Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

THE TREASURY
Kaitohutohu Kaupapa Rawa

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

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

Action sought

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

Contact for telephone discussion (if required)

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

24 April 2019

Minister of Finance
Minister of Revenue

Cabinet Paper - Options for Taxing the Digital Economy

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

Discussion Document

2. On 18 February 2019 Cabinet agreed to issue a discussion document to consult on options for taxing the digital economy (CAB-19-MIN-0041). That Cabinet paper noted you would report back to Cabinet with a draft of the discussion document prior to its release. We provided you with a draft of the discussion document on 11 April 2019, together with our policy report IR2019/208, T2019/1045.

3. An updated draft of the discussion document (Discussion Document), entitled *Options for Taxing the Digital Economy*, is **enclosed,** together with a draft Cabinet paper seeking approval to release it. This version is very similar to the version we provided you on 11 April. The main change is to the structure of the document. Chapter 3 and parts of Chapter 2 have been moved to the appendices. Chapter 3 is now concerned with the possible adoption of a digital services tax (DST) as an interim measure, and previous chapter 4 has been merged into it. We attach a marked-up version of the Discussion Document showing the changes we made (other than where we have just moved the text around).

4. If Cabinet approves the Discussion Document, we will issue it on 30 May 2019 (i.e. Budget Night). In consultation with your offices, officials would appreciate the ability to make minor editorial and technical changes to the Discussion Document before its public release.

Options for taxing the digital economy

5. We remain of the view that the under-taxation of the digital economy poses risks to the sustainability of Government revenue and the fairness of the tax system. There are two options for addressing this issue:

   - a DST, which could be adopted as an interim measure (i.e. subject to an appropriate international solution being reached at the OECD); or
   - a multilateral solution, which is currently being discussed at the OECD.

6. The advantages and disadvantages of each course of action are set out and explained at length in the Discussion Document. However, for convenience, a brief summary of these is provided below.

Advantages and Disadvantages of a DST

7. Adopting a flat, targeted, low rate DST would result in a tax which is relatively simple to calculate and administer. Most importantly, it would improve the fairness of the tax system by collecting revenue from businesses which have historically paid little tax either in New Zealand, or overseas. A DST could also increase economic efficiency and welfare by helping address the current favourable international tax treatment of the digital sector in comparison to more traditional businesses.

8. A DST does have some disadvantages, however. For example, as a DST would apply in addition to income tax, it could subject firms to double taxation (including possibly some domestic firms). Some of the burden of a DST (we estimate between 30% and 50%) would likely be passed on to New Zealand consumers rather than borne by the digital firms themselves. Internationally, there is the risk that a DST could affect New Zealand's reputation as a place to do business and place pressure on New Zealand's relationships with its trading partners.

9. As a rough estimate, we expect a 3% DST would raise between \$30m and \$80m of tax[1], depending in part on how it is designed.

Advantages and Disadvantages of a Multilateral Solution

10. A multilateral solution at the OECD would integrate the taxation of the digital economy into the income tax system and would avoid double taxation, by allowing any income tax payable in New Zealand to be creditable overseas. There are two measures under consideration at the OECD for changing the internationally agreed income tax rules. These are:

- A measure to allocate greater taxing rights over a multinational's profits to market countries. The measure would not require the multinational to have a physical presence in the country. There are three proposals being considered for this purpose (only one of which would be adopted):

    - A limited proposal for digital services only, focussing on social media, digital advertising, multi-sided platforms and data. This is the European Union (EU) and the United Kingdom (UK) proposal.

    - A broader proposal, which would allow greater taxing rights to market countries (such as New Zealand) based on certain "marketing intangibles" created there by multinationals. This is the United States proposal and it would apply beyond the digital economy. s 6(a) [redacted]

    - A proposal which provides for apportionment of a multinational's profit to market countries under an agreed formula, which would be based on certain factors such as sales and user participation. This proposal could extend beyond the digital economy and is supported by a group of 24 developing countries (the G24).

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

- A minimum tax measure suggested by France and Germany. This proposal would apply beyond the digital economy and would ensure that multinationals pay a minimum level of tax on profits earned in low tax jurisdictions.

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

11. However, there is a risk in waiting for a multilateral solution to emerge from the OECD. Further, even if a common approach could be agreed, there would be some delay between the agreement being reached and its implementation, costing the Government in revenue foregone and leaving multinationals unfairly taxed in the interim.

12. We expect the OECD measures to all raise revenue. However the proposals are not detailed enough for us to estimate the revenue impact yet.

Next Steps

13. As you have agreed to a 30 May 2019 release date, the next steps will be as follows:

- **2 May 2019:** the Cabinet paper and the Discussion Document is lodged with Cabinet Office
- **8 May 2019:** the Cabinet paper goes to the Cabinet Economic Development Committee (DEV).
- **13 May 2019:** the Cabinet paper goes to Cabinet for its approval to issue the Discussion Document.
- **30 May 2019:** The Discussion Document is released.

Recommended action

14. We recommend that you:

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

Signed and referred

Signed and referred

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

Referred

Referred

s 9(2)(a) [redacted]

Mark Vink
Manager
Tax Strategy
The Treasury

s 9(2)(a) [redacted]

Senior Policy Advisor
Policy and Strategy
Inland Revenue

Hon Grant Robertson
Minister of Finance

Hon Stuart Nash
Minister of Revenue