



# KPMG Tax Chat



## Taxing your digital fix, are governments starting to get to grips with the new age?

As I sat in a house bulging at the seams with teens and tweens over the last school holiday period, the sheer volume of digital content being consumed – Netflix, Amazon Prime, Spotify, YouTube, Google, Facebook, Steam - forced me into a startling realisation; I have raised unashamed digital junkies.

Digital products are increasingly distinguishing themselves as star performers in our export sector. In conjunction with the omnipresence of Netflix, Amazon, Google, Twitter and Facebook (among others) as crucial sources of advice, news, entertainment and relationships, it's fair to say that technology has become fully entrenched in our lives.

However, global tax systems have been far slower to react to the technological age. Rather, the international tax system has its foundations still firmly rooted in traditional, linear business models, and is not fit-for-purpose in the fast moving digital age in which we now live and transact. Specifically, existing rules do not typically give countries the right to tax unless a company has a physical presence in that country (most commonly referred to as a "permanent establishment"). For many companies in the tech space, the existence of no more than a digital footprint enables them to sell into, and extract significant profits from, many markets without a need to pay tax. Savvy tech multinationals have used this to their advantage (significantly so in some well publicised examples). A recent report from the EU has calculated the effective tax rate of digital companies at 9.5%; considerably lower than their traditional business counterparts at 23.4%.

In fact, the digital economy has been accused of almost bringing the international tax system to its knees (not to mention privacy standards, but I digress...). In Europe the discussion has become far more politicised, focusing on whether digital companies are "paying their fair share of tax".

However, at long last it appears that the debate has reached boiling point, and tax authorities are determined to see digital companies meet their tax comeuppance.

The European Commission was first cab off the rank, proposing an "interim" measure (pending a longer term solution) which would tax large internet companies, such as Google, Amazon and Facebook 3% of their turnover. The proposed rules would only apply to digital companies with annual worldwide revenues of at least €750 million and EU in-country revenues of at least €50 million. The 3% would be levied on the in-country advertising revenue earned from online platforms such as search engines or social media sites, thereby catching Google and Facebook. Similarly, large "intermediate" online merchants such as Amazon and eBay would also be caught at 3% of in-country revenue.

This shifts the focus onto taxing based on user participation, rather than any actual physical presence, with the Commission proposing that the new tax would be collected by the member state where the users are located.

The OECD has also been prominent in discussions, taking a related, but different approach. Its recent report on taxing digital businesses focuses on taxing where the specific value is created; but due to a lack of consensus among member nations the OECD equivocates and has not yet provided any concrete recommendations. It was however notable in suggesting the potential of a “virtual permanent establishment”. This would provide countries with the ability to tax companies who derive revenue from their market but lack a physical presence there. Implicit in such an approach is that the value in a company is not just held in the algorithms or code from which it can target advertising, but rather that user participation is also something of value which should be taxable.

The European Commission has been quick to state that they believe their proposed rules are consistent with the OECD’s approach, and given the EU’s 28 member nations will need to agree to the changes (and many have signalled they will not), their implementation is likely still a fair way off. Ireland for example, which is the European headquarters for a number of large US tech companies, says the EU must wait for a global consensus. Vested interest much?

As you can probably guess, most of the companies impacted by any reform will be US-headquartered, with the US a significant opponent to any reform thus far. A new European turnover tax is only likely to further strain EU-US trade tensions (it could be seen as a form of digital service tariff).

Ongoing delays in reaching a global, or even an EU, consensus will no doubt increase frustration in many countries, ultimately leading to the unilateral adoption of draconian rules by individual countries. Where this leads us is increased complexity for digital companies and tax authorities alike, and the very real prospect of double taxation.

To get a read on how this will impact New Zealand, it is best to keep an eye on the OECD. New Zealand has long followed OECD guidance and all indications are that it is likely to continue to do so for the foreseeable future. Tellingly, despite our small population, the New Zealand tax base stands to gain from the imposition of turnover taxes given our high uptake of technology.

While the “how” for digital company taxation may be starting to become clearer; the implementation and the finer detail still appears some time off with no easy answer. In all likelihood there will be no such thing as a non-digital business in the future; the digital junkies will continue to need their fix, and our policy makers will need all their ingenuity to fairly tax these emerging businesses in the future.



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