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ARTICLE

Clicks, Not Bricks: An Analysis of New Zealand's Proposed Digital Services Tax

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The digital services tax is not a new concept. And nor is it uncontroversial. But that does not mean it is unjustifiable. This article examines New Zealand's proposed digital services tax and the extent to which it can be justified. Currently, multinational enterprises can reap the benefits provided by the State and derive income from providing digital services without maintaining a physical nexus sufficient to give rise to New Zealand tax liability. And although achieving a multilateral solution is an admirable goal, doing so seems impracticable—at least in the near future. The proposed digital services tax, whilst somewhat inconsistent with certain principles of taxation, could be a useful tool to mitigate base erosion in the interim. Perhaps more importantly, it provides the basis for a more permanent solution—and certainly one which is needed.

I Introduction

Participating in the digital economy is essential. That is especially true for businesses and consumers in New Zealand, given the country's significant geographical distance from the major foreign markets. However, doing so presents a notable challenge—that is, appropriately taxing the digital operations of multinational enterprises (MNEs).

This article addresses the justification for imposing a digital services tax (DST). The possibility of implementing a DST in New Zealand was initially floated in June 2019.[1] However, amid the onslaught of tax policy announcements in the lead-up to the 2023 General Election, the Labour Government changed tack from supporting an international solution to the under-taxation of the digital operations of MNEs to announcing the

* LLB(Hons), University of Auckland. I would like to thank Professor Craig Elliffe for his feedback and genuine interest in our discussions.

1 Grant Robertson and Stuart Nash *Options for taxing the digital economy: A Government discussion document* (Inland Revenue, June 2019).

unilateral decision to rush through the Digital Services Tax Bill (Bill) before the dissolution of Parliament.[2]

My interest in this topic stems from the ever-increasing development of digital technology and society's dependence on it. With no sign of this diminishing, Parliament has three options to ensure MNEs pay their fair share of tax on their digital operations: (1) wait for a suitable multilateral solution; (2) implement an effective solution through domestic legislation; or (3) maintain the status quo and accept base erosion on a long-term basis. Clearly, the third option is untenable.

In summary, the purpose of this article is to identify the extent to which the proposed DST, as in the Bill, can be justified. Although this article has eleven parts, the analysis is broadly undertaken in two stages. First, whether the implementation of a source-based tax is theoretically justified. Second, focusing on the extent to which the proposed DST adheres to the generally accepted principles of taxation, with reference to the "tax system principles" in the now-repealed Taxation Principles Reporting Act 2023.

II Relevant Concepts of Taxation

A *Source taxation*

New Zealand's tax legislation provides that a non-resident is liable to pay New Zealand income tax only on income that is derived from a source in New Zealand.[3] The Income Tax Act 2007 (ITA) provides a comprehensive list of the classes of income treated as having a source in New Zealand.[4] Currently, the provision of digital services—broadly, services provided electronically, rather than by way of physical interaction—by non-resident MNEs does not give rise to a sufficient nexus to impose domestic source taxation.

B Double tax agreements

Juridical double taxation is the taxation of the same income by multiple jurisdictions.[5] A double tax agreement (DTA) is an agreement between two countries to reduce or eliminate double taxation.[6] With very limited exceptions, DTAs override the ITA to the extent that conflict exists between the two.[7] In cross-border transactions, the effect of a DTA is to allocate the taxing rights on income between the country of residence and the source country.[8] This allocation either reduces or eliminates juridical double taxation, which is undesirable and impedes cross-border economic activity.[9]

New Zealand has 40 DTAs in force with its main trading partners.[10] Most provide that business profits are only taxable in the state of residence unless the enterprise carries on

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2 Digital Services Tax Bill (288-1).
3 Income Tax Act 2007, s BD 1(5).
4 Section YD 4.
5 Section BH 1(2).
6 Joshua Aird and Brendan Brown "Double tax agreements and the multilateral instrument" [2017] NZLJ 118 at 118.
7 Income Tax Act, s BH 1(4).
8 Inland Revenue and New Zealand Treasury *New Zealand's implementation of the* Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS – *an officials' issues paper* (March 2017) at 1.
9 Aird and Brown, above n 6.
10 Inland Revenue "Tax treaties" (27 November 2023) Tax Policy <www.taxpolicy.ird.govt.nz>.

business through a permanent establishment (PE) in the source state. Generally, the profits attributed to that PE are taxable in the source state.[11]

C *Permanent establishments*

Understandably then, whether a non-resident MNE has a PE in the alleged source state has been, and will continue to be, a matter of dispute. Although determining the confines of the PE definition is not the subject of this article, the PE concept generally applies in two scenarios—where the MNE is resident in a country with which New Zealand has a DTA that defines the term "permanent establishment", and where the MNE is resident in a country with which New Zealand does *not* have a DTA that defines the term.

Where the MNE is resident in a country with which New Zealand does not have a DTA that defines the term, a PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on.[12] However, where the term is defined by an existing DTA, the meaning of a "PE" is either that given by the DTA or, where applicable, that given under the "deemed PE" provision in s GB 54 of the ITA.[13]

New Zealand's DTAs generally provide that a PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on. This indicates that a physical situs is required. However, several of New Zealand's DTAs include negotiated definitions that extend the definition of a PE—to include, for example: (a) the provision of services through an agent in the source state; (b) the operation of substantial equipment in the source state; or (c) the activities carried out by an agent who habitually concludes contracts in the source state.[14]

D *Application to digital business*

MNEs can maintain a significant presence in a market jurisdiction without a physical presence.[15] Because of this, the traditional PE concept included in most of New Zealand's DTAs—that is, a "*fixed* place of business"—struggles to have effect as intended.[16] Specifically, where an MNE has no physical presence in New Zealand, DTAs and domestic legislation currently interact so that a source-based tax cannot be imposed for that lack of physical presence.[17]

11 See New Zealand's double tax agreements generally and Double Tax Agreements (China) Order 2019, art 7. Exceptions to this include Fiji, Indonesia, Vietnam, and the Philippines.

12 Income Tax Act, s YD 4B(3) and sch 23.

13 Section YD 4B(2).

14 Double Tax Agreements (China) Order, art 5(3); and Double Taxation Relief (Australia) Order 2010, art 5(4).

15 Xiaorong Li "A Potential Legal Rationale for Taxing Rights of Market Jurisdictions" (2021) 13 WTJ 25 at 27.

16 José Ángel Gómez Requena and Saturnina Morena González "Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence" (2017) 45 Intertax 732 at 734.

17 At 734.

III The Benefit Theory

New Zealand's current international tax system is lagging behind the digitalisation of the economy. Failing to impose a source-based tax on the digital operations of MNEs plainly demonstrates that. Income ought to be taxed in the jurisdiction where value is created.[18] Value is created due to the interaction between an MNE and the market jurisdiction.[19] Imposing a source-based tax is justified based on the income-generating activities having a sufficient nexus with the market jurisdiction, even absent a physical situs.[20]

The benefit theory can be considered as authority for the proposition that if a market jurisdiction provides an economic benefit that enables the creation of value for an enterprise, that enterprise is obligated to contribute.[21] Applying this, the benefit theory justifies the taxation of income derived by the digital operations of non-resident MNEs on the basis that the MNE derives an economic benefit from the public goods, services, and market conditions provided by the government of the market jurisdiction.[22]

The benefits provided to non-resident MNEs fall into two classes—the "general" and the "specific". General benefits include certain tangible pillars of a developed society, such as education; emergency services; public health; and the legal system. Specific benefits include the social environment and the provision of a stable economy, which are conducive to carrying on business.[23]

Where the only contribution of the market jurisdiction is the customer base or the market conditions, arguably few or no benefits are provided which have a sufficient nexus to the derivation of income. In such cases, imposing a source-based tax may not be justified. Similarly, one could argue that a tax quantified based on the cost of both general and specific benefits provided by the market jurisdiction is an inadequate measure of the actual benefit received by the non-resident MNE.[24] However, it is clear that despite a lack of physical presence, a non-resident MNE conducting digital operations in New Zealand obtains substantial benefits from the economic and social market conditions, infrastructure, and legal system. Therefore, the income derived from the digital operations of non-resident MNEs should be taxable to the extent to which it is attributable to the market state.

In summary, a source-based tax is imposed because of the nexus between the state and the income-generating activities. Imposing a source-based tax on the income derived from the digital operations of non-resident MNEs can be justified by the benefit theory on the basis that the government of the market jurisdiction should be compensated for the cost of providing specific and general benefits to non-resident MNEs.[25] In this context, the

18 Steffen Postler "The OECD's Work on Profit Allocation and Nexus Rules for a Digitalized Economy – A Potential Improvement of the International Taxation Framework?" (2020) 74 Bulletin for International Taxation 76 at [3.2].

19 At [2.2.2].

20 Lorenzo Riccardi *Chinese Tax Law and International Treaties* (Springer, Heidelberg (Germany), 2013) at [6.4.2].

21 Craig Elliffe "Justifying Source Taxation in the Digital Age" (2021) 52 VUWLR 743 at 763. See also Charles Garavan "The Membership Theory of Taxation" (2023) 51 Intertax 290.

22 Matthew Weinzierl "Revisiting the Classical View of Benefit-Based Taxation" (2018) 128 The Economic Journal 37. See also Postler, above n 18, at [3.2].

23 Garavan, above n 21, at 306.

24 David Elkins "The Case Against Income Taxation of Multinational Enterprises" (2017) 36 Va Tax Rev 143 at 177.

25 Klaus Vogel "Worldwide vs source taxation of income – A review and re-evaluation of arguments (Part III)" (1998) 11 Intertax 393 at 394. See also Riccardi, above n 20, at [6.4.2].

source-based tax acts as a charge for the benefits received in conducting digital operations in the market jurisdiction.[26]

IV The Multilateral Solution

It would be remiss to analyse the proposed DST without considering how we got here. Although the New Zealand Government formally recognised the ability to implement a DST to combat the under-taxation of the digital economy in 2019, it affirmed its commitment to pursuing a multilateral solution at the Organisation for Economic Co-operation and Development (OECD).[27]

The same year, the OECD released the *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*,[28] which proposed taking a "unified approach" to allocating taxing rights on income generated from cross-border digital business.[29] Under that approach, the market jurisdiction would have the right to tax an MNE's "deemed residual profits"—so-called "Amount A".[30]

A *Introduction to Amount A*

Broadly, Amount A is the amount remaining after allocating the deemed routine profit to the countries where the business activities are performed.[31] The starting point for determining the routine profit would be identifying the MNE group's profits from its consolidated financial statements. The second step would require the approximation of the income of the routine business activities based on an agreed level of routine profitability. The profit exceeding the routine profitability would constitute Amount A, which would then be apportioned to each market jurisdiction per a unified fixed percentage.[32]

B *Application of Amount A*

Three points are apparent. Crucially, taking this new unified approach to allocating profit and taxing rights would require changes to existing DTAs, which would require multilateral implementation.[33] For the MNE to be caught within the scope of Amount A, the MNE must exceed both EUR 20 billion in revenue and 10 per cent profitability. Furthermore, the market jurisdiction would be eligible to tax Amount A if the MNE group derives more than

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26 Miranda Stewart "Abuse and Economic Substance in a Digital BEPS World" (2015) 69 Bulletin for International Taxation 399 at [2.2]. See also Mindy Peden "You Get What You Pay For: Historicizing Business Metaphors of Government, Principles of Justice in Taxation, and 'Benefit Theory'" (2008) 82 Studies in Political Economy 105 at 108.

27 Robertson and Nash, above n 1, at 48.

28 OECD *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* (May 2019).

29 Phil Greenfield and others "OECD Work Programme for Reaching Consensus on Tax Challenges from Digitalisation Sets Ambitious Targets" [2019] Journal of International Taxation 32 at 32.

30 Danish Mehboob "G20 endorses OECD's July statement on two-pillar solution" (12 July 2021) International Tax Review <www.internationaltaxreview.com>.

31 OECD *Public consultation document – Secretariat Proposal for a "Unified Approach" under Pillar One* (12 November 2019) at 9.

32 At 15.

33 At 10–11.

EUR 1 million in revenue from that jurisdiction or EUR 250,000 if the market jurisdiction's GDP is less than EUR 40 billion.

C *Rationale behind Amount A*

The Secretariat recognised the need for a new approach to allocating taxing rights and taxable profits on the basis that the attribution to a physical presence was insufficient to appropriately tax the income of MNEs derived from digital operations.[34] Therefore, the proposal included this new nexus concept—in recognition of the ability of MNEs to interact significantly with customers in the market jurisdiction and create meaningful value without the traditional brick-and-mortar presence.[35]

D *The benefit theory as justification*

The Secretariat's proposed new nexus rule would apply where a business:[36]

> … has a sustained and significant involvement in the economy of a market jurisdiction, such as through consumer interaction and engagement, irrespective of its level of physical presence in that jurisdiction.

Clearly, such a nexus is within the ambit of the benefit theory.

Although the multilateral solution can be theoretically justified by the benefit theory, its evident impracticability sheds light on the circumstances that have led to the Government proposing to implement a DST. The multilateral solution appears to be an untenable option to pursue further.

V Background to New Zealand's Proposed DST

The ability of MNEs to have little to no physical presence in the market jurisdiction, where economic activity takes place, was formally recognised by the Government six years ago. In 2019, the Government released a discussion document entitled *Options for taxing the digital economy*.[37] The document expressed the significant international concern regarding the under-taxation of the digital economy and regarded deficiencies in the current international tax rules as causing this under-taxation. To ensure that non-resident digital MNEs "pay their fair share" of tax, the Government considered two options: the first being supporting a multilateral agreement at the OECD, and the second being reforming New Zealand's domestic legislation to implement a DST. The somewhat underwhelming conclusion regarding the DST was that the Government would "seriously consider" adopting one if the OECD did not "make sufficient progress [on achieving a multilateral solution]" that year.[38]

Relative silence followed until 2023. Two exceptions included an article on the Labour Party website written by then-Finance Minister, the Honourable Grant Robertson. In this article posted in September 2020, Mr Robertson stated that "[the majority Labour

34 At 6.
35 At 7.
36 At 8.
37 Robertson and Nash, above n 1.
38 At 1.

Government] will be prepared to implement a Digital Services Tax" and that a DST would be "very narrowly targeted" and would not apply to sales of goods or services, but to digital platforms which depend on a base of users for income from advertising or data.[39] In an article posted in August 2023, the Party announced that if a multilateral solution is not found in an appropriate period, the Labour majority would "be ready to introduce a DST [themselves]".[40] On 29 August 2023, the Government announced it would introduce the Bill to the House on 31 August 2023. The Bill is currently in its First Reading.

VI Digital Services Tax Bill

The Bill provides that the DST is payable by a "digital services group", if that group's global revenue from taxable digital services for the "DST revenue year" is at least EUR 750 million.[41] The rate of the proposed DST is 3 per cent of "digital services revenue" per "DST revenue year".[42] Three immediate issues are apparent:

(1) what is a digital services group?;
(2) what is a DST revenue year?; and
(3) what is digital services revenue?

Rather helpfully, the Bill defines a "digital services group" as a group of all persons either: (a) included in the consolidated financial statements of an ultimate parent entity, if those financial statements are prepared following International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (GAAP); or (b) that would be included in the consolidated financial statements of an ultimate parent entity, if IFRS or GAAP applied to the persons and their financial statements were prepared in accordance with it.[43] This definition ensures that subsidiaries and joint venture companies of the ultimate parent would fall under the umbrella of "digital services group". That is, of course, in addition to the ultimate parent company itself.

The Bill also defines "DST revenue year" as the relevant annual accounting period under IFRS or GAAP for a group or on an entity-by-entity basis.

However, the approach taken to define "digital services revenue" is more complicated. The Bill defines this as the gross amount obtained from taxable digital services to the extent to which those services are provided to New Zealand users under s 12 or connected to New Zealand land.[44]

A *Taxable digital services*

The Bill defines taxable digital services as:[45]

> … services, to the extent to which the services are—
> (a) an intermediation platform:

39 Grant Robertson "Balanced revenue policy targets debt, and protects essential services like health and education" (9 September 2020) NZ Labour Party <www.labour.org.nz>.

40 LabourVoices "Release: Labour tackles cost of living for families" (13 August 2023) NZ Labour Party <www.labour.org.nz>.

41 Digital Services Tax Bill, cl 8.

42 Clause 7.

43 Clause 5.

44 Clause 10.

45 Clause 11(1) (emphasis in original).

(b) a social media and content sharing platform:
(c) providing an internet search engine:
(d) advertising on, linked to, connected with, or facilitated by, a platform, service, or engine described in **paragraphs (a) to (c)**:
(e) activities related to user-generated data gathered in connection with a platform, service, engine, or advertising described in **paragraphs (a) to (c)**:
(f) any activity that is incidental to a platform, service, engine, or advertising described in **paragraphs (a) to (c)**.

Notwithstanding this list, cl 11(2) clarifies that any of the above services are not taxable digital services if they are merely incidental to another supply of goods and services that are not a service described above.[46] Similarly, online financial marketplace activities that are supervised or regulated by various financial regulation legislation are not taxable digital services.[47] Most relevantly, this appears to exclude the provision or advertising of digital trading, investing and lending platforms.[48] Finally, the Bill deems that an online platform for a loyalty programme that is incidental to the supply of goods and services is not a taxable digital service.[49]

If the service provided is a taxable digital service, then the gross revenue obtained from providing that service will contribute to the digital services revenue of the digital services group if either the service has been provided to a New Zealand user, or is connected with New Zealand land.[50]

B *Provided to New Zealand users*

A taxable digital service has been provided to a New Zealand user to the extent to which the service has been used or consumed by a person who is normally in New Zealand.[51] Whether a person is "normally in New Zealand" is evidenced by any of the following indicators:[52]

(a) the person's billing address:
(b) the person's delivery or shipping address:
(c) the internet protocol address of the device used by the person:
(d) the person's bank details, including the account the person uses for payment or the billing address held by the bank:
(e) phone number area code or country calling code:
(f) global satellite positioning data on the person or another geolocation method
(g) other information considered relevant by the Commissioner:
(h) an indicator agreed to by the Commissioner with the DST representative member.

46 Clause 11(2)(a).
47 See Financial Markets Conduct Act 2013; Financial Markets Authority Act 2011; Financial Service Providers (Registration and Dispute Resolution) Act 2008; Banking (Prudential Supervision) Act 1989; or under corresponding legislation in another jurisdiction.
48 Digital Services Tax Bill, cl 11(2)(b).
49 Clause 11(2)(c).
50 Clause 10.
51 Clause 12.
52 Clauses 12(a)–(h).

C *Connected to New Zealand land*

New Zealand land includes: (a) an estate or interest in, or agreement in relation to, land in New Zealand; or (b) goods and services connected to an estate or interest in, or agreement in relation to, land in New Zealand.[53] Unfortunately, the term "connected" is not defined in the Bill. However, the commentary on the Bill suggests that the "connected to New Zealand land" arm of the taxable digital services definition is designed to capture revenue where an owner or user of land in New Zealand is not a "New Zealand user" under cl 12. The commentary provides that taxable digital services related to land include the lease or rental of accommodation or other buildings and services relating to the sale of land.[54] Notably, this would capture users on holiday in New Zealand.

VII Application of and Theoretical Justification for the DST

The proposed DST is a tax on gross revenue. It is not an income tax. Therefore, the DST would apply to the digital operations of MNEs in New Zealand regardless of the taxing right-allocation provisions of existing DTAs.

In the Government press release on 29 August 2023, Mr Robertson noted that "our ability to tax them [non-resident digital MNEs] is restricted and the burden falls to smaller groups of taxpayers".[55] Mr Robertson also concluded that the DST would target MNEs earning income from New Zealand users of social media platforms, internet search engines, and online marketplaces.[56] Following the benefit theory, a non-resident is liable to tax in the market jurisdiction only if that non-resident receives an economic benefit from that market jurisdiction.[57] Despite a lack of a physical presence sufficient to give rise to a right to tax, the non-resident MNE obtains significant economic benefits from New Zealand in structuring their business operations in this way. In terms of general benefits, for example, the benefit provided by New Zealand's technological and network infrastructure is critical to non-resident MNEs providing taxable digital services. Without this infrastructure, the MNE could not provide these services in this manner. Secondly, New Zealand's legal system affords these MNEs the same legal rights provided to companies resident in New Zealand. These general benefits are in addition to the specific benefits of providing a relatively stable economy and social conditions benefitting the MNE's business.

The benefit theory justifies imposing a source-based tax, such as the DST, on the digital services provided by non-resident MNEs. The Government ought to be compensated for the cost of the benefits it provides to non-resident MNEs providing digital services to New Zealand users.

53 Clause 5.
54 Grant Robertson and Barbara Edmonds *Digital Services Tax Bill – Commentary on the Bill* (Inland Revenue, August 2023) at 42.
55 Grant Robertson and Barbara Edmonds "Government to enable digital services tax on multinationals from 2025" (press release, 29 August 2023).
56 Robertson and Edmonds, above n 55.
57 Garavan, above n 21, at 306.

VIII Introduction to the Taxation Principles Reporting Act

Thus far, this article has concluded that both the multilateral solution and the proposed DST can be theoretically justified. Both approaches recognise the ability of non-resident MNEs to interact with customers in the market jurisdiction and create value without requiring a physical presence. The next issue to consider is whether, in the absence of a consensus on a multilateral solution, the proposed DST is an appropriate solution assessed against the tax system principles in the Taxation Principles Reporting Act (TPRA).

The TPRA was passed by Parliament on 23 August 2023 and received Royal assent on 30 August 2023.[58] It established a statutory framework that required the Commissioner of Inland Revenue to annually report on New Zealand's tax settings against a set of principles—these seven principles being the "key principles considered for designing or changing a tax system".[59] Subsequently, the Taxation Principles Reporting Act Repeal Act 2023 was passed and received Royal assent on 22 December 2023. The Repeal Act, as the name suggests, repealed the TPRA.[60] However, notwithstanding the repeal of the TPRA, the "tax system principles" remain generally accepted principles of taxation.[61] As worded in the TPRA, the "tax system principles" were:[62]

Key principle	**Description**
Horizontal equity	**Horizontal equity** is the extent to which people with similar levels of economic income pay similar amounts of tax. In considering horizontal equity, the time value of money matters and the tax system should generally recognise the economic effect of income. In considering horizontal equity, there are important areas where exemptions to taxing economic income are justified in the pursuit of wider societal outcomes (for example, not taxing the imputed rent or gains on an owner-occupied home).
Efficiency	**Efficiency** is the extent to which tax revenue is raised in ways that minimise costs to the economy, including distortions.
Vertical equity	**Vertical equity** is the extent to which the tax system is progressive. Tax is progressive if people with higher levels of economic income pay a higher proportion of that income in tax. A progressive tax system does not mean that every tax is progressive (for example, GST is regressive relative to income) but the overall system ought to be. In practice, wealthy people should pay no lower an average rate of tax relative to their economic income than middle-income New Zealanders.
Revenue integrity	**Revenue integrity** is the extent to which the tax system is sustainable over time and minimises opportunities for tax avoidance and tax evasion.

58 Deborah Russell "Bill requiring regular reporting on tax system passed" (press release, 23 August 2023). See also Taxation Principles Reporting Act 2023, sch 2.

59 Schedule 1.

60 Taxation Principles Reporting Act Repeal Act 2023, s 4.

61 Inland Revenue *Taxation Principles Reporting Act: Annual Report (Draft)* (December 2023) at 4.

62 Taxation Principles Reporting Act, sch 1.

Compliance and administrative costs	**Compliance and administrative costs** is the extent to which compliance and administrative costs for taxpayers and the Government are reasonable, but minimising costs is not justification for substantial unfairness in the tax system.
Certainty and predictability	**Certainty and predictability** is the extent to which the tax system is coherent and transparent and taxpayers are able to determine their tax obligations before they are due.
Flexibility and adaptability	**Flexibility and adaptability** is the extent to which the tax system keeps pace with changes in society, in particular technological and commercial developments, and changes in inequality or comparative wellbeing.

IX Analysis of DST Against Principles of Taxation

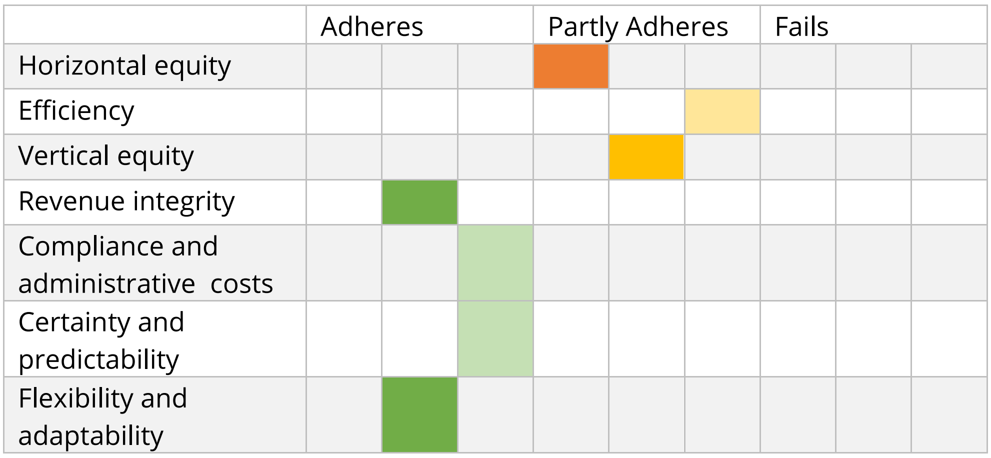

Figure 1: Analysis of DST against the key principles of taxation as in the TPRA.

A *Horizontal equity*

The principle of horizontal equity calls for equal treatment of people in equal positions,[63] meaning that people with similar circumstances and incomes should pay the same amount of tax.[64]

(1) Addressing market distortions

The purpose of the DST is to address the ability of MNEs to generate substantial profits from providing digital services without a physical presence in the market jurisdiction. The interaction between New Zealand's domestic tax framework and DTAs causes a market distortion in this area. Investments are distorted in favour of digital MNEs, which pay lower worldwide income tax than other industries and companies resident in the market jurisdiction that provide similar services.[65]

As mentioned, the DST is highly targeted. Because of this, the imposition of the proposed DST appears to address the market distortion arising from the currently

63 Richard A Musgrave "Horizontal Equity: A Further Note" (1993) 1 Florida Tax Review 354 at 355.
64 Tax Working Group Secretariat *Tax and fairness: Background Paper for Session 2 of the Tax Working Group* (February 2018) at 15.
65 Robertson and Edmonds, above n 54, at 6.

inadequate taxation of digital MNEs. However, if the MNE is required to bear the economic burden of the DST, this may deter investment in the economy and, consequentially, the erosion of the tax base that the DST is designed to target.[66]

It is difficult to definitively conclude whether the proposed DST is sufficient to correct the market failure in this area, having regard also to its potential to cause erosion to the tax base by deterring inbound investment.[67] As the fundamental purpose of the DST is to address a market distortion, it would be problematic to conclude that the proposed DST does not promote horizontal equity. However, given that the DST has the potential to distort the current market, the practical advantage appears weaker than expected.

(2) Inconsistent taxation

As mentioned, the DST is a tax on gross revenue. The original discussion document noted that a DST would apply in addition to income tax, which could result in double taxation by the same state.[68] Given the physical nexus generally required to give rise to a PE, this is highly unlikely to be a material issue for non-resident digital MNEs.

However, the proposed DST would likely lead to non-resident digital MNEs being taxed twice on the same income. The first is by way of the DST at a rate of three per cent on gross revenue from taxable digital services, and the second is by way of corporate income tax in the country of residence. This does not promote horizontal equity. Additionally, double taxation is not economically efficient.

There is the potential, too, for under-taxation. The Bill provides that an MNE's digital services revenue is reduced by 50 per cent if the amount is also connected to a user who may reasonably be assumed to use the platform in a foreign country with a tax substantially the same as a DST.[69] Unhelpfully, there are no statutory indicators to aid in this determination. However, the commentary on the Bill suggests that the onus is on the digital services group to "consider all the information about that user's location available to them and any other relevant facts or circumstances".[70] The commentary also suggests that businesses may use the same statutory indicators in cl 12 of the Bill. This 50 per cent reduction improves horizontal equity by allocating each market jurisdiction an equal portion of the digital services revenue. Although efficiency is discussed below, for the sake of continuity, cl 13 may cause inefficiency. For example, the MNE could deem cl 13 to apply, and the Inland Revenue could disagree. The resulting cost, of administration and litigation for example, would be inefficient beyond the point at which the compliance cost exceeds the potential revenue.

66 Favourate Y Mpofu and Tankiso Moloi "Direct Digital Services Taxes in Africa and the Canons of Taxation" (2022) 11 Laws 1 at 11.
67 World Economic Forum *Digital Trade in Services and Taxation: White Paper* (October 2021) at 18.
68 Robertson and Nash, above n 1, at 23.
69 Digital Services Tax Bill, cl 13.
70 Robertson and Edmonds, above n 54, at 43.

B *Efficiency*

Broadly, economic efficiency refers to the optimal production and distribution of resources in a market jurisdiction.[71] Generally, taxes distort this optimal distribution, as they influence businesses' decision-making.[72] Tax-induced distortions that negatively impact economic efficiency are the excess burden of taxation, which is the excess cost to the market of raising revenue through the imposition of tax.[73] As Adam Smith proposed, the cost of collecting taxes should not exceed the generated revenue.[74]

(1) Addressing market distortions

As discussed under horizontal equity, non-resident MNEs providing digital services to New Zealand users can take advantage of this area's distorted market. For the reasons discussed above, under the "addressing market distortions" heading of the horizontal equity principle, the DST increases economic efficiency by addressing the current market distortion.

However, similarly to the above, it is difficult to conclude that the DST will likely correct the market failure in this area, considering that it may erode the tax base by deterring inbound investment. The practical benefit in terms of increasing tax efficiency appears to be weaker than expected.

(2) Trade conflicts

A second disadvantage of the DST, having regard to efficiency, is the reasonable likelihood of trade conflicts. In 2019, the United States' Trade Representative investigated France's DST. That investigation concluded that France's DST was discriminatory towards major United States-based digital companies and inconsistent with international tax policy principles.[75] This conclusion was primarily reached on the basis that:

(1) the DST targeted two categories of services predominantly provided by United States-based companies;[76]
(2) the de minimis thresholds exempt many successful French companies and target United States-based companies;[77]
(3) the DST would be a deductible expense for French-resident companies;[78]
(4) a tax on gross revenue may give rise to double taxation;[79] and
(5) the DST unfairly targets a small number of mostly United States-based digital companies.[80]

71 Congressional Research Service *Digital Services Taxes (DSTs): Policy and Economic Analysis* (25 February 2019) at 15.
72 Mpofu and Moloi, above n 66, at 11.
73 Alan J Auerbach and James R Hines Jr "Taxation And Economic Efficiency" (March 2001) National Bureau of Economic Research <www.nber.org> at 8.
74 Miranda Stewart *Tax and Government in the 21st Century* (Cambridge University Press, Cambridge, 2022) at 76.
75 Robert E Lighthizer *Section 301 Investigation: Report on France's Digital Services Tax* (Office of the United States Trade Representative, 2 December 2019) at 1.
76 At 35.
77 At 41.
78 At 48.
79 At 57.
80 At 67.

This conclusion led to the United States announcing the imposition of tariffs on certain imports from France.[81] These tariffs were subsequently suspended in light of the ongoing investigation of similar DSTs adopted in other jurisdictions.[82] However, the tariffs intended to be imposed on French imports to the United States were valued at USD 325 million, compared to the estimated DST revenue of USD 567 million.[83] The United States has also prepared to implement tariffs against other countries with a DST, including the United Kingdom.

The likelihood of the United States imposing retaliatory tariffs was acknowledged in the Regulatory Impact Statement, which was published with the DST Bill. It noted that unilaterally adopting the proposed DST may harm New Zealand's trading environment. The scale of possible retaliatory tariffs "can be expected to be proportionate to the DST".[84] Given the small amount of revenue that New Zealand's proposed DST is estimated to collect, it is likely that any tariffs imposed would significantly reduce, neutralise, or even exceed the revenue the DST is designed to collect. In all likelihood, it appears that the United States would take issue with New Zealand's DST if it were implemented. This strongly suggests that implementing the proposed DST would be economically inefficient because there is a reasonable likelihood of trade tariffs having a neutralising effect.

(3) Conclusion on efficiency

The DST is designed to act as a stop-gap measure by addressing a current distortion in the market. However, imposing an additional tax on MNEs may deter inbound investment in New Zealand, eroding the tax base it is designed to target. Additionally, because the DST is a tax on gross revenue, there is the potential for double taxation, which is inefficient. Furthermore, the 50 per cent exemption and discretion given to MNEs in this area may lead to disputes and ensuing litigation, thereby increasing enforcement costs. No less substantial is the reasonable likelihood of the United States imposing trade tariffs on New Zealand imports. Although the proposed DST partially adheres to the principle of efficiency, given that its purpose is to correct a market distortion, the inconsistencies highlighted above lead me to conclude that the proposed DST only just adheres to the principle of efficiency.

C *Vertical equity*

(1) Progressivity

On its face, the DST appears to be a progressive tax. Firstly, a digital services group is only liable to pay DST if the group's global revenue from taxable digital services during the accounting period is EUR 750 million or greater.[85] Secondly, the group must also obtain at least NZD 3.5 million in revenue from taxable digital services provided to New Zealand

81 Jim Tankersley "U.S. Will Impose Tariffs on French Goods in Response to Tech Tax" *The New York Times* (online ed, New York, 10 July 2020).

82 Office of the United States Trade Representative "Suspension of Tariff Action in France Digital Services Tax Investigation" (press release, 7 January 2021).

83 Inland Revenue *Regulatory Impact Statement: Digital Services Tax* (9 August 2023) at 23.

84 At 4.

85 Digital Services Tax Bill, cl 8.

users or connected to New Zealand land.[86] If both of these de minimis thresholds are not met, then the group has a DST liability of zero.

The inclusion of these de minimis thresholds was noted in the original discussion document as essential thresholds to increase the chance of the DST applying to profitable businesses and reduce the DST's impact on start-ups and small businesses.[87] These de minimis thresholds and the specific services towards which the DST is targeted support the reasonable conclusion that the DST promotes progressivity. However, one aspect of the proposed DST indicates that it is problematic in terms of its progressivity.

The DST is a tax on gross revenue rather than an income tax. For in-scope MNEs (ie MNEs that obtain gross revenue above the two de minimis thresholds), deriving greater revenue means a higher DST liability. In practice, this means there is a reasonable possibility that an MNE with a narrower profit margin could have a higher DST liability than an MNE that obtains lower gross revenue but has a higher profit margin. Similarly, out-of-scope MNEs that derive one euro cent less than the EUR 750 million de minimis can escape DST liability, notwithstanding whether they have an equal or greater profit margin than MNEs subject to DST. Acting as a tax on gross revenue rather than an income tax, the DST is not as progressive as it first appears. Nevertheless, the two de minimis thresholds ensure that the DST is narrowly targeted at providers of digital services that consistently have a gross revenue well above the EUR 750 million threshold. So long as MNEs do not artificially arrange their operations to deliberately fall below either of the two de minimis thresholds (which appears unlikely), the DST seems to adhere to the progressivity element of vertical equity.

(2) Economic incidence

The term "economic incidence" refers to the party that bears the burden of the DST. The taxable digital services the DST targets are generally free-to-use services for end-users.[88] These services are often monetised through payments from other parties, such as developers and advertisers.[89] If the cost of the DST is borne by the MNE, that promotes the principle of vertical equity. However, if the cost of the DST is passed on to end-users or other relatively smaller businesses, that directly contradicts the DST's principle and purpose.

The writers of the discussion document considered that to the extent any costs associated with the DST were passed on, they would be passed on to the commercial users of the services and not the end-users. It was also surmised that applying the DST to MNEs with a profit margin above the required rate of return "might be very efficient and not be passed on to New Zealand customers".[90]

The taxable digital services towards which the DST is targeted capture MNEs such as Amazon, Apple, eBay, Facebook, Google, Instagram, Uber, and YouTube.[91] In 2022, the National Audit Office of the United Kingdom investigated the United Kingdom's DST. The report noted, among other things, that major MNEs such as Amazon, Google, and Apple

86 Clause 9.
87 Robertson and Nash, above n 1, at [3.24].
88 At [3.82].
89 Isobel Asher Hamilton "Apple, Amazon, and Google hike their developer and ad client fees to pass on the costs of paying new digital taxes in Europe" (2 September 2020) Business Insider <www.businessinsider.com>.
90 Robertson and Nash, above n 1, at [3.83].
91 At [1.8].

have all publicly acknowledged that they would pass on the cost of the DST to their customers.[92] If smaller commercial users are required to bear the burden of the cost of the DST, that would strongly subvert vertical equity. The principle is even more strongly undermined if end-users must foot the bill. Following the vertical equity principle, those with less should not be required to contribute more.

Given that the DST has not yet been implemented, the true incidence of the economic burden is unclear. However, a reasonable assumption can be made that at least some of the MNEs which the DST is designed to target will pass on the tax to commercial users or end-users. Such a proposition strongly suggests that this facet of vertical equity does not justify the DST.

(3) Conclusion on vertical equity

On paper, the DST appears to adhere to the principle of vertical equity. Indeed, its two de minimis thresholds promote this principle. However, flaws can be observed in its application as a tax on gross revenue. The most notable is its application to MNEs with a higher gross revenue but a lower profit margin. Although this may cause some inconsistency with the principle of vertical equity amongst MNEs exceeding the de minimis thresholds, the tax is, as a whole, progressive. More significantly impacting the DST's adherence to the vertical equity principle is the economic incidence of the tax. As with New Zealand's Goods and Services Tax (GST), there is an increased risk that the DST would be passed on to consumers. Such conduct would defeat the object and purpose of the DST. Given the number of MNEs publicly acknowledging that they would pass on the cost of the DST to their customers, this is a significant issue for vertical equity. Although, prima facie, the DST appears to promote vertical equity, it seems that, in practice, the result would be shifting the economic burden to consumers. The DST partly adheres to the principle of vertical equity, but there is a significant issue with the economic incidence of the tax.

D *Revenue integrity*

As has been covered extensively, the DST has been proposed as a temporary solution to the inadequate taxation of the digital services provided by non-resident MNEs. The definition of "revenue integrity" in the TPRA presents two questions:

(1) does the DST promote coherency and sustainability of the tax system?; and
(2) does the DST minimise opportunities for tax avoidance and evasion?

The proposed DST is unusual for coherence and sustainability because it creates a new nexus. This new nexus extends New Zealand's right to tax beyond the PE rules and exists outside of our DTAs. Because of this, it cannot be concluded that the DST is consistent with the existing tax system. However, considering the benefit theory, the new nexus is a logical step to adequately tax non-resident MNEs.

In terms of avoidance and evasion, the purpose of the DST is to reduce base erosion. Although it may go too far to say that digital MNEs are currently evading tax, they are no doubt avoiding it. The nature of their business model allows them to do so. Enacting the proposed DST most certainly supports revenue integrity.

92 National Audit Office *Investigation into the Digital Services Tax: HM Revenue & Customs* (23 November 2022) at [1.11].

E *Compliance and administrative costs*

(1) Clear mechanism for payments and refunds

The DST Bill provides a clear mechanism for making payments and collecting refunds.[93] The ultimate parent entity of the group must nominate a company in that group to be the "DST representative member",[94] which is then required to assess the amount of DST payable for the DST revenue year.[95] In the absence of a nomination, the group's ultimate parent entity is deemed to be the DST representative member. Clause 15 of the Bill explicitly states that the DST representative is liable to pay the amount of DST for which the digital services group is liable to the Commissioner by the date six months after the end of the group's DST revenue year. Similarly, cl 16 provides that the Commissioner must refund any overpayment of DST if the Commissioner is satisfied or receives notice that the group is entitled to the refund before the end of the four-year time bar.[96]

As with any tax, compliance and administrative costs will no doubt increase. However, it appears that any such costs will be limited. Because the Bill provides that the ultimate parent company is deemed to be the entity responsible for calculating and paying the group's DST liability in the absence of any nomination, this mitigates any administrative costs. Of course, expenditure on compliance is required to calculate and pay the appropriate DST to the Commissioner. These costs should be immaterial because the DST is a tax on gross revenue. These figures can be taken from the group's consolidated financial statements.[97] The increased compliance costs associated with the proposed DST in this area do not appear to be unreasonable. Therefore, it can be concluded that this aspect contributing to increased compliance costs does not materially affect the DST's adherence to this fundamental principle.

(2) Clear de minimis

As discussed, the proposed DST has two de minimis thresholds that must be met.[98] The first EUR 750 million threshold is certain and applies regardless of the digital services group's size, type, or structure. This threshold is the same as the international standard for country-by-country reporting and the threshold under Pillar Two.[99] Given that the global revenue de minimis in the proposed DST is mainly similar to that in the DST of other countries and is a well-known standard at the OECD, it is unlikely that compliance costs would be materially increased due to this.

The second de minimis provides that the DST does not apply unless the group obtains NZD 3.5 million or more in digital services revenue. Similarly, this threshold is certain and applicable regardless of the group's size, type, or structure. This domestic revenue threshold is far lower than in other jurisdictions' DSTs, such as the United Kingdom.[100] Although the domestic de minimis is not a well-known standard, it appears unlikely to give

93 Digital Services Tax Bill, cls 14–16.
94 Clause 33.
95 Clause 28.
96 See also cl 30.
97 Robertson and Edmonds, above n 54, at 27.
98 Digital Services Tax Bill, cls 9 and 15.
99 Inland Revenue, above n 83, at 18.
100 The United Kingdom domestic de minimis is £25 million.

rise to any significant compliance costs, given it is a statutory de minimis and explicitly provided for in the Bill.

(3) Clause 12 indicators

The cl 12 indicators provide that certain information is evidence that the digital services have been provided to a user who is "normally" in New Zealand. The effect of these indicators is to lower the cost of ascertaining where the user is based. Most of the indicators concern information that is stored or routinely collected through normal business processes. Regarding this arm of the definition of "taxable digital services", the information required is not of a kind to seriously increase compliance costs.

(4) Monitoring and enforcement

The disadvantage associated with the DST in terms of compliance and administrative costs is the cost associated with setting up the systems required to administer the DST. This cost is estimated to be NZD 2.4 million over four years.[101] Additionally, the Inland Revenue has acknowledged that, given that the DST is supposedly a temporary measure, there would be costs incurred in winding down the DST to transition toward a multilateral solution.

It is unclear whether a multilateral solution will ever eventuate, so the costs of winding down the DST may never come to fruition. However, the administration cost is approximately one per cent of the revenue the DST is estimated to collect. Although this is not a significant percentage of the total estimated revenue, it is essential to note that the DST would increase administrative costs incurred by the Inland Revenue.

(5) Conclusion on compliance costs

Implementing the DST would bring associated administrative costs. Regarding the costs imposed on the MNE, the Bill provides a clear mechanism by which DST can be calculated and paid. Regarding the costs imposed on the Inland Revenue, this mechanism reduces the likelihood of disputes associated with the underpayment or overpayment of DST. The material impact of the DST on this fundamental principle is the significant cost for the Inland Revenue associated with monitoring and enforcing compliance. However, the compliance costs are insignificant if the cost is considered a percentage of the total revenue that the DST is estimated to gather. It can be concluded that the proposed DST mainly adheres to this principle.

F *Certainty and predictability*

(1) Certainty of DST liability

The proposed DST is relatively consistent with the principle of certainty. The Bill imposes a tax at the rate of 3 per cent on digital services revenue for a DST revenue year. Although the Bill introduces new terms such as "digital services revenue", "DST revenue year", and "taxable digital services", these terms are clearly defined in the Bill. These terms and their application have been discussed throughout this article. Additionally, cl 11 promotes

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101 Inland Revenue, above n 83, at 5.

certainty by clarifying which services constitute taxable digital services, and it also advances certainty by elucidating what digital services are not in the scope of the DST.

The statutory framework provided by the DST Bill is far more certain than the current nexus rules, which require the non-resident digital services group to determine whether it has a PE in the market jurisdiction and further define the income attributable to that PE. As it is, the DST would at least reduce the need for a non-resident MNE providing digital services to seek tax advice on whether they have a PE in the market jurisdiction. The proposed DST significantly improves the certainty of whether the MNE has a sufficient nexus to give rise to tax.

(2) Government indecisiveness

In the same press release announcing the introduction of the DST Bill to the House on 29 August 2023, the Government reaffirmed its support for reaching a multilateral solution at the OECD.[102] For this reason, the Bill contains a provision allowing the Minister of Revenue to delay the commencement of the Digital Services Act, if the Bill passes, between 1 January 2025 and 2 January 2030.[103] Leaving aside the issue of whether the Bill passes, this provision confers a broad discretion on the Government to delay the commencement date of the DST. Although it is unlikely that the DST would come into force at short notice, this provision creates reasonable uncertainty.

Secondly, given that the DST is intended to be a temporary solution, an issue as to certainty arises when the "temporary" DST is eventually repealed. To the extent to which there is any temporal overlap between New Zealand's domestic DST and any multilateral solution, the Bill provides no revenue allocation for the DST revenue year in which the DST is repealed. Failure to provide for this would be a failure in the eyes of certainty. The omission to provide for the reasonable likelihood of the DST and the multilateral solution overlapping in time could result in double taxation.

(3) Conclusion on certainty

The DST Bill is sufficiently detailed to clarify which services are and which are not within the scope of the DST. The Bill creates a new nexus that is significantly more certain than the current approach to PEs. However, the Government has a broad discretion to delay the commencement date of the DST, which impedes certainty. Although the Government's indecisiveness does create uncertainty, the DST itself is certain and allows taxpayers to determine their liability to tax with more certainty than the current nexus rules. The DST adheres to the principle of certainty.

G *Flexibility and adaptability*

As will be discussed in the next part of this article, the proposed DST is not perfect. However, it solves the problem of inadequate taxation of non-resident MNEs providing digital services to New Zealand. For the reasons discussed in this part of the article, the proposed DST delivers a solid foundation for a more permanent solution. The theoretical justification for the DST is sound. If a non-resident MNE receives an economic benefit from the market jurisdiction enabling the creation of value, then the Government of that

102 Robertson and Edmonds, above n 55.
103 Digital Services Tax Bill, cl 2.

jurisdiction should be compensated. The DST generally adheres, to varying degrees, to the fundamental principles of taxation; however, the DST cannot be said to cohere entirely with the principle of flexibility. The shortcomings of the DST in terms of equity and efficiency prevent me from concluding that the DST fully adheres to this principle. Notwithstanding these shortcomings, the DST provides the building blocks to construct a more permanent solution. The proposed DST and its potential led me to conclude that the DST mostly adheres to the principle of flexibility.

X Solution: Effective Third De Minimis

Most notably, the proposed DST is currently lacking in its congruence with horizontal and vertical equity and efficiency principles. These shortcomings must be addressed to more adequately adhere to the generally accepted principles of taxation. Given that the Bill is in its First Reading, it would be most advantageous to address these issues sooner rather than later.

Concerning these principles, the most noteworthy issue with the DST that could be addressed is its effect as a tax on gross revenue. As discussed, this could cause double taxation and inconsistency in the application of the tax. The DST was introduced as a tax on gross revenue to prevent any inconsistency with New Zealand's DTAs, which generally provide that a DTA applies to an income tax or a tax "substantially similar [to an income tax]". This means that if the DST were an income tax or deemed to be substantially similar to an income tax, then the non-resident MNE's tax liability in New Zealand would be zero, except to the extent to which any income from digital services could be attributable to a PE in New Zealand.

One solution to mitigate these issues is introducing a provision to the Bill that effectively acts as a third de minimis. While the Bill already has two de minimis thresholds—the global revenue threshold of EUR 750 million; and the New Zealand revenue threshold of NZD 3.5 million—the DST still falls short, considering the principles of equity and efficiency. The DST looks to impose an equal liability on non-resident MNE "A", which has the same gross revenue as non-resident MNE "B", but has a lower profit margin. This cuts across the principles of equity and efficiency. In considering how a third de minimis could apply, guidance can be obtained from the United Kingdom's DST. In the Finance Act 2020 (UK), an additional provision exempts a group's first GBP 25 million of revenue from DST.[104] New Zealand's domestic threshold of NZD 3.5 million does not exempt revenue under that threshold. Therefore, one solution proposed to promote equity and efficiency is to amend cl 9, introduce cls 9A and 9B, and include two definitions into cl 5 of the Bill:

> **9 Digital services tax: exception**
>
> (1) A digital services group's digital services tax liability is zero if—
>
> (a) the digital services group's digital services revenue under section 10 is less than $3.5 million for the DST revenue year; or
>
> (b) if the digital services group has a digital services profit margin not greater than zero.

104 Finance Act 2020 (UK), s 47.

9A Digital services tax: Profit margin allowance

(1) Notwithstanding sections 8 and 9, a digital services group has a digital services allowance.

9B Definition: digital services allowance

(1) Digital services allowance means:
  (a) if a digital services group's digital services revenue under section 10 is at least $3.5 million for the DST revenue year—
    (i) the first $3.5 million of digital services revenue obtained from taxable digital services is exempt from digital services tax.

(2) Notwithstanding anything in subsection (1):
  (a) a digital services allowance may not be carried forward to a future DST revenue year; and
  (b) digital services revenue exceeding $3.5 million is subject to digital services tax.

5 Interpretation

Digital Services Profit is the total digital services revenue derived by a digital services group in a DST revenue year minus the expenses incurred in providing taxable digital services to the extent to which those expenses can be directly attributed to the provision of taxable digital services to a New Zealand user or connected to New Zealand land.

Digital Services Profit Margin is the digital services profit divided by the income of the digital services group which can be attributed to the provision of taxable digital services to a New Zealand user or connected to New Zealand land during that DST revenue year, if that income is—
  (a) reported in the consolidated financial statements of an ultimate parent entity, if those financial statements are prepared in accordance with generally accepted accounting practice; or
  (b) that would be reported in the consolidated financial statements of an ultimate parent entity, if generally accepted accounting practice applied to the persons and their financial statements were prepared in accordance with it.

New sub-cl 9(1)(b) exempts any loss-making companies from DST liability in New Zealand. The proposed additional definitions in cl 5 function with new subclause 9(1)(b) to improve both vertical and horizontal equity, efficiency, and certainty. New cls 9A and 9B work together to provide a company with an untaxable allowance on digital services revenue for a DST revenue year, up to a maximum of NZD 3.5 million. This means that the first NZD 3.5 million of digital services revenue derived by a company per DST revenue year is not taxable.

This proposed solution promotes horizontal equity by ensuring that an in-scope MNE with a negative profit margin and similar gross revenue to another MNE is exempt from DST liability. It also ensures that the digital services revenue of each digital services group is tax-free up to a maximum of $3.5 million, rather than the current approach to having no exception to DST if above the two de minimis thresholds. The solution furthers vertical equity for the same reason regarding profit margin allowance. This solution develops greater efficiency by more effectively minimising market distortions. Finally, this solution also promotes flexibility by ensuring equality and aligning our DST more closely with that of the United Kingdom.

XI Conclusion

Currently, the provision of digital services in New Zealand by non-resident MNEs does not give rise to a sufficient nexus to impose source taxation. That is despite the substantial digital presence maintained, and other benefits enjoyed, by many such entities.

Tax liability ought to arise where value is created. Following the benefit theory, a market jurisdiction should be compensated for the benefits it provides, which enable the non-resident MNE to interact with customers in the market jurisdiction, absent a traditional brick-and-mortar presence.

Although achieving a multilateral solution is an admirable goal, doing so appears impracticable, at least in the near future. In the absence of a multilateral solution, it follows that implementing a domestic solution, such as the “temporary” DST, ought to be carefully considered. And although the DST Bill has great potential, in its current state, it is materially inconsistent with the principles of horizontal and vertical equity and efficiency. These are vital principles of taxation, and the purpose of introducing the DST is mainly to promote tax equity. What seems like an unnecessary addition of provisions that effectively function as a third de minimis may be the solution to ensure the DST adheres to most, if not all, of the principles of taxation.