

Implications of the modern global economy for the taxation of MNE's

1. Views are sought on the extent to which another country not exercising its right to tax should be a matter of concern to Australia.

Double tax agreements need to do exactly what their title suggests and remove the incidence of double tax, however, they should not act as a shield to produce double non tax arrangements. This may be one simple change that can be implemented to the international tax treaty framework because, as the reference document points out, having a tax treaty with a country that chooses not to tax a particular income amount is like having a treaty with a tax haven country.

We have a tax system that relies on residency or some other physical presence such as the existence of a permanent establishment to enable the collection of tax. However, we are increasingly seeing goods and services provided over the internet by entities that have no physical presence in Australia. I found the French concept of taxing companies with a virtual presence somewhat appealing – a presence above a certain turnover threshold perhaps. The question might be how you actually collect tax from these types of entities. Maybe some form of licensing system needs to be set up where only entities that comply with their tax obligations can legitimately trade in Australia. This might work for business to business transactions but, for services at least, it would be difficult to police when dealing direct with consumers.

The great advantage that MNE's have in the current environment is the ability to split up different aspects of their business structure and locate each of these in the most advantageous places. The finance arm can be located in one country, the entity that owns the royalty in another, production is done in a low cost location, design is done somewhere else and on it goes. Breaking up the business in this way makes it very difficult to apply transfer pricing rules because all of these different components are potentially subject to individual costing arrangements that are difficult to attack. The "double Irish Dutch sandwich" arrangement is an example of where a MNE can produce almost a zero tax outcome by locating different components of its business in the most advantageous locations. Breaking up the various aspects of the business like this also enables firms to obtain protection from double tax agreements (DTA's) when it suits them but also to circumvent them when they choose to have a component of their business in a non treaty country such as a tax haven.

What was interesting in the example applied to the Google advertising business was that the actual work was carried out in Ireland but the profit was shifted to a Dutch entity under the guise of a Royalty. Effectively, the Australian company was charged for advertising that was supplied by an Irish company and then the Irish company was, in turn, charged a royalty fee for the use of the name Google, which reduced their profit to zero (or maybe a small profit). If it is the royalty/intangible that is the biggest earning asset for entities like Google, Starbucks, Apple, etc, then perhaps there needs to be a tax withheld by an Australian firm for any payments for advertising, or other similar costs, on the basis that the majority of the cost incurred by the actual provider

is in the form of a royalty/intangible. It should be possible to use a look through approach and draw the conclusion that the real cost to the Australian entity for the provision of advertising is in the nature of a royalty, so WHT needs to apply. This type of system would require MNE's to provide greater disclosure in order for some effective tax arrangement to be able to work. Maybe it is possible for a WHT rate to be negotiated internationally with MNE's and every country would apply that percentage whenever a payment is made to a MNE. This would be a system that would involve consultation and cooperation. This would also involve a new concept applying to the taxation of intangibles - a system that shifts the taxing right from the country of the entity that owns the intangible to every country that an MNE operates in. I believe most MNE's are willing to contribute something; they are just driven by their shareholders to pay nothing if it is possible.

- 2. Views are sought on whether there is evidence of Base Erosion and Profit Shifting in Australia. Where it is considered that insufficient data exists to reach a definitive conclusion on the extent and nature of the problem in Australia, comments are sought on how to identify and/or develop such data — including the benefits and costs of requiring companies to provide more detailed information to the ATO.**

The secrecy laws make it difficult to assess how much of the tax base is being eroded by these types of arrangements. However, what is known for certain is the fact that all MNE's are adopting these structures – they have to in order to remain competitive. The other issue is that the behaviour of MNE's drives the behaviour of those entities below them, and so on. So, once this situation is in the public domain, you risk damaging the confidence in the overall system if you do not do anything about it. It is well known that the willingness of the ordinary man in the street to comply is influenced by their perception of how compliant the large taxpayers are.

- 3. Views are sought on whether the key pressure areas identified by the OECD represent the main priorities for action in the short term. If so, what should be the shape of measures to address these pressure areas. If not, what areas should be the focus of action?**

It would seem that a comprehensive approach is required internationally to be able to manage this situation. Australia is too small to be able to force change on MNE's. Much of the legislation is likely to be ineffective as well because MNE's will find new ways around most things. The international rules that govern tax treaties are going to need to be revisited. These tax treaties are able to be used by taxpayers to hide behind when it suits them, allowing them to achieve a double non tax treaty. Changing a multitude of tax treaties world-wide is not going to be an easy task but it may be possible to insert anti-avoidance measures into existing treaties. I still think that any model to change the taxing situation will need to be negotiated with the MNE's themselves, but this assumes that countries can agree on a universal solution to this problem, which is a big ask.