



International Tax in the Digital Age: A Blueprint for Allocating Profits

Kerrie Sadiq



ACKNOWLEDGEMENT OF TRADITIONAL OWNERS

QUT acknowledges the Turrbal and Yugara, as the First Nations owners of the lands where QUT now stands. We pay respect to their Elders, lores, customs and creation spirits. We recognise that these lands have always been places of teaching, research and learning.

QUT acknowledges the important role Aboriginal and Torres Strait Islander people play within the QUT community.

What is the project about?

This project aims to investigate tax avoidance by multinational enterprises in the age of the digital economy. It addresses the difficult problem of determining the location in which profits are made. The project expects to generate new knowledge in international tax by developing a blueprint for allocating profits of multinational enterprises between jurisdictions that aligns with profit making activity and reduces international tax avoidance. A systematic structure for allocating profits of multinational enterprises will address the important problem of tax base erosion caused by profit shifting. This will provide the significant benefit of developing a major tool in securing Australia's revenue base in the digital age

How is it funded?

- Future Fellowships provide 4-year fellowships to outstanding Australian mid-career researchers.
- The objectives of the *Future Fellowships* scheme are to:
 - support excellent basic and applied research and research training by outstanding mid-career researchers to be recruited and retained by universities in continuing academic positions
 - support national and international research collaboration
 - enhance the scale and focus of research in Australian Government priority areas

Process

- Outcomes are based on advice from the ARC Selection Advisory Committee (SAC) which:
 - assigns independent assessors to review the applications
 - assesses applications and reviews assessments made by independent assessors
 - reviews candidates' comments on assessors' reports
 - ranks each application relative to the others on the basis of the application, the assessors' reports and candidates' responses to those assessments
 - assesses and recommends budgets;
- and, advice from the ARC's National Competitive Grants Program (NCGP) Eligibility Committee which:
 - considers eligibility issues identified by ARC staff, the members of the ARC College of Experts or independent assessors
 - where required, seeks advice from the ARC's Medical Research Advisory Group
 - make recommendations to the CEO in respect of ineligible applications.

Assessment Criteria

- Investigator/Capability (50%)
- Project quality and innovation (25%)
- Benefit (15%)
- Feasibility and strategic alignment (10%)

Outcomes

Table 2. Comparison of application numbers, success rates, requested and allocated funds for approved Future Fellowships applications from 2021 to 2022

Funding year	Applications considered	Applications approved	Success rate (%)	Requested funds over project life for all applications considered (\$)	Requested funds over project life approved applications (\$)	Funds allocated over project life approved applications (\$)	Return rate for approved applications (%)
2021	675	100	14.8	\$676,822,277	\$100,291,555	\$93,020,678	92.78
2022	627	100	15.9	\$645,938,071	\$103,014,716	\$94,249,836	91.5

Outcomes

Table 3. Application numbers, success rates, requested and allocated funds for approved Future Fellowships applications 2022

Salary Level	Applications considered	Applications approved	Success rate (%)	Requested funds over project life for all applications considered (\$)	Requested funds over project life approved applications (\$)	Funds allocated over project life approved applications (\$)	Return rate for approved applications (%)
Level 1	140	24	17.1	\$121,083,669	\$21,066,284	\$19,093,859	90.6
Level 2	236	39	16.5	\$237,573,794	\$39,234,087	\$35,796,579	91.2
Level 3	251	37	14.7	\$287,280,608	\$42,714,345	\$39,359,398	92.1
Total	627	100	15.9	\$645,938,071	\$103,014,716	\$94,249,836	91.5

How do you get a grant?

- What's your passion?
- What grant are you applying for?
- Are you eligible?
- Read about the grant (instructions, previous successes, ...)
- Plan, and then plan some more.
- Write, re-write, and then write it again.
- Seek feedback (and listen!).
- The details matter.
- Budget?

START EARLY

What do you write?

- Who is your audience?
- Why are you the person to do the project?
- What makes you stand out?
- Why does this work need to be done?
- Why do you need money?
- What are your outputs?
- What impact will this grant have if successful?

TELL A STORY

BE AUTHENTIC



International Tax in the Digital Age



International Tax in the Digital Age

Conservative estimates of the loss of tax revenue in Australia due to multinational entities avoiding paying tax is approximately AU\$4.2 billion per year. There is a rapidly diminishing capacity of nations to secure any share of the profits of multinational entities by any tax or other means in the current technological environment. In a post COVID environment, addressing the tax challenges of the digitisation of the economy, ensuring multinational enterprises pay taxes, and developing approaches to meet the need to collect more tax revenues are likely to provide even greater impetus to reach fiscal solutions to international tax avoidance. The [project team](#) is generating new knowledge in international tax by developing a blueprint for allocating profits of multinational enterprises between jurisdictions that aligns with profit making activity and reduces international tax avoidance. This will provide the significant benefit of developing a major tool in securing Australia's revenue base in the digital age.



Our events

[Find out more](#)



Project team

[Meet our people](#)

News

Kerrie Sadiq comments on why the OECD's proposed Pillar One and Pillar Two needs to be introduced in Australia

The Global Minimum Tax and its Effects on Countries' Tax Regimes

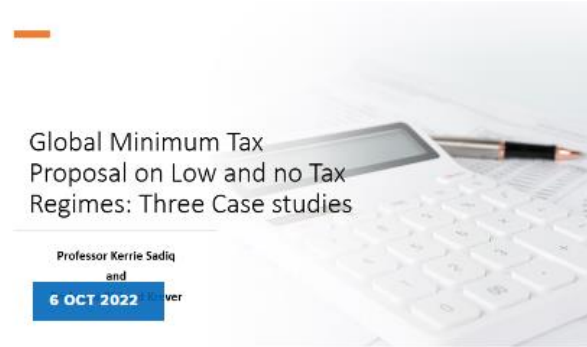
Diagnosing the Corporate Income Tax Compliance Burden: A Cross-Country Assessment

The Impact of the Global Minimum Tax Proposal
Rethinking Noncommercial Loss Rules During Times of Hardship



Kerrie Sadiq comments on why the OECD's proposed Pillar One and Pillar Two needs to be introduced in Australia

By [Kerrie Sadiq](#)
In [News updates](#)



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Why we need to reform Australia's international tax regime

🏠 ▸ News updates ▸ Why we need to reform Australia's international tax regime

AUG 30 2022

By Kerrie Sadiq | In News updates



Read our response to the Treasury Consultation Paper "Government Election Commitments: Multinational Tax Integrity and Enhanced Transparency" outlining why the measures should be adopted as soon as possible: [MNE Tax Integrity](#)

Global agreement on corporate taxation: addressing the tax challenges arising from the digitalisation of the economy

20 days left to have your say

Date: 04 October 2022 - 01 November 2022

Consultation Type: Consultation Paper

Email: contact.internationaltax@treasury.gov.au

Key Documents

[Consultation paper](#) - PDF 781.18 KB

[Consultation paper](#) - DOCX 794.33 KB


[October 2021 statement \(OECD\)](#) - PDF 214.7 KB

[GloBE model rules and commentary \(OECD\)](#) - PDF 4.47 MB

On 8 October 2021 [Australia and over 130 other countries endorsed proposed international corporate tax reforms](#) to address the challenges arising from the digitalisation of the economy. These reforms were developed by the OECD Inclusive Framework on Base Erosion and Profit Shifting and presented as a two-pillar solution that would help ensure that multinationals pay their fair share of tax in the jurisdictions in which they operate.

Impact of the Global Minimum Tax Proposal: A Case Study Approach





Why a case study?

- Allows us to move on from questions such as:
 - Will Pillar Two be implemented?
 - What is Pillar Two trying to achieve?
 - How will the technical aspects of Pillar Two work?

(These are all important questions and have been addressed in the literature)

Will Pillar Two be implemented?

- This presentation is done in a manner that suggests Pillar Two will be implemented.
- There are those who would ask the question as to why a jurisdiction should prepare for Pillar Two at all.
 - The US has stalled in relation to its introduction, and it is unlikely that Pillar Two legislation will be introduced in that jurisdiction in the near future.
 - There is also the failure to achieve consensus on a draft directive to implement Pillar Two in the EU with both Poland and Hungary objecting due to the absence of any steps towards Pillar One.
- Despite such opposition, jurisdictions should prepare for the consequences of Pillar Two adoption by jurisdictions that are home to large MNEs. These jurisdictions will introduce an IIR that affects jurisdictions that have an ETR below the minimum rate.
- Consensus is that adoption by a critical mass of countries will result in an effective GloBE.

What is Pillar Two trying to achieve?

Limit tax competition by introducing a floor

And/or

Address profit shifting

How will the technical aspects work?

- Challenges centred on using financial accounting principles
- OECD Commentary and examples released in March 2022

Design Elements

- Income Inclusion Rule (IIR)
- Backstop Undertaxed Profits Rule (UTPR)
- Qualified Domestic Minimum Top Up Tax (QMTT)
 - Substance Based Income Exclusion (SBIE)
- Subject to Tax Rule (STTR)



The diagram consists of two large blue curly braces on the right side of the slide. The top brace groups the first three bullet points (IIR, UTPR, and QMTT/SBIE) under the label 'GloBE Rules'. The bottom brace groups the fourth bullet point (STTR) under the label 'Treaty Based Rule'.

GloBE
Rules

Treaty Based
Rule

Key Formulas

$$\text{Top-up Tax} = \text{Top-up Rate} \times (\text{Adjusted GloBE Income}^* - \text{SBIE}^*) - \text{QDMTT}^*$$

where

$$\text{Top-up Rate} = 15\% - \text{ETR}^*$$

where

$$\text{ETR} = \frac{\text{Adjusted Covered Taxes}^*}{\text{Adjusted GloBE Income}^*}$$

QDMTT

- The QDMTT, introduced into the Model Rules released in December 2021.
- Its most notable feature is the fact that the QDMTT takes priority over the IIR and UTPR as the final stage in the calculation of the Jurisdictional Top-up Tax is the deduction of any Domestic Top-up Tax.
- However, where a jurisdiction does not implement a QDMTT, it risks the benefits of any incentives that have been granted being lost by the MNE and a consequence tax gain by the jurisdiction of the UPE.

Qualified Refundable Tax Credits (QRTS)

Qualified Refundable Tax Credits are treated as income for purposes of the GloBE Rules, which means the credit is taken into account in the denominator of the ETR computation and is not treated as reducing a Constituent Entity's taxes in the year the refund or credit is claimed.

Non-Qualified Refundable Tax Credits are excluded from income but treated as a reduction to Covered Taxes in the period the refund or credit is claimed, which means they reduce the numerator of the ETR computation.



Substance Based Income Exclusion (SBIE)

The amount of this substance-based income exclusion is equal to the sum of (i) 5% of the carrying value of tangible assets located in the jurisdiction and (ii) 5% of the payroll costs for employees that perform activities in the jurisdiction.

Case Study Approach

What is the impact of the GloBE on different types of regimes?



Case Study One: Restrictive Source Rules

Based on the case of *Newfair Holdings Ltd. v. Commissioner*, [2022] HKCFI 1133

See Sadiq and Krever, *Tax Notes International*, Volume 106, June 13, 2022, p1417

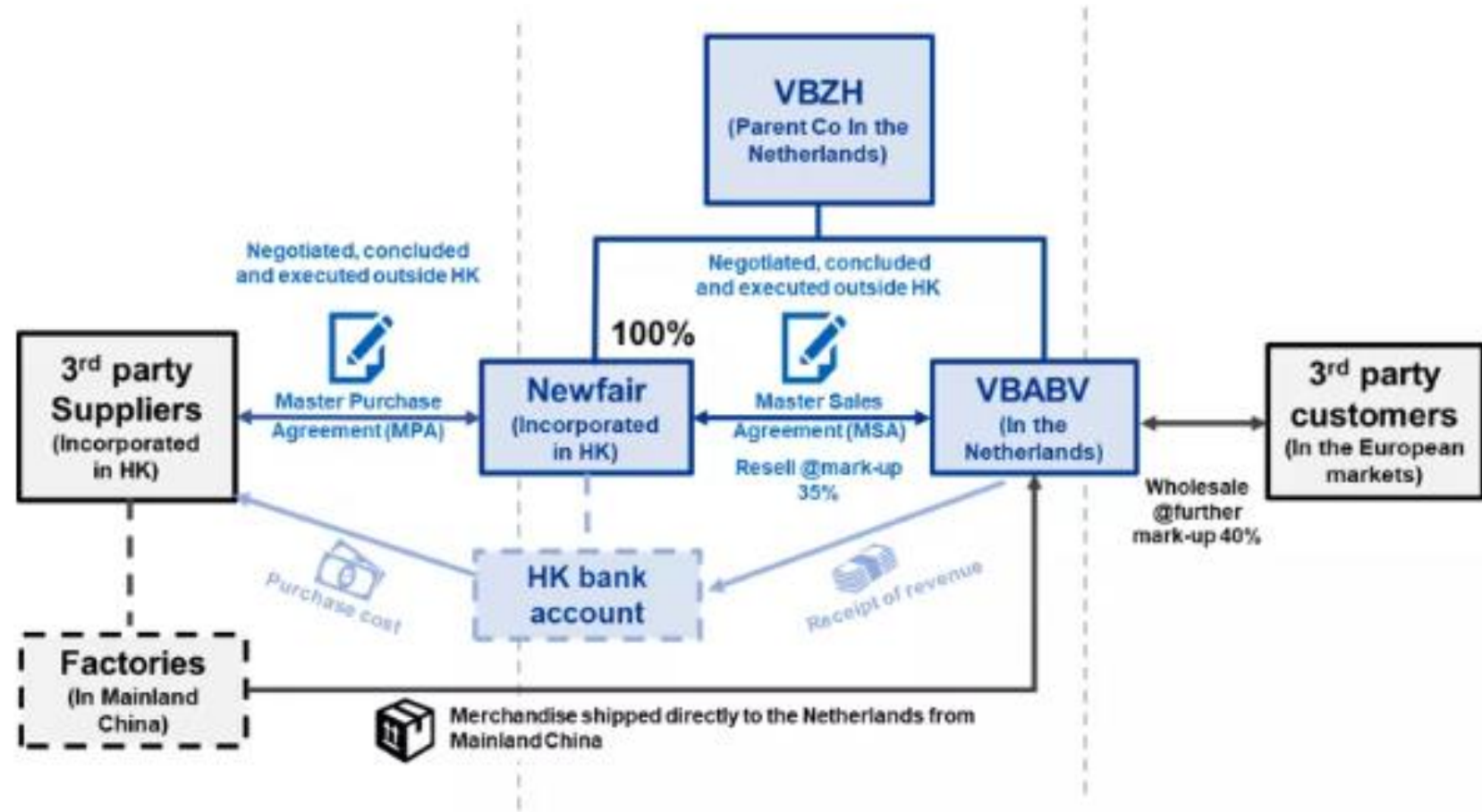
Newfair

A Dutch company importing goods from unrelated suppliers in China incorporated a related Hong Kong firm to act as an intermediary for its purchases from China. A substantial markup of 35 percent was added to the goods by the intermediary firm when the goods were resold to the Dutch owner, thereby diverting much of the Dutch firm's profit to Hong Kong.

If the scheme were successful, a substantial portion of the Dutch firm's profits would have been shifted from the Netherlands, where the company tax rate was at the time 25 percent, to Hong Kong, where the company tax rate was at the time and remains 16.5 percent.

The parties sought a bigger tax savings, however, with an argument that the large profits derived by the Hong Kong firm were exempt from Hong Kong tax.

Newfair arrangement



The Claim for Exemption

- Hong Kong operates a territorial company income tax system.
- *Newfair* claimed it had neither carried on a business in Hong Kong nor derived profits from a source in Hong Kong, leaving the profits outside the Hong Kong tax base.
 - Judicial precedents established by the Hong Kong courts set out two conditions for profits to be characterized as “arising in Hong Kong”: the profits must have a source in Hong Kong and be derived by a business carried on in Hong Kong.
- For the first limb of the source test, the Hong Kong court, relying on long-standing U.K. precedent, agreed with the taxpayer that profits from business contracts for the purchase and sale of inventory are sourced where the contracts are made or, in the words of the ruling precedent, where the contracts are “effected.”
- The court in *Newfair* rejected the confluence of economic profits and business profits. It agreed with the submission by Inland Revenue that the sole purpose of the taxpayer was to act as a tax minimization repository for diverted profits and that all actions carried out by the company through its agents were done toward this end. However, it distinguished the company’s *role* from its *operations*. It was the business activities of the company that gave rise to the profits, not the role, and under English law as applied in Hong Kong, the business operations are carried on where the contracts are made, which was not in Hong Kong.

Current Risks to Hong Kong

A strong case for a finding by the tax authority in the owner's higher-tax jurisdiction that the Hong Kong company has a PE in the higher-tax country in which the owner is located.

Hong Kong has broadly supported the OECD's international tax reform agenda and is a signatory to the inclusive framework on base erosion and profit shifting.

In 2018 it enacted a new transfer pricing regime codifying rules that are largely consistent with the OECD transfer pricing guidelines and it has introduced formal transfer pricing documentation requirements in line with country-by-country reporting.

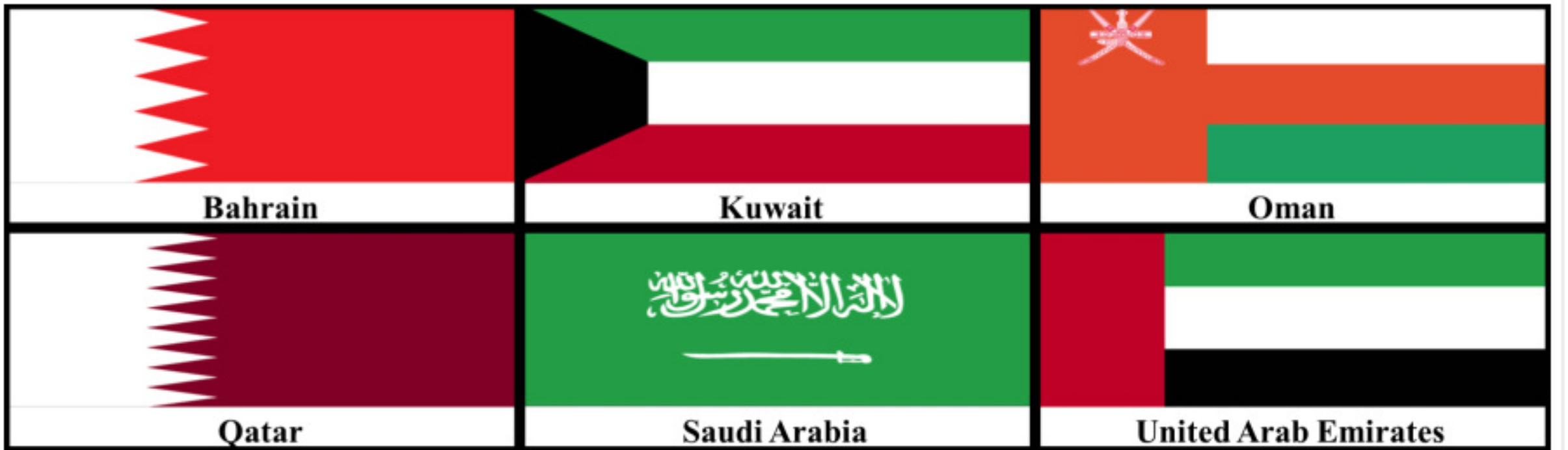
Hong Kong does not fall into the OECD's list of tax havens because it does have full information exchange processes in place.

The risk for Hong Kong as a host jurisdiction grows.

HK: Possible Responses to Pillar Two

- Dutch parent company may enact Pillar Two (EU Directive?)
- Benefit of the arrangement to Mayfair is lost (subject to thresholds, etc)
- HK still fails to collect any tax unless:
 - Alters its source rules (currently precedent) but CIT 16.5%
 - Introduces a QDMTT
 - Provides QRTC
- What about companies in jurisdictions that do not adopt Pillar Two (perhaps the US)?

GCC Countries



GCC Considerations



IN SCOPE
TAXPAYERS



IN SCOPE INCOME



ASSESS THE TYPES
OF INCENTIVES
OFFERED

Factors affecting GCC Countries

Country	Corporate Tax Rate	Number of Tax Treaties
Qatar	10%	60
Kuwait	15%	82
Oman	15%	31
Saudi Arabia	20%	51
UAE	9% from June 1, 2023 (limited corporate tax already exists for enterprises engaged in exploration and production of oil and gas up to 55% and branches of foreign banks at 20%)	112
Bahrain	0% (Proposals for the introduction in 2023)	44

What could GCC countries do?

01

Maintain the status quo. That is, do not introduce the GloBE domestically

02

Introduce a qualified domestic minimum top up tax (QDMTT)

03

Reconsider the design of incentives

04

Increase existing corporate taxes to ensure an ETR at the global minimum rate of 15%

05

Implement a broad-based corporate income tax regime that applies to all businesses; and/or

06

Implement a bifurcated threshold based corporate tax system (15% would apply to companies forming part of a group that meets the €750 million threshold.)

Case Study Two: Special Economic Zones

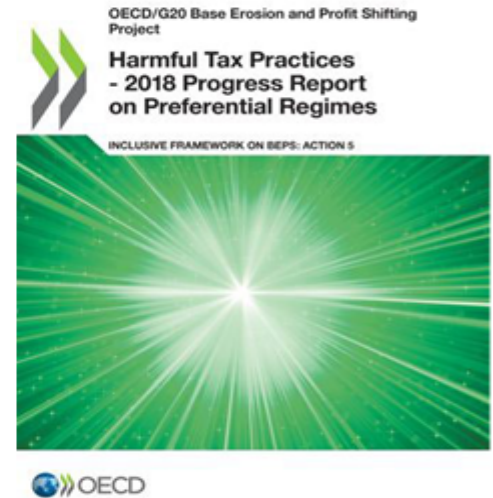
Harmful Tax Practices – Peer Review Results

INCLUSIVE FRAMEWORK ON BEPS: ACTION 5

Update (as of January 2022)

Original report available at:

<http://www.oecd.org/ctp/harmful-tax-practices-2018-progress-report-on-preferential-regimes-9789264311480-en.htm>



7.	Qatar	Exemptions and concessionary rate under Qatar financial centre (QFC)	Not harmful (amended)	Substance requirements (non-IP) in place. No grandfathering provided.
8.	Qatar	Free zone at science & technology park	Not harmful (amended)	Substance requirements (nexus approach and non-IP) in place. Grandfathering in accordance with FHTP timelines.
9.	Qatar	Free zone areas	Not harmful (amended)	Substance requirements (nexus approach and non-IP) in place. Grandfathering in accordance with FHTP timelines.

Qatar Science and Technology Park (QSTP)

Substantial Activity Requirement:

“A QSTP entity shall carry out real economic activities, shall have a substantial economic presence in Qatar Science & Technology Park (QSTP) and shall not facilitate structures or arrangements aimed at attracting profits which do not reflect real economic activity in QSTP.”

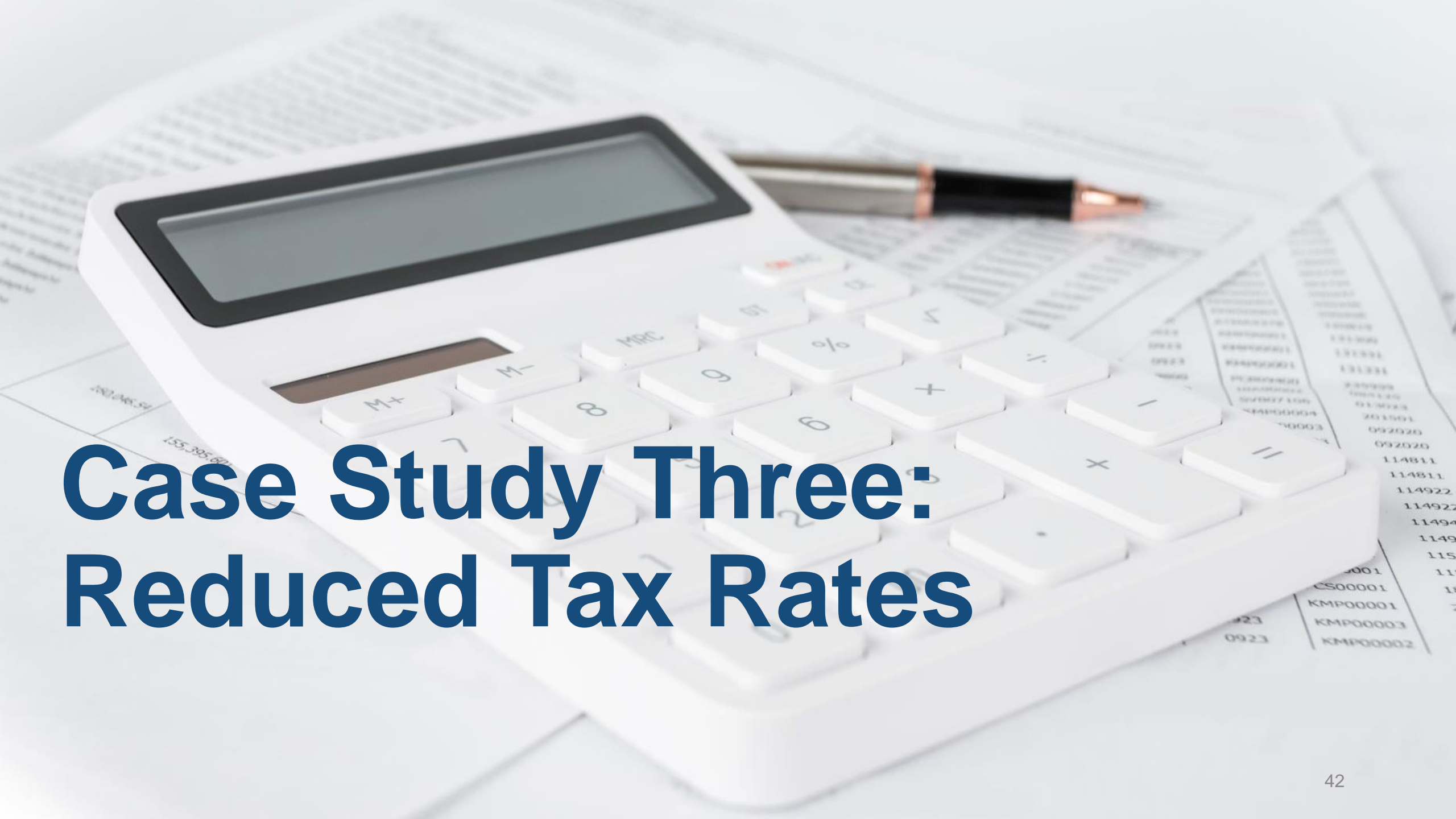


Zone	Incentive	Pillar Two effect
Green (Little or no impact)	Temporary differences: Accelerated depreciation Loss carry-forward	Adjustments taken into account during calculations
	Participation exemption regimes	Dividends received are excluded from the tax base for the purposes of calculating the GloBE ETR
	Imputation regimes	Refunded qualified imputation taxes are included in taxes for the purposes of the ETR calculation
	Withholding tax incentives	Taxation of outbound passive income not included
	Tax Deferral	Recognised and allowed in certain circumstances
Yellow (Impact is dependent on the circumstances)	Deductible qualified expenses	Common ones amongst Inclusive Framework members allowed
	Specific exemptions based on location, sector or entity	Will depend on whether the entity and income is in-scope. Where taxpayer is in-scope and the ETR is below 15%, the Pillar Two rules may be triggered
	Patent Boxes	Where a patent box regime brings the ETR below 15% the Pillar Two rules may be triggered
	Tax Credit Refund	May bring the ETR below 15% and the Pillar Two rules may be triggered
	Capital Gains Tax	Where a CGT is below 15%, the Pillar Two rules may be triggered
Red (Incentive is affected for in scope MNEs where ETR is below 15%)	Zero or less than 15% CIT	GloBE ratio will generally be below minimum, and Top-Up Tax will be payable
	“Tax Holiday”	Likely to bring ETR below 15%, so the Pillar Two rules may be triggered

Impact of Pillar Two

- Tax exemptions will likely lose their attraction.
- Accelerated depreciation and loss carry-forward provisions remain effective.
- Other incentives will be affected to various degrees.
- What remains:
 - substance-based carve-out;
 - shifting to incentives that are less affected by Pillar Two (capital intensive)
 - reducing taxes that are not covered by Pillar II, to the extent that they have a bearing on investment decisions.

**What is most
likely to
occur?**

A white calculator with a black display screen and a black pen with a gold-colored tip, resting on a document with a table of numbers. The calculator is positioned diagonally across the frame. The pen is lying horizontally behind the calculator. The document features a table with multiple columns of numbers, including some with leading zeros and others with negative signs.

Case Study Three: Reduced Tax Rates

Factors affecting GCC Countries

Country	Corporate Tax Rate	Number of Tax Treaties
Qatar	10%	60
Kuwait	15%	82
Oman	15%	31
Saudi Arabia	20%	51
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THANK YOU