At the intersection of international tax and digital transformation

2016: a year of living uncertainly

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About the author

EY is a regular contributor to CCH's *Global Tax Weekly*. As tax and technology professionals, from member firms around the world, we share our insight and technology perspective on topics of interest to executives faced with taxation issues resulting from disruptive innovation and technology enabled digital transformation. The content contained in this document was first published in *Global Tax Weekly* — and is being reprinted with full knowledge and permission from Wolters Kluwer, copyright 2016 CCH.

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2016: a year of living uncertainly

Contemplating the new year is an exercise that can elicit mixed feelings — of optimism, maybe some dread, and a dash of resignation to "more of the same." And we always applaud companies looking ahead, engaging in healthy introspection and planning for the eventualities. However, today's unprecedented level of technology, business and policy changes leaves little time for ambivalence.

In our fast-paced global digital economy, confidence is the order of the day. That can be a tall order, in the current environment of uncertainty — particularly on the tax front. But circa 2016, as companies across all industries operate increasingly digitally and globally, digital confidence is essential to achieve the speed, agility and innovation required to grow and prosper.

Think of digital confidence as a company's enterprise-wide grasp of current and future digital business catalysts, along with their tax, legal and policy implications. With this in mind, let's review the global digital tax environment and consider ways companies can increase their digital confidence.

In my outlook for 2015, I wrote in this column about "a glimmer of tax certainty at the end of the tunnel of digital tax policy deliberation." And the ensuing year did in fact produce greater public-private collaboration, thoughtful consideration of options and lots of hard work.

There were some outcomes, too, affecting globally commercialized intellectual property (IP), for instance, and cross-border business-to-consumer value-added taxes/and goods and services taxes (B2C VAT/GST).

At the same time, however, the tunnel has now gotten longer

I'm speaking, of course, about the Organisation for Economic Co-operation and Development's (OECD's) initiative to clarify global tax policy for the digital age through its base erosion and profit shifting project (BEPS Project). The final package of BEPS reports on 15 action items was released in October and included Action 1: Addressing the Tax Challenges of the Digital Economy. Yet, as this column also forecasted several months ago, the BEPS Project has assigned further work on many important areas of digital economy taxation to its Task Force on the Digital Economy (Digital Task Force), with a second report now due in 2020. (A detailed mandate for this work will be developed in 2016.)

I am also speaking about another source of tax complexity: the myriad new national policies, rulings and taxes we've reported from across the world throughout 2015. Among other trends we've previously identified in this column has been the often troubling level of inconsistency from one country to the next. 2015 saw governments produce new digital-specific VAT/GST, patent box regimes, investigations into purported state aid to multinationals, withholding taxes on alleged diversion of profits and other changes for better or worse. In doing so, some governments came up with varying interpretations of the OECD's draft BEPS reports, acting in advance of multilateral consensus — with the fallout yet to clear.

All of this is serving to prolong uncertainty for businesses operating amid the accelerated evolution of our digital economy. Given what is apparently becoming a five-year series of digital tax reports — one in 2015, 2016 and 2020 — companies are asking themselves whether they have the tax visibility they need to do business planning today.

Informed innovation

Going into 2016, EY tax and technology professionals will continue to write regularly for *Global Tax Weekly* to share insights and experience from around the world. There is a wave of new digital business models coming over the horizon, based on the sharing economy, 3D printing, the internet of things (IoT) and virtual currencies — adding to the current business transformations already being driven by cloud computing, smart mobility, big data analytics and social media.

Tax authorities worldwide are grappling with the compounding implications for their national digital economies, as well as their national treasuries. Companies will need to stay alert to tax changes from all directions — and even engage with local and international policymakers to help shape future digital economy tax policy.

Tax policy 2016

2016 could also be seen as a year of open questions. Even while closing one BEPS chapter, the OECD said that requirements for further digital economy tax measures will be determined by "a broad look at the ability of existing international tax standards to deal with the tax challenges raised by developments in the digital economy, taking into account not just direct taxes, but also indirect taxes, administrative issues, countries' differing levels of development, as well as the impact of any potential change on cross-border trade and investment."[1]

In other words, what happens in 2016, as countries implement BEPS guidelines, will shape deliberations on the next chapter of digital economy tax guidelines, coming in 2020.

All of which leads to top 10 questions for 2016:

1. To what degree will countries fall in line with the OECD's BEPS recommendations (and what about the outliers)?
2. Will the Action 1 recommendations have the impact policymakers intend (and what might be some unintended consequences)?
3. Will companies find themselves overburdened by multiplying permanent establishment (PE) requirements, growing VAT/GST and attempts to untangle transfer pricing in their global value chains? And could unilateral government action in such areas as PE lead to double taxation?
4. Will any countries implement one or more of the controversial options that the BEPS Project declined to embrace, such as a tax on the value of individuals' data or an "equalization levy" on digital businesses operating in-country without a physical presence?
5. When and how might the US Government address the area of digital economy taxation?
6. How will the outlines of the Digital Task Force's 2016 and 2020 reports begin to emerge?
7. Will companies be prepared for tax transparency under the OECD's new country-by-country (CbC) exchange of tax information on large multinationals? (Notably, the US release of its proposed CbC reporting regulations as 2015 came to a close.[2])
8. How will governments tax emerging digital business models such as those based on the sharing economy, IoT or 3D printing?
9. Will media interest in tax controversy wane or spike in the new year?
10. How will companies manage strategic planning in this environment?

Framing success

The biggest step toward managing all of this tax risk and achieving digital confidence is for companies to involve corporate tax teams from the outset in digital enterprise strategy. This is a big step because it requires cultural attunement to the fact that tax can be a fundamental cost of doing business, a drag on innovation, a pitfall in global supply chain operations, a key consideration in digital customer relations — perhaps even a gating factor in some markets — and not something that can be left for consideration at the eleventh hour. It is a step that requires a deliberate framework across all aspects of digital growth, optimization and risk management — a framework that embeds tax considerations in digital incubation, innovation, experience transformation, supply chain enablement and compliance. In 2016, for example, EY's technology and tax teams will be mapping much of their work around this digital confidence framework.

Across the enterprise, by now, it should just be accepted as common sense that every tax change sparks a potential business impact. Consider, for example, what the OECD's 2015 BEPS guidelines on the transfer pricing of intangible assets and risks could mean for the global taxation of IP R&D. There's risk enough on that topic alone for unprepared companies to hit the pause button. Or, think of the impact that the Digital Task Force's 2020 deliberations over "virtual PEs" could have on taxation in global supply chains. Suddenly hitting the reset button in this area of operations is something most companies would prefer to avoid.

Considerations

Despite the lack of private sector estimates of the total cost of BEPS, the OECD has declared that governments worldwide are losing between USD100bn and USD240bn each year in tax revenue due to BEPS – or 4%–10% of global corporate income tax revenue.[3] The BEPS Project, sponsored by the OECD, was designed to redress this loss. Plus, other potential corporate costs, in addition to higher taxes, could come in the form of growing compliance requirements, including CbC tax reporting; escalating information technology systems requirements for multiplying VAT/GST registrations and collection; potential business losses as tax uncertainty hinders new business development; and possible reputational risks for companies found to be noncompliant.

Companies will need to work fast and smart to mitigate the downside potential of BEPS 2015 and the uncertainty of the Digital Task Force's work going forward. So, it's worth repeating:

- Involve corporate tax teams in strategic planning early and often
- Stay alert to tax change coming from all directions and anticipate it with scenario planning
- Engage with local and international policymakers

Engagement with policymakers is especially important in 2016, with the OECD monitoring current BEPS outcomes as the basis for potential future recommendations, and given tax authorities' need to come to grips with even more (and possibly even more disruptive) digital business innovation.

With no irony intended, I'd like to close by wishing readers a prosperous new year – ideally one in which all of this hard work builds the digital confidence needed to compete digitally and succeed globally and locally. Please let me know your views on the impact of BEPS policy and new national digital economy taxation. I also welcome your input on what this column should cover in the coming year.

Sources

1 "Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report," accessed via www.oedc.org, © 2015 Organisation for Economic Co-operation and Development.

2 "US Treasury and IRS issue proposed regulations on country-by-country reporting," EY Global Tax Alert, 24 December 2015, © 2015 EYGM Limited.

3 "Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report," accessed via www.oedc.org, © 2015 Organisation for Economic Co-operation and Development.

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