Multinational taxation and the digital economy
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Key issue
This article examines the nature of taxation in the global economy, and the challenges Australia faces in the near future with the increasing prevalence of a digitised economy.

Foundations of multinational taxation
Like most developed countries, Australia’s corporate tax system determines which activities are subject to tax in Australia by the source of income and the residence of the taxpayer. Generally, tax is only levied on Australian resident companies for income-producing activities that occur in Australia.

To address tax avoidance, Australia’s current tax laws contain provisions that address specific behaviours, supplemented by broad general anti-avoidance provisions.

The rise of large and complex multinational business structures, in conjunction with changes to the nature of their products and services, has created issues for tax authorities globally in correctly attributing taxable income.

Australia is an active participant in the OECD’s creation and implementation of best-practice taxation guidelines. Since 2012, the OECD has paid particular attention to corporate tax planning by multinational corporations (MNCs) seeking to minimise their tax. This led to the development of the Base Erosion and Profit Shifting (BEPS) Action Plan, published in 2013.

Base Erosion and Profit Shifting
BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations. Some common BEPS strategies identified by the OECD include:

- avoidance of a taxable presence—MNCs may have a commercial presence in a country, but avoid having a taxable presence in that country by exploiting differences in countries’ residency rules or by implementing artificial arrangements
- transfer ‘mispricing’—MNCs are able to minimise their tax payable by inflating the prices paid, or reducing the prices charged, when entering into transactions between their related entities in different countries
- relocating highly mobile capital, assets and functions—MNCs can relocate profit generating functions and assets to low-tax jurisdictions so profits generated by those assets are taxed at a low tax rate
- tax arbitrage and treaty shopping—MNCs can exploit differences between countries’ tax rules, rates or treaties to shift profits to low- or no-tax jurisdictions, or to achieve double non-taxation of transactions and
- debt loading—MNCs may use excessive amounts of related-party debt to finance transactions in order to maximise the amount of interest that they can deduct.

Leaders of the G20 endorsed the initial BEPS Action Plan in their July 2013 Communiqué which stated that ‘profits should be taxed where functions driving the profits are performed and where value is created’. This framework underpins a number of recent measures undertaken by the Australian Government to address BEPS.
Significant anti-avoidance laws in Australia

The Multinational Anti-Avoidance Law

Australia’s general anti-avoidance provisions were strengthened with the introduction of the Multinational Anti-Avoidance Law (MAAL) in 2016. The MAAL is a broad anti-avoidance law that applies to large MNCs that enter into a scheme where one of the principal purposes of the scheme is to avoid tax in Australia. In 2017 the Australian Taxation Office (ATO) issued a public update on the MAAL which stated that the MAAL was instrumental in the closure of additional tax assessments of around $1 billion in the 2016–17 financial year. Some large companies, including Google and Facebook, stated that they would return Australian-sourced sales income to Australia as a consequence of the MAAL.

Diverted profits tax

The Government introduced a diverted profits tax (DPT) that came into effect on 1 July 2017 and imposes a 40 per cent tax on MNCs that utilise schemes to divert Australian profits. Like the MAAL, the DPT aims to ensure that large MNCs do not enter into arrangements with off-shore parties for the purpose of avoiding taxation. The DPT also aims to encourage greater cooperation between MNCs and the ATO by requiring upfront payment of a DPT liability, placing an onus on the MNC to demonstrate they have not diverted profits.

Thin capitalisation rules

A thinly capitalised entity is one whose operations are funded disproportionately through debt. The thin capitalisation rules seek to deny thinly capitalised MNCs excessive deductions for debt financing costs. Australia’s long-standing thin capitalisation rules seek to prevent MNCs from debt loading in order to reduce their tax liability.

Taxation in the digital economy

Whilst the introduction of BEPS strategies by a number of OECD countries has addressed some aspects of tax avoidance, taxable presence continues to be a challenge in the digital economy.

Australia has incorporated the OECD principles into its transfer pricing rules. The impacts of the transfer pricing provisions were demonstrated in the recent case of Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 6. The Federal Court of Australia found that Chevron failed to demonstrate that a related-party loan was made at arm’s length and, as a result, the company was required to pay $340 million in taxes, penalties and interest on the $2.5 billion related-party loan.

Transfer pricing

To prevent MNCs from transfer mispricing, the OECD has developed a set of principles that require transactions entered into between related entities to be priced according to the ‘arm’s length principle’. The ATO describes this principle as ‘comparing what a business has done and what an independent party would have done in the same or similar circumstances.’

A 2014 draft discussion paper by the OECD Task Force on the Digital Economy noted that developments in ICT had led to a number of new business models that could be conducted at large scale over great distances. The digitisation of services under these business models, however, makes determining the source of value creation more difficult. Some examples of the challenges presented by increased digitisation include disruption of existing domestic industries, the creation of digital marketplaces and the emergence of a ‘data economy’.
**Disruptive innovation**

Digital disruption has the potential to lead to the erosion of the tax base in traditionally domestic industries. For example, new digital entrants have emerged in the ride-sharing and accommodation services sectors (such as Uber and Airbnb), which enable services to be provided to consumers domestically while profit-generating assets (that is, the enabling software or platforms) are offshore. This has the potential to move profits from traditionally domestic industries, like taxi services or local accommodation services, to foreign jurisdictions where they are taxed. Whilst digital disruption may enhance efficiency and create new opportunities within the Australian economy, it can, in some cases, present operating advantages to MNCs over domestic businesses through more favourable taxation arrangements in foreign jurisdictions.

**Digital marketplaces**

The digital economy has led to the development of digital marketplaces that connect suppliers and consumers across international borders. On 2 October 2018, Treasury issued a discussion paper, *The digital economy and Australia’s corporate tax system* which notes that a digital marketplace can span tax jurisdictions, as the supplier, consumer and marketplace operator may be located in different locations. This creates difficulty in assigning taxation rights across different countries.

**Data economy**

Businesses use consumer data to make business decisions that may increase their chance of sales. Traditional methods of gathering information have included services like flybuys and sales surveys. The proliferation of online transactions and other engagement through social media and web searching has led to a substantial increase in consumer data. This data is collected and monetised by MNCs (by identifying individual consumer preferences) to deliver highly targeted advertising. Issues of data ownership and privacy aside (see ‘The data economy’ elsewhere in this publication), from a tax perspective, the data economy raises questions about whether and how to recognise this data as a profit-generating input and what jurisdiction should have taxing rights, when companies that generate profit from this data can locate themselves in lower-tax jurisdictions.

**Digital transfer pricing**

Difficulty in setting a market price for unique goods or services is a challenge that accompanies transfer pricing rules. Tax authorities—including the ATO—often use industry benchmarks or comparable transactions to establish what an arm’s length transaction might look like. However, it may be impossible to find a comparable market price or transaction where an MNC has a dominant market position or its products are unique (such as patented intellectual property or a new disruptive innovation). Without being able to establish an arm’s length price, it is difficult for tax administrators to challenge an MNC’s pricing position.

**OECD actions**

In 2016 the OECD was tasked by the G20 to explore the tax challenges arising from digitisation and issue a final report by 2020. In March 2018, the OECD handed down an interim report, *Tax Challenges Arising from Digitalisation*, which included an outline for longer-term reforms to the international tax framework to deal with highly digitised MNCs and profit attribution. The report also included a set of guiding principles for countries wanting to take more immediate action (referred to as an ‘interim measure’).

The OECD’s interim report does not propose changing the international tax framework for all businesses; rather, it focuses on options...
for taxing highly digitised MNCs that exhibit the following three key characteristics:

- the ability to have a significant economic presence in a country with limited or no physical presence in that country
- heavy reliance on intangible assets (especially intellectual property) and
- highly digitised businesses that rely on user data and participation and user generated content.

The implementation of these recommendations will require consideration by the Australian Government and Parliament.

Whilst its recommendations are not finalised, the OECD issued a policy note, *Addressing the Tax Challenges of the Digitalisation of the Economy*, in January 2019 for the OECD/G20 Inclusive Framework on BEPS. This note indicates that the final recommendations, due in 2020, will centre on changing rules that assign countries the right to tax profit based on either a physical presence or a tangible transaction.

**Digital services taxation—interim actions**

Interim measures to deal with digital services taxation have been explored internationally.

The European Commission (EC) proposes allowing EU countries to apply company tax to large sellers of digital services even if the company offering the service does not have a physical presence in the country. The EC also considered the implementation of an interim ‘digital service tax’ (DST) rate of three per cent—applied only to businesses with total annual worldwide revenues exceeding €750 million and EU taxable revenues exceeding €50 million. The DST has not yet received support from all EU member nations. Moreover, the 2018 OECD interim report identifies that the economic cost of such taxes: (i) are likely to be borne by consumers (rather than MNCs); (ii) may have adverse economic impacts; and (iii) could be inconsistent with international trade obligations.

Treasury’s discussion paper on the Digital Economy notes that the current composition of taxation in Australia may mean digitisation has a pronounced effect on Australian tax revenue:

Australia relies more heavily on corporate income tax than comparable OECD countries. 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.

Following consultation on the discussion paper, the Treasurer announced on 20 March 2019 that the government had considered the concerns of stakeholders and decided not to implement any interim measures. Australia will continue to engage with the OECD’s multinational process on these issues.

**Further reading**
