



Senator Chris Ketter
Chair
Senate Economics References Committee
Parliament House
CANBERRA ACT 2600

Dear Chair

Provided below are responses to the requests for additional information made to Microsoft by the Australian Senate Economics References Committee during its hearing into Corporate Tax Avoidance on August 22, 2017.



1. Overview of New Sales Model

The change of the Microsoft sales motion, or how we sell Microsoft products into the Australian market is a fundamental change to the Microsoft model. Under the new sales model, Microsoft Australia will record revenue and expenses for sales to Australian customers

Under the old model, the Microsoft Regional Operating Center (ROC) in Singapore would sell software directly to Australian customers and partners. The ROC in Singapore would then pay Microsoft Australia a commission to compensate Microsoft Australia for the sales and marketing services performed by Microsoft Australia. Under the new model, Microsoft Australia will purchase Microsoft products directly from the Singapore ROC, with Microsoft Australia then selling the Microsoft products to the Australian customer. This new model is referred to under international and OECD tax principles as the “Buy-Sell Model.”

Under the Buy-Sell Model, Microsoft Australia will contract with and invoice Australian customers directly, with the exception of the Original Equipment Manufacturers (OEM) and Online Advertising businesses, which are centralized in the US and operate under a model where customers globally purchase products and/or services directly from Microsoft Corporation and its US-based subsidiaries. This change is part of the overall evolution Microsoft’s business, moving from a company primarily focused on on-premise software and servers to a business focused on cloud services -- including over 40 regional data centers around the world -- providing in-person support services for enterprises globally, and designing, manufacturing, and selling devices. Due to this evolution of our business model, we also needed to evolve our customer-facing business; specifically, we needed to move our business closer to our customers.

As a result of this change, Microsoft Australia will record all revenue and sales to Australian customers on its books and charge the appropriate amount of GST on all sales. Microsoft Australia's statutory accounts will reflect a significant increase in both revenue and COGS that does not appear on the books under the old model, making Microsoft's business more transparent to the Australian government

Moving Microsoft Australia to a Buy-Sell Model is a fundamental shift in Microsoft's operations. Microsoft has invested millions of dollars to understand the business requirements under the buy-sell model, and to modify the Company's SAP ERP and accounting systems. For example, under the old commission-agent model, there was limited need for the SAP system to handle intercompany and Cost-of-Goods Sold (COGS) accounting. The introduction of the new Buy-Sell model requires the design and implementation of a new intercompany and COGS accounting system, ultimately requiring an extensive rewrite of the ERP system. Over the last few years, Microsoft has spent over \$175 Million to understand the business requirements and modify our ERP and accounting systems to enable these changes.

2. Explanation of Statutory Accounts of Microsoft Australia Holdings Pty Limited

The financial report for Microsoft Australia Holdings Pty Limited for the year ended 30 June 2016 is a consolidated financial report for a group including:

- i. Microsoft Australia Holdings Pty Limited (the Parent entity); and
- ii. Microsoft Datacenter (Australia) Pty Limited (the subsidiary).

Microsoft Australia Holdings Pty group holds the assets and expenses from Microsoft's Australian datacenters, and books commission revenue for providing datacenter support services to other Microsoft entities.

The income referred to by the Chair of \$103.6m in FY16 relates to the following:

- Commission revenue – \$102.4m
- Foreign exchange gain – \$0.8m
- Interest Income – the \$0.4m

The approximately \$700m that Mr Goff referred to during questioning relates to the revenue of a different entity, Microsoft Pty Limited, for the year ended 30 June 2016. The principal activity of Microsoft Pty Limited is the marketing of computer software, peripherals, and video game consoles. For the financial year ended 30 June 2016, it booked revenue of \$725.8m which primarily relates to commission income for the marketing services it provides to other Microsoft entities.

The activities of Microsoft Pty Limited will differ from FY17 onwards as a result of the change in structure to the buy-sell model. The activities of the Microsoft Australia Holdings Pty Limited group will not change.

3. Summary of Australian Income Taxes

The chart below summarizes the calculation of Microsoft's Australian income taxes for 2014 through 2016.

Microsoft Tax Consolidated Group¹

	Amount in A\$000's		
	FY14	FY15	FY16
Revenue as per Tax Return	567,753	679,432	776,530
Expenses as per Tax Return	488,538	592,087	683,639
Profit before Tax as per Tax Return	79,215	87,346	92,890
Add/(Subtract) Tax Adjustments:			
- Entertainment expenses non-deductible for tax	1,403	1,465	1,839
- Share based payment expenses non-deductible for tax	15,215	20,199	27,534
- Accounting depreciation non-deductible for tax	6,301	4,632	8,268
- Accounting loss on sale of assets non-deductible for tax	995	(2)	341
- Assets expenses for accounting, capital for tax	139	84	158
- Luxury motor vehicle expenses non-deductible for tax	481	397	420
- Net increase in accounting provisions non-deductible for tax	(56)	20	10,829
- Net increase in accounting accruals non-deductible for tax	7,917	1,460	4,109
- Tax depreciation deductible for tax	(4,201)	(4,417)	(5,008)
- Tax loss on sale of assets deductible for tax	(2,124)	(50)	(901)
- Luxury motor vehicle depreciation and interest deductible for tax	(319)	(174)	(78)
- Unrealised foreign exchange gains not assessable for tax	(84)	(34)	(39)
- Revenue received in advance not assessable for tax	(513)	(719)	(250)
- Deferred rent and lease incentive movements not assessable for tax	(447)	824	436
- Other minor tax adjustments	(36)	85	446
Taxable Income	103,886	111,116	140,996
Tax Payable (at 30% of Taxable Income)²	31,166	33,335	42,299

¹ Tax Consolidated group includes financial accounts of Microsoft Pty Limited, Microsoft Institute Pty Limited, and Microsoft Mobile Australia Pty Ltd (Previously Nokia Australia Pty Ltd).

- Microsoft Pty Limited is responsible for the marketing of computer software, peripherals and video game consoles for Microsoft in Australia.
- Microsoft Institute Pty Limited acts as a supplier of computer software to the Australian Federal Government under a Government Information Technology Contract (GITC).
- Microsoft Mobile Australia Pty Ltd is responsible for the the sale of mobile phones for Microsoft in Australia and New Zealand.

² Amounts included reflect numbers in income tax returns lodged with the ATO for the relevant years.

4. Number of Research and Development employees in Ireland

In 2017 there are 327 employees engaged in research and development roles based in Ireland.

We trust this information is helpful to the Committee.

Yours sincerely

Belinda Dennett
Corporate Affairs Director

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