Submission to Senate Economics References Committee

into

Corporate Tax Avoidance

Microsoft Pty Ltd ("**Microsoft Australia**") is pleased to provide to the Senate Economics References Committee ("**Committee**") information related to Microsoft's operations in Australia.

I. Corporate Structure and Organization

Microsoft Corporation is a corporation incorporated and headquartered in the United States. Microsoft was founded in 1975. Our mission is to enable people and businesses throughout the world to realize their full potential by creating technology that transforms the way people work, play, and communicate. We develop and market software, services, and hardware that deliver new opportunities, greater convenience, and enhanced value to people's lives. We do business worldwide and have offices in more than 100 countries.

We operate our business in five segments. Beginning in fiscal year 2014, we reported our financial performance based on our new segments: Devices and Consumer ("D&C") Licensing, D&C Hardware, D&C Other, Commercial Licensing, and Commercial Other. Approximately 75% of total Windows & Windows Live Division revenue comes from Windows operating system software acquired by original equipment manufacturers ("OEM's) such as Toshiba and Dell, which they pre-install on hardware equipment they sell. The OEM's pay a royalty to Microsoft Corporation which is fully subject to tax in the United States.

II. Economic Footprint in the United States

Microsoft from 2007 to 2009 increased its employment in the United States by 13.2 percent, to 53,892 employees. According to a 2011 study[1] of Microsoft's economic impact on the United States, through its employment, compensation, and purchases of U.S. goods and services, Microsoft's operations supported roughly 462,000 U.S. jobs.

Microsoft also purchased $7.7 billion in goods and services from other U.S. businesses in 2009 and provided $10.8 billion in total direct compensation (wages, non-wage compensation, and stock compensation) to its U.S. employees in that year. The direct impact of Microsoft on the U.S. economy was $18.5 billion, representing the sum of wage compensation and U.S. goods and services purchases. According to the study, the indirect impact of Microsoft's operations in 2009 totaled $91 billion in U.S. industry output, $53 billion in value added, and $30 billion in labor income.

As of June 30, 2014, we employed approximately 128,000 people on a full-time basis, 62,000 in the U.S. and 66,000 internationally, including approximately 25,000 employees transferred as part of the Nokia devices and services acquisition in April 2014. Of the total employed people, 44,000 were in product research and development, 30,000 in sales and marketing, 23,000 in product support and consulting services, 20,000 in manufacturing and distribution, and 11,000 in general and administration.

[1] The 2011 MICROSOFT ECONOMIC IMPACT STUDY Prepared for Microsoft Corporation February 2013 (v3) by Theo S. Eicher, Professor of Economics, University of Washington (available from www.one-report.com/download.html/2014/shared/library/0259-00010864.pdf).

III. Microsoft Australia

Our local operation in Australia started in 1983 with only 20 people. Since then, Microsoft Australia has grown to more than 960 people working in principal cities across Australia.

While Microsoft continues to grow globally, so too has our awareness of the opportunity and responsibility we have to positively contribute in the communities where we live and work. To that end, we actively invest in activities that support Australian industry development and the community.

Microsoft Australia has over 10,000 partners in Australia who are mostly (69%) small businesses. Our partners have a presence in every state and territory in Australia and in 2013 invested $14.5 billion into their Microsoft related businesses. The partner network employs over 292,000 Australians in highly skilled roles, including development, testing, sales, marketing, and support functions. Over 74,000 partner employees have computer science or engineering qualifications while 32,000 employees have Microsoft accredited qualifications. The partner network contributed $19.5 billion to the Australian economy in 2013[2].

Microsoft Australia takes great pride in being able to help Australian businesses, charities, communities and governments benefit from the global growth in technology, and we are proud of our contribution to Australia on both an economic and social level. In the last three years we have made over $120 million worth of software donations to Australian charities and not for profits, ensuring that the benefits of technology can be shared by all.

IV. Worldwide Business Operations and Regional Operating Centers

Microsoft operates in many markets around the world. For FY14, our revenue was split roughly evenly between the US and foreign locations.

Our worldwide OEM business, consisting primarily of the licensing of the Windows operating system to computer manufacturers for pre-installation on PCs, is primarily operated and supplied from our Regional Operating Centre (ROC) located in Reno, Nevada and the resulting income is reported on our consolidated U.S. income tax return as taxable income in the U.S.

Our non-OEM (Retail) business is generally operated and supplied by our ROCs located in the following three regions:

- Our Irish ROC group near Dublin, Ireland supplies software and hardware products to Europe, Middle East and Africa (EMEA);
- Our Singapore ROC group supplies software and hardware to Asia Pacific region (APAC); and
- Our Americas ROC, supplies software and hardware products to the Americas.

Each of these ROCs represents a significant investment in infrastructure and headcount.

The Dublin, Ireland ROC group, created in 1986, supplies products and services to EMEA, representing billions in customer revenue earned and operating expenses incurred serving over 100 countries. EMEA

[2] Research conducted by Capitalis on behalf of Microsoft, June 2014.

group operating costs are funded by the Dublin ROC. Our EMEA group employs thousands of people, including several thousand in R&D. The Dublin ROC group employs over 5,600 employees and vendors performing research and development (R&D), production, distribution, and operations functions for the EMEA region. The Dublin ROC owns and operates the datacenter facilities required to distribute software to EMEA customers. Regional production, marketing and general and administrative (G&A) functions are performed by the Dublin ROC. The profits earned from the EMEA business, after appropriate taxable payments to the US group for technology rights and other support, are earned primarily by the Ireland ROC group.

The Singapore ROC group, organized in 1998, supplies products and services to the APAC region, also representing billions in customer revenue earned and operating expenses incurred serving 18 countries throughout Asia Pacific, including Australia. The APAC group operating costs are funded by the Singapore ROC. The Singapore ROC group employs over 2300 employees and contractors and owns and operates datacenter facilities that distribute software to APAC customers. Regional production, marketing and G&A functions are performed by the Singapore ROC. The profits earned from the APAC business, after appropriate taxable payments to the US group for technology rights and other support and the payment of support fees to the local subsidiaries, are earned primarily by the Singapore ROC group.

The Americas ROC group supplies products and services to the Americas representing billions in customer revenue serving over 25 countries. The Americas business includes Microsoft's US operations and employs many thousands of people, including thousands in R&D roles. Regional production, marketing and G&A functions are performed by the Americas group. The US entities in the Americas group are responsible for substantially all aspects of our OEM business and for the marketing and distribution aspects of the Americas Retail business. The profits from these activities are taxable in the US. The Puerto Rico ROC is responsible for the Americas Retail business and has made substantial taxable payments to the US group for technology rights relating to that business, as described below.

V. Local Marketing Subsidiaries

Microsoft's local subsidiaries such as Microsoft Australia receive an arm's length transfer price paid by the ROC which takes into consideration the functions performed, and the risks assumed by each entity. Local entities are generally required to act under the direction of Microsoft with regards to marketing campaigns, pricing, terms and conditions and policies and procedures. The local subsidiaries provide very limited input into the creation of marketing or technology intangibles embodied in the material provided by Microsoft.

VI. Current Tax Environment

Microsoft complies with the tax rules in Australia and in each jurisdiction in which it operates and pays billions of dollars each year in total taxes, including US federal, state, local and foreign taxes. The tax rules that we follow in the US generally provide for the deferral of US tax on the earnings of foreign subsidiaries until those earnings are repatriated in the form of dividends.

Our foreign ROCs pay tax locally in the jurisdiction in which they operate, and Microsoft pays US tax on the earnings of the foreign ROCs when those earnings are repatriated back to the US in the form of dividends or included in income under other provisions of the Internal Revenue Code. Microsoft also pays US tax on royalties and cost sharing payments that are received from the foreign ROCs. Our worldwide OEM business, consisting primarily of licensing PC operating systems to computer manufacturers for pre-installation on PCs, departs from this regional model and is, with very limited exceptions, operated and supplied from our Americas ROC. The resulting income is reported on our consolidated US income tax return as fully taxable in the US without regard to the location of the customer.

VII. Research & Development and Rights to Use Technology

Microsoft develops most of its software products and services internally. Internal development allows us to maintain competitive advantages that come from closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software design. Before releasing new software platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

While our main research and development facilities are located in Redmond, Washington, we also operate research and development facilities in other parts of the US and around the world, including Canada, China, Denmark, Estonia, Finland, Germany, India, Ireland, Israel, and the United Kingdom amongst others. This global approach helps us remain competitive in local markets and enables us to continue to attract top talent from across the world. In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world’s largest computer science research organizations, and works in close collaboration with top universities around the world to advance the state-of-the-art in computer science, providing us a unique perspective on future technology trends.

Victoria, Australia, is home to our Asia Pacific time zone anti-malware and cyber-protection center, one of only three in the world, which employs more than 30 local, full-time staff.

Microsoft Research invests in collaborations with many of Australia’s finest academic and scientific researchers, institutions, and computer scientists to shape the future of computing in fields such as parallel programming, software engineering, natural user interfaces, and data-intensive scientific research. Microsoft Research programs for PhD Fellows, internships, and students as well as faculty connections seek to advance breakthroughs and gain learnings in computational science and its direct application in a multitude of scientific disciplines.

In collaboration with Melbourne University and the Victorian Government, Microsoft Research is examining the future potential of natural user interfaces for social outcomes through the Centre for Social Natural User Interface, based at the University of Melbourne.

Other notable collaborations in Australia include working with the University of Queensland to accelerate the extraction and correlation of Great Barrier Reef monitoring data from satellite imagery and citizen and scientist observations, and working with the Australian National University to advance medical image analysis through high performance heterogeneous computing, numerical simulation and novel human/computer interfaces.

The legal ownership of intellectual property developed as a result of our research and development activities generally resides with Microsoft Corporation in the US. In accordance with Internal Revenue Code Section 482 and applicable Treasury Regulations. Our three foreign ROC groups, Ireland, Singapore and Puerto Rico, license the rights to use the relevant intellectual property to produce and sell Microsoft products in their respective regions.

The foreign ROC groups make multi-billion dollar initial and annual compensation payments back to the US group for these license rights. One component of these payments requires the three foreign ROC groups to fund the majority of Microsoft's annual worldwide R&D expenditures. These payments increase the income taxable in the US. The foreign ROC compensation payments are computed in compliance with the applicable Treasury Regulations under Internal Revenue Code Section 482. Microsoft complies with the requirements of the US Treasury cost sharing regulations contained in Treas. Reg. section 1.482-7.

Microsoft incurs the large majority of its R&D spending, and employs the large majority of its R&D workforce, in the US. These payments under US tax rules are sourced to the location where the R&D is performed, so payments to Microsoft's US group for US R&D do not generate foreign source income, creating no opportunity to offset the U.S. tax on these payments with foreign tax credits.

VIII. Microsoft's Effective Tax Rate

Microsoft's effective tax rate was 20.7%, 19.2% and 23.8% for fiscal years 2014, 2013, and 2012, respectively. The reduction from the United States federal statutory rate stems from foreign earnings taxed at lower rates from producing and distributing our products and services through our ROCs in Ireland, Singapore, and Puerto Rico. Our foreign earnings, which are taxed at rates lower than the US rate and are generated from our regional operating centers, were 81%, 79%, and 79% of our foreign income before tax in fiscal years 2014, 2013, and 2012, respectively.

Microsoft Australia's effective tax rate in Australia for each of fiscal years 2014, 2013, and 2012 was above Australia's statutory tax rate of 30%.

Please see Appendix 1 for additional information related to Microsoft Corporation's tax rate as filed with the United States Securities and Exchange Commission.

IX. Conclusion

Microsoft's tax results follow from its business, which is fundamentally a global business. In conducting our business at home and abroad, we abide by US, Australian, and other foreign tax laws as written. That is not to say that the rules cannot be improved--to the contrary, we believe they can and should be.

Microsoft is supportive of the current discussions regarding changes to international tax laws that are in conformity with the existing arms' length standard. Laws that are applied on a predictable and consistent basis are also conducive to continued foreign investment.

As noted above, Microsoft Australia takes great pride in being able to help Australian businesses, charities, communities and governments benefit from the global growth in technology, and we are proud of our contribution to Australia on both an economic and social level.

We appreciate the opportunity to provide these comments.

Appendix 1

The following information is contained in the Form 10-K Annual Report of Microsoft Corporation as filed with the United States Securities and Exchange Commission. This information is publicly available.

NOTE 13 — INCOME TAXES

The components of the provision for income taxes were as follows:

(In millions)			
Year Ended June 30,	**2014**	**2013**	**2012**
Current Taxes			
U.S. federal	**$ 3,738**	$ 3,131	$ 2,235
U.S. state and local	**266**	332	153
Foreign	**2,073**	1,745	1,947
Current taxes	**6,077**	5,208	4,335
Deferred Taxes			
Deferred taxes	**(331)**	(19)	954
Provision for income taxes	**$ 5,746**	$ 5,189	$ 5,289

U.S. and foreign components of income before income taxes were as follows:

(In millions)			
Year Ended June 30,	**2014**	**2013**	**2012**
U.S.	**$ 7,127**	$ 6,674	$ 1,600
Foreign	**20,693**	20,378	20,667
Income before income taxes	**$ 27,820**	$ 27,052	$ 22,267

The items accounting for the difference between income taxes computed at the U.S. federal statutory rate and our effective rate were as follows:

Year Ended June 30,	**2014**	**2013**	**2012**
Federal statutory rate	**35.0%**	35.0%	35.0%
Effect of:			
Foreign earnings taxed at lower rates	**(17.1)%**	(17.5)%	(21.1)%
Goodwill impairment	**0%**	0%	9.7%
Other reconciling items, net	**2.8%**	1.7%	0.2%
Effective rate	**20.7%**	19.2%	23.8%

The reduction from the federal statutory rate from foreign earnings taxed at lower rates results from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico. Our foreign earnings, which are taxed at rates lower than the U.S. rate and are generated from our regional operating centers, were 81%, 79%, and 79% of our foreign income before tax in fiscal years 2014, 2013, and 2012, respectively. In general, other reconciling items consist of interest, adjustments for intercompany transfer pricing, U.S. state income taxes, domestic production deductions, and credits. In fiscal years 2014, 2013, and 2012, there were no individually significant other reconciling items.

The components of the deferred income tax assets and liabilities were as follows:

(In millions)		
June 30,	**2014**	**2013**
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 903**	$ 888
Other expense items	**1,112**	917
Unearned revenue	**520**	445
Impaired investments	**209**	246
Loss carryforwards	**922**	715
Other revenue items	**64**	55
Deferred income tax assets	**$ 3,730**	$ 3,266
Less valuation allowance	**(903)**	(579)
Deferred income tax assets, net of valuation allowance	**$ 2,827**	$ 2,687
Deferred Income Tax Liabilities		
Foreign earnings	**$ (1,140)**	$ (1,146)
Unrealized gain on investments	**(1,911)**	(1,012)
Depreciation and amortization	**(470)**	(604)
Other	**(87)**	(2)
Deferred income tax liabilities	**$ (3,608)**	$ (2,764)
Net deferred income tax assets (liabilities)	**$ (781)**	$ (77)
Reported As		
Current deferred income tax assets	**$ 1,941**	$ 1,632
Other current liabilities	**(125)**	0
Other long-term assets	**131**	0
Long-term deferred income tax liabilities	**(2,728)**	(1,709)
Net deferred income tax assets (liabilities)	**$ (781)**	$ (77)

As of June 30, 2014, we had net operating loss carryforwards of $3.6 billion, including $2.2 billion of foreign net operating loss carryforwards acquired through our acquisition of Skype, and $545 million through our acquisition of NDS. The valuation allowance disclosed in the table above relates to the foreign net operating loss carryforwards and other net deferred tax assets that may not be realized.

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when the taxes are actually paid or recovered.

As of June 30, 2014, we have not provided deferred U.S. income taxes or foreign withholding taxes on temporary differences of approximately $92.9 billion resulting from earnings for certain non-U.S. subsidiaries which are permanently reinvested outside the U.S. The unrecognized deferred tax liability associated with these temporary differences was approximately $29.6 billion at June 30, 2014.
Income taxes paid were $5.5 billion, $3.9 billion, and $3.5 billion in fiscal years 2014, 2013, and 2012, respectively.

Uncertain Tax Positions

Unrecognized tax benefits as of June 30, 2014, 2013, and 2012, were $8.7 billion, $8.6 billion, and $7.2 billion, respectively. If recognized, these tax benefits would affect our effective tax rates for fiscal years 2014, 2013, and 2012, by $7.0 billion, $6.5 billion, and $6.2 billion, respectively.

As of June 30, 2014, 2013, and 2012, we had accrued interest expense related to uncertain tax positions of $1.5 billion, $1.3 billion, and $939 million, respectively, net of federal income tax benefits. Interest expense on unrecognized tax benefits was $235 million, $400 million, and $154 million in fiscal years 2014, 2013, and 2012, respectively.

The aggregate changes in the balance of unrecognized tax benefits were as follows:

(In millions)

Year Ended June 30,	**2014**	**2013**	**2012**
Balance, beginning of year	**$ 8,648**	$ 7,202	$ 6,935
Decreases related to settlements	**(583)**	(30)	(16)
Increases for tax positions related to the current year	**566**	612	481
Increases for tax positions related to prior years	**217**	931	118
Decreases for tax positions related to prior years	**(95)**	(65)	(292)
Decreases due to lapsed statutes of limitations	**(39)**	(2)	(24)
Balance, end of year	**$ 8,714**	$ 8,648	$ 7,202

During the third quarter of fiscal year 2011, we reached a settlement of a portion of an I.R.S. audit of tax years 2004 to 2006, which reduced our income tax expense by $461 million. While we settled a portion of the I.R.S. audit, we remain under audit for these years. In February 2012, the I.R.S. withdrew its 2011 Revenue Agents Report and reopened the audit phase of the examination. As of June 30, 2014, the primary unresolved issue relates to transfer pricing, which could have a significant impact on our consolidated financial statements if not resolved favorably. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months. We also continue to be subject to examination by the I.R.S. for tax years 2007 to 2013.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2013, some of which are currently under audit by local tax authorities. The resolutions of these audits are not expected to be material to our consolidated financial statements.