfer Pricing in Law and Economics* (Springer 2012) at 47. See also OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris, 10 July 2017).

[38] See, for example, Simon Bowers and Rajeev Syal, "MP on Google Tax Avoidance Scheme: 'I Think that You Do Evil'" (*The Guardian*, 16 May 2013) <https://www.theguardian.com/technology/2013/may/16/google-told-by-mp-you-do-do-evil> accessed 10 August 2013.

"Don't be evil" is a motto of Google. According to Google "it's about providing our users unbiased access to information, focusing on their needs and giving them the best products and services that we can. But it's also about doing the right thing more generally – following the law, acting honourably and treating each other with respect": see Google Code of Conduct <https://abc.xyz/investor/other/google-code-of-conduct.html> accessed 10 January 2017.

[39] Milton Friedman, "The Social Responsibility of Business is to Increase its Profits" (*The New York Times Magazine*, 13 September 1970) at 32–33, 122–124. See also Milton Friedman and Rose D Friedman, *Capitalism and Freedom* (University of Chicago Press 1982) at 133.

[40] See Alphabet Inc, Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 (form 10-K) for the Fiscal Year Ended on December 31 (2017) at 7 and 10 < https://abc.xyz/investor/pdf/20170331_alphabet_10Q.pdf > accessed 17 March 2018.

means to reduce the amount of tax it pays, because, from the firm's perspective, corporate income tax is a cost that affects both the size of a firm's net profits and the dividends received by the firm's shareholders.

Google, like any other firm, does what it *should* and *can* do within existing legal rules to maximise its profits. The changes of Google business structure promised in the firm's submission of 8 February 2018[41] and their tax implications for New Zealand should be evaluated from this perspective.There are a number of reasons for New Zealand not to be overly optimistic in this regard. First, it is unclear from Google's submission whether all New Zealand customers of Google or only some of them will in the future enter into contracts with a New Zealand subsidiary of Google. The full details about how Google does business in New Zealand have not been made public.[42] Mr Young's letter is a first public statement of Google about some of its business activities relating to the sale of Internet advertising in New Zealand. The statement itself is vague. In this regard, Google's submission before the United Kingdom's House of Commons may be of assistance in understanding how Google is likely to do business in New Zealand.[43]

According to Google, ninety-nine per cent of its customers purchasing Internet advertising services in the United Kingdom deal with Google online through an automatic auction and enter in contracts with an overseas legal entity. The only one per cent of its customers sign contracts with Google with the assistance of Google's local sales professionals. This one per cent, however, generates sixty to seventy per cent of the advertising revenue for Google in the United Kingdom.[44] The government's investigation of Google's business activity in the United Kingdom suggests that local Google entities undertake activities in relation to the sales

[41] The letter of Senior Manager of Google New Zealand Ross Young of 8 February 2018 <http://www.documentcloud.org/documents/4384129-Google-Letter-to-F-amp-E-select-committee.html# document/p3/a405840> accessed 16 March 2018. See also section 4 of this article.

[42] Form Financial Statements of Google subsidiaries in New Zealand it is not clear what foreign subsidiary of Google (Google Ireland Ltd or Google Asia Pte Ltd) receives payments for Internet advertising services, digital intermediation services and digital products sold to customers in New Zealand. Moreover, Google Payment New Zealand Ltd has not been filing its Financial Statements since 2015.

[43] United Kingdom, House of Commons Committee of Public Accounts, "Tax Avoidance-Google", *Ninth Report of Session 2013-14* (10 June 2013) at 8-10 [10-11, 15].

[44] The UK, House of Commons Committee of Public Accounts, "Tax Avoidance-Google", *Ninth Report of Session 2013-14* (10 June 2013) at 8-10 [10-11, 15].

of Google's Internet advertising services to major local customers.[45] These activities, in particular, include negotiation of contract arrangements in relation to Internet advertising services.

In the United Kingdom, a foreign firm is liable for corporate income tax only if it carries on a trade in the United Kingdom through a permanent establishment (PE) there.[46] The PE concept includes situations when a person (who is a dependent agent of a foreign firm)[47] is acting in the state on behalf of the foreign firm and, in doing so, habitually exercises authority to do business (or 'to conclude contracts' as provided in many of the United Kingdom's double tax agreements (DTAs))[48] on behalf of the foreign firm. In most of New Zealand's DTAs, including its DTA with the United States,[49] a PE arises when a dependent agent of a foreign firm habitually exercises an authority to conclude contracts.[50] If Google's business in New Zealand is similar to that in the United Kingdom, it is reasonable to assume that one per cent of Google's customers in New Zealand also sign their contracts with the assistance of sales professionals. Therefore, if Google would change its business operations as it has said, New Zealand may then be able to tax Google's profits generated from the sales made to that one per cent of local customers purchasing Internet advertising services from Google with the

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45 Ibid at 8 [8]. See also Tom Bergin, "How Google Clouds Its Tax Liabilities" (*Reuters*, 1 May 2013) <http://uk.reuters.com/article/us-tax-uk-google-specialreport-idUSBRE94005P20130501> accessed 15 May 2014.

46 Shinasa Wasimi, Jai Nario, and Kathryn Bertram, "Diverted Profits Tax: U.K., Australian, and New Zealand Approaches" (24 July 2017) Tax Notes International 349 at 353.

47 For a model definition of a 'dependent agent PE" see OECD *Model Tax Convention on Income and on Capital: Condensed Version* OECD *Model Tax Convention on Income and on Capital.* Full Version (Paris, 21 November 2017), art 5 (5).

48 For instance under Article 5 (5) of the *Convention between the Government of New Zealand and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains* (4 August 1983) (NZ, Double Taxation Relief (United Kingdom) Order 1984 of 13 February 1984 (SR 1984/24), a dependent PE arises when a person (a dependent agent) "is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise".

49 *Convention between New Zealand and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* (23 July 1983) (The Double Taxation Relief (United States of America) Order 1983 of 26 September 1983 (SR 1983/196)), art 5 (7): a dependent agent PE arises when a person "is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise".

50 In some of New Zealand's DTAs, the PE definition also covers an authority to negotiate contracts. See Shinasa Wasimi, Jai Nario, and Kathryn Bertram, "Diverted Profits Tax: U.K., Australian, and New Zealand Approaches" (24 July 2017) Tax Notes International 349 at 353.

assistance of a local agent. The profits earned from the sales to the remaining ninety-nine per cent of customers cannot be taxed. Therefore, thirty to forty per cent of the business profits generated by Google in New Zealand from Internet advertising would still escape taxation, unless Google will start allocate income to its subsidiary in New Zealand even if customers in New Zealand enter into online contracts with Google. It seems, however, overly optimistic to expect Google to abandon tax advantages it receives from a use of both online contracts and own subsidiaries in low tax jurisdictions that enter into these online contracts on the firm's behalf. Moreover, Internet advertising services may target New Zealand audience but supplied to customers that are not located in New Zealand. Profits from these sales cannot be exposed to taxation in New Zealand.

Secondly, Google submission refers only to Internet advertising and do not mention the digital products (e.g. games, music and web apps) that Google sells through its Google Play web platform. The digital products can be produced in New Zealand and sold through Google Play web platform in New Zealand or overseas. The digital products can also be produced overseas and sold through Google Play to customers in New Zealand. Therefore, in New Zealand Google may receive two types of payments: a fee for digital intermediation services Google provides to developers of digital products in New Zealand and a payment for digital products bought by customers in New Zealand. As with the ninety-nine per cent of the sales of Google's Internet advertising services, both types of payments are made online. Developers of digital products and customers of digital products enter into online contracts with Google (via filling in a form on the Google Play web platform). These contracts cannot be seen as having been "completed or concluded in New Zealand by Google or its agent", because the process of entering into contract is automated. It may also be impossible to prove that digital products Google sells through the Google Play web platform are 'offered for sale in New Zealand'. Like the Google advertising network and advertising exchange web platforms,[51] the Google Play web platform is physically located on and maintained through a myriad of web servers in many countries. Therefore, even if New Zealand customers access this platform or any of its

[51] For detail on Google Search network and Google Display network see <https://support.google.com/adwords/answer/1752334>.

For Google DoubleClick Ad Exchange web platforms see <https://support.google.com/adwords/answer/2472739?hl=en&ref_topic= 3121944>.

country-specific replicas in New Zealand, the physical presence standard to establish the nexus under New Zealand's statutory and treaty rules cannot be met by showing that games, music and web apps ordered through the Google Play web platform were physically offered for sale in New Zealand by Google or its agent. A tax nexus with business profits is traditionally premised on a physical presence standard. When sales are direct cross-border and the process of sales is automated, it is almost impossible for New Zealand to tax the profits from these sales under existing nexus rules. Even if some of the web servers Google uses as a part of its Google Play web platform operation are located in New Zealand, the degree of 'physical presence' in New Zealand is likely to be insufficient to require Google to attribute its profits from cross-border direct automated sales to entities in New Zealand.[52]

In New Zealand, a foreign firm is liable for all of the income that has a New Zealand source, which includes income derived from a business that is wholly or partly carried on in New Zealand and from contracts made or performed in New Zealand.[53] If the business income of a foreign firm is not derived from a business wholly or partially carried on in New Zealand, this income is treated as foreign-sourced and, therefore, not subject to income taxation in New Zealand.[54]

Google would generally have business income sourced in New Zealand in relation to the production of services and products and their sale to local customers only if these services and products were produced by Google in New Zealand, or were offered for sale in New Zealand by Google or its agent, or if sales contracts were completed or concluded in New Zealand by Google or its agent, or, possibly, if Google's services and products were stored in New Zealand.[55]

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[52] See also paragraphs 122 – 131 of commentaries on Article 5 of the OECD Model Tax Treaty Convention made in relation to e-commerce: *Commentaries on the Articles of the Model Tax Convention* in *the OECD Model Tax Convention on Income and on Capital.* Full Version (Paris, 21 November 2017).

[53] Income Tax Act 2007, s YD 4 (2) provides that business income has a source in New Zealand if "the business is wholly carried on in New Zealand", or if the business is partly carried on in New Zealand "to the extent to which the income is apportioned to a New Zealand source under section YD 5".

[54] Income Tax Act 2007, s BD 1 (4).

[55] See generally Craig Elliffe, *International and Cross-Border Taxation in New Zealand* (Thomson Reuters 2015) at 315-316.

Most services are produced and consumed at the same moment. Therefore, the storage of digital services in New Zealand, as an activity separate from production and distribution, is generally impossible. The process of production of digital services, such as Internet advertising and digital intermediation services, takes place on the global infrastructure of the Internet. Only a small part of this infrastructure is located within the New Zealand's territory. Google does not have data centres in New Zealand. Most (if not all) of Google's contracts with New Zealand customers are concluded online on Google's websites, where forms are submitted electronically and online payments are made. Most (if not all) of these websites are located on web servers outside New Zealand. As a result, the business profits of Google from sales of digital products to customers in New Zealand may escape taxation in New Zealand in cases when sales are automated.

Thirdly, Google is a multinational firm. New Zealand taxes the business profits of foreign multinationals in accordance with the separate entity approach. In practice, the use of this approach means that even if Google would sell some of its Internet advertising services through its subsidiary in New Zealand, Google will still be able to allocate most of its profits from these sales to one of its subsidiaries incorporated in a low or no tax jurisdiction that holds the intellectual property (IP) assets of Google.[56] Today, it is the firm's Irish/Bermudian subsidiary Google Ireland Holdings that holds these assets for Google.[57] After 1 January 2020, the 'Irish ingredient' in the 'Double Irish' scheme that Google and many other global matchmakers use to minimise tax will likely to be replaced with another one.[58] Even if Google

[56] See OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [275 - 276] at 97.

[57] For an overview of the Google tax planning scheme, see OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 171-175. See also Jesse Drucker, "Google 2.4% Rate Shows How $60 Billion Lost to Tax Loopholes" (*Bloomberg,* 21 October 2010) <www.bloomberg.com/news/print/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html> accessed 8 April 2013; Michael J Graetz, *Follow the Money: Essays on International Taxation* (Yale Law Library) footnote 324 at 447.

[58] Under political pressure from the European Union and the United States, Ireland in 2015 changed certain provisions of its Taxes Consolidation Act 1997 that had allowed Google Ireland Holdings, the subsidiary of Google incorporated in Ireland, to be treated as a Bermudian tax resident. Since 1 January 2015 all new firms incorporated in Ireland are considered to be tax residents of Ireland with the single exception being firms that are regarded as tax residents of another state under a double taxation treaty with Ireland. The amendments to the Taxes Consolidation Act 1997 have effect from 1 January 2015 for new firms and those firms that did not use the 'Double Irish' scheme. For other firms the scheme remains valid until 31 December 2020.

abandon the entire scheme that it uses for cross-border profit shifting, it is unlikely that the firm will 'return' its IP assets back to a parent company or allocate these assets proportionally among all its foreign subsidiaries.

Transfer pricing rules allow Google to distinguish its sales activities from production activities and thereby claim that the process of production takes place overseas and that production involves the use of IP assets held by various foreign subsidiaries of Google. As a result, only a tiny fraction (and likely only a fraction related to one per cent of sales of Internet advertising in New Zealand) will be allocated to a New Zealand Google subsidiary (if this subsidiary entered into contracts with customers in New Zealand).

Finally, the ability of Google to avoid paying tax on income in many countries where its customers are located is connected to the very structure of the Google's business. The Google segment is a multisided platform business with money and subsidy sides.[59] The Google multisided platform operates in many countries and, therefore, can be appropriately referred as 'global'. When a multisided platform has both money and subsidy sides, customers on one side may provide resources (e.g. attention) for the production of products for customers on another side of the platform (e.g. advertisers), while the second group of customers may subsidise the production of economic products for customers on the first side (e.g. in exchange for their attention to advertisements placed on a search web platform Internet users can use certain services provided by the platform for free).[60] The value produced through a multisided platform is the result of co-participation of the firm's customers and the firm in a single value-generation process. However, this co-participation is not considered relevant for tax purposes.

Google generates significant income on the money side of its global multisided platform from Internet advertising, but receives no income from many of the digital services (e.g. search and maps) that the firm provides to its customers 'for free' as an integral part of its global

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See Ireland, Taxes Consolidation Act 1997, s 23A (as amended by Ireland Finance Act 2014 No. 37 of 23 December 2014, s 43 (1)); see also Jesse Drucker, "Double Irish's Slow Death Leaves Google Executives Calm" (The Bloomberg 15 October 2014) available at <http://www.bloomberg.com/news/articles/2014-10-14/double-irish-s-slow-death-leaves-google-executives-calm>.

[59] For more detail see sections 3.2-3.3 in Victoria Plekhanova, *Global Matchmakers: Tax Challenges and Responses in the Digital Economy*, Doctoral Thesis (University of Auckland 2017).

[60] Ibid.

multisided platform. Expenses related to the production of these ‘free’ digital services are usually not specified in the firm’s annual reports and usually are attributed to research and development, sales and marketing or ‘platform maintenance’ activities of the firm and its subsidiaries.[61] The firm compensates its subsidiaries for the provision of research and development, sales and marketing and other services related to the operation of global multisided platform. This compensation is conducted through intra-group transactions between the firm’s subsidiaries and computed on the cost plus basis.[62] The ‘plus’ element of this compensation or “the cost plus mark up” [63] is supposed to be determined under the arm’s length principle.[64] However, the uniqueness of services provided and, as a result, the lack of comparable prices, make the size of this service fee almost impossible to justify under the arm’s length principle.[65] As a result, Google can legitimately avoid paying a substantial fee to its subsidiaries involved in research and development or sales and marketing activities. Many of these subsidiaries are located in high tax jurisdictions.[66]

Google does not divide its global income among all of its entities (whether subsidiaries or PEs), despite the entities being integrated parts of a single business and participants in a single integrated production and sales process that is Google’s global multisided platform operation. The firm allocates almost all of the income from its profit-generating activities earned outside

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[61] For instance, see Alphabet Inc, Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 (form 10-K) for the Fiscal Year Ended on December 31 (2016) <https://abc.xyz/investor/pdf/20161231_alphabet_10K.pdf> accessed 10 February 2017; Alphabet Inc and Google Inc, Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 (form 10-K) for the Fiscal Year Ended on December 31 (2015) <https://abc.xyz/investor/pdf/20151231_ alphabet_10K.pdf> accessed 18 May 2016.

[62] Cost plus method in OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris, 10 July 2017) at 26, 11-115.

[63] Cost plus mark-up is measured by reference to margins computed after all costs incurred by a supplier in a transaction, see OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris, 10 July 2017) at 26, 11-115.

[64] The arm’s length principle is premised on comparison of prices of intra-group transactions with market prices. See OECD, “Chapter 1: The Arm’s Length Principle” in OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris, 10 July 2017).

[65] For an overview of criticism of the arm’s length principle and transfer pricing rules, see Lorraine Eden, “The Arm’s Length Standard: Making It Work in a 21st-Century World of Multinationals and Nation States” in Thomas Pogge and Krishen Mehta (eds), *Global Tax Fairness* (Oxford University Press 2016) at 154-156.

[66] Google subsidiaries conducting research and development and sales and marketing activities in the Asia-Pacific region are located in Auckland, Bangalore, Bangkok, Beijing, Changhua County, Guangzhou, Gurgaon, Hong Kong, Hyderabad, Jakarta, Kuala Lumpur, Manila, Mumbai, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei, Tokyo <https://careers.google.com/locations/> accessed 6 March 2018.

of its home country (the United States) to the firm's foreign subsidiaries in Ireland (Google Ireland Ltd) and Singapore (Google Asia Pte Ltd). These foreign subsidiaries are located in well-known low tax jurisdictions. Therefore, the arrangements between entities that make up Alphabet's Google segment, which participate in the production and sale of services to customers and businesses in New Zealand and other countries, are tax-driven. The international tax regime, however, has no rules specifically addressing production and value creation through the use of a multisided platform operating across many countries. The regime was designed when this form of business organisation did not exist, let alone operate on a worldwide scale.

The lack of national and international rules addressing the special features of global multisided platforms allows Google to legitimately separate the subsidy side of its multisided platform from the money side. The profits derived from the money side can, therefore, be allocated to a few entities within the firm (Google Inc and its subsidiaries in low tax jurisdictions[67]), while costs generated on the subsidy side are left with other entities of the firm and compensated by Google Inc and its Irish and Singaporean subsidiaries on a cost basis from revenues generated.

In sum, the tax challenges for New Zealand, as a market state for Internet advertising and digital intermediation services and digital products are two-fold. Firstly, the business profits of Google are not attributable to a local PE because the nexus required for this attribution is based on a physical presence standard. Internet advertising and digital intermediation services do not require production, marketing, shipping or storage activities related to these services to be conducted by people physically present within the market state's territory. Sales of digital products also do not require physical presence of a sales person in a market state. Most of activities related to production and sales of digital services and products are conducted at many sites on the global Internet infrastructure. Many of these activities are automated. These activities are 'physical' but not in a sense of 'physical presence' required for the tax nexus purpose developed in the framework of the current international tax regime.

Secondly, New Zealand, as a market state for Google services and digital products it sells via its web platforms, cannot effectively control the allocation of business profits to subsidiaries

[67] Google Ireland Ltd is incorporated in Ireland. Google Asia Pte Ltd is incorporated in Singapore.

of the firm in New Zealand. This is because the transfer pricing rules and the separate entity approach upon which these rules are based allow Google and other multinational firms to disconnect their income-generating activities from their cost-generating activities and locate mobile assets, such as IP, in low and no tax jurisdictions. This disconnection, in particular, has the consequence (and will continue to have the consequence) that New Zealand will have the ability to tax only a tiny fraction of Google's business profits generated from New Zealand.

5.0 THE BILL

New Zealand was a slow starter, but is now set to introduce some unilateral anti-BEPS measures with the Taxation (Neutralising Base Erosion and Profit Shifting) Bill.[68] As an OECD member, New Zealand tries to follow the OECD's guidance on international tax policy.[69] The difficulty, however, is that the guidance that has been provided in the framework of the BEPS project does not solve (or even address) the tax challenges that New Zealand faces in dealing with Google and the other global matchmakers supplying Internet advertising and digital intermediation services to customers in New Zealand. This is because the underlying model that the international tax regime applies for the allocation of business profits to entities of a multinational firm remains unchanged.

The dynamics of the BEPS project[70] means that the OECD is unlikely recommend the replacement of the separate entity approach with its only alternative - the unitary combination and formula apportionment method as a basis for international allocation of

[68] Taxation (Neutralising Base Erosion and Profit Shifting) Bill 2017 (3-1).

[69] See, for instance, New Zealand, The Taxation (Neutralising Base Erosion and Profit Shifting) Bill, Explanatory Note <http://www.legislation.govt.nz/bill/government/2017/0003/latest/whole.html#DLM7505936> accessed 2 January 2018.

[70] OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2014 Deliverable, OECD/G20 Base Erosion and Profit Shifting Project* (16 September 2014) at 143-148; OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 107-117, 147-148, 276-283; OECD, "Preventing the Artificial Avoidance of Permanent Establishment Status", *Action 7: Final Report 2015, OECD/G20* (5 October 2015) at 15-44; OECD, "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties", *Action 15: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015); *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris, 7 June 2017); OECD, "Transfer Pricing Documentation and Country-by-Country Reporting", *Action 13: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015); OECD, "Aligning Transfer Pricing Outcomes with Value Creation", *Actions 8-10: 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015).

business profits to entities of a multinational group.[71] Therefore, transfer pricing rules are likely to continue to apply for the purpose of allocating the business profits of multinational firms (and costs related to these profits) among tax jurisdictions. Whether or not the OECD would ever recommend the replacement of a physical presence standard for the tax nexus with an economic presence standard that would be applied to the business profits generated in the digital economy it is hard to say at this point.[72] This uncertainty, together with the concerns of market states about base eroding activities of multinationals and a lack of coordinated solution to the tax challenges in the digital economy,[73] has triggered a wave of unilateral responses to these challenges across the globe.[74]

The United States has substantially contributed to the modesty of the OECD recommendations[75] and the resulting tax unilateralism in many countries. The United States is the headquarters of most of the largest global matchmakers. Twenty out of the top thirty

[71] Under the unitary combination with formula apportionment method a firm with a group structure is treated as a single taxpayer. The business income of this taxpayer (and expenditures related to this income) are combined into a single tax base and divided among tax jurisdictions under a formula. The unitary combination with formula apportionment method is applied by some countries (e.g. the United States and Canada) at the sub-federal level. See OECD, "E-commerce: Transfer Pricing and Business Profits" (12 May 2005) 10 Tax Policy Studies at 140 [303-304]. See also Paul R McDaniel, "Formulary Taxation in the North American Free Trade Zone" (1994) 49 (4) Tax Law Review 691 at 709-710. The unitary combination with formula apportionment method also was proposed as the model for the division of the taxable profits of European firms earned within the European Union in the Common Consolidated Corporate Tax Base (CCCTB) proposal. See European Commission, "A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action", Communication from the Commission to the European Parliament and the Council COM/2015/302 (Brussels, 17 June 2015) at [1]. See also European Commission, "Commission Proposes Major Corporate Tax Reform for the EU". Press release (Strasbourg, 25 October 2016) <http://europa.eu/rapid/press-release_IP-16-3471_en.htm> accessed 1 April 2017.

[72] For discussion of a PE nexus based on the concept of significant economic presence, see OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 107-111 [277-280]. See also Peter Hongler and Pasquale Pistone, "Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy", IBFD Working Paper (20 January 2015).

[73] Many countries were disappointed when in its Final BEPS Report issued in October 2015 the OECD discussed some aspects of the "broader tax challenges in the digital economy" but made no recommendations in this regard. See OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 146-147 [376-380].

[74] For detailed overview of unilateral responses to the tax challenges in the digital economy see Chapter 4 in OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018).

[75] For examples of a role United States has played in the OECD's actions and inactions see Michael C Durst, "OECD Guidelines: Causes and Consequences" in Wolfgang Schön and Kai A Konrad (eds) *Fundamentals of International Transfer Pricing in Law and Economics* (Springer 2012) at 128-132.

suppliers of Internet advertising and digital information services,[76] as well as major providers of digital intermediation services (e.g. Microsoft, Amazon, Google and Apple) are incorporated in the United States. Google (Alphabet) and Facebook alone have accounted for almost two thirds of global adspend growth since 2012.[77] Unsurprisingly, the United States does not support changes to the international tax regime that may result in an increase of the foreign tax liabilities of global matchmakers.[78] The United States refused to sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI).[79] The United States sees its participating in the MLI as unnecessary because the country's tax treaty policy is consistent with most of the MLI measures.[80] At the G20 summit in Hamburg held in July 2017, the United States Secretary of the Treasury Mr Mnuchin "acknowledged concerns about the taxation of digital firms but advised against rushing through changes to the international tax rules because of the complexity of the issue."[81] In a meanwhile, multinationals incorporated in the United States and their

76 Zenithoptimedia, "Google and Facebook Now Control 20% of Global Adspend" (Blog post of 2 May 2017) <https://www.zenithmedia.com/google-facebook-now-control-20-global-adspend/> accessed 30 October 2017.

77 Ibid.

78 In Reuven S Avi-Yonah's opinion, multinationals have successfully lobbied countries and the OECD against the meaningful reform of the international tax regime: Reuven S Avi-Yonah, "Hanging Together: A Multilateral Approach to Taxing Multinationals" in Thomas Pogge and Krishen Mehta (eds), *Global Tax Fairness* (Oxford University Press 2016) at 125.

79 *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris, 7 June 2017), art 12 (1):

1. Notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", but subject to paragraph 2, where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise […]

See also OECD, "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties", *Action 15: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015).

80 Jessica Silbering-Meyer, "68 Sign the Multilateral Instrument" (The Thomsonreuters, Blog post of 25 October 2017) <https://blogs.thomsonreuters.com/answerson/68-sign-the-multilateral-instrument-mli/> accessed 5 February 2018.

81 Julie Martin, "Progress Needed on International Tax Rules for Digital Companies, OECD's Saint-Amans Says" (*MNE Tax,* 14 September 2017) <https://mnetax.com/progress-needed-international-tax-rules-digital-companies-oecds-saint-amans-says-23465> accessed 9 October 2017.

shareholders have received a substantial tax cuts and new options for tax avoidance (national and foreign) as a result of the recent tax reform in the United States.[82]

New Zealand relied on the MLI and its Article 12 in particular. The MLI was released by the OECD on 24 November 2016,[83] within the framework of the BEPS project,[84] and signed on 7 June 2017 by sixty-eight states, including New Zealand.[85] The importance of the MLI for New Zealand is its multilateral nature and that paragraph 1 of Article 12 of the MLI incorporated the recommendation in the Final BEPS report to amend paragraph 5 of Article 5 of the OECD Model Tax Convention.[86] The rule extends the meaning of a dependent agent PE by providing that such a PE would arise when a person:

> […] is acting in a Contracting State on behalf of an enterprise and has, and, in doing so, habitually concludes contracts, or habitually plays the principal role[87] leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise […][88]

For New Zealand, this rule change provides the possibility to tax income of a foreign supplier when this supplier physically enters into sales contracts outside New Zealand. However, since

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82 David Kamin et al., "The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the New Legislation" (SSRN 13 December 2017) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3084187.

83 *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris, 7 June 2017).

84 OECD, "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties", *Action 15: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015).

85 OECD, the List of Signatures of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris, 7 June 2017). Status as of 7 June 2017 available at <http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>.

The MLI is not yet in force in New Zealand. See IRD NZ statement available at <http://taxpolicy.ird.govt.nz/tax-treaties/multilateral-convention-beps>.

86 OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 148 [383] and 144-146 [368-375].

87 'Habitually plays the principal role leading to the conclusion of contracts' refers to situations:

[…] where the conclusion of a contract directly results from the actions that the person performs in a Contracting State on behalf of the enterprise even though, under the relevant law, the contract is not concluded by that person in that State. See OECD, "Preventing the Artificial Avoidance of Permanent Establishment Status", *Action 7: Final Report 2015, OECD/G20* (5 October 2015) at 18 [9] on from the proposed amendment to paragraph 32 (i.e. subparagraph 32.5); *Commentaries on the Articles of the Model Tax Convention* in *the OECD Model Tax Convention on Income and on Capital.* Full Version (Paris, 7 June 2017).

88 See OECD, "Preventing the Artificial Avoidance of Permanent Establishment Status", *Action 7: Final Report 2015, OECD/G20* (5 October 2015) at 16 [9].

the home country of Google and many other global matchmakers – the United States - has refused to sign the MLI,[89] and many countries that signed the MLI have elected not to apply its Article 12 to their own DTAs, the MLI is an instrument with a very limited scope.

The MLI does not treat a multinational firm is a single tax entity. As a result, multinationals can avoid tax nexus implications of the MLI by operating through subsidiaries incorporated in countries that have not signed the MLI or chose not to apply Article 12 of the MLI to their DTAs. For instance, in New Zealand Google sells its services there through its Irish and Singaporean subsidiaries. Both Ireland[90] and Singapore[91] elected for Article 12 not to apply to DTAs of these countries covered by the MLI. Therefore, even if the United States would sign the MLI and made no reservations in relation to its Article 12, it would not result in a tax nexus under Article 12 of the MLI between New Zealand and the business profits of Irish and Singaporean subsidiaries of Google.

A market country needs tax legislation that would establish a tax nexus with business profits when the MLI cannot be applied. It is also make sense to change a meaning of 'presence' required for the purpose of this nexus, if a market country wish to respond to the tax challenges of digitalisation of the global economy. The Taxation (Neutralising Base Erosion and Profit Shifting) Bill tries to overcome both difficulties by broadening the PE rules of the MLI and extending these broad rules to firms incorporated in countries that are not parties to the MLI or countries that elected not to apply Article 12 of the MLI to their own DTAs. The Bill contains a modified version of the PE concept. Under this provision, the concept of a PE is expanded so that a foreign supplier would be deemed to have a PE in New Zealand if there is a person acting in New Zealand on behalf of this foreign supplier and in doing so this person "habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise".[92]

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[89] See Signatories and Parties of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris, 7 June 2017) <http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf> accessed 1 September 2017.

[90] Ireland, *Status of List of Reservations and Notifications at the Time of Signature of the MLI* at 30, available at < http://www.oecd.org/tax/treaties/beps-mli-position-ireland.pdf>.

[91] Singapore, *Status of List of Reservations and Notifications at the Time of Signature of the MLI* at 20, available at <http://www.oecd.org/tax/treaties/beps-mli-position-singapore.pdf>.

[92] Taxation (Neutralising Base Erosion and Profit Shifting) Bill, schedule 23, para 8 (a).

This modified PE concept would be in line with the amendments to paragraph 5 of Article 5 of the OECD Model Tax Convention and paragraph 1 of Article 12 of the MLI. Clause 34 of the Taxation (Neutralising Base Erosion and Profit Shifting) Bill, however, further broadens the meaning of physical presence required for the tax nexus purpose. This clause proposes the insertion of s GB 54 into the Income Tax Act 2007, which means that New Zealand would have a right to tax the business income of a foreign firm from the cross-border direct supply of goods and services to customers in New Zealand when this supply was facilitated in New Zealand.[93]

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[93] Taxation (Neutralising Base Erosion and Profit Shifting) Bill, clause 34:

After section GB 53, insert:

Arrangements involving establishments and non-resident businesses

GB 54 Arrangements involving establishments

When this section applies

(1) This section applies when—
(a) a non-resident makes, under an arrangement, a supply (the **facilitated supply**) that is of goods or services to—
(i) a person in New Zealand (the **recipient**):
(ii)a person in New Zealand (the **intermediary**), who makes under the arrangement a supply of the goods or services to another person in New Zealand (the **recipient**); and
(b) a person (the **facilitator**), who is not an intermediary for the facilitated supply, carries out in New Zealand under the arrangement an activity for the purpose of bringing about the facilitated supply to the recipient; and

(c) the facilitator—

(i) is associated with the non-resident:
(ii) derives 80% or more of the facilitator's assessable income from services provided to the non-resident or to persons associated with the non-resident; and
(d) the activity is more than preparatory or auxiliary to making the facilitated supply; and

(e) income of the non-resident from the facilitated supply is not within the scope of a double tax agreement that—

(i) incorporates article 12(1) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting:
(ii) includes a provision having a scope equal to or greater than the scope of the article referred to in **subparagraph (i)** and being negotiated after 7 June 2017; and
(f) **section YD 4B(3)** (Meaning of permanent establishment) does not determine whether the non-resident has a permanent establishment in New Zealand; and

(g) income of the non-resident from the supply is not attributable, other than under this section, to a permanent establishment in New Zealand of the non-resident; and

(h) the arrangement has a purpose of affecting the imposition on the non-resident of income tax, or of income tax and the income tax of a country or territory other than New Zealand, by directly or indirectly—

(i) altering the incidence of income tax:
(ii) relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax:

The ability of states to deal effectively with the fiscal absence of global matchmakers is very limited, in particular because physical presence of these firms in a market state required for the tax nexus purpose can be avoided.[94] If a meaning of 'physical presence' remains substantially unchanged, tax implications of anti-BEPS measures of market states that force large multinationals to change their business arrangements and conduct sales in these states countries through own local subsidiaries may be fruitless, as the experience of Australia and the United Kingdom has demonstrated. The United Kingdom introduced the Diverted Profits Tax (DPT)[95] and Australia introduced its Multinational Anti-Avoidance Law (MAAL)[96] and some form of the DPT.[97] The purpose of the DPT was a discouragement of large multinationals from selling goods and services to local customers through own foreign subsidiaries.[98] Australian media have found the fiscal outcome of anti-BEPS tax reforms on Google disappointing.[99] Similarly, the Government of the United Kingdom has not been impressed with the size of

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(iii) avoiding, postponing, or reducing a liability to income tax or a potential or prospective liability to future income tax; and

(i) the purpose is more than merely incidental; and

(j) the non-resident, or a group of persons that include the non-resident, is a large multinational group.

Income and activities attributed to permanent establishment

(2) The non-resident is treated as having a permanent establishment in New Zealand—

(a) through which the non-resident makes the facilitated supply in the course of a business carried on in New Zealand; and

(b) to which activities of the facilitator referred to in **subsection (1) (b)** are attributed.

94 For a summary, see OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [309] at 107.

95 Finance Act 2015 (UK). See also HM Revenue and Customs, "Diverted Profits Tax: Guidance" (30 November 2015). In the United Kingdom the Diverted Profits Tax is applied since 1 April 2015.

96 The MAAL came into effect on 11 December 2015. It applies to certain schemes on or after 1 January 2016, irrespective of when the scheme commenced, see Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015 (No 170) (Australia).

97 Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017 (No 27, 2017) and Diverted Profits Tax Act 2017 (No 21, 2017) (Australia).

98 For an overview of this type of anti-BEPS unilateral measures see OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [363-365] at 147 - 148.

99 For instance, "Google and Facebook have reported only a third of their estimated Australian revenue under the first year of the Multinational Anti-Avoidance Legislation, while slashing payments they made to their local operations for services. The two tech giants, which account for more than three-quarters of all online advertising in the world, reported a combined $1.2 billion in ad revenue from Australian clients, but lifted their combined pre-tax profits by only $77 million. Thanks to MAAL, tax was up by $19 million": Neil Chenoweth and Max Mason, "How Google, Facebook Dodged $1.2 billion MAAL Tax Bullet" (*Financial Review*, 28 April 2017) <http://www.afr.com/technology/social-media/google/how-google-facebook-dodged--12-billion-maal-tax-bullet-20170428-gvuzjd> accessed 12 October 2017.

Google's increased tax payments.[100] Clause 34 of the Taxation (Neutralising Base Erosion and Profit Shifting) Bill pursues the same goal as the DPT. At the same time, the Bill does not substantially change the meaning of 'physical presence' required for the tax nexus between New Zealand and business profits of foreign firms. Therefore, the Bill will unlikely result in substantial increase of tax revenue collected from global matchmakers.

Finally, the Taxation (Neutralising Base Erosion and Profit Shifting) Bill, if enacted, would require New Zealand to change, terminate or override its DTAs, because some of proposed rules are not in line with commitments New Zealand has made in its DTAs, including DTAs with the United States,[101] Ireland[102] and Singapore.[103] If New Zealand choose to terminate its DTAs, New Zealand and its nationals would be left without important treaty benefits. In particular, a size of overall income tax liability of New Zealand residents in relation to income earned from sources in foreign countries can increase because limitations in relation to tax rates, tax base and specific tax relief provisions of terminated DTAs would not apply. Clause 34 of the Taxation (Neutralising Base Erosion and Profit Shifting) Bill suggests that New Zealand is prepared to override its DTAs, at least in certain circumstances. Articles 26 and 27 of the Vienna Convention on the Law of Treaties makes clear that states have an obligation to implement their treaties in good faith.[104] However, the New Zealand Parliament has the power to override a treaty as a matter of New Zealand law, but not international law. The DTAs do not determine the consequences of overriding the treaty. However, a breach of one

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[100] United Kingdom, House of Commons, Public Accounts Committee. *Corporate Tax Settlements*. HC 788 (23 February 2016).

[101] *Convention between New Zealand and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* (23 July 1983) (The Double Taxation Relief (United States of America) Order 1983 of 26 September 1983 (SR 1983/196)).

[102] *Convention between the Government of New Zealand and the Government of Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains* (19 September 1986) (The Double Taxation Relief (Ireland) Order 1988 of 15 August 1988 (SR 1988/189)).

[103] *Agreement between the Government of New Zealand and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* (21 August 2009) (The Double Tax Agreements (Singapore) Order 2010 of 10 May 2010).

[104] *Vienna Convention on the Law of Treaties* (Vienna, 23 May 1969), art 26:

"treaty in force is binding upon the parties to it and must be performed by them in good faith";

art 27:

"party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. […]"

or more DTA creates political and economic risks for an overriding country. By ignoring its DTA commitments, New Zealand will undermine its reputation as a reliable treaty partner and could make the country less attractive for foreign investment. A decrease in foreign investment inflows would likely to have a negative impact on economic growth in New Zealand. Moreover, New Zealand and its residents may also be harmed if other states that are party to DTAs with New Zealand do not see themselves as bound by the commitments made in their DTAs. Finally, an override of own DTAs could trigger a reciprocal response from other states. This response could be very harmful to the New Zealand economy if it would involve key trade partners of New Zealand.

At the same time, even if the MLI was signed by all countries, including the United States, Ireland and Singapore, the MLI would not assist solving the tax base erosion problem in New Zealand or any other market state arising from cross-border direct sales of Internet advertising and digital intermediation services.[105] Neither does the Taxation (Neutralising Base Erosion and Profit Shifting) Bill. Therefore, tax problems discussed in section 4 of this article will remain even if the Bill is enacted. If New Zealand wish to ease eroding effects of these problems on its own tax base, the country would be better off looking for solutions that would not violate international commitments of New Zealand.

6.0 APPROVED ALTERNATIVE

There are at least two non-tax options for New Zealand to gain more control over the taxation of global matchmakers and protect its tax base from erosion. However, none of these options is good from a perspective of economic efficiency. First, New Zealand potentially could close its markets to Google and other global matchmakers. However, by closing its national market New Zealand may cause much greater harm to its national economy than it suffers as a result of the tax avoidance by global matchmakers. Many local firms and individuals use global web platforms such as Airbnb, Booking.com, Trivago, Amazon Marketplace, Taobao, e-Bay, Uber, Apple iTunes and Google Play to offer services and products to potential customers in many countries. Many small stand-alone firms all over the world got their opportunity to enter

[105] Moreover, it is estimated that the changes recommended under Action 7 will only be implemented in a fairly limited number of bilateral treaty relationships: see OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [272] at 94-95.

foreign markets, because their businesses were advertised through Google's advertising network or on Facebook. According to Interactive Advertising Bureau (IAB) New Zealand:

> […] advertising in New Zealand was worth 2.4% of GDP, or $6 billion in 2015. This is a significant economic contribution, roughly equivalent to what tourists spend in New Zealand every six months. Furthermore, the advertising industry is a significant employer. Over 44,000 jobs are supported by advertising in New Zealand, including over 12,000 people directly employed in advertising.[106]

Secondly, New Zealand may force global matchmakers to change their business organisation and operate only through local subsidiaries. Chapter 14 of Trans-Pacific Partnership (TPP),[107] now incorporated into the Comprehensive and Progressive Agreement for a Trans-Pacific Partnership (CPTPP),[108] contains anti-localisation provisions for the e-commerce.[109] However, the number of participants of the TPP and the CPTPP is limited. For instance, the United States has not signed either the TPP or the CPTPP, which means New Zealand has no obligations to avoid anti-localisation treatment of American firms.

Changes to the business organisation and the localisation of business may be especially harmful for the global matchmakers, because these firms reduce their costs and generate extra profits as a result of their ability to operate on a global scale. For instance, the productive efficiency of Google would be reduced if its business model had to be replicated in miniature in every state where the firm operates. If global matchmakers were de-globalised, network effects and advantages of economies of scale and scope could not be exploited at the global level, which would have a negative impact on the profitability, and potentially the viability, of these firms. Moreover, these firms may not be able to provide services that are valuable to their customers. For instance, in the case of Google, the global scale and structure of its multisided platform helps the firm to create a unique product – personalised Internet advertising services, which are produced and delivered over the global

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[106] IAB New Zealand "Advertising Pays - The Economic, Employment and Business Value of Advertising" (Blog Post of 7 June 2017) <https://www.iab.org.nz/news/advertising-pays-economic-employment-business-value-advertising/> accessed 3 October 2017.

[107] *Trans-Pacific Partnership* (Atlanta, 5 October 2015).

[108] *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (Santiago, 8 March 2018).

[109] *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (Santiago, 8 March 2018), arts 14.4, 14. 10, 14. 11, 14.13.

infrastructure of the Internet. Today many Internet users are very mobile and, therefore, may 'leave digital traces' in parts of the Internet infrastructure that belong to many different states. Accordingly, the localisation of Google's global multisided platform could make the entire production of personalised Internet advertisements less effective. To collect personal data about Internet users and maintain the Internet users' advertising profiles that the firm uses for the production of Internet advertising, Google must operate at the global scale and have access to the Internet infrastructure of as many countries as possible. Without operating on a global scale and using the global infrastructure of the Internet Google would not be able to access data from across the world. The quality of search services Google provides to Internet users could also be limited. The localisation of its business might also reduce the pace of innovation, and prevent customers having access to as many free services that currently provided by Google.

Economic efficiency requires that the tax rules to be structured in a way that does not encourage inefficient forms of business organisation. At the same time, the is a need for New Zealand to protect national tax base from erosion. To avoid economic inefficiencies and welfare losses nationally and globally, and at the same time, to be able to collect fair amount of tax revenue from global matchmakers, New Zealand could follow the implicit recommendations made by the OECD in its Interim report on the tax challenges arising from digitalisation (Interim Digitisation Report).[110]

The Interim Digitisation Report, which is a part of the BEPS project,[111] reveals that a number of fundamental political shifts have occurred since the Final BEPS Report was issued in October 2015.[112] First, the Interim Digitisation Report recognises that the modifications to the definition of a PE and improvements of transfer pricing rules made in the framework of

[110] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018).

The final report on the implications of digitalisation for taxation due in 2020: see OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 13.

[111] The final report on the implications of digitalisation for taxation is due in 2020: see OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 13.

[112] OECD, *Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015).

the BEPS project[113] may not solve "broader tax challenges in the digital economy".[114] Secondly, the 'not ring-fencing the digital economy from the rest of the economy for tax purposes'[115] and 'fitting into existing rules' objectives have become a call for 'revaluation of existing rules' and possible development of fundamentally new rules for both traditional and digital economies.[116] Thirdly, the Interim Digitisation Report reflects the view, shared by many states, that the digitalisation of economy has changed the division of gains among states under the international tax regime.[117] This outcome substantially defers from that which many states would have expected in the non-digitalised economy. A new consensus on how the gains in the digitalised economy should be divided is required. Finally, the OECD has tried to coordinate the unilateral responses of states to the tax challenges arising in the digitalised economy.[118] In this regard, the OECD has discussed the possibility of an excise tax that could be implemented by states as an interim measure.[119] Although no recommendations in relation to the implementation of such a tax have been made, the detailed analysis of how an excise tax could be used made in the Interim report provides significant guidance for those states looking to protect their national tax bases from erosion caused by global matchmakers like Google.

The European Union may regard the implicit endorsement of an excise tax in the Interim Report as a political triumph. In September 2017, the European Commission stated if there

[113] OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 148 [383] and 144-146 [368-375].

[114] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [255, 259] at 90 - 91.

"Broader tax challenges in the digital economy" are related to nexus, data, and characterisation of income for the purpose of direct tax: see OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 146-147 [376-380].

[115] OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 11, 54 [115] and 142 [364].

[116] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [379 - 397] at 160 -173.

[117] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [312] at 108.

The final report on the implications of digitalisation for taxation due in 2020: see OECD, "Addressing the Tax Challenges of the Digital Economy", *Action 1: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (5 October 2015) at 13.

[118] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018), Chapter 4.

[119] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018), Chapter 6.

was inadequate progress at the global level in addressing the tax challenges arising in the digital economy, the European Union would go ahead with a ‘long-term strategy’ and ‘short term solutions’.[120] The long term strategy would likely to be the implementation of the unitary combination with formula apportionment method within the European Union as suggested by the European Commission in 2011[121] and reintroduced in 2015.[122] Options suggested by the European Commission for ‘short term solutions’ in September 2017 included: an equalisation tax on the turnover of digitalised companies, a withholding tax on digital transactions and a levy on revenues generated from the provision of digital services or advertising activity.[123] On 21 March 2018 the European Commission proposed a levy (a digital services tax) on some digital services[124] in addition to ‘significant digital presence’ as an extended version of a PE concept and a basis for taxation of income from cross-border business activities of some suppliers of digital services.[125]

The excise tax described in the Interim Digitisation Report[126] is a more developed version of

[120] European Commission, “A Fair and Efficient Tax System in the European Union for the Digital Single Market”. Communication from the Commission to the European Parliament and the Council COM(2017) 547 final (Brussels, 21 September 2017) <https://ec.europa.eu/taxation_customs/sites/taxation/files/1_en_act_part1_v10_en.pdf> accessed 21 November 2017. See also European Commission, “Questions and Answers on the Communication on a Fair and Efficient Tax System in the EU for the Digital Single Market”. Fact Sheet (Brussels, 21 September 2017) <http://europa.eu/rapid/press-release_MEMO-17-3341_en.htm > accessed 21 November 2017.

[121] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) COM/2011/121/4 (Brussels 2011).

[122] European Commission, “A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action”, Communication from the Commission to the European Parliament and the Council COM/2015/302 (Brussels, 17 June 2015); European Commission, “Commission Proposes Major Corporate Tax Reform for the EU”. Press release (Strasbourg, 25 October 2016) <http://europa.eu/rapid/press-release_IP-16-3471_en.htm> accessed 1 April 2017.

[123] European Commission, “A Fair and Efficient Tax System in the European Union for the Digital Single Market”. Communication from the Commission to the European Parliament and the Council COM(2017) 547 final (Brussels, 21 September 2017) <https://ec.europa.eu/taxation_customs/sites/taxation/files/1_en_act_part1_v10_en.pdf> accessed 21 November 2017.

[124] European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services COM/2018/148 final (Brussels 21 March 2018) available at <https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf>.

[125] European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence COM/2018/147 final (Brussels 21 March 2018) available at <https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf>.

[126] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [412 – 463]at 180 -190.

the levy on revenues generated from the provision of digital services or advertising activity proposed by the European Commission.[127]

In brief, the excise tax implicitly approved by the OECD should be:

> (i) levied on the supply of a certain defined category or categories of e-services and imposed on the parties to the supply without reference to the particular economic or tax position of the supplier; (ii) charged at a fixed rate, calculated by reference to the consideration paid for those services (without reference to the net income of the supplier or the income from the supply); and (iii) not creditable or eligible for any other type of relief against income tax imposed on the same payment.[128]

The excise tax, if it was introduced as an interim measure, could be levied only on non-residents.[129] This tax should be levied temporarily,[130] only in relation to cross-border Internet advertising and digital intermediation services,[131] and at a low tax rate applied to the profit margins of the business.[132] The excise tax should have a common place of supply[133] and a threshold to limit undue tax impact on start-ups, business creation and small businesses.[134] For Internet advertising services, the proposed common place of supply is the place where the advertising is targeted (i.e. the jurisdiction where the end user accessing or viewing Internet advertisements is located).[135] For digital intermediation services, the proposed common place of supply is location of the customer that pays the commission for the

[127] The proposed levy on revenues generated from the provision of digital services or advertising activity was a separate tax on all transactions concluded remotely with in-country customers where a non-resident entity has a significant economic presence: see ibid.

[128] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [421] at 182.

[129] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [425 - 426] at 183.

[130] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [412, 432 - 433] at 180, 184.

[131] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [436-439] at 184 – 185.

[132] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [446] at 187.

[133] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [458-463] at 189 – 190.

[134] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [450-456] at 187 – 189.

[135] OECD, “Tax Challenges Arising from Digitalisation”, *BEPS Interim Report* (Paris, 16 March 2018) [459] at 189.

intermediation service.[136]

According to the OECD, an excise tax designed in accordance with the above specifications would be administratively efficient and would not breach international commitments of countries, create excessive tax or compliance burden on multinationals or affect start-ups and small businesses.[137] The OECD has emphasised that any interim measure should be temporary and targeted.[138]

If New Zealand would introduce an excise tax designed in accordance with the Interim Digitisation Report, it would be able to collect tax revenue from Internet advertising services of foreign global matchmakers that target end-users in New Zealand. In addition to that, New Zealand would be able to collect tax revenue from digital intermediation services that foreign global matchmakers provide to customers in New Zealand. For instance, the profit from commission paid by hotels, car drivers, web apps and content developers to foreign global matchmakers in New Zealand, would be subject to excise tax in New Zealand. With a careful tax design, services that global matchmakers provide to advertising agencies in New Zealand (i.e. access to advertising network and advertising exchange platforms) would also fall under the category of digital intermediation services.

An excise tax is not a substitution to an income tax. If there was a tax nexus with the business profits of global matchmakers recognised under statutory or (when applied) treaty rules of New Zealand, New Zealand would be able to collect income tax revenue form these global matchmakers in addition to excise tax levied on the profits margin from these services.

7.0 CONCLUSION

Using the example of Google, this article draws attention to a growing gap between the economic presence of foreign global matchmakers in New Zealand and the tax outcomes of this presence for New Zealand. The article analysed key anti-BEPS measures proposed in the Taxation (Neutralising Base Erosion and Profit Shifting) Bill, which would modify the required

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[136] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [462-463] at 190.

[137] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [412] at 180-181.

[138] OECD, "Tax Challenges Arising from Digitalisation", *BEPS Interim Report* (Paris, 16 March 2018) [412, 432-426] at 180, 184 – 185.

tax nexus with the business profits. It concluded these measures may not be effective, if the global matchmakers continued operating in New Zealand 'remotely' and did not allocate income from sales conducted with customers in New Zealand to subsidiaries incorporated in New Zealand. The article argues that, until a coordinated solution is developed in the framework of the BEPS project, New Zealand would benefit from introduction of an excise tax as an interim and additional measure that could protect the national tax base from erosion caused by global matchmakers.