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Taxes, the Internet and the Digital Economy

Abstract

The Internet and the Digital Economy have disturbed and outmanoeuvred taxes. First, there is the problem of taxing transactions that take place across the Internet. Services can be delivered digitally. Some goods are digital goods – for example, software programs, music and videos downloaded from the Internet. Can and should you tax such transactions with a sales tax, and if so where? Second, the Internet has aided global and multinational companies to shift their business about the world to catch favourable tax environments. The Digital Economy is nimble. For example, Google came under fire when the web giant paid just £6m corporation tax, while notching up £2.5bn of sales in the UK. One headline stated: ‘Google 2.4% Rate Shows How \$60 Billion is Lost to Tax Loopholes’. Apple has also attracted criticism. In response, Apple welcomed an examination of the US tax system, ‘which has not kept pace with the advent of the digital age and the rapidly changing global economy’. In our increasingly borderless globe, national tax laws cannot do the job on their own. Global companies – especially the digital multinationals – are easily able to elude higher taxing jurisdictions. Capital moves fluidly and at lightning speed but these dramatic efficiencies of the digital economy comprehensively disrupt taxing patterns. National economies are being forced to cooperate, to shore up the revenue leaks and to pursue some sort of common ground and global parity among tax systems.

Keywords

global tax, tax evasion, tax avoidance, taxing intangibles, e-commerce tax, double irish, google tax, apple tax, online sales tax

TAXES, THE INTERNET AND THE DIGITAL ECONOMY

JIM CORKERY*, JAY FORDER**, ENRICO MERCURI*** AND DAN SVANTESSON****

The Internet and the Digital Economy have disturbed and outmanoeuvred taxes. -First, there is the problem of taxing transactions that take place across the Internet. Services can be delivered digitally. Some goods are digital goods – for example, software programs, music and videos downloaded from the Internet. Can and should you tax such transactions with a sales tax, and if so where? Second, the Internet has aided global and multinational companies to shift their business about the world to catch favourable tax environments. The Digital Economy is nimble. For example, Google came under fire when the web giant paid just £6m corporation tax, while notching up £2.5bn of sales in the UK.¹ One headline stated: ‘Google 2.4% Rate Shows How \$60 Billion is Lost to Tax Loopholes’. Apple has also attracted criticism. In response, Apple welcomed an examination of the US tax system, ‘which has not kept pace with the advent of the digital age and the rapidly changing global economy’. In our increasingly borderless globe, national tax laws cannot do the job on their own. Global companies – especially the digital multinationals – are easily able to elude higher taxing jurisdictions. Capital moves fluidly and at lightning speed but these dramatic efficiencies of the digital economy comprehensively disrupt taxing patterns. National economies are being forced to cooperate, to shore up the revenue leaks and to pursue some sort of common ground and global parity among tax systems.

INTRODUCTION

Google, Amazon and Facebook produce invisible digital products. Like the Invisible Man,² these products can be made and moved anywhere on the globe, leaving few traces. This is where the threat to tax systems lies. The term ‘cloud computing’ implies this borderless mobility or, as the tax offices would have it, their elusiveness. It is hard to tax invisibles (or commandeer and sell them if company taxes are not paid). It is difficult to contain the cloud or give it a residence for tax purposes. Much has changed since 1696 when King William III introduced the window tax in England and Wales, based on the number of windows of a property and therefore the implied wealth of the owner.³ Similar taxes on bricks, glass and even wallpaper had the virtue of

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¹ Katherine Rushton, ‘Google: Tax Controversy Has Not Deterred Users’ *The Telegraph* (online), 15 January 2013, <<http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/digital-media/9803523/Google-tax-controversy-has-not-deterred-users.html>>.

² In HG Wells’ *The Invisible Man* (1897), Griffin the scientist makes himself invisible, but cannot reverse the procedure. In his disappointment, he takes to murder.

³ *An Act for granting to His Majesty several Rates or Duties upon Houses for making good the Deficiency of the clipped Money* [Chapter XVIII. Rot. Parl. 7&8 Guil. III. p. 5. n. 4]. Conversely, not much has changed in tax avoidance strategy: taxpayers under William III began to brick up windows. Taxes on glass and bricks

tangibility, at least. Intangibles are notoriously difficult to catch and count. This article will address the issues raised above by examining the tax avoidance practices of MNEs.

AN ONLINE SALES TAX

'Bricks and mortar' retailers already collect sales tax. They have long protested that untaxed online retailers have an unfair advantage. The United States' House of Representatives is tackling sales tax on online purchases and, while appreciating the complexity of the issues, trying to keep it simple. Though collecting sales tax can be costly, technology makes it easier, and the gain in revenue could be enormous.

The United States Bureau of the Census estimated that \$4.1 trillion worth of retail and wholesale transactions were conducted over the Internet in 2010. That amount was 16.1% of all U.S. shipments and sales in that year. Other estimates, based on different data, projected the 2011 so-called e-commerce volume at approximately \$3.9 trillion. The volume, roughly \$4 trillion, of e-commerce is expected to increase, and state and local governments are concerned because collection of sales taxes on these transactions is difficult to enforce.⁴

The principle of technology-neutral law suggests that online purchasers should pay the same tax as in-person purchasers. Some online purchasers do pay sales tax, because it is charged by the vendor and the vendor has a base within the purchaser's jurisdiction. In the US, under a 1992 Supreme Court ruling, states cannot make out-of-state retailers collect sales taxes – unless the seller has a bricks and mortar presence in the state, such as a shop. In most states with sales taxes, consumers should keep track of online purchases and pay sales tax as a 'Use Tax'. Buyers and consumers invariably ignore that requirement.

Sales tax is hardly a game breaker for purchasers – buyers will not stop using the Internet simply because a sales tax is imposed. Consumers are accustomed to sales tax and no doubt regard the inability to collect Internet sales tax as an anomaly. Big e-commerce sellers tend to support an Internet sales tax. They often have in-state retail outlets and thus, tax is collected anyway. Their warehouses are stuffed with products ready for same day delivery. This is not so with smaller operations which, unsurprisingly, tend to oppose the imposition of tax.

Many brick-and-mortar stores are behind the implementation of an online sales tax system for obvious reasons, as are big box retailers like Target who already have to pay sales tax on most online transactions because they have physical locations in many states. States are also keen on a fix because they're losing out on an estimated \$23 billion in sales tax revenue per year [in the US].

E-commerce giant Amazon went from opposing to supporting online sales tax proposals recently, most likely because it will help the company stay competitive with other online retailers as it expands its physical operations into more states to support same-day delivery.⁵

had their architectural impacts. 'Taxes on light and air', they were called, and they were blamed for rampant unhealthiness in cities.

⁴ Steven Maguire, *State Taxation of Internet Transactions* 2013
<https://www.fas.org/sgp/crs/misc/R41853.pdf>

⁵ <<http://www.washingtonpost.com/blogs/the-switch/wp/2013/09/18/heres-the-republican-vision-for-a-national-internet-sales-tax-system/>>.

TAXING THE DIGITAL MULTINATIONALS

The imposition of an online sales tax may assist governments searching for ways to grow their tax base, which became an imperative during the Global Financial Crisis. Governments were eager to source new taxes, to enable them to insert fiscal stimulus into their economies. This focussed attention on the wealthy but low-taxpaying multinationals.

High-tech companies tend to place their massive banks of computer servers and their technical centres of management in countries with reasonable living standards, favourable weather and friendly corporate tax rates. While the average global corporate tax rate is well over 20% (the US is 35%), some countries spruik their low rates. Ireland's corporate tax rate is 12.5%, while individual countries impose even lower rates and Bermuda does not tax corporations at all. Little surprise, then, that Google's massive profits may end up in Bermuda. How, then, does it get there?⁶

It begins with Google licensing its intellectual property, largely created in America, to Google Ireland Holdings. The Irish company then licences it to a Dutch company, which licences it back to a second Irish company, Google Ireland Ltd, located in downtown Dublin.⁷ This Dublin entity employs most of the staff and sells Google's products (including advertising) across the globe. It is estimated that most of Google's non-US sales — about 90% — go through or are sold by the Dublin entity.

In 2008, the Dublin entity reported profits of less than 1% of the sales total. How come? The Dublin entity claimed massive deductions for royalty payments it makes on its licensed intellectual property; i.e., the Dublin entity pays the first Irish company, Google Ireland Holdings, over \$5 billion for the Google intellectual property, a cost that is deducted directly from the Dublin entity's profits. The privileged deduction of various 'business' costs such as intellectual property, miscellaneous legal costs, and executive stock options – popular with top executives – are a significant tax advantage companies have over personal taxpayers.

Doesn't that mean that Google Ireland Holdings, also located in Ireland, pays Irish corporate taxes on these profits? Not so. Google Ireland Holdings says its 'effective centre of management' is Bermuda. This makes it a Bermudian entity, rather than an Irish entity. Under Irish law, it is subject to the tax system of Bermuda. This manoeuvre, intuitively termed a Double Irish, means that Google Ireland Holdings pays no taxes.

In involving the Dutch company, the scheme misses Irish withholding taxes, too, as royalties for the intellectual property do not go straight to Bermuda:

To steer clear of an Irish withholding tax, payments from Google's Dublin unit don't go directly to Bermuda. A brief detour to the Netherlands avoids that liability, because Irish tax law exempts certain royalties to companies in other EU-member nations. The fees first go to a Dutch unit, Google Netherlands Holdings BV, which pays out about 99.8 % of what it

⁶ See Jesse Drucker, 'Google 2.4% Rate Shows How \$60 Billion is Lost to Tax Loopholes', *Bloomberg* (online), 21 October 2010, <<http://www.bloomberg.com/news/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html>>; see also Edward D Kleinbard, 'Stateless Income' (2011) 11(9) *Florida Tax Review* 699; Mike Secombe, 'Google: Don't Be Evil, Don't Pay Tax', *The Global Mail* (online), 7 June 2012, <<http://www.theglobalmail.org/feature/google-dont-be-evil-dont-pay-tax/261/>>.

⁷ The reason the licence passed through The Netherlands is explained later in this article.

collects to the Bermuda entity, company filings show. The Amsterdam-based subsidiary lists no employees. Inserting the Netherlands stopover between two other units gives rise to the 'Dutch Sandwich' nickname.⁸

The *Double Irish Dutch Sandwich* minimised Google's taxation liability by approximately \$3.1 billion in 2008–2010 (only about 3% of what would have been required, had US tax law been applied).⁹

This taxation phenomenon is not limited to Google. Other high-tech companies like Facebook, Microsoft, IBM, Amazon, and Paypal use similar systems to minimise their corporate taxes.¹⁰ Companies from emerging economies are seeking to emulate them. Chinese e-commerce mammoth Alibaba filed its registration statement in May 2014 with the US Securities and Exchange Commission. The initial public offering (IPO) is estimated to raise US\$20 billion which, if achieved, will eclipse the IPOs of Visa, Facebook and General Motors.¹¹

Relevantly, Alibaba is headquartered in Hangzhou, China, where it conducts most of its operations. However, the company is incorporated in the Cayman Islands and conducts business in China through its subsidiaries and *variable interest entities* (VIEs). The prospectus asserts Alibaba is not a resident of China under the relevant Chinese Enterprise Income Tax Law test. It is not clear what view Chinese authorities are taking of this interpretation.¹²

Apart from residence issues, there may also be transfer-pricing concerns regarding whether transactions between the parent and its subsidiaries are indeed arm's length. According to registration documents Alibaba founder, executive chair and principal shareholder, Jack Ma, is also majority shareholder of the VIEs.¹³ For their part the VIEs have contractual agreements with Alibaba, which allows Alibaba to exercise control over them. The structure of the arrangements is described as uncertain and not well-tested. Consequently, their integrity may pose the risk of adjustments by tax authorities.¹⁴

These multinationals are doing what is instinctive financial behaviour. They minimise their taxes within the law. They do this by operating entities in low-tax countries, and by relying on the separate personality doctrine – a company is a separate person from its shareholders and directors and must be treated as such for tax purposes – to legally operate in other jurisdictions. If the funds are 'brought back' to the US, for example, they would face a relatively high tax rate of 35%. Hence Tim Cook, CEO of Apple, was urging the US to declare a tax holiday on returning or repatriated funds, so that they would indeed return and bolster the strengthening US economy: 'If

⁸ Drucker, above n 6.

⁹ Ibid.

¹⁰ Ireland is no innocent bystander in this. The Irish economy profits tremendously from the number of multinational corporations located there, employing local staff, paying local living expenses, and so on. See, eg, Simon Duke, 'The Anti-Social Network', *The Sunday Times* (online), 12 February 2012, <http://www.thesundaytimes.co.uk/sto/business/Tech_and_Media/article871166.ece>.

¹¹ Amanda Athanasiou, 'Chinese E-Commerce Giant's IPO Filing Exposes Tax Risks' *Tax Analysts* 9 May 2014 <http://www.taxanalysts.com/www/features.nsf/Features/3356949F5492E90B85257CD30046FF5C?OpenDocument>.

¹² Ibid. See reference to the Circular 82 test.

¹³ Ibid.

¹⁴ See as an example the discussion below of the broader discretion of the Commissioner of the ATO in making adjustments in transfer-pricing cases.

Apple had used its overseas cash to fund this return of capital, the funds could have been diminished by the very high corporate U.S. tax rate of 35 percent'. Having already paid taxes in, say, Ireland of 2% or 15%, the companies could claim that as an offset, but would still be required to pay taxes up to the 35% that operates in the US. Given the economic advantages to the US, Mr Cook's proposal is worth serious consideration. It is the best way to bring the profits home and subject them to reasonable taxes in a manner tolerable to business.

RESIDENCE AND SOURCE

Tax liability attaches to a taxpayer's *residence* or to income derived at *source*. In other words, the taxing rights are associated with the taxpayer's geographical location and its commercial activities.

The historical rules on residence and source struggle to be effective in the digital economy. Where are these intangibles located, and where are the commercial activities performed? Geographical constraints such as the residence of a company once dominated considerations of what tax it would pay. In a tangibles-based economy, the identification of who owes how much is more easily achieved. With the increase of international trade, identification of income source also became important, as sovereigns negotiated treaties to determine who had the right to tax that form of income. This led to the concept of *jurisdiction to tax*.

Today, jurisdiction to tax involves the process of treaty signatories allocating taxing rights between them. The intention is to ensure taxpayers are only taxed once. This means allocating taxing rights to certain income to the country of residence; for other forms of income, the allocation may apply to both countries, with the country of residence providing tax relief for the tax paid in the other country; less commonly, the country where the income is sourced is allocated exclusive taxing rights.¹⁵

Where treaty partners both claim to be a taxpayer's residence and/or source, there are also 'tie-breaker' rules which ensure that, for the purposes of the double tax agreement, the taxpayer only has one country of residence or income source subject to double tax relief.¹⁶ The established rules seek a balance in allocating taxation rights. Previously, where there has been dispute as to where the taxpayer is resident, relevant tests have been applied.¹⁷ Correspondingly, the question of income being regarded as source income and taxed accordingly is one of fact rather than law.¹⁸

This approach has become somewhat anachronistic. Taxpayer group members can now be residents of no jurisdiction. That is, they are stateless. Consequently, there is no jurisdiction to tax at all. Edward D Kleinbard comments:

¹⁵ Taxation Ruling TR 2001/13 Income tax: Interpreting Australia's Double Tax Agreements at paragraph 9.

¹⁶ Ibid paragraph 13.

¹⁷ Section 6(1) *Income Tax Assessment Act 1936*.

¹⁸ *Nathan v FCT* (1918) 25 CLR 183, Isaacs J at 189. Further, the substance of the facts overrides legal form: *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886 and *Esquire Nominees Pty Ltd v FCT* 73 ATC 4114.

Stateless income comprises income derived for tax purposes by a multinational group from business activities in a country other than the domicile of the group's ultimate parent company, but which is subject to tax only in a jurisdiction that is neither the source of the factors of production through which the income was derived, nor the domicile of the group's parent company.¹⁹

In its current 'tax erosion' or BEPS²⁰ discussion draft, the OECD laments:

Companies may ... use arbitrage between the residence rules of the intermediate country and the ultimate residence country to create stateless income.²¹

This, then, lies at the heart of matter. The responsibility for tax payments to a jurisdiction is alienated through use of legal constructs. The OECD comments, again:

Broadly speaking, the same techniques that are used to reduce taxation in the market country are often utilised also to reduce taxation in the country of the ultimate parent company of the group or where the headquarters are located. This can involve contractually allocating risk and legal ownership of mobile assets like intangibles to group entities in low tax jurisdictions, while group members in the jurisdiction of the headquarters are undercompensated for the important functions relating to these risks and intangibles that continue to be performed in the jurisdiction of the headquarters.²²

This strategy creates a corporate culture where responsibility for taxation is distanced from both the residence and income source of the relevant taxpayer. The funds subject to this treatment become detached from the concept of taxable income, yet remain controlled by the taxpayer or its delegates. The net result is nullification of tax liability, whilst retaining the full value of economic transactions. As Nelson Rockefeller advised; 'the secret to success is to own nothing, but control everything.'

A CURRENT SOLUTION: TAXING TRANSFER-PRICING

One fix for this problem has been to tax transfer-pricing. Transfer-pricing is where companies overcharge or undercharge various related entities for goods and services, and thereby shift profits around to gain tax advantages. The ploy is a favourite of multinational corporations, who point to the separate personalities of their various companies and brandish the 'arms-length' principle to justify related entities being treated as separate for tax purposes. This principle is confirmed in the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2010). It suggests certain strategies for regulating tax transfer-pricing to minimise the more extreme results. Australia has introduced this legislation.²³

¹⁹ *Stateless Income* Edward D Kleinbard USC Gould School of Law November 15, 2011. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1791769

²⁰ OECD, 'Base Erosion and Profit Shifting' (BEPS). *About BEPS*. <http://www.oecd.org/tax/beps-about.htm>

²¹ Public Discussion Draft. *BEPS Action 1: Address the tax challenges of the digital economy*. 24 March 2014 – 14 April 2014

²² *Ibid* para 134.

²³ *Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012* (Cth); *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Sharing) Bill 2013* (Cth).

One of the issues with a transfer-pricing tax involving intellectual property and intangible assets is that the price of these assets is difficult to calculate and compare against a ‘normal’ corporate asset price.²⁴ The OECD is redrafting its chapter on *Transfer Pricing Aspects of Intangibles* to address concerns.

In addition, and in response to transfer-pricing concerns, Australian authorities have issued draft guidance material on interpreting new transfer-pricing legislation.²⁵ This material now gives the Commissioner of Taxation greater discretion to reconstruct transactions in cases where the conduct of the relevant parties does not conform to their written agreement. Further, the Commissioner can make adjustments when the agreement itself does not conform to the way unrelated parties would otherwise transact with one another.²⁶ As a result, parties are theoretically restrained to true arms’ length dealing on commercial terms, under threat of having their transactions undone for tax purposes. This draft has raised concerns over the increase in breadth of the Commissioner’s discretion and the related subjectivity of analysis in arriving at the decision to reconstruct transactions.

A GLOBAL FINANCIAL TRANSACTION TAX (FTT)

To combat global poverty, the Human Rights Council of the UN proposed, in 2012, the introduction of a global *financial transaction tax* (FTT). In response, the European Telecommunication Network Operations Association (ETNO) suggested a *Global Internet Tax* - taxing Internet companies when they deliver content. One commentator, Rifat Azam, proposes a *Global E-Commerce Tax* (GET) – a 15% flat rate on net income from cross border transactions – be established by an international treaty and imposed by a supranational institution, the Global Tax Fund. The aim, again, is for the tax receipts to fund global public goods.²⁷ Azam maintains the GET would not infringe on the separate economic and political status of countries, while achieving ‘legitimate, certain, efficient and fair taxation on cross border e-commerce income’.²⁸

INTERNET DATA TAX

French economists have created a unique solution to tax intangible assets — an Internet data tax. To secure some meaningful tax payments from Google and other multinationals,²⁹ France considered a new tax on personal data.³⁰ Colin (Inspector of Finance)³¹ explains to *Forbes*:

²⁴ See, eg, Kleinbard, above n 6, 734; Seccombe, above n 6.

²⁵ Amanda Athanasiou. ‘Australian Transfer Pricing Guidance Departs From OECD Guidelines.’ *Worldwide Tax Daily*, 21st April 2014.

²⁶ Ibid. Also see s 815-130 Income Tax Assessment Act 1997.

²⁷ Rifat Azam, ‘The Political Feasibility of a Global E-Commerce Tax (2013) 43 *The University of Memphis Law Review* 2.

²⁸ Ibid 3.

²⁹ Google receives 2 billion Euros each year in revenues from France, but pays a trifling amount of tax: Richard Dunlop-Walters, ‘France Suggests a Tax on Data Collection’, *The Brief* (online), 21 January 2012, <<http://thebrief.io/news/france-suggests-a-tax-on-data-collection>>.

³⁰ This follows an earlier proposal to tax online advertising, which has languished due to complaints from the industry that it would affect small businesses rather than multinational corporations like Google.

³¹ Pierre Collin and Nicolas Colin, *Mission d’expertise sur la fiscalité de l’économie numérique* (Fact-Finding Mission on the Taxation of the Digital Economy) (January 2013) <http://www.redressement-productif.gouv.fr/files/rapport-fiscalite-du-numerique_2013.pdf>.

The report mainly recommends that developed countries recover the power to tax profits made by giant tech companies. A new definition of a permanent establishment must be introduced, grounded in the fact that users play a key role in digital value creation. Through user data, value is created where applications are used by people, not only in Bermuda or in the Cayman Islands.³²

The report suggests France negotiate with the EU and the OECD to implement definitions and rules. The tax rate would depend on the company's compliance with data protection standards, how many users are tracked, and whether their ownership of the data is respected.³³ Companies would be required to self-report, supervised by external auditors.

This type of tax raises several questions. For example, it is unclear how it will impact data protection. The scheme may strengthen data protection, as the annual auditing process would require firms to file declarations indicating the extent of data monitoring.³⁴

On the other hand, companies that pay a tax for the personal data they use may feel a certain degree of ownership over that data, a sense of ownership that may be harmful to data protection. Further, the monitoring and auditing of the scheme may be privacy invasive in itself:

The report indicates that the annual declaration filed by Internet companies would be subject to audit and that as the last resort, the government may look at incoming and outgoing data flows at peering points. The report acknowledges that this would be extremely difficult in practice and may require deep packet inspection, which raises other thorny issues.³⁵

There are issues of how the tax rates are calculated. The formula for different types of data and quantities is 'likely to be highly contentious', including the proposal that freely-provided information (like holiday photos uploaded onto Facebook) should be included as taxed data.³⁶

The report has not been endorsed by the French government.³⁷ The proposals require a major change to the economy, where 'users effectively work for companies like Google and Facebook, providing what they call the "raw material" of the digital economy: personal information, used for selling advertising'.³⁸ French users of the Internet may end up paying for their data, in the event Google, Facebook and others opt to pass on taxes to the consumer.

³² Nicolas Colin, 'Corporate Tax 2.0: Why France and the World Need a New Tax System for the Digital Age', *Forbes* (online), 28 January 2013, <<http://www.forbes.com/sites/singularity/2013/01/28/corporate-tax-2-0-why-france-and-the-world-need-a-new-tax-system-for-the-digital-age/>>.

³³ Ibid; see also Winston Maxwell and Xenia Legendre, 'French Report Recommends Privacy Tax', *Hogan Lovells Chronicle of Data Protection* (online), 22 January 2013, <<http://www.hldataprotection.com/2013/01/articles/international-eu-privacy/french-report-recommends-privacy-tax/>>.

³⁴ Winston Maxwell and Xenia Legendre, *ibid*.

³⁵ *Ibid*.

³⁶ Anna Leach, 'Oh, Those Crazy Frenchies: Facebook Faces Family Photo Tax in France', *The Register* (online), 24 January 2013, <http://www.theregister.co.uk/2013/01/24/france_potential_data_tax/print.html>.

³⁷ Eric Pfanner, 'France Proposes an Internet Tax', *The New York Times* (online), 21 January 2013, <<http://www.nytimes.com/2013/01/21/business/global/21iht-datatax21.html>>.

³⁸ Dunlop-Walters, above n 29.

COORDINATION OF INTERNATIONAL TAX TREATIES TO CLOSE OFF LOOPHOLES

By registering in the Cayman Islands, Vanuatu, or Delaware for that matter, the digital multinationals gain vast tax advantages. Google pays tax at a lowly rate of 2.4%, barely a flesh wound. Starbucks paid no corporate tax in Britain last year. Apple likewise – using its complex system of subsidiaries over the world – pays little in taxes. This is not illegal behaviour; it is tax minimisation. Boardrooms may feel it is their duty to minimise taxes while pursuing the maximisation of profits. But there is public anger at the cynical artificiality of the manoeuvres and the sheer volume of taxes minimised:

As Nelson D. Schwartz and Charles Duhigg report in the *New York Times* on Tuesday, Congressional investigators found that some of Apple's subsidiaries had no employees and were largely run from the company's headquarters in Cupertino, Calif. But by officially locating them in places like Ireland, Apple was able to, in effect, make them stateless — exempt from taxes, record-keeping laws and the need for the subsidiaries to even file tax returns anywhere in the world.³⁹

In 2010, the island groups of British Virgin Islands, the Cayman Islands and Bermuda sheltered US companies that earned \$130 billion, although their total population was only about 150,000. The scale of these hidden earnings is illustrated in that, by contrast, those companies earned only \$12.6 billion in China from its huge population. Nothing illegal occurred, they point out – our tax law allows such minimisation to exist. US companies can report profits in low-tax countries where they in fact have no income generating operations. There are thousands of subsidiaries of multinationals in these tax havens, most of them routing profits and paying the local tax rate, which is sometimes zero.⁴⁰

These strategies have a darker side, where financial and legal engineering are confronted with the forces of commercial reality. Such ingredients are a frightening echo of the characteristics behind the implosion of US corporate giant Enron. In that case, management employed off balance sheet liabilities and the use of 441 entities in the Cayman Islands in the year it filed for bankruptcy.⁴¹

The US Government Accountability Office (GAO) commented:

Certain investment banks facilitated and participated in complex financial transactions with Enron despite allegedly knowing that the intent of the transactions was to manipulate and obscure Enron's true financial condition.⁴²

³⁹ 'Apple's Web of Tax Shelters Saved It Billions, Panel Finds' 20 May 2013 *NYTimes*
http://www.nytimes.com/2013/05/21/business/apple-avoided-billions-in-taxes-congressional-panel-says.html?pagewanted=all&_r=0

⁴⁰ *NYTimes* 5 June 2014 'The Islands Treasured by Offshore Tax Avoiders' <
<http://www.nytimes.com/2014/06/06/business/the-islands-treasured-by-offshore-tax-avoiders.html?mabReward=RI%3A11&action=click&contentCollection=Business%20Day®ion=Footer&module=Recommendation&src=recg&pgtype=Blogs>>.

⁴¹ United States General Accounting Office. GAO Report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services Investment Banks. 'The Role of Firms and Their Analysts with Enron and Global Crossing.' Reference: GAO-03-511.

⁴² *Ibid.*

The bankruptcy declaration of its debt levels was substantial but showed only part of the picture:

Enron's bankruptcy filings show \$13.1 billion in debt for the parent company and an additional \$18.1 billion for affiliates. But that doesn't include at least \$20 billion more estimated to exist off the balance sheet.⁴³

The collapse has of course led to the human cost. Much of it was borne by its staff of 31,000.

Finally, technology now available to traders can lead to unpredictable consequences. High Frequency Trading makes use of algorithms to engage in acquisition of investment positions.⁴⁴ These positions can be held for mere microseconds. As the volume of trading can account for up to 75% of all buying and selling of US equities, it was not surprising that, in 2010, there was the infamous 'flash crash.' A 2011 example of this was the fluctuation of the share price of insurance company Enstar Group Ltd, which went from US\$100 to US\$0 and back to \$100 in milliseconds.⁴⁵ Such investment positions are taken and liquidated by computers acting independently of human control. What will happen when High Frequency Trading is combined with engineering of transactions of multiple entities based across multiple secrecy jurisdictions? As this becomes an increasing reality, without appropriate controls it may be that corporate accountability is sacrificed for commercial advantages. In the event of a crash, will it be possible to identify responsibility for the social impact that would ensue?

CORPORATE SOCIAL RESPONSIBILITY – IT'S RESPONSIBLE TO PAY TAX

The concept that corporations owe social duties is relevant here. Digital multinationals were rooted in social responsibility activism – 'Do No Evil' was Google's first motto. Some show willingness to direct Internet liberated profits towards supporting the societies in which they operate - by paying more taxes, as well as by doing good works. They are developing a philanthropic edge and they court socially responsible reputations. For some, social responsibility is at the core of their branding. In the tax area, this leads to an acknowledgement that it is fair and proper to pay taxes where the work is performed and the income generated. After all, the infrastructure in which the companies operate is paid for by local taxes, the markets into which they sell their products are created there, and so too the education and social systems that are instrumental in their prosperity.

From the Paris School of Economics, Thomas Piketty's *Capital in the Twenty-First Century* (2014) argues that, with wealth in the form of capital polarising in the hands of the wealthy, taxing capital wealth is fair and makes sense. Inequality is growing unacceptably: taxes will help to reduce that. The tax would be small at lower levels but more substantial (5% pa) if you were a billionaire. The tax would have to be global, otherwise the wealthy would shift their wealth to havens to avoid the impost. There has been an apparent capital flight from France in 2013 – 14 recent times following its tax on wealth.

⁴³ *Boomberg Business Week Magazine*. 'The Fall of Enron.' December 16, 2001
<http://www.businessweek.com/stories/2001-12-16/the-fall-of-enron>

⁴⁴ Corkery and Zornada, 'High-frequency trading and a financial transactions tax' (2012) 22 *Revenue Law Journal* <http://epublications.bond.edu.au/rlj/vol22/iss1/3>.

⁴⁵ *Ibid*.

Although it appears to be impractical while nations still assert their individual tax sovereignty, wealth taxes are more achievable with sophisticated computers and dramatically increased cooperation among tax authorities. We have a version of a global tax for Australian residents who are taxed on their worldwide income (Americans are, too), and there is powerful technology to make this work. Profitable entities place significant value in their reputation, and sometimes transparency, shaming and reputational risk can do the work of a thousand regulators.

Google and Amazon came under fierce attack from MPs and tax campaigners after fresh whistleblower allegations put further strain on claims by the internet giants that their multibillion-pound UK-facing businesses should not be taxed by Revenue & Customs.

Margaret Hodge, chair of the public accounts committee, told Google's northern Europe boss, Matt Brittin, that his company's behaviour on tax was 'devious, calculated and, in my view, unethical'.

He had been recalled by MPs after being accused of misleading parliament over the firm's tax affairs six months ago. Hodge said: You are a company that says you 'do no evil'. And I think that you do do evil.' Hodge was referring to Google's long-standing corporate motto, 'Don't be evil,' which appeared in its \$23bn US stock market flotation prospectus in 2004.⁴⁶

The famous retort by Australian business leader Kerry Packer - that giving more money in tax to what he thought were bureaucratic and wasteful governments is sending good money after bad - will not do in this more socially-responsible age, although he made a popular point.⁴⁷ Bureaucratic waste ought to be controlled, but society's infrastructure is best paid for by broad taxes, which spread the burden onto those who can afford to pay more. US companies paid an effective tax rate of 12.6% in 2010, reports *Dealbook* at the *NYTimes* on 15 April 2014: 'That compares with the nominal federal tax rate of 35 per cent, so all those accountants appear to have done their jobs in exploiting the loopholes in our tax code'.

Global transparency about who pays what taxes and where is part of the solution. Multinational miner Anglo-American reports taxes paid by country, which gives insight into their global operations including any shifting of profits and minimisation of tax. For their part, companies will find it useful to record the variety of taxes they pay. Their reputation as diligent taxpayers should be valuable, just as a reputation as carbon neutral or being generously philanthropic add lustre to a corporate name.

⁴⁶ Bowers and Syaz, 'MP On Google Tax Avoidance Scheme: "I think that you do evil"?' 17 May 2013 <http://www.theguardian.com/technology/2013/may/16/google-told-by-mp-you-do-do-evil>.

⁴⁷ 'The late media mogul Kerry Packer turned tax minimisation into a national sport with his 1991 appearance before a parliamentary inquiry, when he said anyone who didn't do everything legal to reduce their tax bill "wanted their head read because I don't think you're spending it that well that I should be donating extra". In that spirit, HLB Mann Judd, a firm of accountants and business and financial advisers, has listed checks that investors and taxpayers should make before the end of the financial year, to ensure that they not only take full advantage of all regulations available to them but also avoid falling foul of them.' http://www.brw.com.au/p/investing/like_penny_more_packer_not_penny_LzPhkkGui60ZETHqkJYC AI. See also <http://en.wikipedia.org/wiki/Kerry_Packer>.

Putting an end to income/profit shifting, so that income is taxed where it is earned in fact rather than in form, will require unprecedented international cooperation. Thought might even be given to recompensing the tax havens, in the unlikely event they were put out of business. They currently rely on the enormous corporate and tax minimisation industries that they host.

IN CONCLUSION

We have sought to draw attention to some significant tax-related issues in e-commerce, and some potential approaches for addressing those issues. In our increasingly borderless globe, national tax laws cannot do the job of taxing equitably and fairly on their own. Global companies – multinationals – easily elude higher taxing jurisdictions, one way or the other. Capital now moves so fluidly and at such speed that the efficiencies that make the digital economy so attractive are also the great disrupter of taxes and taxing patterns.

The economies of the globe are being forced to cooperate and pursue that elusive goal of integrity and fairness across nations, not just within individual economies. The global debate on fair taxes is just beginning. The ringmasters in that debate are the OECD, the G20, the central banks, the UN, as well as the leaders of the larger economies. The UN discussed in 2012 the imposition of global taxes on the very wealthy and on financial transactions that span the globe, to enable the UN to redistribute income more equitably across the globe and to solve the more urgent problems of resources and shortages.

[T]he global taxes slated to be considered by the UN this year [2012] are a 1 percent tax on billionaires around the world, a ‘tiny’ tax on all financial transactions worldwide and even yet another fee tacked on to already heavily-taxed airline tickets. Columbia University Professor Jeffrey Sachs, who also serves as an UN assistant secretary general, suggests that global excises include carbon taxes and other green-friendly initiatives in order to find a way to tackle the ever-present issue of climate change. ‘We have to make a technological transition that’s quite deep to new energy systems, new transport systems, more efficient buildings and that can be back loaded,’ Sachs said to the media earlier in the week at a Climate Week NYC conference in New York.⁴⁸

Rarely is a tax debate shaped by moral rather than legal or commercial issues. It is happening now. It was once thought that a defensible course was to scrupulously minimise one’s taxation – and publicly doubt governments’ competence with money, to boot. The new transparency along with its ‘name and shame’ approach and social media allies are changing all that.⁴⁹ It is nigh on impossible to keep one’s tax affairs confidential. As part of the broader trend towards Corporate Social Responsibility, multinationals are becoming publicly assessed and their brands are being shaped by their tax contributions, among other criteria. There is reputational risk in being exposed as minimising – let alone avoiding – tax.

We do not any longer seriously resist taxes, although we may resent them. It is considered moral to pay taxes – immoral to avoid them. Society is appreciating what good taxes can do and what absence of taxes and ill-disciplined collection of tax means to a nation. This leads to a consideration of whether a low financial transactions tax extracted worldwide for the UN will be our first global tax. A small tax on transfers of wealth – financial transactions – will also

⁴⁸ 28 September 2012 < <http://rt.com/usa/un-global-tax-carbon-252/>>.

⁴⁹ See Ernst & Young’s 2013 report *Tax Transparency – Seizing the Initiative* [http://www.ey.com/Publication/vwLUAssets/Tax_Transparency_-_Seizing_the_initiative/\\$FILE/EY_Tax_Transparency.pdf](http://www.ey.com/Publication/vwLUAssets/Tax_Transparency_-_Seizing_the_initiative/$FILE/EY_Tax_Transparency.pdf).

discourage high-frequency movements of vast sums to speculate and distort our stock markets and financial systems.

The tools of the digital economy may well make it easier to minimise tax. They also make it easier to collect them, and easier to pursue benefits through a unified global approach. Globalisation and the digital economy have disrupted taxation systems. But they will also eventually simplify taxation, minimise tax avoidance and enable us seriously to consider fair taxes across the globe.