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Principal Adviser
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The Treasury
Langton Crescent
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Dear Sir or Madam,

Re: Submission – "The Digital Economy and Australia's Corporate Tax System"

Treasury Discussion Paper – October 2018

Please find enclosed a submission to the discussion paper; as well as a copy of the Woodward Protocol.

Yours faithfully,

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SUBMISSION – TREASURY DISCUSSION PAPER
THE DIGITAL ECONOMY AND AUSTRALIA'S CORPORATE TAX SYSTEM

APPLICATION OF THE WOODWARD PROTOCOL

INTRODUCTION

1) The Woodward Protocol (WP) proposes an extremely fair method of taxing income generated in individual jurisdictions by multinational entities (MNEs), and in particular, by the recently evolved digital businesses.

2) It is glaringly obvious that relatively small amounts of tax are paid by the digital MNEs in the countries comprising their crucial markets. The initial focus of the WP will be on these digital MNEs, (Target MNEs – TMNEs), but the principles will eventually have applicability to other more general taxing situations.

3) It is unhelpful to approach the activities of TMNEs as "aggressive minimisation" or even "tax avoidance". The real problem is that archaic tax laws are quite unsuited to levy what the WP would argue is a fair amount of tax on the earnings of TMNEs generated in most jurisdictions.

Attempting to patch up perceived shortcomings in outdated tax laws is a complex, time-consuming, ongoing and relatively unsatisfactory solution.

4) Is there a simpler way for a Government to levy a fair and just amount of tax? The WP justifies its proposal on a two-step fairness analysis:

a) It is fair for a government to require tax to be paid on net income generated in that jurisdiction?

This first step requires a measure of the gross income generated in a particular jurisdiction, either from direct sales to its residents, or from sales entities which rely on services supplied directly to its residents (e.g. advertising sales which are derived because of services being supplied to the residents).

The crucial task here is to determine the gross income generated either by direct sales to residents or from income closely linked to sales relying on services to its residents.

The crucial break with traditional tax law is to make it completely irrelevant whether the MNE has a permanent establishment in that country, or where the income is invoiced from. The focus is squarely on what gross income is generated in that country.

b) It is then fair to tax the real net income resulting from these sales

Traditional tax law has evolved with complex rules determining whether certain expenses are deductible, and to what extent.

The problem here is that the huge digital TMNEs have operations in virtually every country – some with high tax rates, some lower rates, some with no tax. Expenses may be paid in some countries which have applicability to gross income raised in numerous other jurisdictions. How are these to be allocated?

In addition, it is standard procedure to creatively manipulate certain expenses such as royalties and interest so that these are tax-deductible in high-tax countries; these are paid as income to related entities in low- or no-tax countries with minimal resulting tax

There are some claw-backs of tax on such transfers such as withholding tax on royalties and interest paid to non-residents, but always to the advantage of the TMNEs.

The difficulty of trying to remedy the fairness by refining the traditional framework is highlighted by the G20 / OECD Base Erosion and Profit Shifting (BEPS) Project. This was initiated in 2013, with BEPS Project Action released in October 2015. It is now 2018, with only some of the recommendations taking hold.

The WP proposes a far simpler method of measuring the net income generated in a particular jurisdiction.

5) The huge digital MNEs produce annual financial statements showing their **Consolidated World-Wide Accounts (CWWA)**, based on international accounting standards and audited by an internationally-accepted auditing firms. Their share market value relies on these accounts.

The crucial feature of these CWWAs is **consolidation**. For example, expenses paid either directly or indirectly for royalties, interest, and administration by an Australian branch to other majority-controlled entities of the group which become income in low tax countries are **eliminated** as both expenses and income in the CWWAs based on the **consolidation principle**. Virtually all of the problems being tackled by the OECD's BEPS measures become irrelevant if we have a measurement of real expense which cancels out the effect of profit shifting.

The gross income in the CWWAs is the income from sales to non-related customers. The expenses in the CWWAs are genuine expenses paid to non-related parties, plus write-offs based on accepted accounting principles.

6) The WP argues: It is to attribute a share of the net income before tax in the CWWAs to a particular country in proportion to the gross income derived in that country.

For each TMNE there will be a **Consolidated Expense Percentage (CEP)** – the percentage of consolidated expenses (before income tax) as a fraction of consolidated revenue.

Each jurisdiction will be free to calculate its own **Adjusted CEP (ACEP)**, based on the CWWA but adjusted if required for principles of taxation peculiar to that country. The WP leaves it to each jurisdiction to come up with its own adjustments if that jurisdiction decides these are warranted.

For example, in Australia, capital gains tax is levied in the year that the capital gain is crystallised through sale or other disposal. The CWWAs may contain income and expense items mirroring increases and decreases in the fair value of assets and liabilities, which are not normally taxable or deductible in Australia in that year if no disposal occurs. It is possible that the Australian taxation authorities could decide on a method to adjust for (eliminate) changes in fair value, when calculating the ACEP for a particular company. But if the likely adjustments are very minor, it is also probable that this adjustment will not be warranted.

Another example is depreciation. The Australian Taxation system has principles for calculating depreciation, which applied across the board might impact on the ACEP. Because of the complexity of

the issue, and the likely minor material impact, it seems very likely that depreciation based on international accounting standards in the CWWAs would be allowed to stay unaltered.

7) **The WP then proposes a conceptually simple system by which the profits of a TMNE will be taxed in a particular jurisdiction:-**

a) The gross income of the TMNE will be the gross income generated in that jurisdiction.
b) The allowable expense will be the ACEP as adjusted for that jurisdiction applied to the income.
c) Income tax will be the corporate tax rate of the jurisdiction applied to the difference between income generated in that jurisdiction and the notional expense calculated as in b) above, less any quasi-company tax already paid (e.g. withholding tax on royalties, interest etc.).

It is claimed that this represents a very fair way of allocating the net income of a TMNE between the jurisdictions responsible for its profitability.

Discussion Q1. – "User Created Value"

The WP's focus is on gross income of a TMNE attributable to that country, regardless of its permanent establishment (PE) or source of invoicing.

It seems likely that governments already have access to such information. Alternatively, there should be an equitable method of proportioning income between jurisdictions based on statistics such as numbers of users.

It would be required for TMNEs to include audited apportionments between jurisdictions as part of their annual accounts.

Discussion Q2 – "Valuing Marketing Intangibles"

The possibility of allowing a deduction in a particular country for royalty is eliminated, if this is simply paid to another branch of the TMNE. The WP shares the view that the market countries are the source of value for the marketing intangibles.

If the TMNEs annual accounts include a "profitable" revaluation of the marketing intangibles, then Australia would likely agree to an ACEP which does not tax this increase. This is because Australian tax law is based on the principle of only taxing capital gain when the gain is realised.

In regard to the capital cost of developing the marketing intangibles, accounting principles might permit amortization of the actual cost of developing the intangible which might be deductible expense.

In addition, if the TMNE incurred losses in its developmental period, it is likely that an Australian ACEP would allow for losses to be brought forward to offset the current year CEP, until such losses are completely offset.

Discussion Q3 – "Profit Attribution Rules"

In the case of the TMNEs, the WP argues that a jurisdiction has the right to tax gross income generated from direct sales to its residents or indirect sales closely linked to services to its residents.

Whether or not there is a PE in that jurisdiction is considered irrelevant. The "residency" of the TMNE is also irrelevant.

It is agreed that where large businesses have varying lines of business, there may be an argument for taxing only the digital activities in terms of the WP, leaving more traditional activities to be taxed under the existing framework.

Discussion Q4 – "Residual Profits"

The WP agrees with the UK outline of likely-needed changes to the international tax framework, set out as a) to e) in Section 4.4 of the Discussion Paper. The WP provides the in-principle way in which this might occur.

Discussion Q5 – "Existing Nexus Rules"

As already foreshadowed, the SP relies on taxing the gross income attributable to sales/services to its residents, regardless of the existence of a PE. If this requires a new definition of a "virtual PE", resulting from a "significant economic presence" (SEP), surely the lawmakers will be able to draft appropriate legislation.

Discussion Q6 – "Digitalised Economy"

Quantum changes in world business have flowed from the digital economy, and in particular resulted in hugely successful multinational entities. The sheer scale of their operations, their ability to operate without a PE in a particular country, their ability to locate "head offices" and value-holding entities in low- or no-tax countries, the difficulty of putting a value on expenses "artificially" shifted to these places – all of these cry out for a fresh look at taxation principles.

In addition, the movement off-shore of income from traditional on-shore business sources such as advertising leaves a significant hole in taxation revenue.

The WP proposes what it considers a fair basis for taxing these companies. The cost of its application would seem likely far less than the costs of say the OECD Action Plan, the execution should be much faster, and the benefits (tax raised) likely far greater. As well, there would be a perception by the public of a fairer tax system.

Discussion Q7 – "International Nexus and Profit Attribution Rules – Ring-Fenced to Highly Digitalised Business?"

The most pressing need for reform is for a fairer method of taxing the very large digitalised TMNEs. Already countries are setting high thresholds defining the targets (TMNEs) – the entities initially being targeted. Australia is looking at Significant Global Entities (SGEs) with annual global turnover above AUD one billion dollars.

It makes sense to start looking at radical change in a limited area, while legislation is developed and debated. When this legislation is bedded down, no doubt attention would turn to its applicability to smaller businesses, and more diversified entities.

However, there well may be other ways in which the concept of using information in the CWWAs may be employed to scrutinise expenses of MNEs – when examining interest, royalties, profit margins from goods sold, etc.

Discussion Q8, Q9 and Q10

The author does not have the expertise, the time or the resources to offer advice on actual implementation.

The crucial concept offered by the WP is the principle of fairly allocating net income of the TMNEs between the jurisdictions responsible for their profits.

Because countries are becoming desperate to raise fair tax now, (not in 10 years time), we are starting to see ad-hoc, interim measures to levy tax.

India has legislated a 6% levy on the income derived by non-resident digital advertisers. The OECD discusses a proposed Digital Services Tax (DST) of 3% on gross revenue. (Note – implicit in such proposals is the assumption that jurisdictions will be able to quantify the gross income to be taxed).

A vital advantage implicit in the WP is that it proposes a tax specifically based on the actual Consolidated world-wide profitability of each particular TMNE in each particular year.

There is arguably much greater fairness in this approach, compared to an ad-hoc flat levy applied at the same rate to all companies in every year.

29/09/2018

THE WOODWARD PROTOCOL – REVISION 3

An Equitable Method of Taxing Multinational Companies

1. INTRODUCTION

The Woodward Protocol proposes a fundamental change in the principles of taxing certain multinational entities (MNEs), with a particular focus on the "digital economy" - world-wide internet - and technology-based businesses (the target MNEs).

Taxation is levied by individual sovereign states. The traditional model taxes the income earnt in that country by a MNE ("assessable income"), reduced by the expenses incurred by that branch of the MNE ("deductible expenses"). The resulting "net taxable income" is taxed at the appropriate company tax rate.

However, it has become glaringly obvious that in the developed countries providing virtually all of the markets for the target MNEs, relatively little tax is being paid on the income generated in these countries.

The MNEs have subsidiaries in virtually every country, including countries with low, very low and no tax rates. The MNEs have been able to limit their tax in the high tax countries which are their major sources of income, through strategies focussing on what constitutes assessable income, and what are deductible expenses, based on traditional legal principles.

Firstly, an MNE branch located in a low-tax country may invoice the actual sale either to the final client or the advertiser in the high-tax country, and maintain that this income is export income belonging to the low-rate country ("Income Profit Shifting") and not taxable income of the high-tax country.

Secondly, an MNE branch in a high tax country may inflate its deductible expenses by making expense payments to branches in low-tax countries for interest on capital, administration expenses, inflated values for goods sold, and royalties on intellectual property (IP) ("Expense Profit Shifting").

To combat either of these by fine-tuning the traditional taxation principles varies from being very difficult to impossible. In the case of expense profit shifting, taxation authorities regularly challenge expenses claimed which exceed "market value" – especially in regard to the cost of goods imported by MNEs from their subsidiaries in low-tax countries. This issue of "transfer pricing" is hotly debated, and challenged by the Big Four accounting firms representing the MNEs, at a huge cost to all concerned.

Where a royalty for unique IP is paid to a low tax country, how do you establish a market value? These royalties paid to a treaty country may attract a 10% withholding tax in Australia, compared to the 30% company tax rate applying to net income in Australia. How do you calculate a fair value of this expense, if we stick with traditional tax principles?

Similar problems arise when challenging income profit shifting; existing law involves complex questions about the derivation of income.

2. SEISMIC CHANGES IN WORLD BUSINESS

It is obvious that huge sales are made, and huge net income results, from the world-wide activities of the target MNEs.

For instance, in 2014 Google world-wide generated USD66 billion in sales, with net income before tax of USD17.3 billion (26.2% of sales). In 2014 in Australia, Google declared AUD357M as its Australian revenue and paid tax on net income of AUD58M, even though there are estimates that between AUD2 to AUD3 billion of its world-wide revenue relates to Australian users.

Also bear in mind that the revenue derived by target MNEs such as Google and Facebook is primarily advertising income. Before the huge changes occurred in world commerce relating to the internet, most advertising revenue would have been earned by Australian companies paying Australian tax on all of the net income. As a result, there has been a very substantial reduction in Australian tax income from this source.

3. THE FAIRNESS PRINCIPLE

The Woodward Protocol (WP) argues that it is fair for sovereign countries to levy tax on the net income generated in that country, either through direct sales to its residents or through sales to businesses dependent on services supplied to its residents.

With regard to "assessable income", the WP requires changes in tax legislation to include in assessable income the value of income either from direct sales to its residents or from sales to businesses which result directly from services supplied to its residents (especially advertising income). Such legislation needs to specifically dismiss as irrelevant whether or not the target MNE has a "permanent establishment" in the country, or whether the sales involved are invoiced from a different jurisdiction.

Secondly, the WP looks to establish a fair measure of the net income which the target MNE derives in a particular country as a result of the sales (as newly-defined) in that country. It argues that the most appropriate index of the net income being generated is the world-wide consolidated net income percentage of the MNE, rather than net income based on archaic principles of what expenses are deductible in a particular country.

It seems fair to argue that if Australian residents account for say 2% of Google's world-wide sales, then 2% of its net income can be attributed to these sales. And if Google world-wide has net income equalling 26.2% of its world-wide revenue, it is also fair to argue that 26.2% of Australian sales income is a reasonable index of net income resulting from its Australian sales.

4. THE ACCOUNTING PRINCIPLE OF CONSOLIDATION

Virtually all of the target MNEs produce world-wide annual consolidated accounts, usually audited by the respected Big Four accounting firms. These accounts are an important basis for their stock market valuations.

A crucial principle in producing these accounts is consolidation. In amalgamating the accounts of the various world-wide subsidiaries into the one global set of accounts, transactions between the subsidiaries are cancelled out. As a result, the final accounts show only income from and expenses paid to non-related parties, to give an accurate picture of the real results for the global group.

So with expenses in the consolidated accounts, all of the expense shifting between subsidiaries (whether for taxation or genuine administration purposes) is eliminated by being offset against corresponding income items in the "shifted" country. The resulting consolidated income and expense is a true index of the real world-wide income and expense of the company.

5. APPLICATION OF THE WOODWARD PROTOCOL

Application of the Woodward Protocol requires appropriate legislation in four basic areas.

A) Definition of assessable income. It is crucial that assessable income of a target MNE in a particular jurisdiction be defined so that it includes sales to residents of that country, regardless of whether the entity invoicing the sale is deemed to be a resident or not. In addition, where sales are made to advertisers and other businesses which are contingent on services being supplied to residents of the country, these sales must also be deemed to be assessable income in that country, regardless of the location of the entity invoicing the sale.

One option would be to exclude sales from offshore of goods at market value to non-related resellers, and in this respect not modify existing principles of taxation in respect of such sales. This is further discussed in the Addendum, Issue 2.

The crucial issue at stake here is the ability to tax the net income resulting from direct sales to residents, regardless of age-old questions such as whether there is a "permanent establishment" in the country. This then opens a Pandora's Box regarding taxation of non-residential suppliers, given world-wide internet sales through the likes of Paypal.

To be practical, it is envisaged that initial legislation in this area would include a very substantial minimum annual revenue condition for the new rules to apply. In the Australian context, preliminary legislation to tax MNEs looks at such a condition. However, when the new principles become bedded down, it is likely that the basic principle would be extended to look at increasingly lower (but significant) levels of activity.

B Definition of deductible expense. Deductible expense will be calculated by application of the consolidated world-wide expense percentage (CWWEP) to the assessable income in the individual jurisdiction. This is further elaborated below (The CWWEP formula).

C) Definition of target MNEs. This will require a definition of the principles by which target MNEs are selected. This is already well underway, given the current legislative interest in taxation of MNEs. The major focus is on world-wide technology- and internet-based business.

The 2018 Australian Government Budget deals with the definition of a Significant Global Entity (SGE).

However, as suggested above, once the new principles of taxation become established, it is likely that their application will be progressively widened to include a far wider range of international business.

D) Adjustment of tax payable for quasi-income tax payments. Expenses such as interest and royalties currently paid to related non-resident entities attract withholding tax (currently 10% in most cases). Because these expenses paid to related entities are eliminated as separate deductions in the Woodward Protocol regime, any such withholding tax paid should be credited against the final income tax payable.

Administration. It would make good administrative sense to allow MNEs to align their global financial years with their tax year in individual jurisdictions, with appropriate transition rules for the first year. This is because their global financial accounts are a crucial basis for application of the WP.

6. THE CWWEP FORMULA

For each jurisdiction, the WP requires each target MNE (TMNE) to produce audited financial statements showing its **Consolidated World-Wide Accounts (CWWA)**, based on international accounting standards and audited by an internationally-accepted auditing firm. In most cases, these are already being produced and are publicly available.

Based on these CWWAs, for each TMNE there will be a **Consolidated Expense Percentage (CEP)** – the percentage of consolidated expenses (before income tax) as a fraction of consolidated revenue.

Each jurisdiction will be free to calculate its own **Adjusted CEP (ACEP)**, based on the CWWA but adjusted if required for principles of taxation peculiar to that country. The WP leaves it to each jurisdiction to come up with its own adjustments if that jurisdiction decides these are warranted.

For example, in Australia, capital gains tax is levied in the year that the capital gain is crystallised through sale or other disposal. The CWWAs will contain income and expense items mirroring increases and decreases in the fair value of assets and liabilities, which are not normally taxable or deductible in Australia in that year if no disposal occurs. It is possible that the Australian taxation authorities could decide on a method to adjust for (eliminate) changes in fair value, when calculating the ACEP for a particular company. But if the likely adjustments are very minor, it is also probable that this adjustment will not be warranted.

Another example is depreciation. The Australian Taxation system has principles for calculating depreciation, which applied across the board might impact on the ACEP. Because of the complexity of the issue, and the likely minor material impact, it seems very likely that depreciation based on international accounting standards in the CWWAs would be allowed to stay unaltered.

The WP then proposes a conceptually simple system by which the profits of a TMNE will be taxed in a particular jurisdiction:-

a) **The income of the TMNE will be the income generated in that jurisdiction, either from direct sales to residents, or income dependent on services supplied to residents.**
b) **The allowable expense will be the ACEP as adjusted for that jurisdiction applied to the income.**
c) **Income tax will be the corporate tax rate of the jurisdiction applied to the difference between income generated in that jurisdiction and the notional expense calculated as in b) above, less any quasi-company tax already paid (e.g. withholding tax on royalties, interest etc.).**

Where a TMNE has sales in a particular jurisdiction composed partly of sales in terms of (a) above and partly of sales of goods from overseas at arms-length values to non-related resellers, that jurisdiction might decide to tax only the direct sales using the WP (but refer to Addendum, Issue 2).

7. APPLICATION

The Taxation principles of the WP embody a sea-change in the principles of taxation. However, because of the relatively straight-forward principles involved, drafting the appropriate legislation might actually be far less complex in many respects than say the proposed OECD measures. An interesting side-effect would be the extent to which TMNEs lose interest in low-tax jurisdictions and profit-shifting machinations.

As examples of what might result:

a) Google
It has been suggested Google generated AU$1 billion in sales in Australia in a recent year but paid less than AU$1 million in tax.
In 2014, Google had a CEP of 78.58% in its CWWA. Applying the Woodward Protocol to Australian sales of approximately AU$1 billion, income tax payable in Australia would be 30% of AU$214.2 million, equal to AU$64.26 million, (compared to approximately AU$1 million actually paid).

b) Apple
It has been suggested Apple generated AU$6 billion in sales in Australia in a recent year, but paid less than AU$40 million in tax.
In 2014, Apple had a CEP of 70.73% in its CWWA. Applying the Woodward Protocol to Australian sales of AU$6 billion, income tax payable in Australia would be 30% of AU$1756 million, equal to AU$526.86 million, (compared to AU$40 million actually paid). (However, if the AU$6 Billion sales include sales to unrelated resellers, the taxable net income on these might be calculated on existing principles).

The above tax estimates might reduce appreciably if a tax-sharing tax rebate was agreed to (refer below), but would still represent a huge increase in tax revenue in Australia.

8. TAX-SHARING TAX REBATE (TSTR)

The Woodward Protocol effectively cancels out any allowance for royalty on the intellectual property (IP). This is particularly relevant because the TMNEs presently have a huge incentive to "locate" their IPs in a low- or no-tax country.

The WP envisages the possibility that in due course, there might be a political concession to share some of the tax generated in a particular jurisdiction with the real country of origin of the IP as a royalty acknowledgement. However, the WP would suggest that this should be a negotiated rather than an "as of right" concession, and far less likely to be offered if the nominated country of origin is low- or no-tax.

9. LONG-TERM SIMPLIFICATION

The OECD has fifteen Action Items attempting to patch up the present system through special anti-avoidance measures, addressing issues such as transfer pricing, interest deductions, artificial permanent establishments and the like.

This is likely to be a never-ending task, with MNEs challenging rulings in the courts and advisers looking for new profit-shifting tactics.

In contrast, the Woodward Protocol proposes a far simpler system, far simpler to understand and implement and likely requiring a far lower level of ongoing modification. In principle, it should remove the incentive to juggle income and expenses between subsidiaries only for taxation reasons, if the Woodward Protocol were to be implemented on a world-wide basis.

10. APPLICATION OF THE WOODWARD PROTOCOL TO SPECIFIC TAX ISSUES

The various principles of the Woodward Protocol have a likely wider application, beyond dealing with the Target MNEs.

a) The extension of the definition of assessable income to include direct sales to residents of that jurisdiction and also sales to businesses directly linked to services supplied to residents, opens up the ability to tax a wide range of non-resident sellers.

The initial focus of the WP will be to levy a fair tax on the huge TMNEs. Administration of the new laws will be greatly facilitated by the existence of audited consolidated world-wide accounts for these TMNEs.

Further widening of the tax net to smaller but still very significant businesses will not be as straightforward if they do not have audited world-wide accounts. However, the tax authorities will have assessable income defined, and the onus will be on the overseas business to justify the appropriate deductible expenses.

b) A MNE (not a Target MNE) may have a permanent establishment in Australia, and presently submit accounts for taxation where all of the assessable income and many of the deductible expenses are considered fair and reasonable within existing law.

However, questions inevitably arise when specific expenses are paid to related non-resident entities of the MNE. The most vexed question involves "transfer pricing" – are the goods imported for resale from related entities being priced above their true market value, allowing the MNE to decrease its net income in the higher-tax sales destination jurisdiction and increasing its net profit in the low- or no-tax supplying jurisdiction?

Obviously the taxing jurisdiction needs the MNE to disclose which amounts are paid to related non-resident entities (RNREs) whether for all or part of Goods for Resale, interest, administration, royalty for use of intellectual property and the like.

The principle of using information in the consolidated world-wide accounts (CWWA) may then have applicability to determining the fairness of amounts paid to RNREs. For example, if all goods sold are imported from RNREs, it may be deemed fair to adjust costs of goods sold (and the resulting gross profit) to align with the gross profit percentage in the CWWAs.

Where only some of the goods for resale are imported from RNREs, the question is more complex. Nevertheless, to resolve the issue as to whether transfer pricing is involved (goods being imported at higher than fair market value), an analysis of the gross profit percentage (GPP) on sales of these specific goods compared to both the GPP of other goods sold and the GPP in the CWWA of the entity would help determine the question.

Likewise, where there is a question whether interest being paid to a RNRE is at a higher than market rate, it may be instructive in some cases to look at the rate of interest paid in the CWWAs as a percentage of borrowings.

11. CRITICISMS OF THE WOODWARD PROTOCOL

In a recent letter from an accounting body requested to offer a preliminary appraisal of the Woodward Protocol, it was suggested:

A) *The problem "requires a multilateral solution",*

This is disputed. The current measures proposed by the OECD require multilateral measures, inevitably involving complex and time-consuming political and legislative processes. These are primarily designed to detect the extent of both income and expense profit-shifting. But because the Woodward Protocol should cancel out the effects of profit-shifting, there is no reason the WP could not be applied unilaterally.

It is nonsense to say the WP could only be implemented if this occurred simultaneously across all jurisdictions. But it would be very surprising if there were not rapid adoption of the principle across all major countries which stand to benefit hugely from adoption of the WP.

B) *It disregards the "necessity to compete for businesses and jobs in the global economy".*

This is nonsense when applied to the target MNEs. Google and Facebook will still want to supply services to Australian residents, regardless of Australia's tax regime. They might not like the tax, but they would not withdraw their services.

C) *It "presumes accounting income is the appropriate determinant in respect of applying income tax", (and refers to a paper analysing flaws in such an approach).*

In practice, virtually all jurisdictions start off with accounting income, and then to a greater or lesser degree modify this income with their tax legislation.

The Woodward Protocol envisages that individual jurisdictions may wish to apply their own adjusted CEPs (ACEPs) to incorporate principles of taxation peculiar to the particular country. However, the acid test is whether the Woodward Protocol results in a fair method to tax net income generated in a particular country.

12. PROTECTION OF THIS IDEA

The author has attempted to protect the intellectual property of the Woodward Protocol through copyright and a Provisional Patent (Application 2016904481). It would be nice to receive some financial recognition to invest in other projects, particularly when considering the massive increase in tax likely to be collected.

But regardless of whether or not this eventuates, the world is crying out for a fair and equitable method of taxing the huge multinational technology companies, as well as simplified but effective methods to combat specific areas of international tax avoidance.

ADDENDUM

ISSUES ARISING FROM PRIVATE COMMENTS OF A RESPECTED AUSTRALIAN TAX ADVISOR

1) Commonly MNEs have substantial losses in their formative years – how would these be dealt with?

Since the WP is based on a fairness principle – a fair division of the true global accounting income – the logical answer would be to allow accounting losses before tax of prior years to be deducted from the net income before tax of the MNE, before calculating the CEP for that year.

2) Apportionment of Non-WP Assessable Income

The WP was primarily aimed to combat both income profit shifting and expense profit shifting. It was focussed on determining income generated in a particular entity (not income after shifting), and calculating the resultant net profit.

It was suggested that where income of such entities was also generated from sales to non-related resellers in that country, traditional taxation principles might still be applicable to this portion of income.

However, it is quite likely that problems generated by expense shifting may still be present, and it might be more practical to simply apply the WP to all income. This would require a deeper analysis.

3) Australian Labour Party Proposal for a World-Wide Gearing Calculation for Thin Capitalisation.

The "beautiful simplification" in the WP lies in accounting consolidation. Interest paid to and received by related parties is eliminated in the bottom line – as are royalties and all other manner of expenses which lie at the heart of income and expense profit shifting. The only interest being claimed as an expense in the Consolidated World-Wide Accounts should be interest paid to non-related entities, so "thin capitalisation" becomes irrelevant.

As mentioned earlier – world-wide adoption of the WP would very likely lead to a sudden loss of interest in low- and no-tax jurisdictions.

It would also have implications in other areas such as the US laws dealing with repatriation of foreign profits. If realistic tax has been paid on both net income generated in the USA and net income generated in other jurisdictions, we would be looking at a different ball-game.

4) Would Double-Tax Treaties Prevent/Complicate Unilateral Adoption of the WP?

This would require a legal analysis outside the scope of this proposal. Nevertheless, the huge gains in tax collection and in perceived fairness of the tax system would surely militate a speedy solution to this question.

And surely – once the benefits of increased and fair tax collection become evident to other jurisdictions, it is hard to comprehend why the system should not be adopted world-wide (excepting, of course, in low- and no-tax countries).

5) Recent Australian "Digital Tax" Proposals

These were discussed in the 2018 Budget, and primarily link in with the OECD Base Erosion and Profit Shifting (BEPS) programme.

Issues discussed in the Budget include:

a) Amending the definition of a significant global entity (SGE).
b) Tightening cross-border financing and thin capitalisation.
c) Providing "double gearing" structures.
d) Tightening asset calculations (linked to "thin capitalisation").
e) Dealing with "inbound" and "outbound" consolidated entities.
f) Actions relating to the fifteen OECD Action Items.

As argued in the Introduction to the WP, combatting Income Profit Shifting and Expense Profit Shifting through legislation which fine-tunes traditional taxation principles is a very difficult and time-consuming process. It is likely to be never-ending, to tie-up extensive legislative resources, and to provide substantial income for the Big Four accounting firms.

The WP offers a far simpler framework, with its fairness difficult to dispute, and is likely to require simpler and less complex and costly ongoing modification.