Regulatory Impact Statement: Digital Services Tax

Coversheet

Purpose of Document	
Decision sought:	This analysis has been prepared for the purpose of informing Cabinet of the options to tax highly digitalised multinational enterprises on income earned from New Zealand. The two options are: • Amount A of Pillar One of the Organisation for Economic Co-operation and Development's (OECD) Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy; and • A New Zealand digital services tax (DST). The analysis enables Cabinet to decide whether to implement a DST for an interim period whilst the OECD solution takes effect in practice.
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Revenue, Minister of Finance
Date finalised:	9 August 2023

Problem Definition
The international tax framework relies on principles of physical presence and value attribution that have not kept pace with changes in modern business practice and with the increasing digitalisation of commerce. This means that highly digitalised multinational enterprises can derive significant revenue from a country (such as New Zealand) without being taxed in that country.

Executive Summary
There are concerns that highly digitalised multinational enterprises do not pay tax commensurate with the revenue they derive from their markets. The issue arises because the existing international tax framework is not adequately able to tax business profits arising from use of digital business models and other new business practices. These developments mean the traditional criteria for taxation (allocation of profits based on tax residence or physical presence in a source country) are less effective. The result is that countries' tax bases are undermined, and that digitally capable businesses are able to access tax advantages because traditional tax settings were devised for a pre-digital world. Over time this will mean that the tax burden is less evenly shared between participants in a jurisdiction's economy. It will also undermine the perceptions of fairness that underlie voluntary compliance. Concerns that highly digitalised multinational businesses are able to minimise taxes and shift profits are not new. These concerns are shared by members of the international tax community and by other interested parties, such as some non-governmental organisations. The Base Erosion and Profit Shifting work undertaken by the Organisation for Economic

Co-operation and Development (OECD) aimed to address the issues and find a solution which better enables taxation of the profits of these businesses by both the countries they are resident in and those from which they earn income. However, that work has focussed on reducing opportunities to avoid paying tax under the existing framework. The problem posed by highly digitalised multinationals requires a more fundamental change to the framework itself.

We consider the risks to social cohesion and the integrity of the tax system are too great to leave the problem unaddressed in the long term. As a result, two options have been considered that would address the under taxation of highly digitalised multinational enterprises in New Zealand. These are:

- Pillar One, Amount A of the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the Two Pillar Solution). This is an OECD-led multilateral response. Amount A would reallocate some income from large multinationals to market jurisdictions; that is the jurisdiction in which the sales generating the profits are made. Pillar One also includes an Amount B, which aims to simplify the transfer pricing rules for marketing and distribution activities.

  At the time of writing, Amount A is still under negotiation after missing a deadline for its completion in July. However, the OECD expects the multilateral convention that will allow for its implementation to open for signature in the latter part of 2023. While Amount A of Pillar One is preferred by both officials and the Government, [redacted] s 6(b)(ii), s 9(2)(g)(i)

- A unilateral digital services tax (DST) which would tax the revenues of in-scope highly digitalised businesses at a low rate, based on the revenue attributable to local users. This could be implemented more quickly than a multilateral solution, although it entails certain risks.

The options for New Zealand to act unilaterally are constrained by international tax and trade agreements. This means any unilateral solution cannot be an income tax (as it would be inconsistent with existing double tax agreements) or discriminate against foreign nationals (which would be inconsistent with our trade obligations). Further, in the absence of an effective international solution, it would be optimal to make any unilateral solution broadly align with those already proposed or in effect abroad. These constraints mean that if the Government seeks to take action outside of a multilateral framework, a DST is the only realistic option at this point in time.

While officials and the Government consider the multilateral solution to be the preferred solution, the Government has directed officials to prepare a DST as a potential interim solution, pending effective implementation of an acceptable multilateral outcome from the OECD process.

The New Zealand DST is designed to tax multinationals that derive revenues from New Zealand users of search engines, social media platforms and online marketplaces. Businesses in-scope of the DST are those which have a global revenue in excess of €750 million per year from digital activities and have New Zealand revenue from those activities in excess of NZD $3.5 million per year. It taxes the revenues (rather than profits) derived from these activities, regardless of the multinationals' physical presence in New Zealand. The DST will be imposed at a low rate (3%).

We have considered two broad options for the timing of the imposition of a New Zealand DST:

- A DST Bill with a fixed commencement date of 1 January 2025 (Option C in the analysis); and
- A DST Bill with an ability to defer the commencement date by Order in Council (Option D in the analysis)

The DST has been compared against the status quo and the OECD's Pillar One, Amount A solution under eight criteria:

- addressing the tax policy problem;
- minimisation of compliance costs;
- minimisation of administration costs;
- the effect on our international relationships;
- retaining flexibility to change course;
- ability to be deployed in a timely manner;
- minimisation of negative impacts on New Zealand's trading environment; and
- the domestic impact.

Both solutions address the tax policy problem. For the DST, the Government's flexibility and ability to act in a timely manner in light of all the objectives sought from the proposal are affected by when the Government decides to introduce a DST Bill and by what mechanism it chooses to decide upon an effective date.

Implementing Amount A of Pillar One would deliver the highest net benefits while meeting the policy objectives (assuming the outstanding issues are resolved in a way that does not undermine what was proposed in the *Statement on a Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (the October Statement)[1]). The final form of Pillar One is not yet certain — in particular, whether both Amount A and Amount B will need to be implemented together. The attractiveness of Pillar One to potential signatories will depend on that final formulation. Officials think that it would be better to take a cautious approach and wait until the effectiveness of Pillar One as a whole, and its chance of successful implementation, can be better judged in light of future developments before introducing a unilateral DST.

While both options entail compliance and administration costs, Pillar One aligns with New Zealand's multilateral approach to international relations. It also has domestic stakeholder support. s 6(a), s 9(2)(j), s 6(b)(ii), s 9(2)(g)(i) [redacted]

Implementing Pillar One also requires a commitment that unilateral measures will not be imposed, constraining the Government's flexibility should Amount A of Pillar One take a number of years to be ratified and implemented by signatory countries.

s 9(2)(g)(i) [redacted]

[1] *Statement on a Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (October 2021), OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

A DST is able to quickly address the identified policy problem and public perceptions that fairness is lacking in the rules for the taxation of highly digitalised multinational enterprises. The Government will be able to change to an acceptable multilateral option at an appropriate time.

However, imposing a DST may have tax and non-tax consequences. Prior consultation via the Government Discussion Document *Options for taxing the digital economy* (2019) indicates that many stakeholders may view a DST poorly. It should also be noted that the burden of the DST is likely to passed on to some extent by the affected taxpayers to New Zealand customers of in-scope digital service providers.

A DST may improve social cohesion and bolster the integrity of the tax system. However, this would be achieved at the expense of imposing compliance and administration costs in the interim period — which may be short. Further, it is considered likely to damage New Zealand's relations with some international partners if New Zealand were to unconditionally adopt a DST while the OECD solution was still making progress. In addition, a DST may harm our trading environment. s 6(a) [redacted]

While the exact scope and scale of possible retaliatory tariffs is hard to predict, they can be expected to be proportionate to the DST. While we expect tariffs to be a small amount in the context of New Zealand's total trade, they will be significant for affected exporters.

Of the two options that enable the Government to progress a DST, Inland Revenue and Treasury officials strongly advise against the first option (Option C — a DST Bill with a fixed commencement date). From an international relations perspective, the Ministry of Foreign Affairs and Trade (MFAT) strongly recommends continuing to wait for a multilateral solution. s 9(2)(h) [redacted]

Officials from these agencies recommend the Government wait until the beginning of 2024, before deciding whether to introduce a DST Bill. This is because:

- introducing the DST Bill in early 2024 would not delay the imposition of the DST. There would still be enough time for the Bill to be enacted before 1 January 2025, which is the earliest proposed effective date for the DST;
- an introduction in early 2024 would allow more time to communicate in good faith with key stakeholders;
- we will be better able to maintain New Zealand's reputation as a strong supporter of multilateralism;
- we will have a better idea of Pillar One's prospects of success in early 2024, in particular whether a critical mass of countries has signed the Amount A multilateral convention and whether Pillar One as a whole would benefit New Zealand; and
- s 9(2)(d), s 9(2)(f)(iv), s 9(2)(g)(i) [redacted]

s 9(2)(d), s 9(2)(f)(iv), s 9(2)(g)(i) [redacted]

However, Inland Revenue and Treasury officials see merit in the second option (Option D — a DST Bill with an ability to defer the commencement date). s 6(b)(ii), s 9(2)(g)(i) [redacted] preparation for a DST is a reasonable option. The ability to defer the commencement date is preferred as it does not commit the Government to adopting a DST at this time, but enables flexible and timely adoption if the Government views this as necessary at a later date. Introducing a DST Bill now may also add pressure to conclude and implement Pillar One to ensure it is an effective solution.

Implementing a DST is expected to have a cost to Inland Revenue of $2.4 million over the forecast period (2022/23 to 2026/27), assuming a 1 January 2025 implementation date. It would then be forecast to collect $222 million in revenue over this same forecast period, assuming the same implementation date.

To be compliant with our OECD commitments, a DST cannot be imposed before 1 January 2025 (provided a critical mass of countries sign the Amount A multilateral convention by the end of 2023). This is also the earliest feasible implementation date from a systems perspective. Inland Revenue will be responsible for the implementation and ongoing operation of the DST.

Limitations and Constraints on Analysis

Limitations on analysis

The problem of under taxation of multinational enterprises is generally accepted by participants in the international tax community. As a result, jurisdictions have sought both unilateral and multilateral solutions to the problem. Given the focus on this area of the international tax framework, changes to the taxation of multinational businesses which address the issue should be expected as many jurisdictions perceive the current framework as deficient. The form the solution will take is not yet certain.

Currently, work is ongoing at the OECD on the Two Pillar Solution. Amount A of Pillar One of the Two Pillar Solution will require in-scope multinational enterprises to reallocate a portion of their super-normal profits to market jurisdictions — that is the jurisdiction in which the sales generating the profits are made. Amount A of Pillar One is the OECD's answer to the policy problem.

Most alternative solutions to Amount A that have been proposed or implemented in other countries take the form of a narrow or comprehensive DST. We are only considering a comprehensive DST, as this more fully addresses the policy problem. Narrow DSTs implemented abroad typically focus on advertising, although the policy problem is not limited to businesses selling advertising. A narrow DST would create different taxation treatment for different digital business models and would not fully address the underlying tax policy issues. Further, countries that have implemented narrow DSTs have also been the subject of retaliatory trade measures in response to their DST.

The OECD has also issued guidance on the design of alternative measures in an effort to ensure consistency where countries do move ahead unilaterally while a multilateral solution is negotiated.[2] The guidance states that unilateral measures would need to be consistent with any World Trade Organisation and free trade agreement obligations, including the obligation not to discriminate against foreign service providers. Any alternative to Amount A of Pillar One would also need to be consistent with our double taxation agreements, meaning it could not be an income tax. These constraints, together with the particular policy problem, limit the alternative solutions. Other options, such as changes to the taxation of intangible assets, have been considered but do not sufficiently answer the policy problem. They are not further considered in this regulatory impact statement.

Ministers have directed officials to prepare legislation for a potential New Zealand DST which could be introduced to Parliament to signal New Zealand's commitment to address the policy problem. This legislation is intended to act as a backstop and take effect if countries cannot make sufficient progress towards implementing the OECD solution by 1 January 2025.

While our preference would be to set the commencement date by Order in Council, of the two options we have analysed for progressing the DST, we prefer introduction of a DST Bill with the commencement date capable of deferral until 1 January 2030 (Option D in the analysis). The deferral mechanism will allow Ministers to make a judgement in light of important future developments and allow for greater flexibility and ability to mitigate international risks.

To enable highly digitalised multinational enterprises to comply more easily across jurisdictions a potential New Zealand DST should be similar to those designed by other OECD countries. It should also be simple to operate given its intended interim nature.

Given these constraints, we consider that a full DST is the only feasible unilateral measure that could solve the policy problem.

Officials have been working on the high-level design of the DST for some time, but the confidential nature of the proposal and the limited timeframe since direction to prepare a Bill was received has limited the ability to fully assess the impacts on external stakeholders including exporters and Māori.

Consultation may produce further insights into the impact and design of the DST. However, based on our experience in similar international workstreams, we consider it likely that public engagement with technical features of the DST is more likely to occur when a bill is introduced to Parliament. As such, consultation could occur at the Finance and Expenditure Committee stage as part of the select committee process.

Understandings and assumptions

A number of key assumptions and understandings underpin our impact analysis.

<u>Two Pillar Solution</u>

- New Zealand committed not to impose any unilateral measures until 1 January 2024 under the October Statement. This was intended to allow time for the OECD work to progress.

[2] *Tax Challenges Arising from Digitalisation: Interim report 2018*, OECD/G20 Base Erosion & Profit Shifting Project: https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1681856848&id=id&accname=guest&checksum=EFF050652C3113CE4834F91996890C38

- This commitment was extended until 1 January 2025 under the *Final Outcome Statement on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*[3] (the Outcome Statement) which New Zealand approved in July 2023. However, this extension is conditional on a critical mass of jurisdictions signing the Amount A multilateral convention before the end of 2023. It is not yet certain whether this critical mass will be achieved.

- There is also the possibility of a further extension to 1 January 2026. This has not yet been agreed to by country members of the OECD's Inclusive Framework. Any extension would require sufficient progress to have been made on Amount A.

- If Amount A is successfully implemented by a critical mass of countries, then the DST will not be necessary. s 6(b)(ii), s 9(2)(g)(i) [redacted]

<u>New Zealand DST</u>

- The DST should be ready for implementation (should the Government wish to do so) as soon as is practical, subject to constraints placed on us by our international obligations and internal resourcing. This means the DST would be effective from 1 January 2025 at the earliest.

- The DST would be an interim measure while work continues on a multilateral solution.

- The DST would be repealed once an acceptable international solution is implemented.

- Inland Revenue can design and implement systems and guidance to support the DST from the effective date. Systems should be easy to turn off when the tax is no longer required.

- There are a limited number of potential taxpayers (estimated to be 15 to 20), therefore the compliance and administration impact of the tax will be limited.

- These taxpayers will comply without significant enforcement activity from Inland Revenue.

<u>Other risks</u>

- Countries in which in-scope multinational businesses are headquartered (host countries) have reacted strongly and negatively to countries that have already proposed or implemented a DST. This includes implementing retaliatory tariffs on specific exports from DST imposing jurisdictions.

- Other interested parties may perceive New Zealand's actions poorly or as premature. However, this risk would be mitigated if we act alongside with other likeminded jurisdictions. Some international partners may be concerned that preparing for an interim alternative signals a lack of confidence in the OECD process and therefore undermines Amount A's chances of success. This can be

[3] *Final Outcome Statement on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (July 2023), OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

mitigated by not definitively committing to adopting a DST at this time, in order to allow time for Amount A to succeed.

- The costs and benefits of implementing a DST have not been fully analysed. As above, other countries that have implemented a DST have experienced trade retaliation from host countries s 6(a) [redacted] In other cases, where a DST has been proposed but not implemented, trade retaliation did not eventuate.

s 6(a) [redacted]

- Based on evidence from overseas, some of the cost of the DST is likely to be passed on to consumers in at least some circumstances. This means the tax will be borne to some extent by New Zealanders rather than digital multinationals.

- Although a multilateral solution is preferred, the Pillar One proposal may not ultimately be in New Zealand's best interests. Pillar One consists of two loosely related measures: Amount A and Amount B. The final linkages between the two measures not yet clear and therefore the package overall cannot be analysed. s 6(b)(ii) [redacted]

Data and evidence

Due to the novel nature of this tax, there is not a wide range of data sources. As such, the data and evidence used to analyse the risks and benefits of a DST is limited. The analysis is based upon international experiences and publicly available corporate financial statements.

Responsible Manager(s) (completed by relevant manager)

Sam Rowe

Policy Lead

International

Inland Revenue

s 9(2)(a) [redacted]

9 August 2023

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue

Panel Assessment & Comment:	The Quality Assurance reviewer from Inland Revenue has reviewed the *Digital Services Tax* regulatory impact statement (RIS) prepared by Inland Revenue and considers that the information and analysis summarised in the RIS **partially meets** the quality assurance criteria. This is because the stakeholder views summarised in the RIS are mainly informed by a public consultation which took place in 2019, and there has not been more recent stakeholder consultation. Since 2019 there have been developments on the OECD's Pillar One work and updated evidence from DSTs operating in other jurisdictions which stakeholders could have views or insights on. The RIS uses other sources of information to analyse recent developments such as Inland Revenue's participation in the OECD work and published reviews and news articles about the impacts of DSTs which have been implemented in other jurisdictions.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

Current international tax framework

1. The international tax framework was developed in the 20th century. However, our modern economic system has outgrown this framework. The growth of the digital economy means that highly digitalised multinational enterprises can derive significant income from a country without being liable for income tax there. This means very large businesses can have a large presence in the New Zealand market without contributing their "fair share" of tax.
2. Features of digital business models that have exposed shortcomings in the current international tax framework include:
    a. **Scale without mass:** multinational enterprises are able to transact with customers over the internet without having the physical presence required by double tax agreements for income tax to be charged in the country.
    b. **User value creation:** Even where a digital company does have a physical presence, the profit allocation rules do not recognise the new kinds of value that digital companies can generate in their market countries.
    c. **Intangibles:** Much of the value of modern multinational enterprises is attributable to intangible assets. Intangible assets are both difficult to value and highly mobile, meaning that such businesses are able to shift their profits to low tax jurisdictions by locating their intangible assets there and charging royalties.
3. While these features also exist for other business models, they are particularly acute for highly digitalised businesses.

Modernising the tax framework for multinational enterprises

4. Over the last ten years New Zealand has taken steps to improve the tax framework that applies to multinational enterprises. For example, initiatives such as the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project have reduced the ability of multinational businesses to engage in aggressive tax planning. New Zealand has acted to implement these initiatives. Changes in New Zealand's collection of GST have also helped to level the playing field for local businesses.
5. These measures, combined with our strong anti-avoidance rules, mean that New Zealand's tax laws are effective at preventing tax avoidance by multinational enterprises. There is evidence that taxpayers are responding to these measures by reducing related-party debt, removing hybrid instruments (and entities) and restructuring their business operations in New Zealand.
6. Further, in recent years Inland Revenue has placed an increased level of compliance scrutiny on the tax practices of multinational businesses. This has been supported by enhanced disclosure requirements, guidance, binding rulings and advance pricing agreements to support compliance with our tax laws.
7. These measures have strengthened the existing international tax framework by reducing opportunities for businesses to avoid tax. However, these measures do not address the new challenges of "scale without mass," "user value creation" and "intangibles" posed by the digitalisation of the economy. Addressing these issues requires more fundamental changes to the international tax framework.

OECD Two Pillar Solution

8. There has been global concern about the under taxation of the digital economy. Efforts are underway at the OECD to negotiate a modernisation of the international tax framework, addressing these concerns.[4]
9. One part of the proposed OECD reforms is “Pillar One Amount A” of the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Two Pillar Solution).
10. Pillar One Amount A addresses tax issues in the digital economy by creating a new global mechanism by which multinationals would pay more tax in the jurisdictions where they generate revenues, regardless of their physical presence there. Multinationals would be required to reallocate 25% of their income over a 10% return on revenue to market countries, in proportion to their sales in those countries. Effectively they would share a quarter of their super profits with market countries. The countries where those super profits are currently being returned would then need to provide tax relief on the reallocated amounts. Amount A is not limited to digital companies. Instead it would apply to all multinationals (with some limited exceptions) with global revenue over €20 billion (likely falling to €10 billion after seven years).
11. However, the outcome of the Amount A process is uncertain. Even if the agreement is concluded according to the latest timeframes, effective implementation would require participation from key countries, including those who are a major location for multinational enterprises. s 6(b)(ii), s 9(2)(g)(i) [redacted]
12. A New Zealand digital services tax (DST) would address the same tax issues as Amount A via a different approach. The DST is designed to tax multinationals that derive large revenues from New Zealand users of search engines, social media platforms and online marketplaces. It taxes the revenues (rather than profits) derived from these activities, regardless of the multinationals’ physical presence in New Zealand. Agreement to a solution implementing Amount A will require countries to remove all unilateral measures such as DSTs and to commit to not introducing them in future.
13. Pillar Two of the Two Pillar Solution creates a global minimum corporate tax rate of 15% to address tax competition and the erosion of the corporate tax base. New Zealand is currently working towards implementing Pillar Two via domestic legislation. Pillar Two is not dependent on the success of Pillar One and can co-exist with a DST due to its differing purpose.

Status quo

14. The status quo damages New Zealand’s collective wellbeing by reducing Government revenue on an ongoing basis and increasing the perceived unfairness of the tax system. This undermines social cohesion and the public’s confidence in the integrity of the nation’s tax system. As the digital economy continues to expand at a faster rate than the rest of the economy, and digitalisation increasingly drives economic and productivity growth, the effect of this is only expected to grow.[5] However, this effect is not currently quantifiable as there are no authoritative estimations of the New Zealand digital economy’s growth rate. For the advertising

[4] Base erosion and profit shifting - OECD BEPS

[5] *Tax Challenges Arising from Digitalisation – Interim Report 2018*, OECD/G20 Base Erosion & Profit Shifting Project,: https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-interim-report_9789264293083-en

sector, it can be observed that digital advertising now accounts for over half of all advertising spending and continues to grow at a faster rate than traditional advertising.[6] A competition inquiry in Australia found that large multinationals like Google and Facebook account for the majority of digital advertising revenue.[7]

15. The reduction in revenue arises from the amount of profit that New Zealand is unable to tax under the current tax framework. Present estimates suggest that a DST could collect revenue of approximately $86-90 million for each assessment year, growing in line with growth in the digital economy. Due to the design of the DST, this revenue is representative of profits realised by highly digitalised multinational enterprises that are attributable to users in the New Zealand market.
16. This problem poses a threat to New Zealand's tax revenue through a decline in voluntary taxpayer compliance and a narrowing of the tax base. Narrowing could happen in two ways.
    a. First, if growth in the digital economy continues to outstrip growth in traditional business models the ability to tax an increasing proportion of income earned in New Zealand by multinationals will be constrained.
    b. Secondly, more businesses may adopt structures to take advantage of the shortcomings in the international tax framework.
17. If a solution is not ready to implement in the medium-term, this will allow the status quo to become further embedded, with all the risks that entails.

Interactions with other government work programmes

18. Other government agencies are leading work programmes that could be seen as part of an overarching theme of responding to the challenges (and opportunities) presented by the growth of the digital economy.

    - Manatū Taonga Ministry for Culture and Heritage is engaged in work that would require digital platforms to enter negotiations with New Zealand news media entities for their content that is made available by digital platforms. There is likely to be overlap between the digital platforms required to negotiate and the highly digitalised multinationals captured by the DST.

    - The Ministry of Foreign Affairs and Trade (MFAT) engages in and supports other agency engagement in international discussions on digital issues, including trade in multilateral bodies (e.g. OECD, World Trade Organisation (WTO) and United Nations), and digital trade is a common feature in international trade negotiations including free trade agreements and the US-led Indo-Pacific Economic Framework, which seeks to support the growth of the digital economy.

What is the policy problem or opportunity?

The problem

19. There is international concern about the ability of highly digitalised multinational enterprises to derive significant income from a country without being liable for income tax in that country. This is because the international tax framework was developed in

[6] *NZ Advertising Turnover Report*, Marketing Association, 28 August 2022, https://marketing.org.nz/news/nz-advertising-turnover-report

[7] *Digital Platforms Inquiry – Final Report*, 26 July 2019, Australian Competition & Consumer Commission, https://www.accc.gov.au/publications/digital-platforms-inquiry-final-report

the early part of the 20th century and has not kept pace with changes in modern business practice and with the increasing digitalisation of commerce.

20. The features of digital multinational enterprises (“scale without mass”, “user value creation” and “intangibles”) create two issues that damage the integrity and fairness of the tax system:
    a. They allow multinational businesses to earn revenue from a country without being liable to income tax within its borders; and
    b. They allow multinational businesses to shift profits to low tax jurisdictions.
21. These issues are most acute for highly digitalised enterprises. However, they also apply to a lesser extent more generally, as more ordinary business models have become increasingly digitalised. This leads to an equity issue whereby the tax base is narrowed, concentrating the tax burden on a smaller group of taxpayers who cannot shift their income offshore or whose income is not derived from the digital economy.

Affected population

22. The key groups affected by the proposal to implement a DST are highly digitalised multinational enterprises and the individuals and businesses across New Zealand who use their services.
23. The experience of other countries, such as the United Kingdom, shows that the number of highly digitalised multinationals is quite small, though each multinational enterprise is large. The United Kingdom’s DST has just 18 taxpayers.[8] We expect a similar, or smaller, number of taxpayers in New Zealand. Based on their public statements and previous consultation, highly digitalised multinational businesses recognise the problem, but do not support a DST. They consider countries should address the problem through Pillar One of the OECD Two Pillar Solution instead.
24. We assume that use of one or more of the in-scope digital services is widespread. Based on previous consultation we know the public at large view the problem similarly to Inland Revenue (as discussed under “Previous Consultation” below).
25. Others who may be indirectly affected by the imposition of a DST will include:
    a. New Zealand exporters. s 6(a), s 9(2)(d), s 9(2)(g)(i) [redacted] and
    b. New Zealand departments and agencies who support exporters or hold other relationships with countries that are potentially affected by the implementation of the DST.
26. The OECD and other countries may also be indirectly affected to the degree it affects their own work programmes.
27. Officials expect Māori to be affected in the same way as others in similar circumstances. Time and process constraints limited analysis on this point.
28. At present, no other specific population groups have been identified that will be disproportionately affected by the tax changes proposed. Affected populations and their concerns may become apparent via submissions to the Finance and Expenditure Committee.

[8] *Investigation into the Digital Services Tax*, National Audit Office, 23 November 2022: https://www.nao.org.uk/reports/investigation-into-the-digital-services-tax/

Previous Consultation

29. A discussion document was issued by the Government in 2019, *Options for taxing the digital economy* (the 2019 discussion document). This canvassed views on a DST and the multilateral solution. We received 374 submissions, including 333 from individuals that followed the same template. Submissions primarily focused on whether or not to adopt a DST, rather than the design of either instrument. Nearly all submitters agreed that a multilateral agreement at the OECD would be the best long-term solution to the challenges facing the international tax framework.
30. There was widespread opposition to any DST from the business sector, including many domestic firms that would not be subject to it. These submitters generally acknowledged the challenges posed by the digital economy. However, they argued that a DST would impede innovation and growth, undermine the international tax framework, and expose New Zealand to the risk of trade retaliation. They were also concerned about the compliance costs of a DST, and its application to New Zealand firms. Finally, they were concerned that affected multinational enterprises would simply pass on the cost of a DST to New Zealand consumers. Overall, they considered the risks and disadvantages of a DST outweighed the amount of revenue it would raise. They argued that New Zealand should focus its efforts on a multilateral solution at the OECD instead.
31. By contrast, individuals and non-governmental organisations (NGOs) supported a DST as an interim measure. These submitters were generally concerned about deficiencies with the current income tax rules. They consider that the current rules lead to economic inequality, the under taxation of multinational businesses, and a lack of government revenue to fund public services. These submitters supported greater taxation of multinationals.
32. In the development of the 2019 discussion document, officials also considered alternative options, such as a minimum corporate tax (which the Government is now moving to implement as part of Pillar Two of the OECD solution) and a tax on offshore royalties. While a minimum tax addresses profit shifting by multinationals generally, neither it nor a tax on offshore royalties would address the fundamental challenges of taxing the digital economy. Therefore, the only realistic options are the multilateral solution or a comprehensive DST.
33. It is currently envisaged that any future consultation will occur at the Finance and Expenditure Committee stage via the select committee process.

What objectives are sought in relation to the policy problem?

34. The objective of the DST is to ensure highly digitalised multinational enterprises pay tax in New Zealand commensurate with the value they generate from our market. Broadly, an acceptable DST should:
    a. Minimise compliance costs,
    b. Be compliant with New Zealand's international obligations, and
    c. Be interim in nature, pending a more permanent acceptable multilateral solution.
35. For the DST to ensure highly digitalised multinational enterprises pay more tax in New Zealand, it needs to be easy to comply with. Otherwise, there is the risk of the affected firms refusing to comply or leaving the New Zealand market.
36. To be effective, the DST needs to exist outside of the current international income tax framework. This means it cannot be an income tax (or creditable against an income tax). It would also need to comply with New Zealand's obligations under the WTO and our free trade agreements.

37. New Zealand also needs to maintain a business and regulatory environment which attracts foreign capital and trade. As a small open economy and capital importer, New Zealand is heavily reliant on foreign direct investment and trade to drive its economic growth and development. Accordingly, New Zealand's DST should not depart too far from international norms.

Section 2: Deciding upon an option to address the policy problem

1. There are three options considered in this regulatory impact statement that have been used as a comparison against the status quo. These are:
    a. Pillar One, Amount A;
    b. An unconditional commitment to a DST, by introducing a bill with a fixed 1 January 2025 application date; and
    c. Progressing a DST, by introducing a DST Bill with a commencement date that can be deferred by Order in Council.

What criteria will be used to compare options to the status quo?

2. Given our objectives, the options are to be compared against eight criteria:
    a. **Tax Policy**: the option should address the tax policy problem of highly digitalised multinational enterprises not paying tax in New Zealand commensurate with the revenues they derive from our market.
    b. **Compliance costs**: compliance costs should be minimised as far as possible.
    c. **Administration costs**: administration costs should be minimised as far as possible. This includes ensuring the option can be implemented, and repealed, with low administrative costs.
    d. **International relations**: the option should be compliant with our obligations to other countries under OECD instruments and under other international agreements, including international trade agreements. Diplomatic and trade risks should be minimised as far as possible.
    e. **Flexibility**: in a fluid international environment, flexibility to change course should be retained for as long as possible.
    f. **Timeliness**: the option should contribute to the Government having an instrument, or instruments, prepared that can be deployed in a timely manner.
    g. **Trading environment**: the option chosen should minimise negative impacts on the trading environment. This includes impacts on both businesses directly affected by the option chosen and those indirectly affected by possible non-tax impacts, such as exporters.
    h. **Domestic impact**: the economic effect on exporters and consumers. The views of stakeholders should also be considered when comparing options, as this may affect successful policy implementation.
3. There will be trade-offs between achieving our tax policy objective and our objectives for international relations, flexibility and timeliness.
4. As the DST design is not finalised, costs have been provided on a best estimate basis. These costs may change in accordance with final decisions on the design and implementation of the DST.

What scope will options be considered within?

5. Ministers have directed officials to progress work on a New Zealand DST. This is intended to be an interim solution while Pillar One of the OECD's Two Pillar Solution awaits finalisation and implementation. Further, at this time no decision has been made by the Government to definitively adopt any particular solution (including Pillar One).
6. Other options which have been considered include:
    a. A narrow DST focused on digital advertising only. However, the same issues arise in connection with other types of digital business. As such, a narrow DST would create different taxation treatments for different digital business

models and would not fully address the underlying tax policy issues. Further, the international reaction to narrow DSTs has been similar to the reaction to comprehensive DSTs and therefore this option does not remove the risk of trade retaliation.

   b. A tax on offshore royalties paid into low taxed countries. This would discourage a common form of profit shifting. It could serve a role in signalling the Government's intolerance of tax avoidance by multinationals. However, based on the UK's experience with such a rule, is unlikely to fully address the policy problem in the same way that as a comprehensive DST or Amount A of Pillar One.

7. Pillar Two of the Two Pillar Solution deals with profit shifting generally rather than addressing the specific challenges of taxing the digital economy. Pillar Two creates a global minimum tax. It is not linked to Pillar One or a DST, in that Pillar Two can be adopted with or without a DST or Pillar One. Pillar Two legislation was introduced into the New Zealand Parliamentary process on 18 May 2023.
8. As noted above, the constraints mean the only two options for solving the problem are Amount A of Pillar One of the Two Pillar Solution (which would require us to sign a multilateral convention once it was agreed) and a comprehensive DST (provided it is consistent with our international obligations).
9. In October 2021, New Zealand, alongside 136 other jurisdictions, committed to the pursuit of the Two Pillar Solution (via the October Statement[9]). As part of this commitment, New Zealand has agreed not to introduce a DST or other unilateral measures until 1 January 2024. This commitment was extended to 1 January 2025 under the Outcome Statement[10] (provided a critical mass of countries sign the Amount A multilateral convention by the end of 2023). Adherence to both Statements is consistent with New Zealand's longstanding reputation as a supporter of multilateralism. Further the Statements limit the timing of possible options.
10. The progression of a DST could take a number of forms. The Government could unconditionally commit to adopting a DST now, or it could progress a DST to take effect if Amount A cannot be implemented within a reasonable timeframe. As such, the options analysis considers both the immediate introduction of a DST Bill following Cabinet's decision with a fixed commencement date, and introduction of a DST Bill with a commencement date that can be deferred via Order in Council. Under the latter option, the Government could defer the commencement of the DST by fixing a date (no later than 1 January 2030) via Order in Council. This mechanism could be exercised multiple times, provided the date specified is before the backstop commencement date of 1 January 2030. This would enable the Government to consider the progress towards implementation of Amount A and other relevant international developments and defer the DST if deemed appropriate.
11. A further limitation is that, if a DST were to be implemented, it should be similar to those designed by other OECD countries. This will assist highly digitalised multinational enterprises to comply across jurisdictions.
12. The DST should also be simple to administer given its intended interim nature and for ease of compliance and administration.

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[9] *Statement on a Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy,* (October 2021), OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

[10] *Final Outcome Statement on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (July 2023), OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

13. The OECD has provided guidance on the adoption of interim solutions.[11] It advises that DSTs should be designed in a way that limits their impact to large firms rather than start-ups. New Zealand has done this through the use of the €750 million in-scope revenue threshold (that is revenue from digital activities).
14. The €750 million per year in scope revenue threshold is based on the following analysis:
    a. The threshold builds upon the international standard for Country by Country reporting and Pillar Two of the OECD's Two Pillar Solution. This is a well-known standard that is administratively simple.
    b. The application of the threshold to highly digitalised businesses targets the DST at those entities who are more likely benefit from the existing deficiencies in the international tax rules.
    c. The threshold provides certainty to businesses by providing a bright-line test. Setting the gross revenue threshold at a high level carves out digitalised businesses that do not have a significant global presence. This minimises the compliance costs for smaller business entering domestic markets (such as New Zealand).
    d. Setting the threshold in relation to digital turnover targets mature digital business activities. This reduces negative effects on growth and innovation (including for existing firms looking to adopt new business models).
15. s 9(2)(h) [redacted]
16. Following the OECD's guidance, the gross revenue threshold is supplemented with a local threshold. The purpose of this threshold is to exclude those businesses with only small or negligible user participation and related network effects in New Zealand. The $3.5 million dollar threshold for in-scope New Zealand revenue is broadly in line with the equivalent thresholds adopted in other countries relative to gross domestic product.
17. There are no non-regulatory options available (as any change in tax policy needs to be via regulation). Accordingly, aside from the status quo, there are no readily apparent regulatory or non-regulatory options other than some form of a DST or Amount A of Pillar One (which would still be pursued as the preferable solution if a DST was adopted in the interim). As such, this regulatory impact statement considers the DST as a potential interim solution.

What options are being considered?

Option A – Status Quo – no solution implemented

18. Option A is the status quo. New Zealand would not address the problem.
19. **Tax Policy:** The tax policy problem will remain unaddressed with highly digitalised multinational enterprises not paying tax in New Zealand commensurate with the revenues derived from the New Zealand market.
20. **Compliance Costs:** As no action will be taken, additional compliance costs will be non-existent.

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[11] Tax Challenges Arising from Digitalisation – Interim Report 2018: Chapter 6, Inclusive Framework on BEPS | OECD/G20 Base Erosion and Profit Shifting Project | OECD iLibrary (oecd-ilibrary.org).

21. **Administration costs:** As no action will be taken, additional administration costs will be non-existent.
22. **International relations:** As no action will be taken, there will be no immediate effect on international relations. In the longer term, if other countries implement solutions, New Zealand's international reputation would not be materially damaged if we chose not to act, but it could set our international tax policy apart from key partners as we would not be addressing the problem at all.
23. **Flexibility:** Flexibility to change course is retained even when deciding to continue with the status quo.
24. **Timeliness:** As no action will be taken, the Government would be less prepared for the agile deployment of a policy solution. It would take at least two years to design and implement an alternative solution from scratch.
25. **Trading environment:** This option is not expected to affect New Zealand's trading position.
26. **Domestic impact:** This option is expected to be well received by businesses and taxpayers who would be subject to a DST. It would also be acceptable to exporters as there is no risk of trade retaliation. However, the status quo probably would not be supported by interested individuals and NGOs.
27. In the longer term, the uncertainty arising from not acting may frustrate some stakeholders. Further if an OECD solution cannot be implemented within a reasonable time period, taxpayers are likely to be frustrated at the continued under taxation of prominent digital multinationals. This perceived unfairness would reduce social capital and undermine voluntary compliance along with the integrity of the tax system.

Option B – OECD Pillar One Amount A

28. Option B would be to wait for Pillar One Amount A to be finalised by participating parties at the OECD and implemented, or for it to clearly have failed, before considering any further action.
29. Amount A of Pillar One would create a new taxing right on a portion of the profits of multinational groups with more than €20 billion in annual revenue. Amount A requires 25% of any profit in excess of a 10% margin to be redistributed to the countries where the revenue was earned. This new taxing right would be subject to exclusions for certain activities (such as extracting resources and financial services) and aims to ensure the affected companies pay more tax where they earn their revenues.
30. **Tax Policy:** Amount A of Pillar One is our preferred solution, and the Government has stated that Amount A is also its preferred solution. Amount A is designed to address the challenges of taxation in the digital economy but is not limited to highly digitalised companies. Amount A would address the tax policy problem by requiring in-scope multinational enterprises (including digital multinationals) to reallocate specified profits to market jurisdictions, therefore ensuring these businesses pay tax commensurate with their revenues in a jurisdiction. It has the added advantage of being a multilaterally agreed and coordinated solution that fundamentally updates the international tax framework. This should result in greater certainty for business while addressing the policy problem. As Amount A is integrated into income tax systems, it would also be a tax on net income, which avoids the negative effects of taxes on gross income such as the DST (such as application to loss making firms).
31. While there has been substantial agreement on most key elements of Amount A, further work is required before the end of 2023. This means we cannot yet estimate with reliability the potential revenue (although we expect it to be roughly comparable to a DST based on current settings). We expect any further changes to Amount A to either be neutral to New Zealand or in our favour.

32. However Pillar One also includes Amount B, which is a simplified approach to pricing distribution and marketing activities carried out between related parties. s 6(b)(ii), s 9(2)(g)(i) [redacted] It is not yet clear whether Amount B will be linked to Amount A, such that countries cannot (or will not) sign up to one without the other. Some form of linkage seems likely at this stage. If Amount B is required to be adopted alongside Amount A, Pillar One as an overall package may not be in New Zealand's best interests. This could leave a DST as the only acceptable solution for New Zealand.
33. **Compliance costs:** As currently proposed, Amount A of Pillar One would entail considerable compliance costs for a small number of very large multinational enterprises (around 100 initially, though the scope is intended to increase over time). These amounts could be quantified via the Amount A process at the OECD. However, in-scope multinationals would face only one set of global rules rather than different rules in each jurisdiction they operate in. The compliance costs for in-scope multinationals in respect of their New Zealand operations and obligations are expected to be incremental. No New Zealand headquartered multinationals are expected to be in scope of Amount A (including following the scope expansion, although this could change at some point in the more distant future).
34. **Administration costs:** There would be some administration costs to Inland Revenue in the establishment and ongoing maintenance of the Amount A regime. These will be limited due to provisions included for the global administration of Amount A and the fact that no New Zealand headquartered companies will be in scope. While currently it is not possible to estimate the costs to Inland Revenue, it is expected they will be no more than the cost of implementing Pillar Two ($11 million build cost with $3 million ongoing annual administrative costs).
35. **International relations:** There would be no adverse effect on international relations or trade with the adoption of this option, as it would necessarily be internationally agreed. This option would strengthen New Zealand's reputation as a supporter of multilateral approaches.
36. **Flexibility:** Adopting Amount A will involve New Zealand agreeing not to introduce any DSTs or similar measures in the future. This would constrain New Zealand's flexibility to change course in the future. Further Amount A, once agreed at the OECD, will not be open for further negotiation reducing flexibility. New Zealand would be able to withdraw from Amount A in the future within the limits of the multilateral convention (although this would be a significant step and is not something New Zealand typically does).
37. **Timeliness:** By committing to Pillar One Amount A, the Government's timeline is constrained by progress at the OECD, which has been repeatedly delayed.
38. The OECD had expected to agree the text for a multilateral convention that would implement Amount A by the end of July 2023. While there was agreement on most elements of Amount A, agreement was not possible on some outstanding elements. Accordingly the finalisation of Amount A has been delayed until later in 2023. The OECD currently intends to have a multilateral convention for Amount A open for signature by the end of 2023.
39. In addition, if Amount A and Amount B are linked, a successful conclusion for Amount A will depend on the progress of Amount B. The finalisation of Amount B has been delayed to January 2024. We are not certain whether this timeframe can be met as

there is still significant disagreement between counties on key elements of Amount B (as reflected in the public consultation document for Amount B issued in July 2023[12]).

40. Even if Amount A is finalised and signed, it still needs to be ratified by a critical mass of countries before it comes into force. This means the participation of key countries is essential to Amount A's success. s 6(a), s 6(b)(ii), s 9(2)(g)(i) [redacted] f Amount A does come into force, the time required to implement the tax in the domestic laws of different countries mean that there will be another six months to two years before in-scope multinationals start paying tax under Amount A.
41. Accordingly, there are significant timeliness disadvantages with Amount A.
42. **Trading environment:** As the internationally agreed solution, widespread implementation of Amount A should mean there would be no adverse impact on New Zealand's trading environment. However, uncertainty over yet to be agreed aspects of Amount A could have the potential to change this advice.
43. **Domestic impact**: As the internationally agreed solution and based on previous consultation, if this option was implemented it would be accepted by most stakeholders. However, individual stakeholders and civil society are likely to become frustrated if there is a significant delay in implementing Amount A. If Amount A is not implemented for a significant period of time, then this option could have a similarly negative effect on social capital as the status quo.

Option C – Commit to adopting a DST (introduce a DST Bill with a fixed commencement date)

44. Option C would be for the Government to introduce a DST Bill as an interim measure pending the implementation of an acceptable multilateral solution.
45. Under this option the Government would commit to adopting a DST now. The DST would be implemented on 1 January 2025.
46. As currently proposed, the DST would be levied at a rate of 3% on gross digital service revenues that are attributable to New Zealand users. Only groups with global revenue from digital services of more than €750 million per year and with revenue from digital services connected to New Zealand users or land of more than NZD $3.5 million per year would be liable to pay DST. These key design features are in accordance with the OECD's suggestions for designing unilateral measures and are similar to those of DSTs already in force in other jurisdictions.
47. **Tax Policy:** By implementing a DST, the tax policy problem would be addressed, and highly digitalised multinational enterprises would begin paying tax on their income from the New Zealand market. Present estimates suggest that a New Zealand DST could collect revenue of approximately $86 million in the 2025-26 tax year, increasing with the growth in the digital economy.
48. An increase in tax paid by affected multinational enterprises is evidenced by the experience of other countries who have introduced DSTs. The UK's DST raised £358 million in tax revenue in its first year and most of the affected taxpayers now pay slightly more DST than corporate tax (£351 million).[13] The DST effectively doubled

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[12] *Tax challenges of digitalisation: OECD invites public input on Amount B under Pillar One relating to the simplification of transfer pricing rules;* oecd.org/tax/beps/oecd-invites-public-input-on-amount-b-under-pillar-one-relating-to-the-simplification-of-transfer-pricing-rules.htm

[13] *Investigation into the Digital Services Tax*, National Audit Office, 23 November 2022: https://www.nao.org.uk/reports/investigation-into-the-digital-services-tax/

the tax paid by these multinational groups in that year, although the mix of taxes paid was not evenly spread – i.e., some paid more DST than corporate tax and others the reverse.

49. In other jurisdictions it has been observed that some multinationals have passed on some of the cost of the DST to their customers.[14]
50. **Compliance costs:** The affected firms would have increased compliance costs by being subject to a DST. The UK Audit Office found collecting the data required to calculate the liability was a significant challenge for some groups,[15] however this could be addressed through an adequate choice of calculation methods in the design of the tax (including allowing multinationals to use the same method as they use for the UK DST). If other jurisdictions also move to introduce a DST at the same time, highly digitalised multinational enterprises may find themselves having to comply with many differently designed DSTs. We do not currently have an estimate of those costs as there is no clear international data, but we may obtain insights via the select committee process.
51. **Administration costs:** There would be estimated administrative costs of $2.4 million over 2022/23 to 2026/27 for Inland Revenue in setting up the systems required for a DST, as well as ongoing collection and enforcement costs. Eventually, there would be costs associated with winding down the tax if an acceptable multilateral solution is agreed.
52. **International relations:** It is expected that if the Government commits to adopting a DST now there will be adverse impacts on New Zealand's international relations and reputation as a strong supporter of multilateralism. s 6(a), s 6(b)(ii) [redacted]
53. s 6(a) [redacted]
54. **Flexibility:** By committing to introduce a DST New Zealand would have identified an interim solution and would take steps to implement it. However by proceeding with a fixed commencement date, New Zealand would not have flexibility to respond quickly to international developments, such as progress towards implementing the OECD solution and the reaction of other countries to similar measures. Given that a DST is a unilateral measure, New Zealand would still be able repeal the DST in order to implement a multilateral solution at an appropriate time.
55. Further, a definitive implementation date would make it difficult to effectively message to our international stakeholders the interim nature and conditionality of the DST, as well as limit our ability to confidently emphasise our continued commitment to the multilateral process.
56. **Timeliness:** This option could mean there is a measure in place sooner than otherwise. However, once in place, the DST would need to be repealed as part of a future acceptable multilateral solution. This could be accomplished alongside the legislation to implement the Government's current preferred solution.

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[14] Apple, Google, and Amazon respond to European tech taxes by passing on costs - The Verge

[15] *Investigation into the Digital Services Tax,* National Audit Office, 23 November 2022: https://www.nao.org.uk/reports/investigation-into-the-digital-services-tax/

57. **Trading environment:** Any DST implemented would also need to take account of New Zealand's international trade law obligations.
58. s 6(a), s 6(b)(ii) [redacted]
59. The exact scope and scale of possible retaliatory tariffs is hard to predict, but they can be expected to be proportionate to the DST. The value of the tariffs would likely be a relatively small amount in the context of New Zealand's total trade. However, they will be significant for affected exporters. For example, when the US announced its intention to impose tariffs on France in response to their DST, these were valued at US$325 million[16] compared to estimated DST revenue of US$567 million.[17] This package was at the upper bound of those prepared against other DST-imposing nations.[18] Significantly, the tariffs targeted high value, recognisable French products such as cosmetics and handbags.
60. The US has also prepared tariff packages against other countries which have introduced a DST. These include the United Kingdom, Italy, Spain, Austria, Türkiye and India. The value of these packages ranged from US$16.25 million to US$221.75 million based on DST revenues to be incurred by US firms of US$45 million to US$325 million.
61. s 6(a) [redacted]
62. Consistent with the experience of other countries outlined above, it is expected that the value of any retaliatory tariffs would counteract some or even all of the potential revenue from the DST. s 6(a) [redacted] As a result, despite the increased government revenue from the DST, overall national welfare may not increase as much as expected. s 6(a) [redacted]
63. Other negative impacts on our trading environment, such as on New Zealand's international reputation or the trade inefficiencies arising from these tariffs, are unknown and unquantifiable.
64. **Domestic impact:** Submissions received in respect of the 2019 discussion document suggest businesses and the taxpayers subject to a DST would oppose this option.

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[16] Notice of Action in the Section 301 Investigation of France's Digital Services Tax, Office of the United States Trade Representative, 16 July 2020, https://ustr.gov/sites/default/files/enforcement/301Investigations/France_Digital_Services_Tax_Notice_July_2020.pdf

[17] *France's new digital tax will net 500 million euros*, DW, 3 March 2019, https://www.dw.com/en/france-to-set-new-500-million-digital-tax-for-30-tech-giants/a-47759058

[18] Section 301 investigations – Digital services taxes, Office of the United States Trade Representative, 26 November 2021, https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-digital-services-taxes

There is likely to be greater support from NGOs and individuals. Further feedback on both technical aspects of the DST and broader considerations is expected at the Finance and Expenditure Committee stage through the select committee process. Some submitters may be of the view that further consultation should have taken place prior to introduction to Parliament.

65. We do not expect a DST to result in any existing digital platforms deciding to exit the New Zealand market. This is based on the relatively small size of the proposed DST (3% tax on revenue), and the way digital platforms have responded to the imposition of DSTs in other countries.
66. We also do not expect that the imposition of a DST in New Zealand alone would have a material impact on global investment in innovation by these digital platforms. However, it is worth noting that in an international environment where multiple unilateral DSTs have been proposed or implemented, it is possible that digital platforms could respond by reducing the quantity and quality of research and innovation they undertake. This could potentially reduce the welfare for individuals and the scope for innovation and growth by other businesses that utilise digital platforms.
67. The more likely responses by digital platforms are to either increase the prices they charge for their services, or simply absorb the cost of a DST. Which of these is preferred will depend on the specific market power and elasticities of demand and supply that each in-scope platform faces.
68. If in-scope firms' profit maximising response is to simply absorb the additional cost and not exit the New Zealand market or make any changes to their investment in innovation, then we would consider a DST to be a highly efficient tax. It would be levied entirely on foreign multinationals, with none of the incidence falling on New Zealand individuals or businesses.
69. In contrast, if the profit maximising response by in-scope firms is to increase prices, the economic incidence of a DST would be borne at least in part by purchasers of taxable services (e.g., companies paying digital economy firms for advertising etc.) and possibly consumers downstream from those transactions. This could also potentially result in a negative flow on impact to productivity and innovation for domestic firms.
70. There are several factors that determine the incidence of a tax. The primary factors are the level of market competition and the elasticity of demand and supply for a given good or service. These factors are unlikely to be consistent across all in-scope digital platforms. Very detailed information about demand elasticities is likely necessary to predict how tax costs would be borne by each platform, and/or passed through to others. This is information that officials do not possess.
71. Officials have instead identified four characteristics that, if met, would tend to suggest that an in-scope digital platform will bear the burden of the DST:
    a. they can generate a higher return than is necessary for them to sell to consumers at that location (location specific rents);
    b. the cost of selling to one more user is close to zero (no or negligible marginal costs);
    c. the cost of setting up in a location are low (location specific fixed costs); and
    d. there are network effects or barriers that prevent effective competition (contestability).
72. As the theoretical incidence of a DST is highly uncertain, we have looked at the real-world experience of how platforms and investors have reacted to the implementation or announcement of DSTs in other countries.

73. While none of the real-world evidence is conclusive, it does suggest that if a DST was to be implemented, it is likely that at least some of the burden will be borne economically by some of the in-scope digital platforms.
74. Overall the direct macroeconomic impacts of a DST are expected to be small, especially relative to the effect of any trade retaliation. While officials are uncertain as to the incidence of a DST, we are relatively certain that, even in the situation where most of the cost is borne by domestic businesses and individuals, the size of this impact will not be large. This is primarily because the expected tax revenue associated with the DST is small, which means that any increases in price resulting from the tax are also likely to be small. In the unlikely worst case scenario, if all affected multinationals passed on all the cost of the DST, then the prices charged by those multinationals would rise by 3%.

Option D – Progress a DST as an interim alternative to an acceptable multilateral solution (introduce a DST Bill with commencement able to be deferred by Order in Council)

75. Option D would be for the Government to introduce a DST Bill as an interim measure. While largely similar to Option C, under this option, the Government retains flexibility to defer the commencement date in response to progress at the OECD on Pillar One and international developments in response to Pillar One. In this sense, the Government would not commit to adopting a DST unconditionally.
76. Under this option, the DST would have a commencement date of the later of 1 January 2025 or a date specified by an Order in Council made before 1 January 2025; with a backstop commencement date of 1 January 2030. The Order in Council mechanism, if used, would be on the recommendation of the Minister of Revenue.
77. When considering whether to defer the commencement of the DST, the Government could consider international developments and progress at the OECD.
78. Otherwise the key features of the DST would be as described in Option C. As with Option C, the DST would be repealed if an acceptable multilateral solution was implemented.
79. **Tax Policy:** By implementing a DST, the tax policy problem would be addressed as described in Option C.
80. **Compliance costs:** The compliance costs are as described in Option C.
81. **Administration costs:** The administration costs are as described in Option C.
82. **International relations:** The decisions on when to introduce a DST Bill, and when to impose the tax, are highly nuanced. s 6(a), s 6(b)(ii) [redacted] International partners would have some assurance that the DST would not be imposed before 1 January 2025.
83. s 9(2)(g)(i) [redacted]
84. s 6(a), s 9(2)(g)(i) [redacted]

85. s 6(a) [redacted] under this option, it is possible to defer imposition of the tax and to either change course more easily. As such the Government can choose to adopt the DST only if the OECD process proves ineffective and a group of other countries also announced their decision to adopt DSTs. This flexibility means that Option D is preferable from an international relations perspective to Option C.

86. **Flexibility:** This option is more flexible than Option C as it gives the Government the certainty of having a measure in place while maximising its ability to quickly react to changing circumstances, including progress at the OECD, the actions of similarly situated countries, and the overall international context. The latter includes the space to move with likeminded company, s 6(a), s 9(2)(g)(i) [redacted]. It enables the Government to form a view as to the best overall outcome for New Zealand and, unlike Option C, leaves room for the Government to change course in the future. Importantly, not announcing a definitive date for implementation of the DST would allow New Zealand's messaging to emphasise the conditionality of the DST, which could, in fact, encourage progress towards conclusion and implementation of the OECD solution.

87. **Timeliness:** Like Option C, this option could mean there is a measure in place sooner than otherwise. Under this option a DST could still be imposed from 1 January 2025 (like Option C) if the Government decided not to defer commencement. So Option D is not inherently less timely than Option C. However, the ability to defer the commencement date means the Government would be better placed than under Option C to take account of future developments in deciding when and if DST should be imposed. Like Option C, once in place, this option would need to be repealed if an acceptable multilateral option was implemented.

88. **Trading environment:** We do not expect any tariffs to be imposed on introduction of the DST Bill. s 6(a), s 9(2)(d), s 9(2)(g)(i) [redacted]

89. **Domestic impact:** The domestic impact would largely be as described in Option C. However, due to the additional flexibility and timeliness and the opportunities to mitigate harms to our international relations and trading environment, it may be seen more positively than Option C. On the other hand, a significant deferment without meaningful progress at the OECD would likely cause a similar frustration for individuals and non-Governmental organisations as Options A and B.

How do the options compare to the status quo/counterfactual?

	Option A – Status Quo	Option B – OECD Pillar One Amount A	Option C – Introduce DST Bill	Option D – Introduce a DST Bill with ability to defer commencement
Tax Policy	0	++	+	+
Compliance costs	0	-	-	-
Administration costs	0	-	-	-
International relations	0	+	- -	-
Flexibility	0	- -	-	+
Timeliness	0	- -	+	+
Trading environment	0	0	- -	-
Domestic reaction	0	+	-	-
Overall assessment	0	+	- -	-

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

90. Option A (status quo) would leave the problem of under taxation of highly digitalised multinational enterprises unaddressed. Over time, this option is likely to come under pressure due to the identified negative effects on the tax system, or actions taken by other jurisdictions to address the issue. We do not consider that Option A is sustainable.
91. Option B (implement OECD Pillar One Amount A) reflects current Government policy and is the preferred option. It would deliver the highest net benefits while meeting the policy objectives, and at the same time ensuring our international reputation remains intact. However, this option scores negatively on timeliness s 6(b)(ii) [redacted]
92. While Option C (commit to a DST) is not the preferred solution to address the underlying issues with the international tax system and their impact on New Zealand's collective wellbeing (this would be a robust Pillar One Amount A outcome), it would address the identified policy problem in a timely manner and would shape the public perception of fairness around the taxation of highly digitalised multinational enterprises in a way that would likely improve social cohesion. However, Option C would entail significant international relations and trade risks that could reduce the net benefit of a DST for New Zealand. It has not been possible to undertake a full analysis of the costs and benefits for New Zealand.
93. Option D (progress a DST with the ability to defer its imposition) has similar benefits as Option C. However, it enables the Government to have greater flexibility in deciding when to impose the tax. The deferral mechanism will allow Ministers to make a judgement in light of important future developments. If commencement of the DST were deferred until the OECD process had proven ineffective and other countries were also enacting them, then the trade and international reputation risks would be reduced compared with Option C. It would also avoid any perception that New Zealand is undermining the OECD process and could allow us to align our DST with other countries that choose to progress with a DST. Overall, the greater flexibility and greater ability to mitigate international risks means that officials prefer Option D over Option C.
94. In short, the multilateral solution is our preferred option. s 6(b)(ii) [redacted]
95. Our recommendation is to defer imposing or committing to imposing a DST until the benefits of Pillar One and its likelihood of success can be better assessed. At this stage there is still a realistic chance that Pillar One could be successfully agreed and implemented s 6(b)(ii), s 9(2)(g)(i) [redacted] and many countries are still publicly optimistic about its prospects.
96. Further, although a group of countries seeking an alternative to Amount A has not emerged yet, officials consider it likely that other countries will begin to adopt a DST if it becomes clear that Amount A is unable to address the problem for the reasons given above.[19] s 6(b)(ii), s 9(2)(g)(i) [redacted]

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[19] *France Says EU Must Prepare Digital Tax as Global Deal Blocked*, Bloomberg, 20 February 2023.

s 6(b)(ii), s 9(2)(g)(i) [redacted]

97. For this reason, officials strongly advise against Option C. We consider Option D to be a reasonable approach, given it does not commit the Government to adopting a DST at this time, but enables adoption if the Government views this as necessary at a later date.
98. On balance, Inland Revenue and Treasury officials prefer waiting until the beginning of 2024 to decide whether to adopt Option D and introduce a DST Bill. This is because:

- introducing the DST Bill in early 2024 would not delay the imposition of the DST. There would still be enough time for the Bill to be enacted before 1 January 2025, which is the earliest proposed effective date for the DST;
- an introduction in early 2024 would allow more time to communicate in good faith with key stakeholders;
- we will have a better idea of Pillar One's prospects of success in early 2024, while maintaining New Zealand's support for multilateralism, in particular whether a critical mass of countries has signed the Amount A multilateral convention and whether Pillar One as a whole would benefit New Zealand; and
- it is likely that other countries will begin to adopt a unilateral DST if it becomes clear that Pillar One will be unsuccessful. This may s 6(a) [redacted] create the space for New Zealand to move in likeminded company s 6(a) [redacted]

99. Our preference would be to set the commencement date by Order in Council (rather than having a fixed date with the ability to defer it by an Order in Council). Further, best practice indicates that a bill should not provide for an unlimited ability to defer the application date, meaning that a backstop commencement date is required. Option D therefore represents a compromise between certainty and flexibility.
100. Inland Revenue and Treasury officials also see merit in introducing a DST Bill now, following the OECD's inability to land Pillar One by its July 2023 deadline and in light of our concerns with Amount B of the OECD solution. The introduction of a DST Bill may also add pressure to conclude and implement Pillar One to ensure it is an effective solution.
101. MFAT officials strongly recommend staying with Option B, and waiting until 2024 to decide whether to adopt Option D. [redacted]

s 6(a) [redacted]

s 9(2)(h) [redacted]

s 6(a) [redacted]

What are the marginal costs and benefits of the option?

This analysis has been prepared to support the Government's decisions regarding a DST as an option for addressing the problems identified in the international tax framework. The preferred option is Option B — implementing OECD Pillar One Amount A as a multilateral solution. However, in light of the risks of an acceptable multilateral solution being implemented within a reasonable timeframe, the following table and remaining sections of this regulatory impact statement consider the impacts of Option D, introducing a DST Bill with the ability to defer commencement via Order in Council.

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the selected option compared to taking no action			
Regulated groups *Multinationals providing the in-scope digital services*	One off cost to develop systems. Ongoing costs associated with compliance through the filing of returns and payment of tax.	Medium	Medium
Regulators *Inland Revenue*	Both one-off and ongoing. Resources will need to be committed to the administrative build and then ongoing operation of the DST.	Assuming an application date of 1 January 2025, $2.4 million over the forecast period (2022/23 to 2026/27).	Medium
MFAT	Initial and ongoing cost of any international adverse reaction to public progress on a DST.	High	High
Certain New Zealand exporters	If a DST is imposed and trade retaliation occurs, some New Zealand exporters will bear the ongoing cost of tariffs on their goods and services.	High – overseas experience indicates that a range of tariffs have been proposed.[20]	Low
New Zealand customers of in-scope digital service providers	Ongoing. New Zealand customers may experience some pass-on of the DST from some digital multinationals through higher prices for in-scope digital services.	Low – pass-on rates vary from 0%-100% for each digital multinational (a 0-3% increase in digital service costs)	Low
Other interested groups	One-off. Participants will need to commit resources (time and people) to the select committee process.	Low	Medium

[20] See Section 2, paragraphs 59 and 60.

Affected groups	Comment	Impact	Evidence Certainty
Total monetised costs	**One-off & ongoing**	**$2.4m**	**Medium**
Non-monetised costs	**One-off & ongoing**	**High**	**Medium**
Additional benefits of the selected option compared to taking no action			
Regulated groups	Ongoing. Regulated groups will have greater awareness of the Government's policy for addressing the problem.	Low	Low
Regulators	Ongoing. If a DST is imposed, then the tax policy problem will be addressed, and the affected businesses will be paying a commensurate amount of tax.	Assuming an application date of 1 January 2025, $222 million over the forecast period (2022/23 to 2026/27).	Medium
Other interested groups	Ongoing. The groups will have greater certainty about the Government's policy for addressing the problem and what forms the solution could take. Perceptions of fairness and justice in the tax system are expected to strengthen.	Low	Low
Total monetised benefits	**Ongoing**	**$222m**	**Medium**
Non-monetised benefits	**Ongoing**	**Medium**	**Low**

The costs of implementing a DST are medium in size.

- The regulated groups would need to develop systems and then comply with the filing and payment requirements of the tax.
- Inland Revenue would also need to develop the necessary systems to process, manage and enforce the tax. This is costed at $2.4 million over the forecast period (2022/23 to 2026/27), assuming application from 1 January 2025. Additional outreach and compliance activity may also be required, incurring further costs.

s 6(a), s 9(2)(g)(i)

[redacted]

- Consumers are likely to experience some additional costs through the pass-on of some of the tax by the affected taxpayers, however the extent of this is uncertain as overseas experience shows pass-on rates vary from supplier to supplier from nil to 100%. If all affected multinationals passed on all the DST, then prices charged by those multinationals would rise by 3%.

There are limited benefits to directly affected groups.

- Progress towards a DST will offer greater certainty over the Government's approach to this policy problem and engagement in the select committee process at the Finance and Expenditure Committee stage will enable directly affected stakeholders to participate in the development of the final design of the DST. However, the ability to defer commencement does mean some amount of uncertainty will remain.
- Similar benefits accrue to wider government and private sector stakeholders.
- Society will receive some benefit from the strengthening of perceptions of fairness and justice in the tax system.
- If a DST is imposed, then Government revenue will benefit from addressing the tax policy problem because the affected businesses will be paying a tax more closely related to the income realised from the New Zealand market. Assuming a 1 January 2025 application date, this has been estimated to be $222 million over the forecast period (2025/26 to 2026/27).
- Restoring perceptions of fairness and justice in the tax system will also benefit Inland Revenue and the Government, as this will support Inland Revenue's voluntary compliance model.

Section 3: Delivering an option

How will the new arrangements be implemented?

1. The new arrangement would be implemented through legislation. This would be a stand-alone bill, creating a new Digital Services Tax Act. The DST legislation enacted in other jurisdictions has provided examples of suitable legislation.
2. To be compliant with our OECD commitments, a DST cannot be imposed before 1 January 2025. As a matter of policy, the implementation of tax rules on a prospective basis is preferred. This provides taxpayers with maximum certainty about the applicable law. Practically speaking, a prospective approach allows both Inland Revenue and affected taxpayers time to prepare for the new tax. The earliest practical date would be for the DST to apply from 1 January 2025. The date deviates from the New Zealand tax year but has been chosen as simpler for the affected taxpayer to comply with and allows time for them to prepare for the implementation of the tax.
3. If a DST were imposed, Inland Revenue would be responsible for producing guidance to support taxpayer compliance and for the administration of it as part of its normal operational activity.
4. There are a number of risks to the successful implementation of a DST, if one were to be imposed.
    a. These include the possibility that the system impacts on Inland Revenue or the affected taxpayers are larger than expected, or take additional time or resource to implement. This risk can be reduced through undertaking further consultation to develop the detailed design and providing sufficient lead-in time before application of the DST to enable the relevant systems to be built.
    b. Some set up costs could be incurred but the DST never gets imposed (it gets repealed, possibly after deferral(s)) or is only in force for a short period. Should Pillar One Amount A become the selected option, compliance and administration costs will also be incurred. This will have the effect of duplicating the costs of preparing for a solution to the policy problem.
    c. Some taxpayers may not comply with the DST without enforcement action. However, we consider this to be unlikely. We note the UK Audit Office reported that HMRC had not identified any non-compliance or avoidance after the first year of their DST.[21] Other taxpayers may leave the New Zealand market (although this is unlikely) or offer less services here than they would otherwise, based on their overall assessment of the costs and benefits of participation. While this has not been observed overseas, most other countries with DSTs have significantly larger markets than New Zealand. This risk can be reduced by designing a DST that is simple to comply with and minimises the additional compliance costs it imposes on the affected multinationals.

How will the new arrangements be monitored, evaluated, and reviewed?

5. Inland Revenue would monitor the effectiveness of any DST on an ongoing basis, through the normal use of data analytics and compliance activity. The information gathered by a DST return would assist in monitoring compliance with the new tax.

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[21] *Investigation into the Digital Services Tax*, National Audit Office, 23 November 2022: https://www.nao.org.uk/reports/investigation-into-the-digital-services-tax/

6. The DST return would be a new return. This return would include the information necessary to assess the tax. The filing of returns and payment of the tax could also be monitored.
7. As there is potential for the impacts of the tax to be felt outside the tax system, other agencies would likely raise concerns with Inland Revenue's policy team. This information, which will be gathered via normal inter-agency correspondence, would feed into the evaluation of the DST.
8. If and when an acceptable multilateral agreement to modernise the international tax framework is reached and implemented, the DST would be repealed as it will no longer be necessary.