

The digital economy and Australia's corporate tax system

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Consultation Process

Closing date for submissions: 30 November 2018

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The principles outlined in this paper have not received Government approval and are not law. As a consequence, this paper is merely a guide as to how principles might operate.

1. Digitalisation of the economy

1.1 What is the digitalised economy?

Digitalisation has had and will continue to have a significant economic and societal impact on all Australians. Australians can now connect to the internet through a range of 'smart' devices that are transforming our everyday lives. Australians shop from the comfort of their living rooms, work from home, find employment opportunities online, purchase transport services (both public and private), access news and media content from almost any country, and engage with people all over the world through social media and messaging apps.

The reach of the internet and its integration into Australian lives is clear from the following statistics.

- Australians are adopting digital sources of news and information – in 2017, Google sent more than 2 billion visits to Australian news websites, and in 2015 nearly 17 million Australians did a Google search at least once a month.¹
- Australians have a significant social media presence – approximately 17 million Australians use Facebook, 15 million Australians access YouTube, 8 million Australians use Instagram and 5 million Australians use Twitter.²
- Australians are embracing digital communication – 6.5 million Australians use Facebook Messenger, 2.2 million Australians use WhatsApp, and 1.6 million Australians use Skype.³
- Australians are also embracing digital services – there are over 8 million Australians using LinkedIn,⁴ 9.8 million Australians using Netflix,⁵ and 3.7 million Uber trips were taken over a three-month period in 2017.⁶

Digitalisation has also transformed the way Australians do business. More than 95 per cent of businesses have internet access and 80 per cent of businesses with over 200 employees have a social media presence.⁷ The reach of digital technology into everyday life is profound. According to CISCO, the global internet community consisted of 3 billion users in 2015, with 16.3 billion devices

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1. Google Australia 2018, *Submission of Google Australia Pty Ltd to the ACCC Digital Platforms Inquiry*, 20 April, <https://www.accc.gov.au/system/files/Google%20%28April%202018%29.pdf>, p 1; Roy Morgan 2016, 'Australians spent 552 million hours Googling in 2015', press release, 5 April, <http://www.roymorgan.com/findings/6743-google-dominates-bing-and-yahoo-as-top-australian-search-website-december-2015-201604050438>.
 2. Roy Morgan 2018, 'Facebook Watch set to leverage off 17mn user base', press release, 31 August, <https://www.roymorgan.com/findings/7719-faceboook-watch-june-2018-201808310758>.
 3. Roy Morgan 2017, 'More Australians are using mobile data for talk, text and chat—especially people born overseas', press release, 5 April, <http://www.roymorgan.com/findings/7203-usage-of-voip-apps-whatsapp-skype-viber-messenger-australia-december-2016-201704050917>.
 4. M Stainkaph 2016, 'Over 8 million Australians now use LinkedIn: Are you making the most of the platform for professionals?', *smartcompany.com.au*, 10 June, <https://www.smartcompany.com.au/marketing/social-media/over-8-million-australians-now-use-linkedin-are-you-making-the-most-of-the-platform-for-professionals>.
 5. Roy Morgan 2018, 'Netflix set to surge beyond 10 million users', press release, 3 August, <http://www.roymorgan.com/findings/7681-netflix-stan-foxtel-fetch-youtube-amazon-pay-tv-june-2018-201808020452>.
 6. Roy Morgan 2017, 'Uber soars and well-placed to tackle rising competition', press release, 16 December, <http://www.roymorgan.com/findings/7444-uber-growth-last-two-years-2015-2017-september-2017-201712150309>.
 7. Australian Bureau of Statistics 2018, *Summary of IT Use and Innovation in Australian Business, 2016-17*, 'Table 1: Business Use of Information Technology, selected indicators, by employment size, by industry - 2016-17', data cube: Excel spreadsheet, cat. no. 8166.0, <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8166.0>.

connected to the internet globally.⁸ CISCO expects these figures to increase to 4.1 billion users and 26.3 billion devices by 2020.⁹

In examining the evolution of digitalisation and the digital economy, the OECD has identified three factors common to highly digitalised business models.¹⁰

- **Cross-jurisdictional scale without mass:** Digitalisation has allowed businesses in many sectors to locate various stages of their production processes in different countries and access customers around the globe. Digitalisation also allows some highly digitalised enterprises to play a significant economic role in a country without any, or only limited, physical presence.
- **Reliance on intangible assets:** Digitalised businesses are often characterised by investment in intangible assets, including brand names, patented inventions, trade secrets and algorithms.
- **Data, user participation and network effects:** Data, user participation, network effects and user-generated content are commonly observed in the business models of more highly digitalised businesses. Search engines and social media businesses rely heavily on gathering data about users' preferences in order to sell highly targeted advertising services to businesses. Network effects occur when the usefulness of a service grows exponentially with the number of users.

While these factors often occur in highly digitalised business models, they are not unique to them.

- Cross-jurisdictional scale without mass exists for a range of sectors, including those that rely only on digital business models to a limited extent. Importers of vehicles, for example, can have significant economic scale in Australia without having a major physical presence, as the retail component of supplying these products to Australian consumers is relatively minor compared to the production process.
- Many businesses that were not traditionally highly digitalised, such as those that supply pharmaceuticals, also rely heavily on intangible assets such as patents.
- Data, user participation and network effects are not unique aspects of highly digitalised businesses. For example, sporting and cultural activities rely on user participation and network effects (mostly at a lesser scale).

Although these features exist in both digitalised businesses and traditional economy businesses, synergies between user participation and intellectual property may be more prevalent among digitalised businesses than traditional businesses.¹¹

1.2 Impact of digitalisation on the economy

The effects of globalisation and digitalisation are significant for an open economy like Australia.¹²

Digitalised businesses provide enormous benefits to Australia. Australians rely on them in their everyday lives, to communicate with each other, for entertainment, to learn, to conduct research and to buy goods and services. The benefits of the digital economy rival those of earlier key

8. Cisco 2016, 'Cisco Visual Networking Index Predicts Near-Tripling of IP Traffic by 2020', press release, 7 June, <https://newsroom.cisco.com/press-release-content?type=press-release&articleId=1771211>.

9. Cisco 2016, 'Cisco Visual Networking Index Predicts Near-Tripling of IP Traffic by 2020', press release, 7 June, <https://newsroom.cisco.com/press-release-content?type=press-release&articleId=1771211>.

10. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris ('*Tax Challenges Arising from Digitalisation – Interim Report 2018*'), para 32.

11. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 131.

12. See, for example, K Henry 2009, 'A tax system for Australia in the global economy', speech, 23 February, Sydney, <http://taxreview.treasury.gov.au/content/content.aspx?doc=html/speeches/02.htm>.

innovations, like the printing press, electricity, mass production and antibiotics. It has been estimated that GDP per person in Australia is close to \$5,000 higher due to the digital economy.¹³

Digitalisation has been driving and will continue to drive welfare-enhancing changes in the Australian economy, and has the potential to enhance choice, competition, innovation and productivity.

- **Choice and convenience:** Digitalisation has given Australians new ways of accessing goods and services, allowing them to choose the method most convenient to them. Digitalisation and globalisation have also expanded the range of goods and services that consumers and businesses can access. In the recent past the range of goods and services available was often limited to those that local businesses chose to stock. Consumers and businesses can now buy goods or services from anywhere in the world, allowing them to choose from a wider range of goods and services that may better meet their needs.
- **Competition:** Digital disruption has led to increased competition in certain Australian markets, benefitting consumers particularly where incumbents had previously used market power to charge high prices, or to provide consumers with poor quality service.
- **Innovation:** Digitalisation can encourage innovation in many ways. Social media is an innovation that has greatly reduced the cost of communication between and among consumers and businesses. Ride sharing has reduced the cost and arguably improved the quality of short-term, short-distance transportation. Competition from innovative digital businesses can encourage innovation in others, particularly in those sectors with high barriers to entry. Competition from digital means of payment has prompted banks to improve the quality of their services, driving the introduction of almost instantaneous transfers and contactless card payments.
- **Productivity:** Digitalisation has allowed consumers and businesses to do more with less. Thirty years ago, sending a message to 100 friends or customers would have involved many hours' work and a significant payment for delivery of the message. Social media allows the same message to be delivered instantaneously and almost for free. Digital books and music are other examples of digitalisation reducing the cost of goods and services.

Digitalisation has enabled and enhanced the trend towards globalisation by dramatically reducing the cost of interacting with others from a distance. Individuals and businesses can now easily cross national borders when communicating and transacting. For some highly digitalised services (for example, audio or visual entertainment) the costs of supplying additional consumers is close to zero.

The process of digitalisation is in its relatively early stages. While some sectors such as advertising, retail, media and transport have been disrupted by digital innovation over the past few years, significant scope remains for further efficiency and quality improvements across other industries. Knowledge intensive industries are the most digitalised so far, while asset intensive industries have generally been slower to adopt digital technologies.¹⁴

Existing digital businesses have generally relied on broadband internet, computers and smartphones as the basis for their activities. However, technology is continually evolving and future changes might involve technologies that are currently emerging, such as blockchain, cryptocurrencies, augmented and virtual reality, 3D printing, artificial intelligence and machine learning.

13. Deloitte Access Economics 2017, *Australia's digital pulse: policy priorities to fuel Australia's digital workforce boom*, p 10.

14. S Blackburn, M Freeland and D Gärtner 2017, *Digital Australia: Seizing opportunities from the Fourth Industrial Revolution*, McKinsey & Company, Australia, p 19.

The continually changing and unpredictable nature of digitalisation will have implications for the tax system. While this paper focuses on the implications of digitalisation for corporate taxation, the Government is also considering the broader implications of digitalisation for the Australian economy,¹⁵ for jobs and employment,¹⁶ and from a competition,¹⁷ cyber security,¹⁸ consumer data rights,¹⁹ and tax administration perspective.²⁰

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15. Australian Government Department of Industry, Innovation and Science, *Digital Economy Strategy*, <https://consult.industry.gov.au/portfolio-policy-and-innovation-strategy/the-digital-economy>. See also Productivity Commission 2016, 'Digital Disruption: What do governments need to do?', Productivity Commission research paper, June, Canberra.
 16. S Hajkowicz, A Reeson, L Rudd, A Bratanova, L Hodggers, C Mason and N Boughen 2016, *Tomorrow's Digitally Enabled Workforce: Megatrends and scenarios for jobs and employment in Australia over the coming twenty years*, CSIRO, Brisbane.
 17. Australian Consumer and Competition Commission, *Digital platforms inquiry*, <https://www.accc.gov.au/about-us/inquiries/digital-platforms-inquiry>.
 18. Australian Government Department of the Prime Minister and Cabinet, *Australia's Cyber Security Strategy*, <https://cybersecuritystrategy.pmc.gov.au>.
 19. Australian Government the Treasury, *Consumer Data Right*, <https://treasury.gov.au/consumer-data-right>.
 20. Australian Taxation Office 2018, 'Tax Administration in a Digital Age: The Australian experience', speech, 5 April, Sydney, <https://www.ato.gov.au/Media-centre/Speeches/Other/Tax-Administration-in-a-Digital-Age--The-Australian-experience>.

2. The corporate tax framework

2.1 Overview of the Australian corporate tax system

When is a company subject to Australian corporate income tax?

In a globalised economy it is necessary to have rules that determine whether income earned by a company should be subject to tax in Australia or overseas.

Australia's corporate tax system relies on fundamental concepts of source (of income) and residence (of a taxpayer) to determine which activities (and income) are subject to tax in Australia. This approach is typical of nearly all developed countries.

Broadly, businesses that are tax residents of Australia will pay income tax on profits that are sourced in Australia. Profits will generally be sourced in Australia where they are attributable to income-generating labour, capital or assets located in Australia. These businesses may also be subject to income tax on passive income earned overseas (including passive income earned by foreign companies that they control), with a credit provided for foreign tax paid.

Income from business activities undertaken offshore is typically exempt from tax in Australia (as it would be expected to be taxed in another jurisdiction). This design feature ensures that Australian businesses that operate offshore can compete on a level playing field with foreign businesses.

A company is generally an Australian tax resident where it:²¹

- is incorporated in Australia (e.g. an Australian subsidiary of a large multinational enterprise); or
- has its central management and control in Australia, or its voting power is controlled by shareholders who are residents of Australia.

A non-resident business that has an Australian permanent establishment (PE) will typically be subject to Australian tax on its Australian-sourced income, but is not taxable in Australia on income derived from its foreign business activities or foreign-sourced passive income.

A non-resident business will generally have an Australian PE where its business activities in Australia are significant enough to constitute a local fixed place of business.²²

This framework is supplemented by Australia's withholding tax regime, under which Australia imposes tax on outbound payments of royalties, interest and dividends sourced from Australian operations.

Conceptual summary of Australia's corporate tax framework*

	Australian-sourced business income	Australian-sourced passive income	Foreign-sourced passive income	Foreign-sourced business income
Resident	Taxable in Australia	Taxable in Australia	Taxable in Australia (with a credit for foreign tax paid)	Taxable overseas
Non-resident	Taxable in Australia	Taxable overseas (Withholding tax may apply)	Taxable overseas	Taxable overseas

* Subject to applicable domestic laws and tax treaties

21. See, *Income Tax Assessment Act 1936* (Cth), section 6(1).

22. 'Permanent establishment' is a defined term in each of Australia's 44 bilateral tax treaties. See, OECD 2017, *Model Tax Convention on Income and on Capital*, November, Article 5, for a more detailed explanation of when an entity will have a permanent establishment.

How corporate income tax rules apply to multinational enterprises

Typically, a multinational enterprise undertakes business in a number of jurisdictions. Not only does it sell its products all over the world, but it will have complex global supply chains, with assets, labour and staff located in different countries, performing different functions to produce a single product. The international tax system recognises and allocates profits according to the different locations of profit-generating assets, labour and capital.

As discussed above, Australian resident businesses will generally be taxable on Australian-sourced business income and passive income from both Australian and foreign sources. In the case of Australian PEs operated by foreign businesses, a set of complex rules exists to determine the amount of profit to be attributed to the PE and therefore subject to tax in Australia. These rules allocate income and expenses according to the location of labour, assets, capital and legal and commercial risks that generate the income.

Individual entities within a multinational group commonly enter into related party transactions. For example, an Australian subsidiary may purchase goods or services from its foreign parent and on-sell them into the Australian market.

Australia's transfer pricing rules require those transactions to be priced according to the terms and conditions that would have been agreed between parties operating on an independent arm's length basis.²³ As a result, profits from the Australian activities (e.g. the sales function) are taxed in Australia, and profits from the offshore activities (e.g. manufacture of the goods) are taxed offshore.

Australia complements its transfer pricing rules with various tax integrity rules, including thin capitalisation and controlled foreign company rules, the Multinational Anti-Avoidance Law and the Diverted Profits Tax.

Why do we tax multinational enterprises like this?

Australia's approach to taxing residents and non-residents aligns with the current international tax framework, which is designed to minimise distortion of investment decisions made by foreign and domestic investors.

Although Australia taxes its residents on their worldwide income, Australia's domestic and treaty-based rules operate to relieve double taxation.²⁴ In particular, where a treaty allows Australia and another country to tax the same income in the hands of the same taxpayer, the treaty will require the taxpayer's country of residence to relieve any double taxation.

This approach provides a coordinated global framework for sharing corporate income taxing rights between countries and reducing the incidence of double taxation.

The role of consumption taxes

Consumption taxes complement corporate income taxes as they provide Australia with taxing rights over the value added component of the price of goods and services that may not be otherwise

23. Australia's transfer pricing rules are consistent with the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, which provide an agreed international best practice on the pricing of related party transactions for tax purposes. These rules seek to align taxation of profits from related party transactions with the location of value-creating assets and activities, to prevent excessive profit shifting. Relevant activities could include people functions (e.g. staff), marketing and development, research and development and support services.

24. For example, Australia's controlled foreign company regime seeks to tax only passive income earned by controlled foreign companies, and rules exist to exempt from tax certain foreign branch income (see *Income Tax Assessment Act 1936* (Cth), section 23AH) and the returns on certain foreign investment (see *Income Tax Assessment Act 1997* (Cth), subdivision 768-A).

taxable here.²⁵ For countries with substantial consumption taxes the problems associated with allocating corporate income taxing rights between countries can be less significant for the overall revenue base.

2.2 Taxation of highly digitalised businesses in Australia

Highly digitalised businesses, like other businesses operating in Australia, are subject to the Australian tax framework. Their Australian-sourced profits will be subject to Australian income tax, and the goods and services consumed by Australians will generally be subject to the GST. However, many foreign-based, highly digitalised businesses have relatively small Australian-sourced profits because the majority of their profit-generating assets and labour are located outside of Australia.

The current international tax framework, which was developed in the 1920s, allocates taxing rights based on the location of physical assets, capital and labour, the source of income and the residence of taxpayers.²⁶ The developers of the framework could not have anticipated the extent to which business would become globalised and digitalised.

The rapid growth of the digitalised economy over recent years has provoked questions about whether there is a need to change the way that taxing rights over business profits are currently allocated between countries (as discussed in Chapter 4 below).

A common characteristic of most digital businesses is the ability to access a market via technological means without necessarily having a physical presence or a significant number of employees in that market.²⁷ Technological advances in telecommunications, improved internet infrastructure and changing social attitudes to the sharing economy have resulted in some digital businesses significantly increasing their international presence, often operating in countries where they have no physical presence. Increasingly, these digital businesses are providing the backbone for economic activity in what have traditionally been solely domestic markets, such as transport, accommodation, advertising and retail sales.

Digital businesses often rely heavily on highly mobile, intangible assets. These assets, such as algorithms, can be located anywhere in the world, and usually only require a network to be established for them to be accessed. As a result a digital business may have a significant economic presence in one jurisdiction, while the majority of its profit-generating assets and labour can be located in a different jurisdiction.²⁸ In this way, under the international tax framework and Australia's corporate income tax system, only a relatively small amount of the global profits of a highly digitalised multinational may be sourced in Australia.

A multinational enterprise's capacity to have a significant economic presence in Australia, but pay a small amount of tax here is not a new challenge.²⁹ For decades, foreign businesses in a range of sectors of the traditional economy have operated business models where the majority of profit-generating assets and labour have been located offshore.

However, increasing digitalisation and increasingly mobile intangible assets intensify this challenge, particularly in sectors of the economy most affected by digital disruption. Specific challenges include:

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- 25. Australia's Goods and Services Tax (GST) is levied at a rate of 10 per cent with a range of exemptions including fresh food; health services; education; water; sewerage and drainage services; and financial services.
 - 26. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 378.
 - 27. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 384.
 - 28. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 385.
 - 29. For example, in 1974 the United Nations noted that national attempts to raise corporate taxes 'can be negated by vertically or horizontally integrated multinational corporations through transfer pricing and the use of tax havens.' See United Nations 1974, *The Impact of Multinational Corporations on Development and on International Relations*, New York, <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N74/381/78/PDF/N7438178.pdf?OpenElement>, p 35.

- **Tax base erosion through disruption:** two of the major instances of digital disruption in Australia have involved ride sharing and accommodation services. Traditionally these services have been wholly domestic, with all of the profits taxed in Australia. More recently, new digital entrants with a reliance on offshore profit-generating assets have emerged. A static analysis could conclude that the new entrants' market share erodes Australia's corporate tax base, as profits are increasingly recognised as being generated in a foreign jurisdiction (as compared to when all profits were recognised as being Australian-sourced). Over time, digital disruption may enhance efficiency (for example, more efficient transport or accommodation services) and create new opportunities within the Australian economy, which could mitigate these concerns.
- **Emergence of multi-sided platforms and marketplaces:** the digital economy has seen the emergence of digital marketplaces that connect suppliers and consumers. However, a digital marketplace does not necessarily fit within one tax jurisdiction, as the supplier, consumer and marketplace may be located in different tax jurisdictions. In such cases it can be particularly challenging to determine the source of profits.
- **Ability to automate and monetise data and information:** some digital advertising businesses have developed the capacity to collect user data and instantaneously identify user preferences in order to deliver highly targeted advertising. Notwithstanding that the user data is sourced from Australia, the current tax framework does not recognise this data as a profit-generating input.

3. Integrity of the Australian tax system

3.1 The G20/OECD Base Erosion and Profit Shifting Project

The Government has been working in partnership with the OECD, and through the G20, to ensure multinational enterprises pay the right amount of tax in the countries in which they operate.

As G20 President in 2014, Australia was at the forefront of the global effort to deliver the first stage of the OECD's Action Plan to combat Base Erosion and Profit Shifting by multinational enterprises (the BEPS Project). The final OECD report recommendations released in October 2015, which were developed on the basis of the unprecedented cooperation of more than 60 countries over two years, provide a common framework for countries to address tax avoidance by multinational enterprises.

Over 115 countries have now joined the OECD's Inclusive Framework on BEPS, broadening the global adoption of the BEPS recommendations.

Purpose and aims of the BEPS Project

In 2013, the G20 and OECD launched the Action Plan on BEPS, an ambitious program seeking to develop a multilateral package of reforms addressing the following themes.

- **Coherence** (Action Items 2, 3, 4 and 5): ensuring coherence in international tax rules, that is, preventing companies from taking advantage of inconsistencies in domestic laws to pay less tax.
- **Substance** (Action Items 6, 7, 8, 9 and 10): ensuring that taxing rights better align with economic substance – e.g. preventing companies from routing payments through certain jurisdictions in which they have very little or no economic activity, purely for tax benefits.
- **Transparency** (Action Items 11, 12, 13 and 14): enhancing the transparency of the international tax system.

The BEPS Project focused on strengthening the existing underlying tax framework and a range of integrity measures were developed.³⁰ More broadly, the G20 and OECD sought to strengthen integrity through preventing the incidence of double non-taxation, and closer alignment of taxing rights with the economic location of value creation.

BEPS Project Action Item 1 focused on examining the tax challenges presented by increasing digitalisation and the capacity of businesses to have a significant market presence without being liable to taxation. However, neither Action Item 1, nor the BEPS Project more broadly, sought to change the underlying principles of the international tax framework. Nor was the BEPS Project intended to address broader challenges related to taxing value creation in the digital economy.

Australia's actions on the BEPS Project

Australia has long been a strong and active supporter of the BEPS Project and has been vigilant in implementing the BEPS recommendations. And, as dealt with in the next section, Australia has also gone further.

30. For example, Action Item 2 focused on designing rules to address multinational enterprises' (MNEs) capacity to exploit differences in the tax treatment of an entity or instrument by two or more countries to achieve double non-taxation; Action Item 3 focused on preventing MNEs from shifting profits to controlled subsidiaries in low-tax jurisdictions; Action Item 4 focused on limiting the opportunities for MNEs to claim excessive debt deductions; and Action Items 8 to 10 focused on closer alignment of transfer pricing outcomes with economic value creation.

Prior to the implementation of the BEPS recommendations, Australia had some of the strongest tax integrity rules in the world. Since 2015, Australia has implemented a number of the BEPS recommendations, further strengthening our tax laws to protect against profit shifting by multinational enterprises. Action taken has included ensuring our transfer pricing laws remain world's best practice, implementing full Country-by-Country reporting (CbCR), adopting a range of integrity rules through the Multilateral Instrument, and introducing new rules to prevent tax avoidance through hybrid mismatches.

Summary of Australia's actions on the BEPS Project

OECD BEPS Action Item	Australian action
<p>Action Item 1 Tax challenges of the digital economy: Addressing the challenges for governments in taxing the digital economy and the capacity of multinational enterprises (MNEs) to have a significant market presence without being liable to taxation.</p>	<p>Enacted legislation to extend the GST to:</p> <ul style="list-style-type: none"> digital products and services imported by Australian consumers from 1 July 2017; and low value goods imported by Australian consumers from 1 July 2018. <p>Legislation to extend the GST to offshore accommodation booking services was introduced into Parliament in September 2018, following an announcement in the 2018-19 Budget.</p>
<p>Action Item 2 Neutralise hybrid mismatches: Designing rules to address MNEs' capacity to exploit differences in the tax treatment of an entity or instrument by two or more countries to achieve double non-taxation.</p>	<p>Legislation will commence on 1 January 2019 to implement the OECD's hybrid mismatch rules to prevent MNEs from exploiting differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions.</p>
<p>Action Item 3 Controlled foreign company rules: Ensuring that MNEs cannot shift profits to controlled subsidiaries in low-tax jurisdictions.</p>	<p>Australia has very strong controlled foreign company rules that are consistent with the OECD's best practice recommendations.</p>
<p>Action Item 4 Limit interest deductions: Preventing MNEs from claiming excessive interest deductions.</p>	<p>Enacted legislation to significantly tighten the thin capitalisation rules by lowering the Safe Harbour Debt limit from 75 per cent to 60 per cent (in 2014).</p> <p>Legislation on improvements to the integrity of the thin capitalisation rules was introduced into Parliament in September 2018, following an announcement in the 2018-19 Budget.</p>
<p>Action Item 5 Counter harmful tax practices: Identifying and addressing harmful tax practices.</p>	<p>Actively engaging in the OECD's Forum on Harmful Tax Practices, which is seeking to eliminate harmful tax practices. Australia is compliant with the BEPS Action 5 transparency framework requirements, which relate to the exchange of information on tax rulings between national tax authorities.</p>
<p>Action Item 6 Prevention of treaty shopping: Ensuring that businesses cannot funnel money through different countries to access tax treaty benefits to reduce or eliminate their worldwide tax obligations.</p>	<p>The OECD's recommendations on Action Item 6 will be adopted in the negotiation of new and updated Australian tax treaties (2015-16 Budget). The 2015 Australia-Germany treaty was among the first treaties in the world to adopt these new rules.</p> <p>Implemented these rules across most of Australia's existing tax treaties by effect of the OECD Multilateral Instrument (MLI).</p>
<p>Action Item 7 Prevent artificial avoidance of permanent establishment status: Ensuring that businesses cannot avoid PE</p>	<p>Signed the MLI, which includes the BEPS Action 7 recommendations. Australia has adopted the majority of the new rules via the MLI and the Government will consider adopting additional rules in the context of future bilateral</p>

status through agency and other artificial arrangements.	treaty negotiations. Implemented the Multinational Anti-Avoidance Law, which took effect from 1 January 2016, to address certain corporate structures that artificially avoid PE status.
Action Items 8, 9 and 10 Transfer pricing and value creation: Addressing BEPS by better aligning value creation with economic location, with a particular focus on intangibles, risk recognition, and capital allocation.	Enacted the OECD's recommendations on Action Items 8-10 as part of Australia's transfer pricing laws, effective from 1 July 2016. Implemented the Diverted Profits Tax from 1 January 2017, to prevent MNEs from implementing schemes designed to artificially shift profits overseas to reduce their Australian tax.
Action Item 11 Methodologies to collect and analyse BEPS data: Aiming to develop indicators showing the scale and economic impact of BEPS	Continuing to work with the OECD on how to monitor and evaluate the effectiveness of the BEPS Project over time.
Action Item 12 Mandatory disclosure of aggressive tax planning: Focused on developing rules requiring mandatory reporting to tax administrators of aggressive or higher risk transactions.	The ATO has extensive powers to collect information to enforce Australia's tax laws. The Government is considering the outcomes of consultation to determine what further powers the ATO may need to detect arrangements designed to avoid tax.
Action Item 13 Transfer pricing documentation and Country-by-Country reporting: Developing multinational reporting rules to enhance transparency for tax administrations, helping them to assess transfer pricing risks for large businesses.	Implemented full CbCR from 1 January 2016 (requiring significant global entities to lodge a CbC Report, Master file and Local file). Ensured the exchange of CbC Reports by signing the CbC Multilateral Competent Authority Agreement. To date hundreds of files have been received and are being analysed by the ATO.
Action Item 14 Dispute resolution: Developing a new minimum standard and best practices for treaty dispute resolution to address obstacles preventing countries from solving treaty-related taxpayer disputes under Mutual Agreement Procedures (MAP).	Ensuring our existing treaty approach to dispute resolution and administration is consistent with the OECD recommendations. Australia is one of 28 countries that have signed up to mandatory arbitration in the MLI.
Action Item 15 Multilateral Instrument: Developing a multilateral instrument to enable countries to amend their bilateral tax treaties via a multilateral treaty, so as to ensure countries can address BEPS in a timely fashion.	Australia signed the MLI on 7 June 2017. To date, at least 84 jurisdictions have signed the MLI. Legislation to give the MLI the force of law in Australia (pending Australia's ratification of the MLI) was passed by Parliament in August 2018, and Australia ratified the MLI in September 2018.

3.2 Australia's actions beyond the BEPS Project

Beyond the BEPS measures, the Australian Government has taken further action to ensure the Commissioner of Taxation has all the powers necessary to combat multinational tax avoidance.

The Multinational Anti-Avoidance Law (MAAL) strengthens the integrity of Australia's PE rules.³¹ From 1 July 2017, the Diverted Profits Tax (DPT) introduced a new 40 per cent penalty tax rate to

31. This is consistent with the recommendations in BEPS Action Item 7. See OECD 2015, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

apply to multinational enterprises that avoid tax by diverting profits offshore. These measures apply to significant global entities (SGEs) with annual global income of \$1 billion or more.

- The **MAAL** prevents SGEs from structuring their affairs to avoid Australian tax by adopting an 'operate here, bill overseas' business model.³² As at 30 June 2018, 44 multinational entities have changed, or are in the processing of changing, their tax affairs to bring their Australian-sourced sales onshore in compliance with the MAAL. More than \$7 billion in sales annually is expected to be returned to the Australian tax base as a result of the MAAL.
- The **DPT** specifically targets arrangements SGEs enter into with a principal purpose of shifting profits overseas to avoid Australian tax.³³ The DPT aims to ensure that the tax paid by multinational enterprises reflects the economic substance of their activities in Australia and aims to prevent the diversion of profits offshore through arrangements involving related parties.
- The Government's **Tax Avoidance Taskforce** strengthens the ATO's capacity to identify and address tax avoidance by large corporates, multinationals and high wealth individuals. With the support of the Taskforce, since its inception in July 2016, the ATO has:
 - raised over \$10.5 billion in liabilities – around \$7 billion against large public groups and multinationals and \$3.5 billion against wealthy individuals and associated groups, including trusts and promoters; and
 - collected over \$6 billion cash – around \$4.1 billion in cash from large public groups and multinationals and over \$2 billion in cash from wealthy individuals and associated groups, including trusts and promoters.
- **The maximum penalties for tax avoidance schemes have been doubled** – from 1 July 2015, the maximum administrative penalties for SGEs that enter into tax avoidance and profit shifting schemes were doubled.
- **Administrative penalties for SGEs have been increased** – from 1 July 2017, the Government increased the maximum penalty for failure to lodge tax documents for SGEs to \$525,000, and doubled the penalties for making false or misleading statements to the ATO.

Due to our strong and comprehensive action, Australia continues to have some of the most robust tax integrity rules in the world.

32. S Morrison (Treasurer) 2016, 'Multinationals paying tax on Australian profits', media release, 9 December, <http://sjm.ministers.treasury.gov.au/media-release/137-2016/>.

33. S Morrison (Treasurer) 2017, 'Turnbull Government continues crackdown on multinational tax avoiders', media release, 9 February, <http://sjm.ministers.treasury.gov.au/media-release/009-2017/>; Australian Taxation Office 2018, *Diverted profits tax*, 19 February, <https://www.ato.gov.au/general/new-legislation/in-detail/direct-taxes/income-tax-for-businesses/diverted-profits-tax>.

4. International trends

4.1 Increasing international pressure

The rapid growth of the digitalised economy in recent years has prompted international debate about whether there is a need to change the way that taxing rights over business profits are allocated between countries under the existing international corporate tax framework.

The concern for some countries is that the current tax framework does not properly capture the value to digitalised businesses of the participation of users, the provision of personal data or user-created content. For countries with large numbers of users but few highly digitalised domestic businesses, there is an increasing prospect of tax revenues diminishing as foreign, highly digitalised businesses replace traditional business activities.

Some other countries see the challenges as being broader than the value to highly digitalised businesses of user participation.

The OECD is therefore examining the challenges posed to the international tax system by globalisation and digitalisation, with a view to developing options for changes to the existing source-based framework. But a multilateral solution is likely to be several years away and there is no guarantee that international consensus will ultimately emerge.

A number of countries are considering imposing a tax on the turnover of highly digitalised businesses as an interim response. Some countries are also considering expanding nexus rules in order to tax highly digitalised non-resident businesses that have a significant economic presence in their country.

The OECD's Interim Report on digitalisation

In 2017 a further mandate for the OECD's Task Force on the Digital Economy (TFDE) was agreed, including delivery of a final report on the tax challenges of the digital economy by 2020 and an interim report in 2018.³⁴

In March 2018 the OECD released its Interim Report, *Tax Challenges Arising from Digitalisation*. The Interim Report builds on the work of BEPS Action 1 (Addressing the tax challenges of the digital economy), exploring options from the 2015 BEPS Action 1 Report,³⁵ including equalisation levies.

The OECD Interim Report acknowledges that there is currently no consensus on whether the digitalisation of the economy presents a problem for the existing international tax framework, how to respond to any such problem, or a timeframe for action.³⁶ Countries' views diverge on whether there is a problem with the existing nexus rules (which determine when a country has taxing rights) or profit attribution rules (which determine how much of a business' profits can be taxed in that country). The OECD spectrum of views on these issues covers three groups.³⁷

- The first group of countries views the lack of recognition of user contribution to value creation as a shortcoming of the international tax system, but considers that it can be addressed through targeted changes to the existing tax framework.

34. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 23.

35. OECD 2015, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris ('*Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*'), Chapter 7.

36. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 372.

37. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, paras 388-394.

- A second group of countries considers that the nexus and profit attribution rules may no longer be adequate. These countries consider that the problems are not limited to the digital economy. Some, but not all, of these countries reject user contribution as a significant driver of value creation.
- A third group of countries considers that the BEPS Project has addressed concerns associated with double non-taxation (while acknowledging that the full implications cannot yet be assessed). Countries in this third group are generally satisfied with existing international tax rules.

There is, however, broad consensus amongst countries that maintaining the relevance and coherence of the international corporate tax framework is important, as fragmentation would lead to inefficiencies and tax-related distortion of international economic activity.³⁸

On this basis, countries have committed to a 'coherent and concurrent' review of the rules that underpin the allocation of taxing rights: the nexus rules and profit attribution rules.³⁹ In its Interim Report, the OECD describes 'a number of outstanding issues associated with or exacerbated by digitalisation that could undermine the sustainability of these long-standing rules'.⁴⁰ The 2020 Final Report will include the TFDE's recommendations for potential changes to those rules. The process of developing options for change to the existing international tax framework will involve complex international negotiations and cooperation, and reaching consensus will be difficult.

The OECD acknowledges that if consensus cannot be reached, or if there is significant delay in coordinated action, some countries may move to take action in the short term. However, the OECD also indicates that interim measures could have a negative impact on investment, innovation and welfare, result in double taxation in some cases and involve compliance costs. The Interim Report sets out a number of guiding principles and a range of considerations for the design of any interim measures (as discussed in Chapter 5 below).

Some of the design considerations for an interim measure set out in the Appendix, including the activities, nexus and thresholds that would trigger taxing rights, would also be relevant to longer-term reform, although a multilateral approach will mitigate many of the risks associated with interim measures.

Both the European Commission (the Commission) and the UK have released papers exploring long-term reform and interim measures. In March 2018 the Commission released two proposals for taxing digital activities in the European Union.⁴¹ The first Commission proposal is focused on longer-term reform to international tax rules to create and attribute profits to a new 'virtual PE'. The second involves an interim tax to apply until a comprehensive solution could be adopted.

In November 2017 the UK released a position paper on corporate tax and the digital economy,⁴² which it updated in March 2018.⁴³ The March paper reflects the UK Government's latest thinking, but does not set out its final position. The UK's preferred solution is 'reform of the international corporate tax framework to reflect the value of user participation'.⁴⁴ Recognising the difficulties of achieving OECD consensus, the UK Government is receptive to working with other countries to explore interim measures to increase the amount of UK tax paid by businesses that derive value from UK user participation, 'preferably implemented on a multilateral basis'.⁴⁵

38. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 396.

39. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, paras 397-398.

40. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 377.

41. European Commission 2018, 'Digital Taxation: Commission proposes new measures to ensure that all companies pay fair tax in the EU', press release, 21 March, Brussels, http://europa.eu/rapid/press-release_IP-18-2041_en.htm.

42. HM Treasury 2017, *Corporate tax and the digital economy: position paper*.

43. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*.

44. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, p 3.

45. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 4.6. See also para 4.1.

The UK has separately announced its intention to extend royalty withholding tax to transactions between two non-residents, a measure that it says will predominantly affect digital businesses.⁴⁶

4.2 Should taxing rights change to reflect user-created value?

Some countries are concerned that businesses can generate significant profits from the contribution of users, but have little or no physical presence in the country where those users are located. Highly digitalised businesses can derive value from user data or user-generated content without significant physical capital, paid labour or investment in the country where the user is located, with the result that current corporate tax laws may not allocate sufficient profits to that country.⁴⁷ Consequently some countries have called for user-created value to be recognised as a basis for allocating a taxing right to the country where these activities occur.

Highly digitalised businesses may benefit from user-created value in several ways:

- **User data:** data collected from consumers allows advertising to be targeted specifically to consumers that are likely to be interested in the advertised goods or services, thereby increasing the value of these advertising services to businesses;
- **User-generated content:** users contribute to digital economy businesses in a variety of ways, including, for example, providing reviews, ratings, photographs or live biographical updates. This content adds credibility and trust, and attracts additional users; and
- **Network effects:** as more users participate in a particular online platform, it becomes more attractive to businesses to participate (and vice versa), which can in turn see the platform attract more users or businesses.

Some businesses rely heavily on user-generated content (e.g. social media) or user data (e.g. search engines). Others (e.g. booking websites) may not rely as heavily on user data or content, but may generate network effects. For a third group of businesses, user participation plays some role, but it is not necessarily the most significant source of value (e.g. for an online marketplace business, the automated system for matching users may be more significant than user ratings).

The international discussion regarding user-created value may be linked to 'the idea that a country that provides the market where a foreign enterprise's goods and services are supplied on its own provides a sufficient link to create a nexus for tax purposes'.⁴⁸ However, some countries distinguish 'users' from 'customers', seeing users as a key part of the supply chain of a digital business. For example, the UK suggests that:

- whereas customers create demand for a product, users contribute to the offering of a business;
- customers have a transactional relationship with businesses, while users have a 'deep and interactive' relationship with certain highly digitalised businesses; and
- whereas customers' role in product improvement is limited and ancillary, network effects mean that users are central to the value of a business.⁴⁹

If user data or user contributions were to create taxing rights, significant work would need to be undertaken on how profits derived from user-created value would be allocated to a country, as there is presently no agreed mechanism to estimate the value of user data or user-generated content. The profits of businesses that derive value from user participation are the result of a range of inputs,

46. HM Treasury 2017, *Royalties Withholding Tax: Consultation document*, para 1.4.

47. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 386.

48. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 390.

49. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 2.29.

including intellectual property and the contribution of capital by the owners of the relevant businesses. Furthermore, newer digital business models that rely on artificial intelligence and machine learning may be less reliant on user participation, so the source of any problem may change quickly.⁵⁰

Discussion Question:

1. Is user participation appropriately recognised by the current international corporate tax system? If not, how should value created by users be quantified and how should it be taxed?

4.3 Should taxing rights change to reflect value associated with intangibles?

Some of the features that the OECD observed are common to highly digitalised businesses can also be observed in other businesses (as noted in section 1.1), including businesses that rely heavily on intangibles (e.g. patents, trademarks and brand names) and businesses that have 'scale without mass' (i.e. high sales volumes with a relatively small capital investment in a country). In this context, some commentators are advocating for reform that would apply more broadly, rather than only to highly digitalised businesses.

One alternative reform option that would extend beyond highly digitalised businesses and user-created value could involve a focus on intangibles. The taxation of intangibles presents challenges for the international tax system; for example, in applying the arm's length principle to value 'unique' intangibles. These difficulties, and the increasingly integrated nature of multinational enterprises, have led some commentators to suggest that profits of multinational entities should be allocated across countries based on a formula – so called 'formulary apportionment'.⁵¹

Replacement of the arm's length principle with formulary apportionment would be a fundamental change to the international tax system that some countries may be reluctant to adopt. A more limited change might be to view the country where consumers of a particular good or service are located as the 'source' country for returns to marketing intangibles (such as trademarks and brand names). This would provide a basis for allocating greater taxing rights over returns from marketing intangibles to the country where the relevant consumers are located.⁵²

Advocates for this option consider that the value of marketing intangibles is inherently linked to the market in which sales take place, potentially meaning that the market country is the 'source' of value for the marketing intangible. In addition, often the market country's laws protect the value of such intangibles.

Arguably, a change of this kind may be more compelling in relation to the value derived from marketing intangibles than value derived from patents or copyrights, as the value of patents and copyrights may be able to be more closely linked with the place where an invention was made or a work was created.

50. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 2.59.

51. See, for example, R Avi-Yonah, K Clausing and M Durst 2009, 'Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split', *Florida Tax Review* 9(5).

52. See M Herzfeld 2018, 'News Analysis: Digital Optimism', *Tax Analysts*, 16 July, pp 4-5.

Discussion Question:

2. Is the value of intangible assets including 'marketing intangibles' appropriately recognised by the current international corporate tax system? If not, how should value associated with intangibles be quantified and how should it be taxed?

4.4 Potential changes to existing profit attribution rules

International discussions regarding longer-term changes to the existing tax framework are focused on the question of whether existing profit attribution and nexus rules remain appropriate. Current rules focus on physical presence as an indicator of economic presence and the location of value creation. But businesses can operate in countries with only a digital presence (that facilitates the flow of data), as they may not require access to traditional physical assets such as offices or machinery, or rely on local labour. Highly digitalised businesses in particular can be heavily reliant on intangible assets (which can be located anywhere) and user participation (which is not recognised under existing tax rules).

Any change to the allocation of taxing rights under the corporate tax system would need to be implemented through changes to the agreed approach to attributing profits to entities (and countries) under the international tax framework.

For example, in its 2015 Action 1 Report the OECD pointed out that, where a business has a significant economic presence with little or no physical presence in terms of tangible assets or personnel, it would not be possible to allocate profits to that country under existing rules. For that reason, significant changes to those rules would be needed to make it possible to attribute profits to a virtual PE (that is, a 'significant economic presence' of the kind discussed in section 4.5 below).⁵³

The 2015 Report set out possible approaches to attributing profits to a virtual PE, including a deemed profit system.⁵⁴ This could involve, for example, determining 'deemed net income by applying a ratio of presumed expenses to the non-resident enterprise's revenue derived from transactions concluded with in-country customers'.⁵⁵ The ratio could be determined by reference to factors including the taxpayer's industry and the type of product or service provided. A simple mechanism would be to classify taxpayers by industry and apply an industry-specific profit percentage to determine deemed profits. A more refined approach would be to divide industries into bands based on other factors (including assets, turnover and employees) and apply different percentages to those bands. The OECD pointed out that challenges associated with such deemed profit methods include applying presumptive industry-specific profit percentages to large businesses that have several lines of business, comparing traditional and digital business models that have significantly different cost structures, and deeming businesses (or specific business lines) to be profitable when there are no profits generated through the virtual PE.

53. OECD 2015, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, Chapter 7.6.2.

54. OECD 2015, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, Chapter 7.6.2, paras 289-291.

55. OECD 2015, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, Chapter 7.6.2, para 290.

Examples

In its March 2018 position paper, the UK Government took the position that 'active user participation creates value for certain digital businesses, and that jurisdictions in which users are located should be entitled to tax a proportion of those businesses' profits'.⁵⁶

That raises the question of where profits attributable to user-created value are currently being realised and taxed. The UK Government's view is that it is most likely that the value highly digitalised businesses derive from user participation sits with companies in the corporate group that receive residual profits of the business (i.e. profits after an arm's length rate of return).⁵⁷ The UK position is that to reflect this value 'some reallocation of the profits currently recorded by these companies to user jurisdictions is justified'.⁵⁸

The UK outlined changes to the international tax framework that would be needed 'if user participation were to be recognised in the allocation of taxing rights and taxable profits between countries'. In summary, existing rules would need to be amended to:

- (a) recognise user participation as an important value driver for certain businesses
- (b) set out a method for determining that value
- (c) identify the companies within a business group that users should be linked to, and that should therefore be taxed on profits attributable to user created value as determined in the preceding step
- (d) give jurisdictions in which users are located the right to tax those companies, even if they are non-resident companies that do not have a permanent establishment under traditional definitions
- (e) set out a method for determining the proportion of those companies' user-created profits, as determined by Step B, that should be allocated to each user jurisdiction that has been awarded a taxing right under Step D'.⁵⁹

Given challenges associated with valuing user contribution,⁶⁰ the UK suggests it might be necessary 'to reward user-created value through a percentage share of the residual profit realised by principal companies in the group'.⁶¹ To do so, the UK suggests:

- awarding an arm's length return to companies undertaking activities for which comparable activities are available; and
- allocating a share of residual profits to user jurisdictions to recognise the value created through user participation.⁶²

Alternatively, some commentators have suggested 'applying arm's-length methods to allocate a routine return to tangible property, while allocating the residual profit to reflect the value of intangibles in excess of routine goodwill and going concern value'.⁶³ A broader range of businesses could be affected by that kind of change.

56. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 3.7.

57. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, paras 3.8-3.11.

58. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 3.14.

59. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 3.53.

60. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, paras 3.16-3.17.

61. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 3.18.

62. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 3.59.

63. See, for example, M Herzfeld 2018, 'News Analysis: Digital Optimism', *Tax Analysts*, 16 July, p 5, referring to P Oosterhuis and A Parsons, 'Destination-Based Income Taxation: Neither Principled Nor Practical?', *Tax Law Review* (forthcoming).

Under the European Commission's proposal for longer-term reform, a digital platform that supplies digital services would be deemed to have a taxable 'digital presence' – a virtual PE – in an EU Member State. Profits would be attributed to a virtual PE on the basis of its economically significant functions – namely its activities 'through a digital interface related to data and users'.⁶⁴ More specifically, 'activities undertaken by the enterprise through a digital interface related to data or users shall be considered economically significant activities of the significant digital presence which attribute risks and ownership of assets to such presence'.⁶⁵ Such activities include collection, processing and sale of user data, the collection, processing and display of user-generated content, the sale of online advertising space and making third-party created content available on an online marketplace.⁶⁶ The Commission points out that the value of the intangible assets of a social network, for example, is enhanced by enlarging the network of users and by processing user data to make advertising more targeted.

The Commission considers the profit splitting method most appropriate to attribute profits to a virtual PE. Factors for profit splitting could include the number of users in a Member State, the amount of data collected in a Member State, and research and development and marketing expenses.

A significant issue with unilateral action based on the Commission's virtual PE and profit allocation rules is the potential for double taxation. In the absence of tax relief granted by the home jurisdiction of highly digitalised businesses, tax would be payable twice on any profits allocated to a virtual PE, once on profit allocated to the PE and again in the home jurisdiction.

Discussion Questions:

3. Are the current profit attribution rules 'fit for purpose'? If not, how should profits be attributed?
4. What are your views on allocating taxing rights over residual profits associated with: (i) user contribution to 'user' countries, or (ii) 'marketing intangibles' to market countries?

4.5 Potential changes to existing nexus rules

Like the profit attribution rules, nexus rules rely on physical presence of people or property connected with the Australian business. Business models that are less dependent on the physical presence of people and property to create value arguably present a challenge in relation to the ongoing relevance of these rules.

As a result, while changes to profit attribution rules are a necessary step to reallocating taxing rights, they would need to be accompanied by changes to nexus rules to ensure that international tax rules provide for a taxable presence where it is considered that significant profit should be taxed in a particular country.

The 2015 Action 1 Report analysed options that countries could consider, including the introduction of rules that would confer taxing rights over digitalised businesses that have a 'significant economic presence', but lack a physical presence, in a country.⁶⁷ However, there was no consensus on the changes to the PE threshold proposed in the Action 1 Report. Furthermore, any changes to nexus

64. European Commission 2018, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, 21 March, Brussels, p 9.

65. European Commission 2018, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, 21 March, Brussels, Article 5(3).

66. European Commission 2018, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, 21 March, Brussels, Article 5(5).

67. OECD 2015, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, Chapter 7.6.1.

rules to create taxing rights over highly digitalised businesses with a significant economic presence would need to be consistent with tax treaties.⁶⁸

Since the release of the 2015 Action 1 Report, there has been a very low uptake of broader changes to nexus rules, with the notable exceptions being the Slovak Republic and India.⁶⁹

From 1 January 2018, the Slovak Republic expanded its domestic law threshold for a PE, by extending the definition of a 'fixed place' of business to cover regular intermediation of transport or accommodation services within the Slovak Republic through a digital platform. These reforms created a new definition of digital platform: a hardware or software platform required to create and administer applications.⁷⁰

India proposes to expand, from 1 April 2019, the circumstances in which a non-resident enterprise is subject to tax in India by introducing a 'significant economic presence' (SEP) concept. Non-resident enterprises that exceed a (yet to be determined) threshold level of local revenue or number of local users will be deemed to have a taxable presence in India. Profits are expected to be attributed to the SEP entity based on transactions or users connected to it, but the OECD notes the legislation does not suggest any modifications to standard profit allocation rules, or clarify how profits will be attributed to an SEP associated with little or no physical presence.⁷¹

The UK and the European Commission have also recently considered changes to nexus rules.

The UK suggests in its March 2018 paper that user jurisdictions should tax profit attributable to users either by taxing companies in the corporate group – termed 'principal companies' – that receive the residual profits of the business, or by taxing companies with which users have some connection, such as a company that a user enters into a contract for digital advertising with.⁷² The UK suggests that a threshold higher than just the presence of users would need to be set to limit taxing rights of user jurisdictions. That permanent establishment threshold 'could be based on a combination of metrics including number of active users and the revenues that the business is generating from those users'.⁷³

The Commission's proposed 'significant digital presence' would be an extension of the existing PE concept.⁷⁴ A digital platform would have a virtual PE if (i) it had €7 million in annual revenues in a Member State; or (ii) it had more than 100,000 users in a Member State in a taxable year; or (iii) over 3,000 business contracts for digital services are created between the company and business users.⁷⁵ These criteria are intended to act as proxies for a significant 'digital footprint', reflecting the reliance of a digital business on a large user base, user engagement and contributions, and user-created value.⁷⁶ The Commission has proposed that the virtual PE concept would apply for the purposes of intra-EU rules and recommends EU Member States negotiate amendments to their tax treaty networks to align with the new virtual PE concept.

68. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 345.

69. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Chapter 4.3.1.

70. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 351; Ernst and Young 2018, *Global Tax Alert: The latest on BEPS*, 7 May, [https://www.ey.com/Publication/vwLUAssets/The_Latest_On_BEPS_%E2%80%93_7_May_2018/\\$FILE/2018G_02725-181Gbl_The%20Latest%20on%20BEPS%20-%207%20May%202018.pdf](https://www.ey.com/Publication/vwLUAssets/The_Latest_On_BEPS_%E2%80%93_7_May_2018/$FILE/2018G_02725-181Gbl_The%20Latest%20on%20BEPS%20-%207%20May%202018.pdf), pp 3-4.

71. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, p 138, Box 4.2.

72. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, paras 3.28-3.40.

73. HM Treasury 2018, *Corporate tax and the digital economy: position paper update*, para 3.44.

74. European Commission 2018, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, 21 March, Brussels, p 7.

75. European Commission 2018, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, p 8.

76. European Commission 2018, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, pp 7-8.

Discussion Question:

5. Should existing nexus rules for determining which countries have the right to tax foreign resident companies be changed? If so, how?

4.6 Can changes only apply to highly digitalised businesses?

As part of its review of nexus and profit attribution rules, the OECD will consider whether any changes to the tax framework should be directed at highly digitalised businesses, or should be economy-wide.⁷⁷

As the OECD has observed, 'the digital economy is increasingly becoming the economy itself'.⁷⁸ As a result, it will be increasingly difficult to quarantine the effect of any changes to highly digitalised businesses. Moreover, since the publication of the OECD's Action 1 Report in 2015, some countries have argued that the concept of 'significant economic presence' could be extended beyond highly digitalised businesses.

Discussion Questions:

6. From a tax perspective, do you consider that the digitalised economy is distinguishable from traditional economy? If yes, are there economic features of the digitalised economy that present special challenges in the context of taxation? How are these features relevant for assessing the costs and benefits of various models of taxation?
7. Can and should any changes to the international nexus and profit attribution rules be ring-fenced to apply only to highly digitalised businesses? If so, how?

4.7 Options for broader reform

The current discussion of the tax challenges arising from the digitalisation of the economy is part of a broader concern about whether existing corporate tax frameworks remain fit for purpose.

Australia relies more heavily on corporate income tax than comparable OECD countries.^{79,80} Around 20 to 25 per cent of Commonwealth tax revenue (excluding GST) comes from company tax. This may mean we are particularly exposed as a result of globalisation and digitalisation.

As discussed above, income taxes are levied based on the 'source' of profits, which is determined by reference to the location of profit-generating assets, capital and labour. Income taxes can therefore be more susceptible to erosion through profit-shifting activities, particularly where the relevant assets, capital and labour are highly mobile.

Short of major reform, changes to the existing source-based international tax framework could seek to allocate more profits to the country where goods or services are consumed. The UK long-term proposal for changes to profit attribution rules, outlined above, is an example of this type of

77. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 398.

78. OECD 2015, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, para 364; OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 15.

79. Over the period since 2000, corporate tax in Australia has ranged between 4.35 per cent of GDP and 6.66 per cent of GDP, compared to the OECD average of 2.67 per cent to 3.25 per cent of GDP (OECD 2018, *Tax on corporate profits (indicator)*, doi: 10.1787/d30cc412-en).

80. Australian Government the Treasury P Henty, C Yi Yong and G Davis 2017, 'US corporate tax reform: Implications for the rest of the world', Treasury working paper, 7 November, Canberra, p 11.

incremental reform, which could be extended beyond application to highly digitalised businesses to apply on an economy-wide basis.

In recent years, several countries have introduced or considered significant tax reforms. The United States, for example, recently introduced a suite of tax reforms, not limited to digitalised businesses. A destination-based cash flow tax has also been proposed as an option for more fundamental reform.⁸¹

Regardless of the exact shape or form of any broader reform – be it reformulation of the existing tax framework, a shift to destination-based taxes, or a range of sector specific responses – it is clear that this could take many years of international co-operation and, at its core, involve more systemic issues than changes focused only on the taxation of the digital economy.

Discussion Question:

8. Are there changes other than to nexus and profit attribution rules that should be made to the existing international corporate tax framework and/or Australia's tax mix to address the challenges presented by globalisation and digitalisation?

81. Australian Government the Treasury P Henty, C Yi Yong and G Davis 2017, 'US corporate tax reform: Implications for the rest of the world', Treasury working paper, 7 November, Canberra, pp 11-15 and 17-18; European Commission 2018, *Commission Staff Working Document: Impact Assessment accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, 21 March, Brussels, p 29.

5. Interim options

As it is likely to be some time before international consensus on a longer-term solution is reached and implemented, the OECD's Interim Report acknowledges that some countries may seek to take more immediate action and provides a framework for countries that wish to introduce interim measures. The OECD's guidance suggests that any interim measure should be:

- targeted at businesses that benefit most from user-created value;
- designed to minimise cost and complexity;
- narrowly targeted to avoid over-taxation;
- designed to minimise impact on business creation, start-ups and small business;
- consistent with countries' international obligations, including World Trade Organisation (WTO) obligations, free trade agreements (FTAs) and tax treaties; and
- apply only until such time as a consensus-based solution is developed.

The OECD has also indicated that the policy responses to these challenges are likely to be imperfect. Accordingly, any interim measure:

- would need to apply to both domestic and foreign businesses (to comply with WTO and other international obligations), and so could result in over-taxation where an interim measure applies to Australian businesses in addition to corporate tax;
- may increase the cost to Australian businesses and consumers of digital products and services that are covered by the interim measure;
- may have an adverse impact on investment, innovation and welfare, for example by distorting the choices of Australian consumers and businesses, or by changing the way in which digital products and services are provided; and
- may have relatively high compliance and administrative costs.

The extent of these impacts would depend on the specific design details of any interim measure. The design details that would need to be considered in developing an interim measure are set out in the Appendix.

On the other hand, as noted earlier, a multilateral agreement will take some time to develop, and there is no guarantee that it will eventuate. Unilateral action may be the only way to address concerns regarding the taxation of digital businesses in the near term.

To date only a small number of countries have implemented or announced interim measures.⁸² Specifically, India and Hungary have introduced taxes on the turnover of digitalised businesses (applying to revenue from digital advertising only).

- India's equalisation levy has applied since 2016 at a rate of six per cent on the revenues earned by non-Indian residents providing digital advertising services to Indian businesses.⁸³
- Hungary's advertising tax is levied on the turnover (exclusive of VAT) earned by resident and non-resident businesses from the sale of advertising services directed to Hungarians. The tax applies to advertising made available in online media, including TV, radio, billboards, newspapers,

82. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Chapter 4.5.

83. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, p 142, Box 4.3.

vehicles, internet websites and others. For online media, the tax applies when the advertisement is displayed predominantly in the Hungarian language.⁸⁴

Italy and Spain have also announced that they intend to introduce interim measures in 2019, which would be broadly consistent with the European Commission's proposal for an interim measure.

The Commission's proposed Digital Services Tax (DST) would be levied on revenue from digital services where user-created value is central, such as digital advertising and intermediation activities, and from the sale of data from users' engagement with digital interfaces.⁸⁵ The proposal explicitly excludes communication and payment services, e-commerce and supply of digital content via a digital interface. The DST would apply to gross revenues (net of VAT) derived from the provision of taxable services, at a rate of 3 per cent, and apply only to businesses with total annual worldwide revenues exceeding €750 million and EU taxable revenues exceeding €50 million.⁸⁶ Member States where users were deemed to be located would have taxing rights and revenues would be allocated according to set criteria – for example, for digital advertisements, the number of times an ad appears on users' devices in a set period would be considered when allocating revenues to that State.⁸⁷

For a new tax to be introduced at the EU level all 28 Member States must unanimously support it unless a smaller group acts through the EU's enhanced cooperation mechanism, which needs the support of nine Member States only.⁸⁸ At the date of release of this paper, France, Spain, Italy, Portugal and Poland had publicly expressed support for the introduction of a digital tax, whereas the Netherlands, Denmark, Ireland and Malta had submitted formal objections to the Commission's proposals based on EU law.⁸⁹ The Finance Ministers of Sweden, Denmark and Finland have issued a statement that sets out those countries' position that: 'there are no reasons to deviate from internationally established principles regarding the allocation of taxing rights for the digital economy.'⁹⁰

Differences in context mean that approaches adopted by other countries may not be able to be readily transposed to Australia. For example, India does not appear to have made any commitments under the General Agreement on Trade in Services with respect to advertising services.

US Treasury Secretary Steven Mnuchin responded to the release of the OECD's Interim Report by stating that he 'fully support[s] international cooperation to address broader tax challenges arising from the modern economy and to put the international tax system on a more sustainable footing', but that the US 'firmly opposes proposals by any country to single out digital companies.'⁹¹

84. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, p 145, Box 4.5.

85. European Commission 2018, *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, 21 March, Brussels.

86. European Commission 2018, 'Digital Taxation: Commission proposes new measures to ensure that all companies pay fair tax in the EU', press release, 21 March, Brussels, http://europa.eu/rapid/press-release_IP-18-2041_en.htm.

87. European Commission 2018, 'Digital Taxation: Commission proposes new measures to ensure that all companies pay fair tax in the EU', press release, 21 March, Brussels, http://europa.eu/rapid/press-release_IP-18-2041_en.htm.

88. See European Commission, *Glossary of summaries – enhanced cooperation*, https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1526387769790&uri=LEGISSUM:enhanced_cooperation. See also S Soong Johnston and T Sprackland 2018, 'Germany Mulls EU Digital Tax Plan Amid Growing Business Concerns', *Worldwide Tax Daily*, 19 April.

89. S Soong Johnston 2018, 'Lawmakers Try Showing "Yellow Card" for EU Digital Taxation Plan', *Worldwide Tax Daily*, 18 May.

90. Government Offices of Sweden 2018, 'Global cooperation is key to address tax challenges from digitalization', joint statement, 1 June, <https://www.government.se/statements/2018/06/global-cooperation-is-key-to-address-tax-challenges-from-digitalization/>.

91. US Department of the Treasury 2018, 'Secretary Mnuchin Statement On OECD's Digital Economy Taxation Report', press release, 16 March, <https://home.treasury.gov/index.php/news/press-releases/sm0316>.

Discussion Questions:

9. What does the experience of other countries that have introduced interim measures or that are contemplating them mean for Australia?
10. Should Australia pursue interim options ahead of an OECD-led, consensus-based solution to address the impacts of the digitalisation of the economy on the international tax system?

Appendix

Design considerations for an interim measure

What digital services could be more appropriately taxed?

Several countries take the view that an interim measure could be targeted to apply to businesses that benefit most from user-created value, i.e., businesses that exhibit one or more of the characteristics outlined above: cross-jurisdictional scale without mass; reliance on intangible assets and data; and user participation and network effects.

A number of countries take the view that interim measures could focus on businesses providing internet advertising or digital intermediation services.⁹² Typically:

- internet advertising can be supplied remotely without the supplier needing to establish a taxable presence in the country where the advertisement is published. Further, in order to deliver highly targeted advertisements, these businesses rely heavily on user data, and intangible assets to process that data; and
- intermediation services, sometimes referred to as platforms, match buyers and sellers on websites or apps. These services rely heavily on data collected through user participation and network effects, which are critical to improving connection of buyers with sellers. Excluded from the OECD definition of intermediation services are websites operated by businesses to supply their own goods or services to consumers. For example, a website that allows customers to make flight or accommodation bookings with third party airlines or hotels would be covered by an interim measure, but booking websites operated by the airline or hotel directly would not.

The OECD guidance suggests that countries should 'carefully weigh the pros and cons of extending the scope of any interim measure to intermediation services',⁹³ given concerns about market distortions and the potential impact on small businesses. The OECD notes that not all platforms involve significant user participation and that a tax on platforms may create incentives to change business models to avoid the tax. Given this, the OECD suggests that countries may consider excluding from the definition of digital intermediation platforms the provision of financial services, e-sales, cloud computing, transactions involving physical goods and the provision of non-intermediary services.⁹⁴ Extending an interim measure to digital intermediation platforms may raise further challenges, given no country has yet implemented such a measure on these businesses.

The OECD points out that the lower a customer's price sensitivity, the more likely it is that the burden will be passed to the customer.⁹⁵ If large digital businesses that could be subject to an interim measure are dominant in the markets in which they operate and there are few substitutes for services they provide, consumers may be relatively insensitive to price increases. This could mean that digitalised businesses subject to an interim measure may be able to pass on at least part of its cost to Australian businesses and consumers in the form of higher prices.

92. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 439.

93. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 445.

94. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 443.

95. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 407.

Discussion Question:

11. What indicators could be used to identify businesses that benefit most from user-created value? Would an interim measure applied to digital advertising and/or intermediation services accurately target that value? How broadly or narrowly should 'digital advertising' and 'intermediation services' be defined?

What nexus would highly digitalised businesses need to have with Australia?

Digital advertising services

An interim measure could apply to revenues earned from providing digital advertising services to Australians. Possible approaches could include applying an interim measure to advertising income earned from digital advertising:

- directed at Australian users;
- paid for by Australian businesses; or
- paid for by Australian businesses and directed to Australian users.

Of these, the first option is likely best to reflect circumstances where a digital advertising service provider benefits from the use of Australian user data. However, there may be challenges in identifying and enforcing an interim measure on advertising directed at Australian users, in particular where it is paid for by a foreign business to a foreign advertiser. The third option is the narrowest base, but would be simplest to enforce.

It is also important that an interim measure does not make it easy for businesses to avoid the measure, by, for example, making payments for Australian digital advertising services to offshore entities.

Administration of an interim measure may be challenging. For example, it may be difficult to apportion a share of advertising published overseas and targeted at a global audience, but viewed by Australians.

Digital intermediation platforms

Where a platform charges a fee or commission, an interim measure could apply to that commission or fee where the underlying service or product has a connection to Australia. Possible options for determining whether a sufficient Australian connection exists include where:

- all fees received for a platform service where the customer is located in Australia;
- all fees received for a platform service where the supplier is located in Australia;
- fees received for a platform service from either an Australian supplier or customer (this could capture scenarios where the platform charges separate fees to consumer and supplier); or
- all fees received for a platform service where both the customer and supplier are located in Australia.

For digital intermediation platforms it can be difficult to determine whether, and to what extent, these two-sided businesses benefit from the contribution of customers, suppliers, or both. In the absence of a clear and accurate method for apportioning the interim measure between customers and suppliers, the OECD suggests that one approach would be to adopt a place of payment rule as a proxy for value creation (the third option above).⁹⁶ Alternatively, the clearest scenario where value

96. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 463.

has been added to the platform by network effects created in Australia is where the supplier and consumer are both located in Australia (the fourth option above).

Consideration also needs to be given to collection mechanisms and compliance processes. The OECD has suggested that existing mechanisms could be used to the extent possible in order to minimise compliance burdens.⁹⁷ Imposing a withholding obligation could present significant challenges, particularly in relation to business to consumer transactions. A system of vendor registration similar to that in place for cross-border GST transactions may be more administratively workable.

Discussion Question:

12. The choice of 'nexus' for an interim measure (or a longer-term 'virtual' PE proposal) involves significant trade-offs between ease of administration and the risk of avoidance. Which nexus option strikes the best balance between these considerations?

Would an interim measure only apply to businesses above certain thresholds?

Start-ups and newly created businesses may have low or no profits due to high establishment costs, but could be subject to measures on revenue, which may reduce profits or increase losses, and act as a disincentive to establish start-ups in Australia.

Thresholds could be designed to ensure that an interim measure would apply to businesses with the ability to pay and would not adversely impact innovation, productivity and business creation. However, any thresholds would need to be consistent with Australia's international obligations (including under WTO law).

The OECD's guidance suggests that one approach to minimising the impact on new digital businesses would be to apply a combined global revenue and local sales threshold. The European Commission's proposed digital services tax incorporates both a global revenue threshold and a domestic revenue threshold. Making the application of an interim measure dependant on a relatively high turnover threshold could address concerns about negatively impacting start-ups and small business. The OECD suggests that countries could look to the CbCR threshold (generally €750 million for EU-based companies).⁹⁸ Australia's CbCR threshold is set at annual global income of \$1 billion.

The OECD suggests that any threshold should be set by reference to the previous accounting period.⁹⁹

Australia's tax legislation provides a number of examples of turnover and income thresholds that have been designed to address compliance cost impacts on new and small domestic businesses. The tax law defines small business entities as those with less than \$10 million aggregate turnover, and the Diverted Profits Tax includes a \$25 million Australian income threshold.

In view of Australia's WTO and FTA obligations, an interim measure would have to apply to both domestic and foreign businesses. Any thresholds would need to be set in this context.¹⁰⁰

Australia's obligations under its tax treaties would also need to be taken into account in the design of an interim measure.¹⁰¹ The scope of each of Australia's tax treaties would need to be separately

97. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 457.

98. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 454.

99. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 452.

100. Australia has long been a strong advocate for a multilateral, rules-based system of international trade. As an open economy, this system continues to be in Australia's national interest. Australia relies on access to world markets for its exports and Australian businesses and consumers rely heavily on imports as inputs for productive processes and to enhance their wellbeing.

101. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, paras 413-424.

considered, but as an excise, an interim measure would not be expected to be covered by Australia's tax treaties.¹⁰²

Discussion Question:

13. What are your views on thresholds for an interim measure, taking into account the need to meet Australia's international trade obligations?

Transitioning from the interim position

The OECD acknowledges that countries seeking to take immediate action could consider an interim measure until such time as a longer-term solution is developed.¹⁰³ However, the OECD also points out that uncoordinated and unilateral interim measures may be a disincentive to countries pursuing longer-term multilateral solutions. This risk is heightened if a country would collect less revenue from a consensus-based solution, or there are significant administrative and compliance costs associated with transitioning from an interim measure.

Given this, the OECD has recommended that an interim measure be temporary, pending the development of a multilateral solution. Any Australian interim measure could be transitioned once international consensus on a longer-term solution is reached.

102. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 422.

103. OECD 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, para 433.

Glossary

Algorithm	A computer program (containing a specific, often unique formula) that performs calculations, data processing and automated reasoning tasks.
Base erosion and profit shifting (BEPS)	A range of tax avoidance strategies that exploit the gaps and mismatches in tax rules to shift profits to low or no-tax jurisdictions.
Blockchain	A digital, decentralised ledger of transactions.
Controlled foreign company rules	Rules that require a taxpayer to include certain amounts earned by foreign entities that they control in their taxable income.
Country-by-Country reporting (CbCR)	Country-by-Country reporting requires that significant global entities (with annual global income of more than \$1 billion) report details of certain transactions with entities in overseas jurisdictions to tax authorities.
Cryptocurrency	A digital currency that operates independently of a central bank and uses encryption techniques to regulate the units of currency.
Digital platform	A digital means of facilitating exchanges between, for example, businesses and consumers.
Intangible property	An asset that is not physical in nature. Examples include patents, trademarks, copyrights and business methodologies.
Multinational enterprise	A corporate group that operates in a number of countries.
Mutual Agreement Procedure	A procedure under tax treaties that allows designated representatives from governments to interact with the intent to resolve an international tax dispute.
Nexus rules	Rules that determine jurisdiction to tax a non-resident enterprise.
Permanent establishment	A fixed place of business through which the business of an enterprise is wholly or partly carried on, including, for example, a place of management, a branch, an office, a factory, a workshop or a mine.
Profit attribution rules	Rules, often incorporated into tax treaties, that determine how much profit should be allocated to different parts of a multinational enterprise.
Tax treaty	A bilateral agreement that aims to avoid double taxation and prevent tax avoidance and evasion.
Thin capitalisation rules	Rules that apply to limit the amount of interest deduction that multinationals can claim against their Australian income.
Transfer pricing rules	Rules that apply to determine the price at which related parties transact with each other.

Key Acronyms

ATO	Australian Taxation Office
BEPS	Base Erosion and Profit Shifting
CbCR	Country-by-Country reporting
DPT	Diverted Profits Tax
EC/Commission	European Commission
EU	European Union
FTA	Free trade agreement
GST	Goods and services tax
MAAL	Multinational Anti-Avoidance Law
MLI	Multilateral Instrument (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting)
MNE	Multinational enterprise
OECD	Organisation for Economic Co-operation and Development
PE	Permanent establishment
SEP	Significant economic presence
SGE	Significant global entity
TFDE	Task Force on the Digital Economy
WTO	World Trade Organization

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