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Richard Thompson Ainsworth
Boston University School of Law

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DATA FIRST – TAX NEXT:
HOW FIJI'S TECHNOLOGY CAN IMPROVE NEW ZEALAND'S "NETFLIX TAX" (Part 4)

Richard T. Ainsworth

This is the fourth paper examining the recent amendments to the New Zealand Goods and Services Tax (GST); amendments that are collectively known as the *Netflix Tax.* These papers assess the effectiveness of the *Netflix* provisions, and how they could be enhanced if New Zealand adopted the technology and vision of Fiji's VAT Monitoring System (VMS). The *Netflix* provisions were effective, July 1, 2017.

This final paper considers: (a) the treatment of domestic agents when they are used by remote service providers to facilitate sales to New Zealand customers;[1] (b) how New Zealand intends to respond to resident consumers who supply false information to remote service providers in an effort to induce those providers into improperly zero-rate transactions, and thereby defeat the GST;[2] and (c) the treatment of dual status taxpayers, New Zealand residents whose status allows them to enter into contracts with remote service providers either as individual consumers or as business taxpayers.[3]

As before, the primary contrast is the difference between New Zealand's traditional (statute and regulation) approach to VAT reform, and the technology-intensive approach of Fiji. Both jurisdictions are struggling to deal with the modern economy, but they approach this challenge very differently. These papers come down on the side of Fiji and technology. In the end they observe that what Fiji understands is that code, computer code, is a very effective, cost-efficient, and self-enforcing form of regulation. There is something important to learn about the way that Fiji utilizes "code" in its tax reform.[4]

DOMESTIC AGENTS

In a very real sense, the domestic agent rules on remotely supplied services (NZ GSTA §§ 60(1A) and 60(1AB)) are drafted as companions to the more complex electronic marketplace rules considered earlier.[5] In the electronic marketplace context both the remote seller and the agent (the electronic marketplace) are non-residents. This creates considerable complexity as well as opportunity for upstream and downstream frauds.

Both the complexity and the opportunity for fraud are greatly reduced in the domestic agent context. A domestic agent is a resident, someone who is (most likely) already registered for GST, without consideration of the agency relationship. The domestic element also makes

1 NZ GSTA §§60(1A) & 60(1AB)
2 NZ GSTA §§5(27) & 51B(7).
3 NZ GSTA §§8(4B); 20(4D); 20(3JC) & 25AA.
4 Lawrence Lessig, *Code Is Law – On Liberty and Cyberspace*, HARVARD MAGAZINE (January-February 2000)
5 NZ GSTA §§60C; 60D; 60D(3); & 60(1C), and Richard T. Ainsworth & Chang Che, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax" (Part 3) (Electronic Marketplaces)* XX TAX NOTES INTERNATIONAL XX (2019)

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some things much simpler.[6] A domestic agent, unlike an electronic marketplace, is fully under New Zealand's jurisdictional oversight.

Nevertheless, some of the same compliance problems that plague electronic marketplaces are present in a domestic agent fact pattern, along with some new problems inherent in the differences among the types of domestic agents. There are captive (dependent) agents and independent agents. The rules at §§ 60(1A) and 60(1AB) deal with both.[7]

NZ GSTA §60(1AB) authorizes remote suppliers and their domestic agents to agree that the agent (not the principal) is the party making the supply. This requires the agent, if its sales exceed the NZ$60,000 threshold, to register, collect, and remit the GST.[8] B2B and B2C sales automatically count against the filing threshold of a New Zealand resident. In an electronic marketplace context, a non-resident will *always* be considered the taxpayer making the supply. In a domestic agent context, it is the resident agent who will *most commonly* be the taxpayer, and only occasionally will the non-resident principal be responsible for collecting, reporting and remitting the GST. This shifting responsibility is controlled by §60(1AB).

The NZ GSTA §60(1AB) *agreement* is critical to understanding resident agents and how they satisfy GST compliance obligations. There are a number of notable elements to the §60(1AB) *agreement*:

- First, the agreement is a one-way election. The agreement will make the resident agent the taxpayer. The §60(1AB) *agreement* functions like similar electronic marketplace rules at §§2, 60D, 60C, and 60(1C). These provisions modify the "main rule" in §60(1). It is the "main rule" that makes the principal the taxpayer;
- Second, the statute does not contemplate an agreement which would have both parties share GST liability on the same transaction. There is only one taxpayer responsible for GST;
- Third, the agreement may be transactional, or granular. That is, the agreement can shift liability back and forth between agent and principal depending on the "particular supply, or a type of supply." In other words, the §60(1AB) *agreement* is not an all or nothing entity-based agreement; it is highly flexible and granular. Details are very important, because if multiple supplies are made between the same parties the GST obligations are not necessarily satisfied in the same manner §60(1B);

[6] Part of the simplification comes from avoiding the threshold issues discussed in Richard T. Ainsworth, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax" (Part 2)* 94 TAX NOTES INTERNATIONAL 319, 320-321 (April 18, 2019). See figure 1.

[7] Borrowing terminology from the insurance sector, an *independent insurance agent (independent agencies)* offers products from numerous insurance companies. They enter into contracts that gives them binding authority to sell on behalf of their principals. They get leads on their own and represent the customer buying the insurance. Independent agents (agencies) work on a commission basis, plus a bonus. *Captive insurance agents (captive agencies, or dependent agents)* work for one specific company. The individual agents work out of an office in the corporate headquarters, or a sales office within a geographic area where the company does business. The agents get leads from the company and represent the product the company sells. The individual agents are employees, compensated with a salary and commission.

[8] The statute is very direct. NZ GST §60(1AB) reads:

> The principal and the agent may agree that the agent, and not the principal, is treated as making the supply in the course and furtherance of a taxable activity carried on by them.

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- Fourth, the agreement is closed. It is only between the agent and principal and does not involve either the customer (who will pay the GST) or the tax authority (that will audit compliance). The interplay between the third and fourth element is particularly troubling from an audit perspective. It is not possible to determine the proper GST treatment from a distance as the *granularity* (third element) is embedded in the closed *agreement* (fourth element).

The essential problem created by the §60(1AB) agreement is that it produces a *real-time information asymmetry* – that is, the supplier and agent (who may be related parties) immediately know the tax impact of their §60(1AB) agreement. However, neither the domestic buyer nor the tax authority share in this information in real-time. The domestic buyer may never know if the invoice it received was accurate. The buyer certainly has no way to immediately know upon receipt of the invoice. The tax authority may suspect that an agreement is in place, and if the right tax was charged and collected, but it will only know for sure after a thorough audit where the §60(1AB) agreement is read and analyzed.

The biggest question raised by a §60(1AB) agreement that a buyer or the tax authority would want answered quickly is: Was this transaction subject to the 15% GST or should it have been zero-rated?[9] One would think that if a private party agreement was going to significantly change the appropriate tax rate on a cross border invoice that there would be: (a) simple notification mechanism to inform all parties concerned, and (b) a verification mechanism that the change that occurred was correct. This would happen in Fiji;[10] it could be the norm in New Zealand, if it adopted Fiji MVS.

There are statutory hints that New Zealand recognizes that it has drafted a statute that may be too flexible to be easily audited.[11] There are real possibilities that more than one invoice

[9] See generally, Figure 2 in Richard T. Ainsworth, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax" (Part 1)* 94 TAX NOTES INTERNATIONAL 159, 168-170 (April 8, 2019). A brief summary of the applicable rules are as follows: if a registered domestic agent makes a taxable supply to a New Zealand business the 15% GST applies, but if a §60(1AB) agreement is *not in place* the same supply is deemed made by the non-resident principal, and the transaction is either not considered, or zero-rated. A non-resident supplier of remote services is initially:

(a) Not required to return GST on supplies to New Zealand GST-registered businesses;
(b) Not required to provide tax invoices;
(c) But, may treat the supply as zero-rated (NZ GST §8(4D)), and if so
(d) May also claim back New Zealand GST cost incurred in making the zero-rated supply (NZ GST §11A(1)(x));
(e) Which is, compounded by a rule that allows the non-resident supplier to presume that a New Zealand customer is not a GST-registered business absent affirmative declarations by the buyer (GST registration number, or New Zealand Business Number, or other notification mechanisms. (NZ GST §8B(5)) with some added flexibility in (NZ GST §8B(6)) in alternate methods allowed by the Commissioner on a case-by-case basis;
(f) With complications for inadvertently charged GST and refund mechanisms; (NZ GST §§20(4C), 25(1) & 25(1)(abb)) which are further complicated by rules covering supplies of less that NZ$1,000 (NZ GST §24 (4)).

[10] Fiji has made plans to adopt a Netflix Tax in 2019.

[11] For example, after §60(1) identifies that the principal is normally the responsible party for issuing the tax invoice, it steps back and adds the following conditions:

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could be issued for some transactions. Problems can arise from automated systems generating invoices. If these systems are not carefully maintained and updated when new §60(1AB) agreements are entered into mistakes will arise which may be difficult to spot by the tax authority, and impossible to identify by a buyer who is unaware of the agreement.

One would expect fewer problems when *dependent* domestic agents are involved than when *independent* domestic agents are used by non-resident principles. Dependent agents and their principals are almost always related parties, and they will (probably) have a unified invoice generating system. Nevertheless, the invoice patterns can be complex, difficult to audit, and opaque to the domestic purchaser, who in cases of errors on invoices exceeding NZ$1,000 needs to secure the GST refund from the counter-party, not through the mechanism of a GST refund (NZ GST §20(4C).[12] See figure 1 (below).

> *provided that*, where that supply is a taxable supply, that agent, being a registered person, *may*, notwithstanding anything in this Act, *issue a tax invoice* or a credit note or a debit note in relation to that supply *as if* that agent had made a taxable supply, and *to the extent* that that tax invoice or credit note or debit note relates to that supply, *that principal shall not also issue*, as the case may be, a tax invoice or a credit note or a debit note.

[12] See the discussion at in Richard T. Ainsworth, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax" (Part 2)* 94 TAX NOTES INTERNATIONAL 319, 328 (April 18, 2019).

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Figure 1: NZ GSTA §60(1AB)
agreement with a Dependent Agent

New Zealand | United Kingdom

Transfer of Compliance Obligations w/ [1], [2], A & B: collection, reporting, remitting GST

Depend Agent

NZ GSTA §60(1AB) *agreement*

Commission #1

UK Insur. Co. #1

GST Compliance Obligations

[1] [2] [3]

A B C

(a) Not subject to GST §8(4D)
(b) Subject to GST If supplier (alone) decides GST 0% §11A(1)(x)

New Zealand | United Kingdom

Figure 1 assumes a UK insurance company offers property insurance in New Zealand through its dependent resident agent. The agent secures six clients, three individuals (#1, #2, and #3) and three businesses (A, B, and C). Each of the businesses are GST registered. Figure 1 also assumes that the UK principal and the NZ dependent agent enter into a §60(1AB) agreement with respect to individuals #1 and #2, and with respect to businesses A, and B. As a result, the dependent resident agent will issue tax invoices to these four clients "as if" it was making the taxable supply (even though, contractually, it is the principal who is, in fact, making the supply).

As a normal domestic transaction, 15% GST will be added to the invoices to #1, #2, A, and B. The resident dependent agent will collect, report and remit the GST. This is not the case with individual #3 and business C. A 15% GST will be collected from individual #3, but it will be by the UK Insurance Company under §8(3)(c). This is the main Netflix Tax rule.[13] This is

[13] See the discussion at Figure 2 in Richard T. Ainsworth, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax" (Part 1)* 94 TAX NOTES INTERNATIONAL 159, 168-170 (April 8, 2019).

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assuming that the UK principal exceeds the NZ$60,000 threshold, and has not "tax planned" around it (using the §60(1AB) agreement with #1, #2, businesses A and B to minimize its New Zealand sales and stay under the threshold.) The same ambiguity applies in the case of business C's invoice. Will it include GST? This transaction could be considered "out of scope" (not taxable at all), or it could be treated (at the sole discretion of the principal) as a taxable sale that is subject to GST at 0%. (§11A(1)(x)).[14]

Different compliance results from what might be considered comparable transactions can cause confusion, but they are necessary because of the way the Netflix Tax integrates non-residents into the New Zealand marketplace without including a bias for or against certain commercial entities. These anti-bias patterns become more complex, when we consider independent agents that facilitate both domestic and remote service transactions.

The independent agent statutory design replicates the treatment of *electronic marketplaces*. Figure 2 (below) shows multiple insurance companies using an independent agent as a domestic platform for selling policies to New Zealand residents. The taxability of the insurance transactions varies from principal to principal. In some instances, the "underlying supplier" (the principal) will be the taxpayer, while in others the "marketplace" (the independent agent) will be the taxpayer.

There is a strong echo of the electronic marketplace rules in the independent resident agent rules. The operative presumptions are set inversely. Electronic marketplaces are presumed to be the taxpayer, unless they fulfil requirements to "opt-out," which make the underlying supplier the taxpayer. In the domestic agent patterns, it is the non-resident principal that is deemed to be the taxpay unless the parties enter into a §60(1AB) agreement which will make the domestic agent the taxpayer. (These provisions operate as mirror images of each other). See figure 2 (below).

[14] See Figure 2 and the discussion of the §11A(1)(j) exception to the zero-rating provision of §11A(1) in Richard T. Ainsworth, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax," (Part 1),* 94 TAX NOTES INTERNATIONAL 159, 169 - 171 (April 8, 2019).

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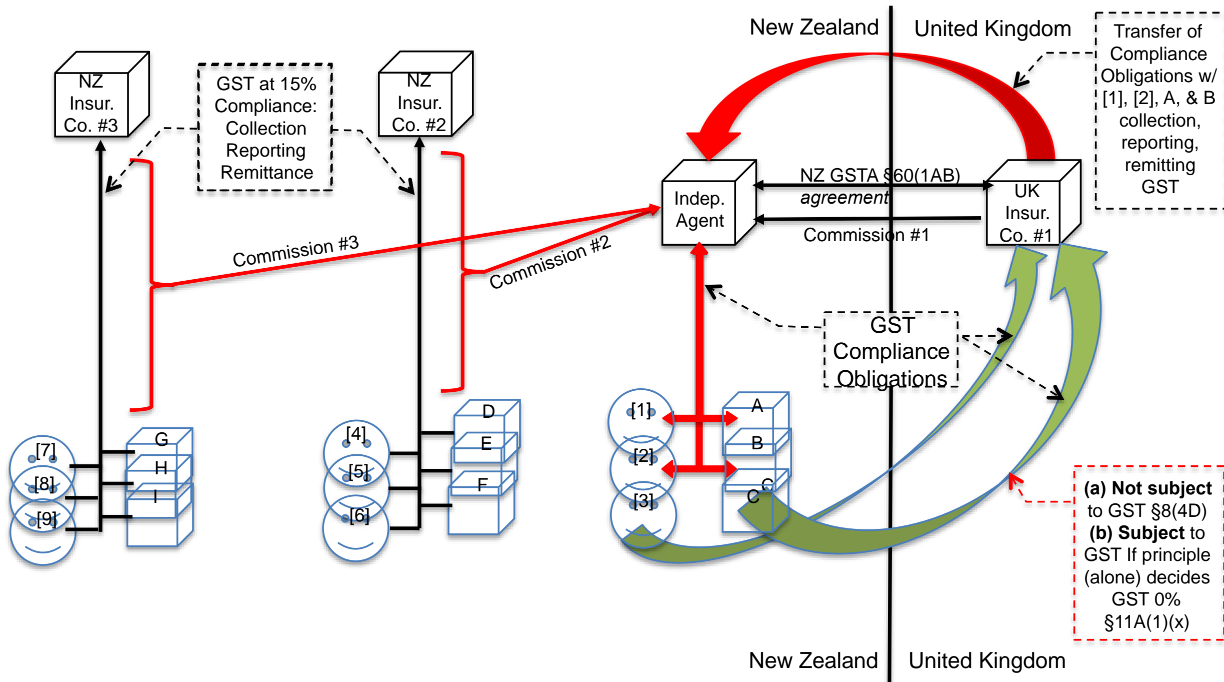
Figure 2: NZ GSTA §60(1AB) *agreement* with an Independent Agent



In this example a single independent agent stands between eighteen New Zealand buyers (9 businesses and 9 consumers) and three insurance companies (2 domestic and 1 foreign). The independent agent functions like an internet platform, offering New Zealand resident customers a range of insurance principals, some of whom offer this service with GST, and some of whom offer it without GST. When tax is imposed, it is at 15%, or 0%.

If there is a chance for error in this fact pattern, it will most likely arise from an independent agent mistakenly charging GST when the principal is charging GST at a zero rate under §11A(1)(x), or where the transaction is deemed not to be subject to GST under §8(4D). Correcting errors becomes complicated if the amount of the transaction exceeds NZ$1,000. In this instance, the Netflix Tax requires the buyer to secure a refund directly from the seller §20(4C). The buyer is not allowed to take a deduction for GST actually (but erroneously) paid over to the seller, even if this amount has been further remitted to the tax authority (§25(1)).

Perhaps the most troubling part of this is that the financial burden of double taxation is on New Zealand resident buyers, and this group is the least likely of all the parties to have any kind of notification that errors have been committed. The IRD will find errors on audit. There is a better way with fiscal invoices.

If everyone selling in and into the New Zealand market was required to issue a fiscal invoice, a lot of the problems would be solved. Fiscal invoices provide a real-time notification mechanism. As discussed in Part 2,[15] fiscal invoices, like those in the Fiji VMS, provide very

[15] See the discussion at Figure 1 in Richard T. Ainsworth, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax" (Part 2)* 94 TAX NOTES INTERNATIONAL 319, 328-30 (April 18, 2019).

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effective notice. If business C, or business F received an invoice from the Independent Agent that included 15% GST, as well as or instead of an invoice by the appropriate principal (either at 15% or 0%), then they could immediately notify the tax authority of the error by scanning the QR code. The Tax Core would see the double/ erroneous invoicing and respond. The whole process should be automated.

Even better, a customer service notification (text message) could be self-initiated by the Tax Core when AI scanned the database looking for errors. The buyer would be automatically alerted. The Tax Core could direct the buyer to refund solutions, and notify the other parties that an error was detected and an update was most likely needed in the invoice generating system.

FALSE INFORMATION

One of the underlying concerns with the Netflix Tax is that individuals in New Zealand are accustomed to making GST-free purchases of services from online vendors. The Netflix Tax is designed to change this; to level the playing field with domestic suppliers. But, this "level playing field" argument may not be able to change attitudes. People can be expected to try to find a way around the new rules.

In response, new penalties have been added. The penalties are discretionary, and operate as a reverse charge. Application is by Commissioner's discretion. §5(27) indicates that, "The Commissioner *may* treat a person resident in New Zealand who receives a supply of remote services to which section 8(3)(c) applies *as if they were making a supply of services* that is chargeable with tax ..." (emphasis added).

The enforcement mechanism has a gentle touch. The Commissioner's discretion is limited to situations "... where the act of the person ... is a repeated occurrence ... [or] ... the amount of tax ... is substantial."[16]

However, the penalties can be serious. In addition to the reverse charge which is specifically authorized, the existing "knowledge offences" also apply when a person deliberately supplies incorrect information for the purpose of avoiding GST. The two main places this would happen are (a) a misrepresentation that a consumer is a registered business or (b) a misrepresentation that a consumer is as a resident of another country.[17] This is a criminal penalty and a person convicted of a knowledge offence is liable for a fine of up to NZ$25,000 for a first-time offence or NZ$50,000 for repeated offences.[18] The problem with enforcement is not the 'gentle touch," or the threat of serious "knowledge offence" penalties; the problem is identifying false information occurrences.

[16] NZ GST §§ 5(27)(c)(i) & (ii).

[17] NZ TAX ADMINISTRATION ACT §143A(g):

> in relation to a recipient of a supply of remote services from a non-resident supplier, and for the purposes of avoiding the payment of goods and services tax, knowingly provides altered, false, or misleading information relating to their residence in New Zealand or their status as a registered person.

[18] New Zealand Inland Revenue, *Policy and Strategy, Special Report: GST on Cross-border Supplies of Remote Services* (May, 2016) at 30, *available at*: https://taxpolicy.ird.govt.nz/sites/default/files/2016-sr-gst-cross-border-supplies.pdf

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These papers have considered intentional misrepresentations of residence and status. The proposal is to adopt Fiji's VAT Monitoring System (VMS), and through it develop a scannable database that will point to misrepresentation incidents. The VMS uses a system of fiscal invoices, which works well for domestic transactions, and which needs to be complimented with a robust, cross-border information exchange in the case of complex international transactions. This information exchange is a challenge that New Zealand cannot meet on its own.

Two examples can be drawn from earlier materials illustrating status misrepresentation and residence misrepresentation. The first, a status misrepresentation borrows from figure 1 (above) involves dependent domestic agents (see figure 3 below). The second, a residence misrepresentation borrows from figure 7 in part 3, and involves the downstream frauds spawned by electronic marketplaces (see figure 4 below).

Status misrepresentation. Figure 1 (above) illustrated a dependent domestic agent which secured six clients for its foreign principal. For example, a UK property and casualty insurance company can be offering accident coverage for business and personal automobiles. Figure 1 assumes that a §60(1AB) agreement is entered into for two individual consumers (#1 and #2) and two business purchasers (businesses A and B). The agreement makes the dependent agent responsible for issuing invoices, collecting, and remitting the GST "as if" it was making the taxable supply to these buyers. The UK Insurance Company remains responsible for invoicing consumer #3 (which is subject to the 15% GST) and company C (which is either not subject to GST under §8(4D) or taxable at a zero-rate under §11A(1)(x)).

If we further assume that consumer #3 (falsely) represents himself as a registered business to the UK Insurance Company, the invoice he receives will likely be zero-rated (erroneously). How would the IRD know? Consumer #3 is unlikely to volunteer this information, and the remoteness of the UK Insurance Company makes it unlikely that it would be able to identify the error.

Figure 3 (below) modifies figure 1 to diagram the basic dynamics of VMS adoption: the presence of a Tax Core in the tax authority, the transmission of transaction data to the Tax Core, and the return of the fiscal invoice to the taxpayer.

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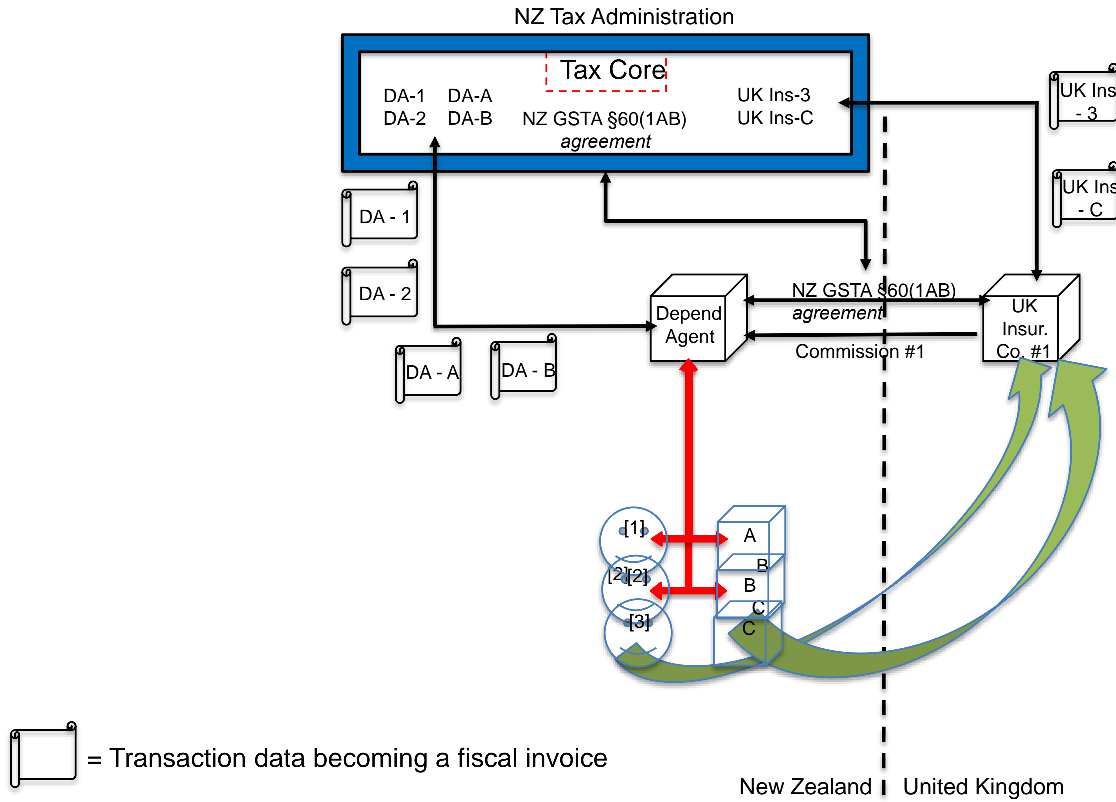
Figure 3: (Replicating & Supplementing Figure 1 above) Dependent Agent & Tax Core with a §60(1AB) *agreement*



The simple mandate of the VMS is that every invoice issued to a resident consumer must be fiscalized. This would go a long way in helping the tax authority identify misrepresentations. Under the Fiji rules, transaction data is first sent to the tax authority, it is checked and verified by the Secure Element in the Tax Core, signed and returned to the supplier (with a QR code). This data, along with the QR code will become the fiscal receipt given to the buyer.

Because the Tax Core now has a digital copy of the invoice issued to the customer who supplied false information, along with every other invoice issued by the UK principal to local residents (as well as invoices issued through the Dependent Agent), the tax authority can risk analyze all the New Zealand insurance contracts for consistency. If New Zealand adopted the VMS it would most likely requiring the §60(1AB) agreement to be transmitted to the Tax Core, where it would be associated with all relevant invoices. A remote audit of the UK Insurance company could be conducted. All the invoices and the §60(1AB) agreement would be in hand.

If the Commissioner sought to penalize consumer #3 for his misrepresentation she might start with an automated message appraising the consumer (as well as the New Zealand agent and UK principal) that a correction was in order. This could be done in real-time with a high-quality AI program.

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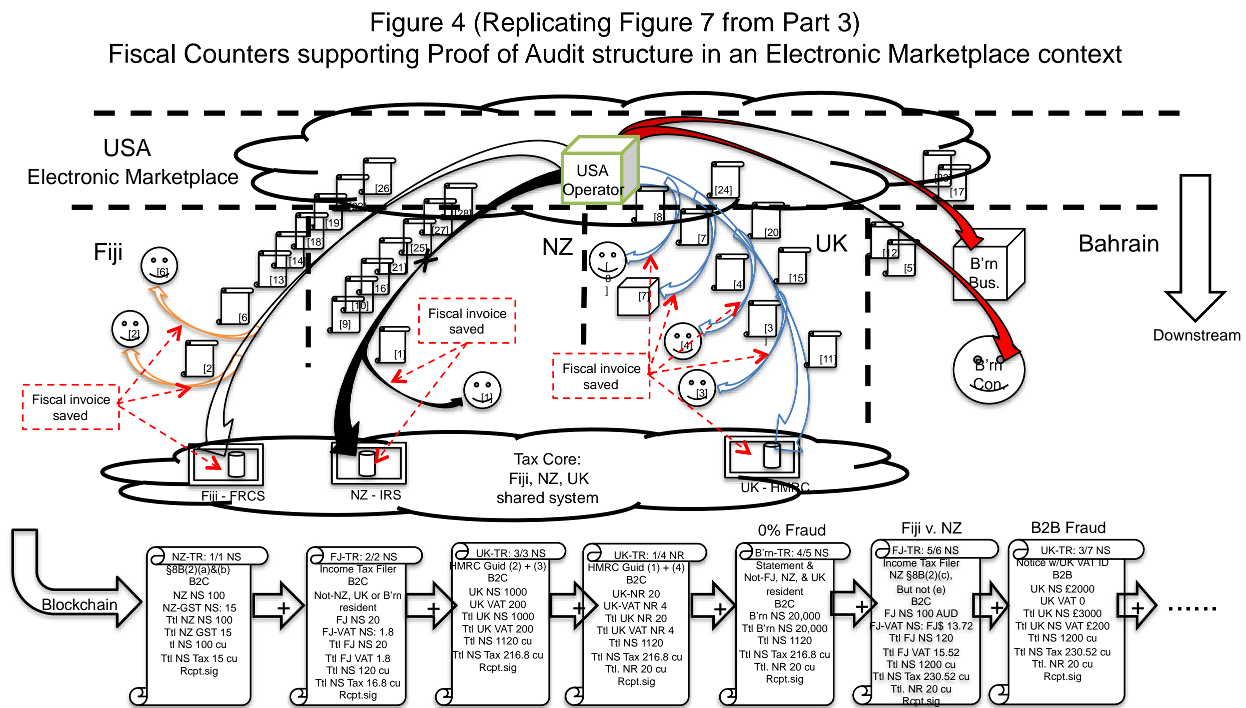
Residence misrepresentation. Figure 7 in part 3 contained two examples of residence misrepresentation. In the first, a UK resident represents himself as a Bahraini, who is not subject VAT in Bahrain, and by doing so avoids a 20% UK VAT on a remote service purchase. In the second, an individual from New Zealand, represents himself as a resident of Fiji, thereby avoiding a 15% GST, although incurring a 9% VAT instead.

Figure 7 is drafted under the assumption that there is a fully functional international system of fiscal invoices modeled on the Fiji VMS, and that the fiscal data gathered on the invoices is shared. In addition, it is also assumed that a macro set of data counters (agreed to among the countries and coordinated by the common Tax Core) are reflected on each of the fiscal invoices. These counters are separate and apart from the counters used within each jurisdiction that would form mini-blockchains of data from each POS. Figure 3 replicates the figure 7 diagram from part 3:

Figure 4 (Replicating Figure 7 from Part 3)
Fiscal Counters supporting Proof of Audit structure in an Electronic Marketplace context



Because Fiji, New Zealand and the United Kingdom share a common cloud-based Tax Core, and because each jurisdiction sends to the cloud the encrypted fiscal invoices generated by the electronic marketplace, the counters produce a meta-blockchain reflective of the activity of the electronic marketplace in Fiji, the UK and New Zealand. Two residence manipulations, one on the sixth invoice and the other on the fifth highlight how false information is easier to detect with the VMS.

It is anticipated that because audits of residence determination are ultimately an audit of the global tax determination programming of the electronic marketplace, that these audits will be best conducted jointly by the impacted jurisdictions. The blockchained meta-data of the joint Tax Core will form the basis of the audit.

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The sixth invoice records a sale to a New Zealand consumer, but the tax algorithm deployed by the electronic marketplace determines a residence in Fiji. The individual's home is in New Zealand, but his purchases obscure this fact. This makes the error seem intentional, and the customer pays 9% VAT rather than 15% GST. Fiji's VAT residence rules are reasonably easy to coopt if someone files a personal income tax return there, and this consumer does.[19] Further investigation reveals that there seems to be a deliberate effort to confuse the tax determination algorithm. The consumer uses an Australian cell phone, and makes purchases with Australian credit cards issued by Fiji branches of Australian banks. This particular supply is purchased from an Australian underlying supplier with a price denominated in Australian dollars.

The electronic marketplace may not be entirely to blame for the mistake here, but with a real-time exchange of invoice data among New Zealand, Fiji and the UK, the IRD has access to the residence determination on the sixth invoice. With fiscal invoices that are shared among the tax authorities, this manipulation could be uncovered. Without it, discovery would be nearly impossible.

The fifth invoice, where a UK resident represents himself as Bahraini would most likely come under scrutiny because of the size of the purchase (20,000 Bahraini Dinars). Because Bahrain is not part of the common Tax Core this invoice would not be subject to fiscalization, and would not be automatically shared among the Fiji, UK and New Zealand tax authorities. However, the tax determining algorithm in the electronic marketplace would retain digital traces of the data presented by the consumer and the decision process applied by the AI. Because the electronic marketplace is deemed to be the taxpayer, and because it has substantial activity in Fiji, UK and New Zealand it would have to respond to audit inquiries about the fifth invoice.

False information can easily disrupt algorithm-based electronic marketplaces. It is difficult for any single jurisdiction to locate these deliberate frauds, largely because the data needed to do so is either in the non-resident electronic marketplace, or with the customer. What the VMS does is preserve a verifiable copy of each invoice generated by the Tax Core in a common cloud as well as the systems of the resident jurisdiction. In most cases this will be sufficient for an audit, but in extreme cases an inquiry may need to be made of the electronic marketplace's programming itself.

DOMESTIC DUAL STATUS TAXPAYERS

[19] Fiji VATA Decree 1991, §2:

Resident means resident as defined in Section 2 of the Income Tax Act 1974;

Laws of Fiji, Chapter 201, Income Tax Act, §2:

Resident" means-

(a) a person, other than a company, who resides in Fiji, and includes a person-

(i) whose *domicile* is in Fiji, unless the Commissioner is satisfied that his permanent place of abode is outside Fiji;

(ii) who has *actually been in Fiji*, continuously or intermittently, during *more than one-half of the income year*, unless the Commissioner is satisfied that his usual place of abode is outside Fiji and that he does not intend to take up residence in Fiji. (emphasis added)

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The final Netflix Tax provisions considered in these papers concern residents who have a dual tax status – that is, the New Zealand resident purchasing remotely supplied services can properly represent themselves to the seller as a business or as a consumer. If the initial purchase is made as a business, but is later transitioned (in part or in whole) to personal use the self-supply (reverse charge) rules come into play.

There is some considerable amount of complexity here as both the reverse charge rules and the Netflix Tax were major statutory responses to technological advances, and the use of the internet as a medium for making supplies. In both cases, cross-border services were the problem. The reverse charge rules took effect in 2005, and the Netflix Tax in 2016.

But there is more. Because the reverse charge rules tended to consider events as transactionally-static, rather than dynamic, New Zealand followed the reverse charge rules with provisions that dealt with *change of use*, effective April 1, 2011.[20] The change of use rules deal with post-purchase decisions by a resident to actually use a supply in a different manner than what was apparent at the time of acquisition. For example, a business purchase of software that over time is dedicated to personal use.

Thus, to get a full picture of this area it is necessary to consider a range of often overlapping provisions: (a) reverse charge rules, (b) change of use provisions, and (c) the Netflix Tax. In outline form the range of tax outcomes are:

- If a New Zealand resident buyer says nothing about his tax status to a remote supplier of services, the statute requires the seller to treat the buyer as a consumer.[21] Saying "nothing" does inject some factual ambiguity into the acquisition. The statute resolves this ambiguity against the domestic purchaser (initially). In this case, the main Netflix Tax rule of §8(3)(c) applies. It requires GST to be imposed at 15%, and requires the seller to collect, report, and remit it. Assuming, of course, that the services are not physically performed outside of New Zealand.[22]
- However, if the New Zealand resident buyer indicates that it is a business, then pre-Netflix Tax rules would have considered these remote services to be supplied outside of New Zealand.[23] The non-resident supplier would not be required to collect GST. A reverse charge by the resident buyer was applicable. Three conditions needed to be met:
    - services were supplied by a non-resident to a resident; and
    - the percentage of *actual or expected use* of the services (for the purpose of carrying out the taxable activity of the buyer) would be less than 95%; and

[20] Part of the difficulty with the change of use rules is that they consider the use in terms of a wasting asset, and allow related input tax credit claims over time, and not immediately upon change of use. Under pre-April 1, 2011 rules a customer would claim all relevant input tax in the GST return period that covered the change date. The design is to "...apportion input tax deductions in line with the actual use of the goods and services." New Zealand Inland Revenue announcement, *GST Adjustments from 1 April, 2011,* available at https://www.classic.ird.govt.nz/gst/additional-calcs/change-adjust/change-adjust-index.html
[21] NZ GST §8B(5).
[22] NZ GST §11A(1)(j) zero-rates services physically performed outside of New Zealand that are also not remote services supplied to a New Zealand person who is not a registered taxpayer.
[23] NZ GST §8(2).

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- the supply would be a taxable supply if made by a New Zealand registered person in the course of their business.[24]

This rule introduces several ambiguous elements into the current statute: (a) the dual standards of *actual or expected* use, measuring (b) whether or not 95% business use was achieved, and (c) the complication of what to do if the buyer did not meet the 95% threshold.

- Even if the above conditions were met, the supplier could still *unilaterally* elect to treat the supply as one that was made in New Zealand.[25] If the supplier did so, GST would apply. The supplier would be required to register (if sales exceeded the NZ$60,000 registration threshold). However, the applicable rate would be 0%.[26] GST would be remitted by the buyer under the reverse charge mechanism.[27] Input tax deductions would be allowed.[28]

NZ GST §8(4B) imposes a reverse charge when supplies are treated as supplied *inside* New Zealand (not if they were considered supplied *outside* of New Zealand). This limitation on the reverse charge presented problems for remotely supplied services under §8(3)(c) when (under the general rule) those services were deemed to be supplied outside of New Zealand.

To solve this problem NZ GST §20(4D) was added to the Netflix Tax rules. This section modifies another new rule that prohibits input tax deductions, §20(4C), for §8(3)(c) remote services unless the recipient has a tax invoice issued under §24(5B), dealing with transactions where GST was incorrectly applied. §20(4D) allows any recipient of remote services who is required to remit output tax through a reverse charge to claim an input tax deduction to the extent the services are used for making taxable supplies.

Consider Figure 5 (below). A New Zealand sole proprietor orders a software package from a UK remote supplier. Given the nature of the software, the order could be for business use, or it could just as easily be for personal use. The buyer declares that the supply is to carry on the business. As a result, the UK supplier does not collect GST, and does not issue a New Zealand tax invoice. The UK VAT is fully refunded to the supplier.

This result is fully consistent with pre-Netflix Tax results under §8(4), but it is achieved for §8(3)(c) transactions through §8(4D). In addition, because the supply is (a) deemed not to be made in New Zealand, and (b) at acquisition (or after an adjustment period) the percentage of intended use or the percentage of actual use of the services *for taxable purposes* was less than

[24] NZ GST §8(4B)
[25] NZ GST §8(4D).
[26] NZ GST §11A(1)(x). The zero rate returned no revenue to the government, but did allow the non-resident supplier to file a return and secure GST refunds for New Zealand input tax paid.
[27] NZ GST §8(4B). For a discussion of this statutory change (compared with the reverse charge provision in Fiji) see, Richard T. Ainsworth, *Data First – Tax Next: How Fiji's Technology Can Improve New Zealand's "Netflix Tax," (Part 1),* 94 TAX NOTES INTERNATIONAL 159, 169 - 171 (April 8, 2019). See also Policy Advice Division of the Inland Revenue Department, *GST Guidelines for Recipients of Imported Services* (October 2004) *available at*: https://taxpolicy.ird.govt.nz/sites/default/files/2004-other-gst-guidelines-imported-services.pdf
[28] NZ GST §20(4D) is a new section that avoids the prohibition on input tax deductions by recipients of remote services if the resident is required to return an output tax under the reverse charge provisions. NZ GST §20(4C). An input tax deduction is allowed to the extent to which the services are used in making taxable supplies.

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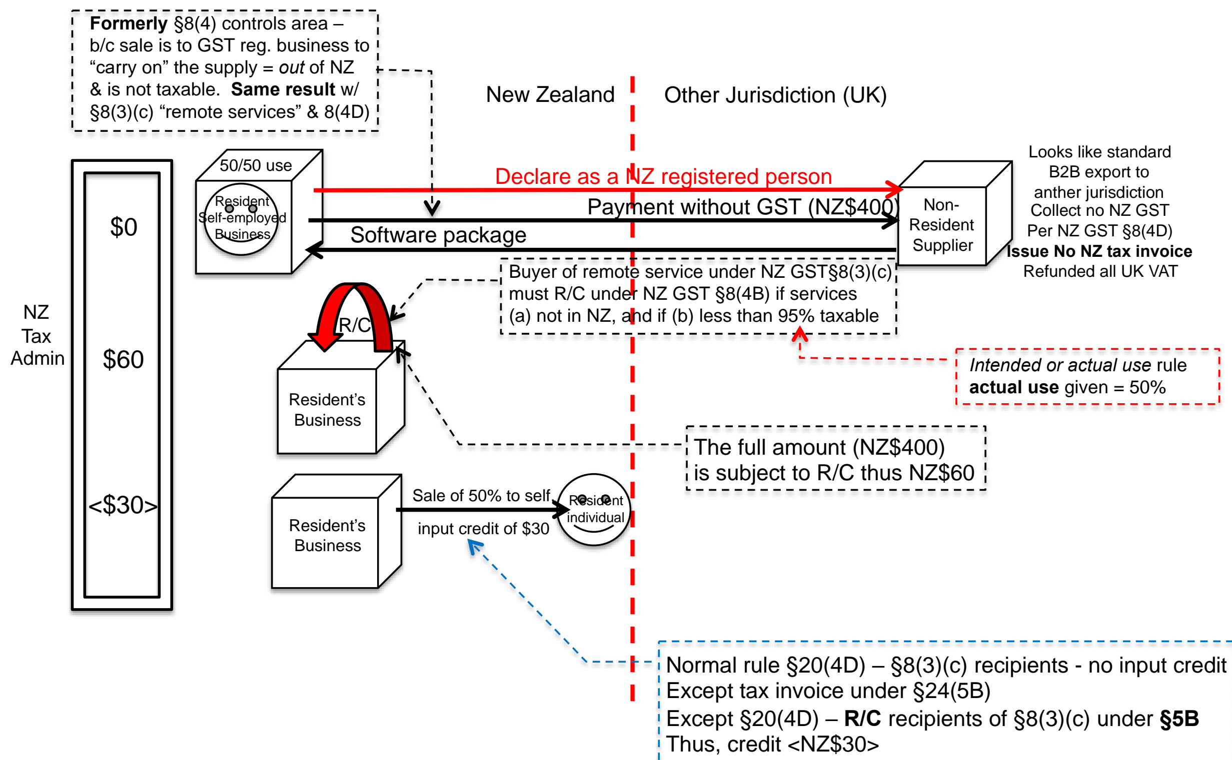
95%, a reverse charge is required. That is, the resident buyer is treated as making the full supply to itself, and thereby returns an output tax of $60 (15% x $400 = $60). Then, after an adjustment period, if it is determined that the New Zealand proprietor actually used the software package for personal purposes for about 50% of the time, and for the other 50% of the time used it for purposes of carrying on the registered business, a deemed sale is necessary. Thus, a second step is required. The resident (as a business consumer) will be deemed to sell 50% of the remote services to himself (as an individual consumer). This sale will produce an input tax deduction of $30 (15% x $200 = $30).

Figure 5:
Reverse Charge – buyer's statement – I am "GST Registered & using services for taxable supplies"



Although these transactions will most likely be offset against one another on a single return, they should be separately analyzed as a $0, $60, and <$30> GST remittance/ refund. The net position is $30.

If there is a problem with Figure 5 it is that the fact pattern is exceedingly difficult to audit. The IRD is not forewarned that a particular New Zealand resident is engaged in a remote service transaction, or that a particular UK supplier is significantly engaged in making remote sales of services into the New Zealand marketplace. The UK supplier collects no GST, files no returns, and remit no revenue. The IRD could initiate one-by-one domestic audits of purchasers, but nothing in the New Zealand GST extends enforcement authority overseas, and that is where the data is that the IRD really needs in order to effectively audits these offshore transactions.

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Figure 6 (below) presents essentially the same fact pattern and tax outcome, but it is structured around a different set of provisions in the New Zealand law. New Zealand recognizes that many remote suppliers pay GST when making domestic supplies, and are unable to deduct these amounts because they are not making taxable supplies. NZ GST§8(4D) changes this by providing remote suppliers an option, exercised unilaterally, to treat sales (like those in Figure 6) as domestic supplies that would be zero-rated under §11A(1)(x). Importantly, the "sticker price" on the remote supply would not change between Figure 5 and 6, just the ability to claim credit for taxes paid.

Figure 6 largely follows Figure 5. A UK remote service supplier sells a software package to a New Zealand resident sole proprietor. The price is the same, NZ$400, and the software can easily be used for business or personal consumption. The supplier is told that the buyer is a registered New Zealand business, but rather than completing the transaction "as is" where the supply will be deemed to be performed outside of New Zealand, the supplier elects under §8(4D) to treat the remotely supplied service as a supply made in New Zealand. The service will be zero-rated under §11A(1)(x).

This purchase is not subject to the reverse charge rules under §8(4B), because those provisions only apply to transactions deemed to be made outside of New Zealand. However, as in Figure 5, the New Zealand resident business owner splits the use of the software 50/50 between onward business sales and personal consumption. As a result, the Netflix Tax provision §20(3JC) applies. It requires the resident buyer to return the same output tax ($30) as in Figure 5. The output tax is imposed directly on the nominal GST component in any non-taxable use of the services. In this case the non-taxable use is at 50% ($60 x 50% = $30). §20(3JC), like §8(4D) in Figure 5, is applied contingently as the taxable use must be less than 95% of all use.

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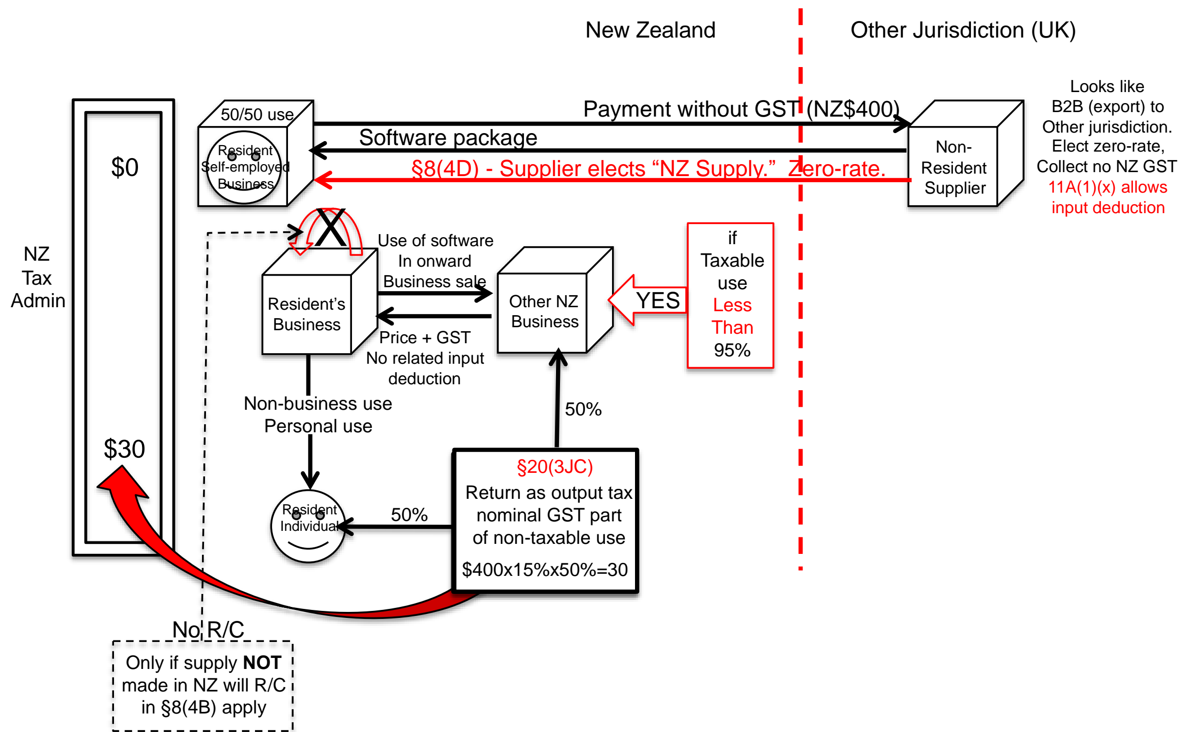
Figure 6:
No Reverse Charge – Supplier Elects "NZ supply"



The important difference between Figures 5 and 6 is not the net GST remitted (that amount is the same in both examples), it is the leverage that the IRD has over non-resident supplier data in Figure 6 that it does not have in Figure 5. In Figure 6 the remote supplier issues tax invoices, and submits GST returns. He elects to do so because he wants the ability to file New Zealand returns claiming GST credits. There is critical audit data in these filings (most notably in the tax invoices). These filings aggregate remote service supply chains. They detail who is purchasing, and who is providing services to New Zealand customers. There is nothing comparable in Figure 5.

The fundamental difficulty here is that in New Zealand the Figure 6 scenario is voluntary. The data the IRD gets is only from *some* of the many non-resident suppliers of remote services selling into the New Zealand market. There is a very good chance that revenue shortfalls do not lie among the *volunteers*.

To effective supervise this market segment (and by extension to effectively oversee all GST compliance in a modern economy), New Zealand needs to adopt technology, like that in Fiji, which will allow comprehensive transactional oversight. Use of secure technological invoice interfaces (a) with the government and (b) among taxpayers should be mandatory. It is not expensive. It is not complicated. But it must be comprehensive. No more data will be sent and compiled than what is expected to be provided on a tax return, or between an arm's length

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buyer and seller. But the data must be available in real-time, not in one or three month delayed-time. Tax-time needs to be real-time.

Throughout these papers it has been very apparent that a number of Netflix Tax provisions (not the least of which are those dealing with electronic marketplaces) have been drafted to deal with the compliance problems that are created when a residence-based system tries to deal with remote, internet-savvy, global supply chains seeking to exploit the New Zealand market. Often the GST is the profit margin for fraudsters. It is difficult to enforce compliance when a residence-based consumption tax intersects with non-resident, digital suppliers. Statutory designs endeavoring to do so can become exceedingly complex and counterintuitive.

New Zealand has not ventured deeply into the kinds of technology-based compliance measures that would resolve these problems. It would benefit from doing so. New Zealand needs to consider using code (computer code) to regulate in the same manner that Fiji does. One final example brings home the technology point being made.

Figure 7 (below) extends Figures 5 and 6 by hypothesizing a simple compliance error. Figure 7 is borrowed in whole cloth from Example 3 in the IRD's *Policy and Strategy, Special Report: GST on Cross-border Supplies. of Remote Services* (May, 2016).[29]

This is not tax fraud. It is a compliance error that the Netflix Tax drafters expect will be somewhat common, given the number of remedial provisions that are used to deal with it. It is the kind of error that frustrates taxpayers and absorbs enforcement resources that are better allocated elsewhere.

In Figure 7 the remote service supplier (UK) sells a software package to a New Zealand resident sole proprietor (just as before). The software can be used either for business or personal consumption, and this buyer uses the software in both capacities. The supplier is told that the buyer is a registered New Zealand business (although we suspect that the seller has not heard what the buyer has told him).

A simple (invoice-based) mistake is made. We are not told why the mistake was made. Perhaps the mistake is made because this transaction occurs very fast, and is entirely online? Then again, perhaps it is the sellers automated point of sale (POS) system, and its invoice generating app that makes the mistake (and does it repeatedly)? Perhaps the POS system is not fully up to date with New Zealand's invoicing conventions? We do not know, but in this environment, it is likely the error is technology driven.

The *Special Report's* Example 3 does not specify how common the IRD feels this kind of double taxation will be. The only reference is the following: "*... there may be instances* when a GST-registered recipient applies the reverse charge and the non-resident supplier also inadvertently charges the GST-registered recipient GST." (emphasis added)[30]

[29] *Supra* note 18 at 8.
[30] *Id.*, at 15.

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With a little imagination we might say there could be many instances. Scenarios are not difficult to imagine. The error-dynamics are the result of Netflix Tax provisions that link taxpayer status to *non-actions* during sales transactions. Not performing, not receiving, or not recognizing the performance of a required action is what triggers the double tax.

A supplier will tax (tax #1) if it is *not notified* of the buyer's business status, and a buyer will tax (tax #2) if it is *not notified* that the supplier has already taxed. This is a formula for tax-disaster.

- *Supplier's tax.* The most common event where a non-resident supplier of remote services is expected to collect and remit GST is on a sale to a New Zealand (resident) final consumer. This is the main Netflix Tax rule at §8(3)(c).
    - *Non-action.* A non-resident remote service supplier is required to treat their services as supplied to a final consumer (who is not GST registered) unless the recipient notifies the supplier that it is a registered business, §8B(5). Non-notification attracts the GST.
- *Buyer's tax.* The most common event where a buyer is expected to perform a reverse charge (impose the GST on itself), is when a sale is made to a registered business. In a business-to-business supply, the non-resident supplier is required not to tax, §8(4D), and the business buyer is required to reverse charge §8(4B).
    - *Non-action.* Effectively, a resident buyer receives notice that it must perform a reverse charge when it does *not* receive an invoice that states that a 15% GST has been imposed. This is the standard result in a business-to-business supply of remote services, because the service is deemed to be supplied outside of New Zealand.[31]
- Figures 5, 6, and 7 are intentionally designed to create the possibility of a double tax event. The buyer is expressly identified as a proprietorship where the same purchase can and is used in a personal and in a business capacity.

Thus, if a seller taxes, but does not announce the taxation event to a business-buyer who does not immediately check behind the invoice to see if GST was actually applied, double taxation is likely under the Netflix Tax. The standard vehicle for communication between buyers and sellers is the invoice. The line item we are looking for recites the GST. This is a standard requirement on a tax invoice. However, §24(5)(b) makes it clear that non-resident suppliers of remote services are not required to issue a tax invoice.[32]

This is a formula for disaster. It makes good sense to have these rules if you know that a particular buyer can only be a consumer, but it is not so good if consumer status is a fall-back position for buyers who fail to provide adequate notice of business status, §8B(5).

[31] A buyer is also notified that it needs to perform a reverse charge when it receives an invoice indicating that the seller has elected to treat the sale as occurring within New Zealand and has imposed a zero-rate on the invoice, §11A(1)(x).

[32] §24(5)(b) states:

> Notwithstanding any other provision of this Act, a supplier is not required to provide a tax invoice if— ... (b) the supplier is a non-resident supplier of remote services to which section 8(3)(c) applies.

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In Figure 7 (below) the invoice issued by the non-resident supplier is for NZ$400. This is not a tax invoice, nor does it have to be. It does not mention GST, but the 15% GST is included in the price. The true cost of the software is $347.83. The GST is $52.17. ($347.83 + $52.17 = $400). The unanswered questions are:

- Why did this happen? Somehow, the non-resident supplier was not adequately informed that the buyer was a registered business. Thus, it (properly) treated the sale as a consumer sale.
- Why was the notification insufficient? Notification procedures are not standardized within the global non-resident remote service provider community. If notification was sent, it was not treated as adequate. The reasons for inadequacy are possibly endless, and may have to do with the systems in place. In a market segment entirely comprised of non-resident remote service providers, this is very likely a technological issue. If it is a technological issue that goes undetected and uncorrected the double tax goes on forever tilting the playing field against remote service providers.
- Why wasn't the error spotted by the buyer? Buyer-notification is invoice-based, and the non-resident seller is not required to issue a tax invoice. To identify the GST embedded in the price the buyer would have to analyze data not necessarily broken out on the invoice. This is an unlikely occurrence in a fast-paced internet-based market.
- Is there a fraud permutation (not just a mistake) in this fact pattern? Yes. This scenario is a common GST/VAT fraud. If the non-resident supplier does not file a return, does not remit the GST collected, and becomes a missing trader, fraud would be very difficult to uncover on audit. It would only be apparent to the IRD after many resident businesses attempt to secure a refund of the double tax, and someone in the IRD identifies the error pattern. Most likely, the attempt to collect from the non-resident supplier will be defeated by his early "disappearance" from the internet.

Getting the tax right after a New Zealand double tax event is a multi-step procedure. In the diagram below, the box on the left records the six transactions with the Treasury that are needed to resolve the problem. The first two entries occur immediately (they are the double tax event), the next four occur after the buyer recognizes that he has paid GST twice on the same transaction.

- The first record is for $52.17. This is the amount of GST embedded in the invoice the buyer received from the seller. The base amount (the true cost of the services) is $347.83. The GST calculation is $347.83 x 15% = $52.17.
- The second record is for $60. This is the GST calculated by the buyer through its reverse charge. Because the buyer mistakes $400 for the true price, $347.83, the reverse charge calculation is $400 x 15% = $60. This amount is not only wrong, it is too high.
- The third record is for <$7.83>. This is an adjustment allowed by §25AA(3)(a). It is a correction for an incorrect calculation of input tax related to the reverse charge where the wrong tax base was used ($400 instead of $347.83).
- The fourth record is for <$52.17>. The Netflix Tax requires that buyer make a direct request of the seller to get the GST back, §20(4C). In instances where the invoice is less than $1,000 sellers are allowed to make the adjustment by issuing a corrected invoice. This special rule is applied in Figure 7 (§24(4)).

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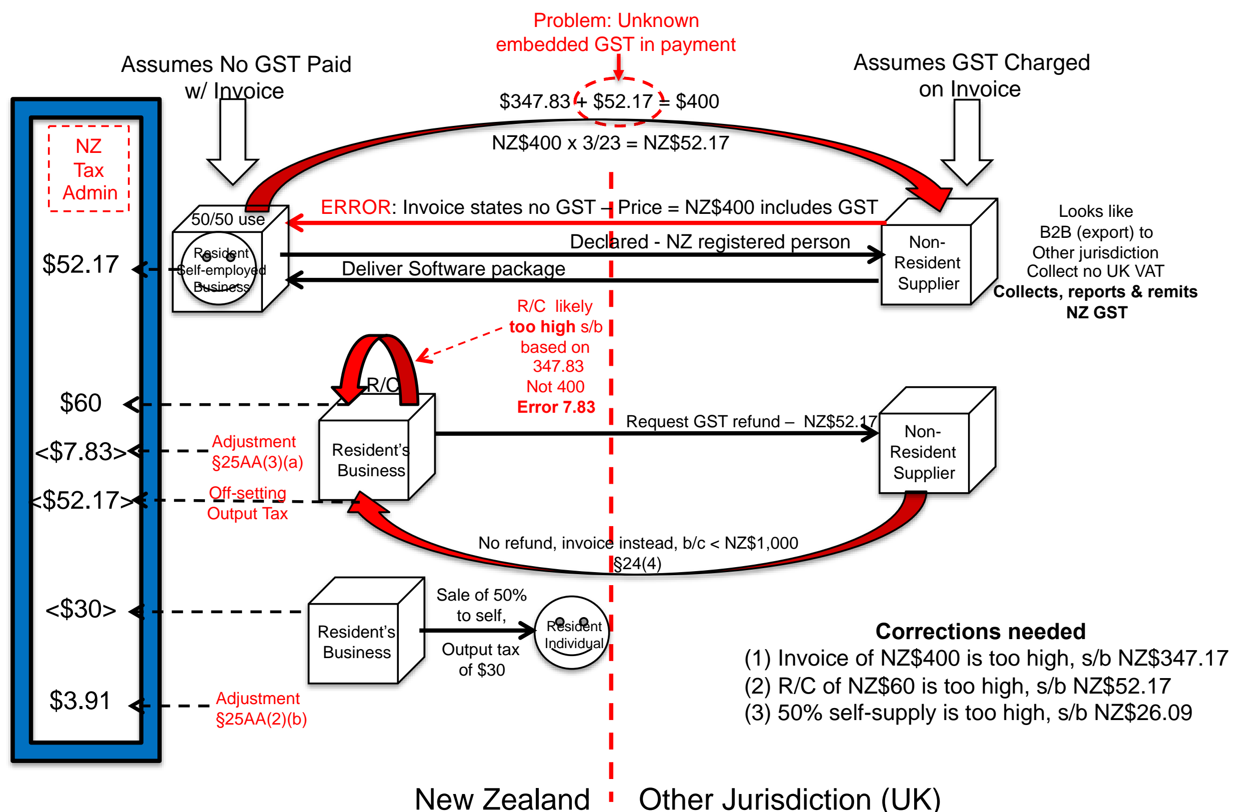
- The fifth record is for <$30>. This is the GST input calculation accounting for the 50% personal (consumer) use of the software. This calculation is in error, because it is relying on the same $400 base price and the $60 GST reverse charge.
- The sixth record is for $3.91. This is an adjustment allowed by §25AA(2)(b). It is a correction for an incorrect calculation of output tax related to the re-sale of the software from business to personal use. It is a companion provision to the adjustment in the third record, but the adjustment is going in a different direction and relies on a different statutory provision.

Figure 7:
Reverse Charge; Double Tax & Less than NZ$1,000 Invoice
(a) Error charging GST; (b) dual business/ personal use; (c) error correction with invoice b/c < NZ$1,000



FIJI'S TECHNOLOGY SOLUTION: THE VAT MONITORING SYSTEM (VMS)

Throughout these papers New Zealand's traditional statute and regulation approach to the problem of non-resident remote service suppliers has been contrasted with the technology intensive reform model developed in Fiji, the VMS. New Zealand's residence-based GST has visible difficulties trying to regulate this market segment with the standard approaches to tax reform. New Zealand works well with the data that it has from residential sources, but it simply does not have what it needs to do the job, and what it does have is not available in real-time. In some instances, reasonably complex rules have been crafted to secure more information. But it

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is clear that something more, something different, something slightly more radical, and very real-time is needed to come to grips with managing compliance with technology-facilitated sales.

In the immediately prior example, how much easier would it be for buyer, seller, and the IRD if a simple rule required that all sales into New Zealand (in order to be enforceable at law)[33] needed to be accompanied by a fiscal invoice that would itemize the purchased supplies, prices charged, and GST amounts due on each transaction. The rule would be self-enforcing. No buyer would buy without receiving a fiscal invoice; no seller should want to sell without one. Everyone would know that transaction data was sent to the IRD in real-time where it was checked for completeness and accuracy in the Secure Element, and then signed by the IRD in the Tax Core before being returned to the seller with a scannable QR code. The QR Code would be required to be printed on the fiscal invoice. Through the QR code anyone could pull up the details of the transaction.

In the instance of Figure 7, the buyer would simply scan the QR code on his invoice to determine if the GST had been imposed by the seller. If the buyer did not check the QR code and attempted to perform a reverse charge (in error) the transaction data sent to the IRD would be returned with a notification that the buyer should check the original invoice, as it appeared that the GST had already been paid. Thus, a single QR Code on a fiscal invoice would eliminate the need for five "corrective" transactions. There would be no need for a reverse charge, or any of the adjustments that followed from the initial error of Figure 7.

The best outcome would be if a single QR Core on one transaction would be sufficient to prompt a seller to re-evaluate its notification system, and make changes so the its automated system would do a better job picking-up notices that it was selling to New Zealand businesses.

If there is a benign fault in Figure 7, its here. Automated errors are difficult to root out, particularly if those errors are in non-resident system. Rather than emphasizing penalties for false information in §5(27), the IRD might re-focus on technology-based penalties. For example, if the IRD determined, through an IA-based examination of fiscal receipts, that the source of multiple double-tax events (like that in Example 7) was likely an off-shore programming error, several automated warning could be followed with financial penalties, leading up to blocking the seller from the New Zealand internet.

If New Zealand hopes to effectively regulate remote service suppliers, it needs the real-time data that Fiji's VMS provides. This is a technology-intensive GST area, and it needs to be met with code-based (computer-code-based) regulation. Fiji shows not only that this works, but that it costs far less that any traditional (gum-shoe-based) enforcement measure.

[33] In Brazil the *digital invoice* has been used for securing internal data for cross-border supplies among the twenty-seven Brazilian states since 2006. It is part of the Brazilian tax modernization program called the *Sistema Publico de Escrituracao Digital* or Public System for Digital Accounting (SPED). Newton Oller de Mello, Eduardo Mario Dias, Caio Fernando Fontana & Marcelo Alves Fernandez, *The Implementation of the Electronic Tax Documents in Brazil as a Tool to Fight Tax Evasion,* PROCEEDINGS OF THE 13TH WORLD SCIENTIFIC AND ENGINEERING ACADEMY AND SOCIETY (WSEAS) INTERNATIONAL CONFERENCE ON SYSTEMS (2009) 449, 453, *available at*: http://dl.acm.org/citation.cfm?id=1627575&picked=prox

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