THE WRONG TAX SYSTEM FOR THE DIGITAL AGE

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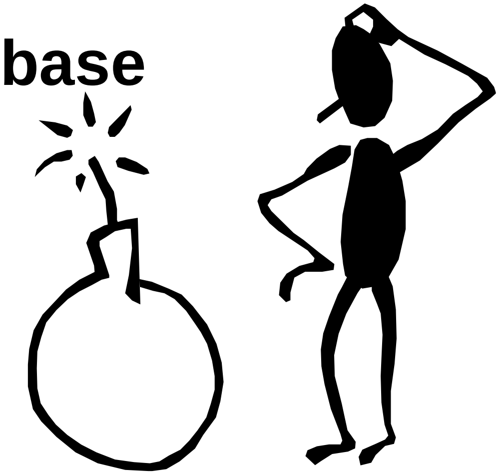
Do we have a problem?



1. We rely very heavily on the income tax base
   - PIT is 40% of total tax revenue (TTR)
   - CIT is 20% of TTR
   - consumption taxes are 27% of TTR
   - [see next slide]
2. The CIT base in particular will become ever harder to tax as a result of many perfectly legitimate (and some suspect) profit shifting strategies by MNCs such as Apple, Glencore, Google, Vodaphone etc
3. BEPS reflects this concern big time

Tax Mix: OECD Averages 1965-2011 (Australia in brackets)

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	1965	1975	1985	1995	2005 (2007)	2011
PIT	26 (34)	30 (44)	30 (45)	26 (41)	24 (37)	24 (39)
CIT	9 (16)	8 (12)	8 (10)	8 (14)	10 (23)	9 (20)
SSC	18 (-)	22 (-)	22 (-)	25 (-)	25 (-)	26 (-)
Payroll	1 (3)	1 (6)	1 (5)	1 (7)	1 (5)	1 (5)
Property	8 (11)	6 (9)	5 (8)	5 (9)	6 (9)	5 (9)
Consumption	36 (35)	31 (29)	32 (33)	32 (29)	31 (27)	31 (27)
Other	2 (1)	2 (-)	2 (-)	3 (-)	3 (-)	3 (-)

What is the problem?

- The prospect of an ever diminishing corporate tax base as a result of mobile global capital (combined with stresses on the personal income tax base as a result of globally mobile labour and an ageing population)
- This constitutes a serious long term risk to revenue
- The risk to revenue is compounded by loss of tax sovereignty and perceptions of an unfair tax system
- As a result a tax architecture that was designed for a bygone era is perceived to be no longer fit for purpose

What can be done about the problem?

- Do nothing
- Move house
- Renovate
- Re-design and re-build

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Moving house?

1. Downsizing

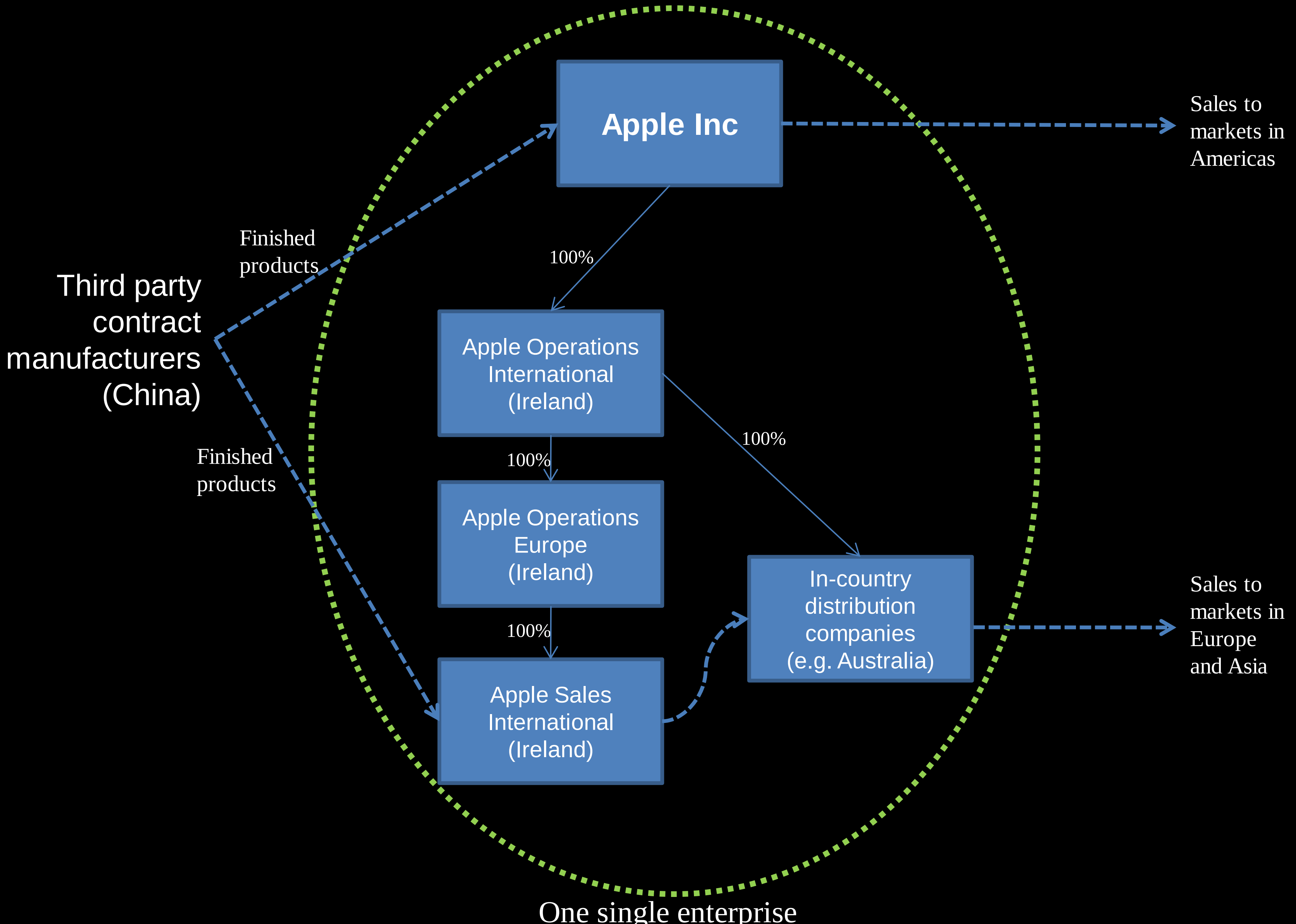
2. Shifting bases
   - The consumption tax option?
   - The under-utilised wealth tax base?
   - Back to Henry?

Renovation?

- The OECD/G20 BEPS approach
- Improve tax system integrity through
  - tighter residency, transfer pricing, thin capitalisation and CFC rules
  - better GAARs
  - improved information exchange
- Essentially unilateral/bilateral
- Always playing catch up

Re-design and re-build

- A more radical solution
- Requires
  - ✓ multilateral action
  - ✓ treat MNCs as a single entity
  - ✓ submission by MNCs of one global profit report to all countries in which they operate
  - ✓ allocation of taxable profits to the countries where business activities are conducted on a pre-determined basis (sales/physical assets/employees)
  - ✓ each country then sets own tax rates


Apple Inc
Sales to markets in Americas
Finished products
100%
Third party contract manufacturers (China)
Apple Operations International (Ireland)
100%
100%
Finished products
Apple Operations Europe (Ireland)
In-country distribution companies (e.g. Australia)
Sales to markets in Europe and Asia
100%
Apple Sales International (Ireland)
One single enterprise

Conclusions

- There is no magic recipe or silver bullet
- Accept that the tax mix may need to change somewhat (consumption; land & resources) but…
- CIT base may be hard to tax but that is no justification for not continuing to tax it and it will continue to be an important base
- OECD G20 BEPS initiatives may help (though I have doubts)
- But ultimately a paradigm shift in international taxation from futile national attempts to tax separate legal entities to one which taxes single global enterprises at a national level on a pre-determined share of consolidated global profits will have to take place, notwithstanding:
  - the inertia effect of the existing rules (including information and resource asymmetry between MNCs and revenue authorities)
  - the power of the MNCs to resist change
  - the ambivalence (and hypocrisy) of governments