ECONOMIC NOTES

TAXING TECH COMPANIES

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Technofeudalism, the latest book by Yanis Varoufakis (2023) describes 'cloud capital' as fundamentally different to capitalism as we know it. Varoufakis argues that we are witnessing a shift comparable to the emergence of capitalism as it emerged from within a feudal economic system. Speaking to the Press Club in Australia about it when visiting Australia in 2024, he pointed to the six things that this cloud capital (as encountered in Amazon or Alibaba) does all at once: it grabs our attention; it manufactures our desires; it sells to us, directly, outside any actual markets, that which will satiate the desires it made us have; it drives and monitors waged labour inside the workplaces; it elicits massive free labour from us, its cloud-serfs; and It provides the potential of blending seamlessly all that with free, digital payments. As he said, 'is it any wonder that the owners of this cloud capital – I call them cloudalists – have a hitherto undreamt-of power to extract?' (Varoufakis 2024).[1]

Because cloudalists originate almost exclusively in the US and China, the competition between them is integral to the dangerous competition between the two superpowers. Seen in this way, the resulting conflict is 'the manifestation of a dangerous clash between two technofeudal systems – one denominated in dollars, the other in yuan' (Varoufakis 2024).

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[1] The 'power to extract' may be taken as referring to extracting value from all the other parties that the cloudalists deal with, whether they know it or not

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As well as being integral to the increasing superpower tensions – in which Australia, via AUKUS, has become more embedded – the cloud has thrown up other issues with which the governments and people of many countries are having to grapple. There are issues of privacy, the issue of 'theft' of news and other produced content, the use of artificial intelligence, and issues to do with anti-competitive behaviour. The last of these issues is an ongoing concern in Australia, where the ACCC is presently in the middle of a five-year inquiry into the intensity of competition, the concentration of power, the behaviour of suppliers, mergers and acquisitions, barriers to entry or expansion and changes in the range of services offered by suppliers of digital platform services (ACCC no date). A Parliamentary committee, the Joint Select Committee on Social Media and Australian Society, recently reported on measures to address the refusal by Meta (Facebook's owner) to renew its funding deals to compensate for the content it steals from Australian media organisations (Doherty 2024). The final Parliamentary committee report is expected to focus on 'online safety, the influence of algorithms on social media feeds, the effects of social media on the mental health of users and age verification technology' (Doherty 2024). The networks seemingly refuse to counter issues such as on-line bullying, sexual harassment, and racism.

Outside Australia, the American Department of Justice is acting against Google which 'pays more than $10bn to Apple and other companies to be the default search engine on their platforms' (*Economist* 2023). Amazon, which charges very high commissions, 'penalises [sellers] for offering cheaper prices on other platforms by downranking products or removing them from the "Buy Box", which allows instant purchases' (*Economist* 2023). Amazon is said to have 40% to 50% of the US ecommerce market.[2] The EU has also been active against abuses. The Australian Government has also been in dispute with X (formerly Twitter) which has refused to ban footage of an attempted assassination likely to induce copy-cat behaviour (Worthington 2024). Arguably, a seventh characteristic could be added to Varoufakis' list of cloudalism's characteristics: recidivism.

[2] For all categories Amazon's share is forecast to be 40.4% for 2024 and can be expected to be higher in categories such as books and recorded music (Lebow 2024).

In private discussion during his recent time in Australia, Varoufakis suggested that the power of the cloudalists might be partially addressed by imposing a special monopoly tax on them. From another direction, Matt Comyn, CEO of the Commonwealth Bank, suggests a $5 billion tax on tech companies, perhaps in the form of a tax on payments to their head offices (Kehoe 2024). Comyn is in dispute with Apple in particular because of the ApplePay monopoly. As The *Financial Review* noted: 'CBA and Apple are locked in a fight for control of billions of dollars of card payments that are made with mobile phones' (Eyers 2021). Apple only allows its own 'digital wallet' to access iPhone's near-field communication (NFC). This means tap-and-go payments have to be made through Apple, which takes a fee in the process. From a wider perspective, this also fits into the cloudalists' strategy of using their unregulated global power to take on banking and payments systems in national jurisdictions (Varoufakis 2023).

The Varoufakis/Comyn tech tax proposal, especially the suggestion that the tax be on payments to head office, reflects one of the mechanisms used to transfer profits out of Australia. For example, Apple Australia is charged by Apple Ireland for the use of intellectual property (IP). Ireland has very low tax rates on certain global incomes as a way of attracting that type of activity to Ireland. That type of transfer can include patents, trademarks, business practices and so on. But there is no logical reason (apart from tax avoidance) why a particular part of Apple should be treated as that which generates the profits on IP. Arguably, that should be allocated internationally according to sales. If so, Comyn's proposal would address some of that sales revenue currently escaping tax.

How much tax do the cloudalists pay?

Table 1 shows the pre-tax income or 'profits' of the various tech giants and expresses that as a share of their total sales or receipts in 2023. Its first column of data shows figures for the global share of profits to sales; and the second column shows comparative figures for Australia, as reported to the Australian Tax Office. Hence for example, Facebook/Meta reports taxable income of 10.0% of sales in Australia while globally the figure is 35.1%. Tesla may appear the odd one out in this group, but it is included because it now includes X (formerly Twitter).

Table 1: Pre-tax income as share of total sales/receipts, 2023 (%)

	Global	Australia
Amazon	-1.1	6.4
Apple	29.7	3.8
Facebook/Meta	35.1	10.0
Google/Alphabet	25.2	21.9
Microsoft	42.1	4.6
Tesla	16.8	3.2

Source: author's calculations based on companies' Annual Reports and ATO (2024).

All but one of the tech companies shown in Table 1 reported lower profit rates for their Australian operations than for their global operations. The exception was Amazon which declared a global loss. All the other giant tech companies appear to have contrived their affairs to make it look like their profitability in Australia is lower than what they have been earning overseas. There is a credibility issue here, because there is no general reason to believe that it is harder to service or otherwise to do business, in Australia than the rest of the world. On this basis, the tech companies have an obligation to explain why they apparently earn a much smaller margin on their sales in Australia. Taking Apple for example, it is hard to understand why its profitability on Australian sales is a mere 3.8%, while its profitability on sales globally is 29.7%.

Taking account of research and development (R&D) spending by the tech companies makes the situation appear yet more anomalous. Currently R&D is treated as an expense and so is deducted from revenue when declaring a profit. Arguably, however, R&D is more of an investment that should not be included as an operating expense. More importantly, R&D on behalf of these companies does not take place in Australia, so that we are not comparing like-with-like when comparing the figures in Table 1. To deal with this concern, Table 2 compares the Australian and global profitability data without R&D expenditures. Its first column of figures shows each company's global income after deduction of R&D spending expressed, as a percentage of its global sales revenue. The right-hand

column shows the profit rate in Australia, as before. That adjustment to the global profitability calculation clearly makes a large difference for the comparison between the global and Australian figures. In all cases, the gap widens substantially when seen in terms of the R&D-adjusted profit rates.

Table 2: Pre-tax income as share of total sales/receipts, after deducting R&D expenditures, 2023 (%)

	Global	Australia
Amazon	13.1	6.4
Apple	37.5	3.8
Facebook/Meta	63.7	10.0
Google/Alphabet	39.2	21.9
Microsoft	55	4.6
Tesla	20.6	3.2

Source: As for Table 1.

Thus, the adjustment for where the tech companies undertake their R&D, on a like-for-like basis, makes the global profit per sales figure look much higher. The very much lower profit rate that the companies claim to be making in Australia is indicative of an artificial lowering that is motivated by tax-minimisation. For example, by excluding R&D spending, the figure for Facebook/Meta's global profitability on sales is 63.7%, while its Australian operation records only a 10% profitability on sales. This is not just a wide difference in the numbers: it points also to a huge credibility gap.

Indeed, it almost inconceivable that such a striking differences between profitability in Australia and the world as a whole are attributable to some inherent attribute/s of the Australian economy. Much more probably, the outcomes reported in Tables 1 and 2 are indicative of successful attempts to disguise Australian profits and make them appear elsewhere in low tax jurisdictions. The tech companies clearly have a case to answer.

How do they do it?

Although Netflix is not included in the list of cloudalists considered so far, it provides a recent and egregious example of multinational tax avoidance in Australia. In 2023, Netflix reported $1.1 billion in revenue, but it paid a $1.01 billion 'distribution fee' to other Netflix companies (Buckingham-Jones 2024). Apparently, most of this used to be paid to Netflix International BV, a Dutch subsidiary. This contrivance ensured that very little tax ($9.4 million in calendar 2023) is paid in Australia (Buckingham-Jones 2024). Tax office figures show that, in 2022-23, Netflix Australia declared just $2.4 million as taxable income on sales of $1,154.9 million and paid no tax (Australian Tax Office 2024).

In 2014, the *Australian Financial Review* reported on Australian-based companies using complex tax avoidance schemes based on secret tax deals in Luxembourg via multinational accounting firm PwC (Chenoweth 2014). The cited means of tax avoidance include 'hybrid debt structures, total swap returns, royalty payments and intra-group loans to reduce taxes.' The article further claims that 'the ability to move profits around the world purely by paperwork in return for what seems a minor fee to Luxembourg is a recurrent feature in the leaked tax agreements' (Chenoweth 2014).

License fees for intellectual property are one of the key means of avoiding Australian tax. This is the case for multinational corporations generally as they can avoid taxation in Australia by claiming to make huge payments overseas for access to IP through licensing arrangements. It is a form of 'transfer pricing', the general practice of transferring profit from high to low tax jurisdictions via artificial third-party transactions. Years ago, it referred to the then common practice of selling commodities below market values from Australia to a subsidiary in *e.g.* Hong Kong, which on-sold them at a profit to another subsidiary *e.g.* in Japan. Although the commodities never entered Hong Kong, the paper transactions would show the profit as due to the Hong Kong subsidiary. These activities, especially those relating to alumina and bauxite exports, were the subject of pathbreaking study by the Transnational Corporations Research Project (TCRP) created and headed by Ted Wheelwright, assisted by Greg Crough. The summary of the TCRP's work by Evan Jones (1982) says that, although it was met with general distain, it appears to have been influential in a High Court judgement that supported the Australian Tax Office against tax avoidance arrangements by Commonwealth Aluminium Corporation

Ltd. The judgement by Justice Murphy (1980) quotes extensively from that TCRP literature on transfer pricing.

The concept applies just as well to the international 'sales' of services. Transfer pricing by high tech companies still involves transfers between related entities, but now the payments are for more ephemeral services that often cannot be measured or quantified. They are now supposedly payments for the right to use IP, business models, brands and the like. Consumers pay a big premium for the tech services from companies, such as Amazon, Google, Facebook, Apple, and others. To minimise tax, these companies set up artificial transactions between themselves, so that the company's subsidiary registered in Australia pays royalties for the IP to a related subsidiary in another country (most likely a tax haven) that is not necessarily the head office of the group.

An example may clarify the process. Consider a company, which we might call TECH, that has subsidiaries around the world. TECH Australia pays TECH Ireland, for example, a royalty for the right to use the IP. If Ireland levies a much lower tax on these receipts than if they had been declared as profits in Australia, the effect is to reduce the total amount of tax paid by the global TECH company. TECH's revenue stream from licensing its IP must be declared in some jurisdiction and, by declaring that TECH Ireland owns the IP, it is thereby able to minimise its global tax. However, the whole arrangement lacks legitimacy. The corporate decision to set up TECH Ireland as the subsidiary that holds the IP has nothing to do with the generation of the IP itself. As the song by Dire Straits put it: 'that ain't working, that's the way you do it, money for nothing…'

Many of these payments overseas appear in Australian Bureau of Statistics figures as payments for services. Such payments abroad for the licensing of IP, information and telecommunications and business services amount to some $37 billion for 2023-24 (ABS 2024). Thus, through ABS figures, we can identify tens of billions of dollars in categories that are likely to contain suspect payments, although much may be legitimate. What we cannot do from the ABS figures is estimate the likely flows between related entities, such as different Apple subsidiaries.

The nature and treatment of intangible assets is the key issue here. They comprise assets such as patents and other intellectual property that are used by a company to make profits, just as they might use any other attribute to their advantage. A tech company, such as Apple, is not suggesting that any additional profit due to its intangible assets should be treated differently.

It is just that tax law allows it to notionally allocate its intellectual property anywhere it wants; and so it will allocate it where company incomes are taxed most lightly. Apple has lots of proprietary technology or monopoly power which allows it to make huge profits globally. Rather than all of Apple owning all of its technology, it is more strategic to say that it is all owned by, say, the Irish subsidiary which then charges the Australian and other subsidiaries for using the technology. In that case, more of the profits appear in Ireland where the tax is low, or zero in some cases. Because the company's proprietary technology is used to generate profit throughout the world, in that sense, its technology is stateless. But it is certainly artificial to allocate that monopoly power to a profit centre in Ireland. The more equitable approach would be to allocate the profit to the regions where the tech company makes its profit and in proportion to sales in each region. *That is exactly what would happen if each tech company permitted itself to be taxed everywhere at the local tax rate.*

How much tax revenue does Australia currently forego as a result of the tech companies deviating from this entirely reasonable norm? Suppose the Australian Tax Office could insist that the intra company payments were ignored. Suppose also that had the effect of bringing Australian taxable incomes in line with the global ratios set out in Table 1. The author's calculations suggest that would increase the taxable income of the multinational tech companies in Australia from $1.5 billion to $8.7 billion per annum. That figure is obtained by assuming that, for each company, the taxable income in Australia would be the same proportion of total receipts as it is globally (Amazon is not included in the calculations because globally it makes a small loss). If the increase in taxable income ($7.1 billion with rounding errors) attracted the 30% company tax applying in Australia, then tax paid by these companies would increase from $0.5 billion to $2.7 billion – an annual increase of $2.1 billion. That would fluctuate from year to year but is more likely to have an upward rather than downward trend, given the increasingly pervasive role of digital technologies in modern economic and social activities and the avowedly oligopolistic character of the giant multinationals companies who control it. A reasonably modest estimate of the additional tax revenue for Australia over the next decade, net of inflationary effects, would be around $20 billion.

Conclusions

The Australian Government has long been interested in the giant tech companies in relation to issues such as stealing content, anticompetitive conduct and privacy violations. Indeed, their behaviour illustrates the comments by Luigi Zingales (2015) that 'fraud' is a feature of markets. Each tech company could be a model corporate citizen but, instead, as the *Economist* (2019) suggests, the contrary tendency is to act like an 'evil genius'.

In a submission to the Treasury on multinational tax integrity, it was recommended that the government change the tax legislation to disallow deductions for licence fees paid abroad for IP and similar payments for other business services to closely owned affiliates and subsidiaries (Richardson 2022). That would have the effect of ensuring that the tax paid in Australia is proportionate to the company profits that derive from Australia. Moreover, the Australian Tax Office (ATO) should ignore any transaction between 100 per cent owned affiliates of a multinational, unless it can be shown that there is a genuine trade between the two. On corporate tax matters, the government is always at a disadvantage, since the taxpayer invariably knows much more about its business than the ATO can discover. The existence of this information asymmetry constitutes a case for considering reversal of the onus of proof when there is good reason to suspect the motive behind the sort of transactions described in this economic note.

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