BusinessNZ
GROWING PROSPERITY AND POTENTIAL

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26 August 2019

Options for Taxing the Digital Economy
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

policy.webmaster@ird.govt.nz

Dear Sir/Madam

Re: Options for taxing the digital economy discussion document

Background
I am writing in response to the discussion document released by the Inland Revenue Department (IRD) entitled *"Options for taxing the digital economy"* ('the discussion document').

We note the discussion document seeks feedback on two primary issues, namely:

1. Changes to the international income tax rules agreed to by countries further to the recent discussions at the OECD/G20; and
2. Introduction of a new 3% Digital Services Tax (DST) applying to certain digital transactions based on New Zealand digital revenues.

BusinessNZ wishes to comment on both issues.

1. OECD options for changing the current international income tax rules

Given the OECD options for changing current international income tax rules involve a large number of moving parts, BusinessNZ will be expressing only high-level views on these options.

First, at a principled level, BusinessNZ believes the best way forward is to develop internationally agreed income tax rules.

Second, it goes without saying that New Zealand must always seek to ensure its own best outcome and not simply accept offshore proposals liable to put the local economy at risk. This is particularly so in that as a small trading nation, New Zealand is often much less able to absorb economic shocks than are many other countries.

While it seems current economic analysis and modelling are beginning to provide a better understanding of the economic consequences of the OECD's proposals, with so

many moving parts in play, that analysis cannot be fool proof and may not provide an accurate answer to the question: will there be a clear economic benefit for all players?

Therefore, it is critical that New Zealand does not simply agree to a set of proposals without first going through a rigorous process examining both the costs and the benefits to this country. While New Zealand's voice on the world stage is a relatively small one, we should do everything we can to establish what the OECD's proposals would mean for us. We should not be afraid to take a principled stance as often what is a concern for one country is also a concern for others.

Whatever the outcome, the implementation of any of the proposals will inevitably mean international tax settings increase in complexity and uncertainty. Therefore, the compliance cost implications will need to be well thought through, both the actual cost to the business community and with respect to any behavioural changes that might subsequently occur. The new rules should not lead, effectively, to offshore companies overlooking the New Zealand market because the costs here are greater than the market's value.

Overall, officials must recognise that whatever is finally introduced needs to be clear and enduring for long term success.

Recommendation: That officials seek the best outcome for New Zealand from the proposed OECD tax changes.

2. Introduction of a 3% Digital Services Tax (DST)

While the Government supports an international solution as the best long-term course of action, the discussion document also outlines a proposal to introduce a new 3% Digital Services Tax (DST) applying to certain digital transactions based on New Zealand digital revenues. Introducing the tax is predicated on the fact that the OECD might have little short to medium term success in making real progress on multilateral outcomes. Therefore, on the face of it, the DST is viewed as a purely interim measure.

We note the two de minimis thresholds outlined in the discussion document regarding the possible introduction of a DST, namely:

1. Consolidated group annual turnover would need to exceed EUR750m; and
2. The digital revenue attributable to New Zealand users would need to exceed NZ$3.5m.

The discussion document points out that the DST is estimated to collect government revenue of somewhere between $30-$80m per year. As outlined below, the DST's risk versus return seems far more weighted towards the former, particularly when account is taken of what will likely be in New Zealand's best strategic interests.

Overall, BusinessNZ does not support the introduction of a DST. From both a principled and practical perspective, we struggle to understand why a DST is being proposed, especially at this time. We believe the overall risks and costs to the New Zealand economy are most likely to be far greater than the somewhat meagre revenue returns government might accrue.

For a small, isolated country, it is often said that New Zealand punches above its weight when it comes to international cooperation and policy development, not only in relation to tax policy but across the various facets of global policy development. To that extent, we support officials' work in ensuring this country's voice is heard at the global table. But at the same time, it must be recognised that as part of our involvement in the international community, we have to take both a cooperative and practical stand, and certainly not one that risks our international influence and reputation by attempting to pull apart the significant global work that has gone into establishing a consensus framework.

BusinessNZ would never advocate for New Zealand to blindly follow offshore practices in any policy area but neither should the country look to jump ship before the final make-up of the consensus framework has been developed – even if development takes longer than expected.

Attempting to lead the pack seems a very unwise move. Proposing a DTS does not send the right international signal that the primary focus is on a multilateral outcome. If, at the OECD, there had been a complete breakdown in the talks seeking an international solution, then BusinessNZ would certainly agree with the Government around looking for other options. However, proposing an alternative option now, even though stating the DTS would be scrapped once an international solution was adopted, sends mixed signals at best.

The above are our high-level principled concerns but BusinessNZ also wishes to outline some of the unintended consequences of a DST. These include:

Reach of the DST

On the face of it, the de minimis for the consolidated group annual turnover appears to be set at the high threshold of EUR750m. Indeed, the discussion document acknowledges the potential application of the tax to New Zealand companies but views the proposed de minimis threshold as the primary way to minimise its impact.

However, the tax will still catch a sizeable number of New Zealand's biggest companies. From Deloitte's Top200 data research it seems that at least 39 New Zealand businesses will be above or near the EUR750m turnover and therefore could be subject to the DST.

In addition, it is well known among the business community that a business's high turnover figure does not automatically correlate to high levels of profit. In fact, the Deloitte data shows that of those 39 New Zealand businesses, 23 have a profit margin of less than 3%. Therefore, the application of the DTS to such businesses, could for all intents and purposes, be regarded as the imposition of an excessive tax.

An impediment to innovation and investment

BusinessNZ is also deeply concerned that a DTS will stifle innovation and investment, with an associated effect on New Zealand's productivity and growth. Companies caught by DTS thresholds would in turn experience reduced options for creating efficiencies. Such outcomes will likely be exacerbated if no international tax solution is reached.

Just following suit?

Chapter 2 of the discussion document outlines the recent international response to the idea of a DST, including announcements from several countries of a DTS introduction. However, when it comes to policy development, the announcement of a policy and its actual implementation can be two very different things. From New Zealand's perspective, it would be better to wait until a significant number of countries have implemented such a tax before deciding to follow suit.

Interestingly, paragraphs 2.29-2.31 of the discussion document outline the Australian approach to DTS introduction. After releasing its own discussion document, the Australian Government decided not to adopt a DST at this time, with many submitters raising significant concerns about the potential impact of an Australian DST across a wide range of Australian businesses and consumers. Aside from the very similar concerns expressed on this side of the Tasman, we wonder why New Zealand would look to press on with a DST when our economically stronger neighbour has decided that continuing to engage in the OECD's ongoing multilateral process is the best way forward.

New Zealand should always monitor where other countries' policies are heading and not jump the gun before black letter law is implemented.

Retaliatory measures most likely

On the above point, New Zealand's introduction of a DST would spark retaliatory measures by other countries. We note the U.S has already sent a clear signal that it will respond very strongly to countries that impose duties on digital services and has sent a strong message to France to ensure that country does not discriminate against U.S interests[1].

Given the US is New Zealand's third-largest individual trading partner (total two-way trade in goods and services over $18b in 2018) with scope for further development, a DST has the capacity to put much of our current trade with one of our largest partners at risk.

Timeframes

Last, we see no strong justification for rushing the introduction of a DST. The revenue collected could be as low as $30m per year, which in the context of government revenue collection is a relatively minor amount, but with, potentially, much greater associated costs.

Therefore, BusinessNZ recommends that a DST does not proceed.

Primary Recommendation: That a Digital Services Tax does not proceed.

Notwithstanding BusinessNZ's primary recommendation above, if a DST were to proceed, we believe, on a without prejudice basis, the following should occur to

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[1] *USTR pledges to take action against digital services taxes* (June 19, 2019).

minimise some of the potential damage that might otherwise be done to the New Zealand economy.

An additional De minimis threshold required

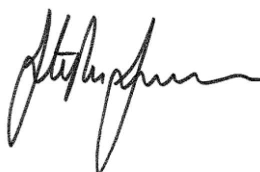
We support the Corporate Taxpayers Group's stance, seeking to add a third de minimis threshold. We understand the two de minimis thresholds proposed are outlined in such a way as to ensure highly digitised multinational companies paying insufficient tax are correctly targeted, ensuring a level playing field with New Zealand companies. However, as mentioned above, there is a very high likelihood of such a tax also affecting a significant number of New Zealand businesses.

Therefore, a third de minimis test/threshold should be included in the test for determining whether a DST measuring a business's digital intensity would apply. While BusinessNZ has no strong view as to what the measure for intensity would be, we would hope that effective consultation by officials would ensure the tax did not inadvertently capture a significant number of New Zealand businesses.

Recommendation: That a third de minimis threshold be introduced to take into account a business's digital intensity.

Thank you for the opportunity to comment.

Kind regards



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