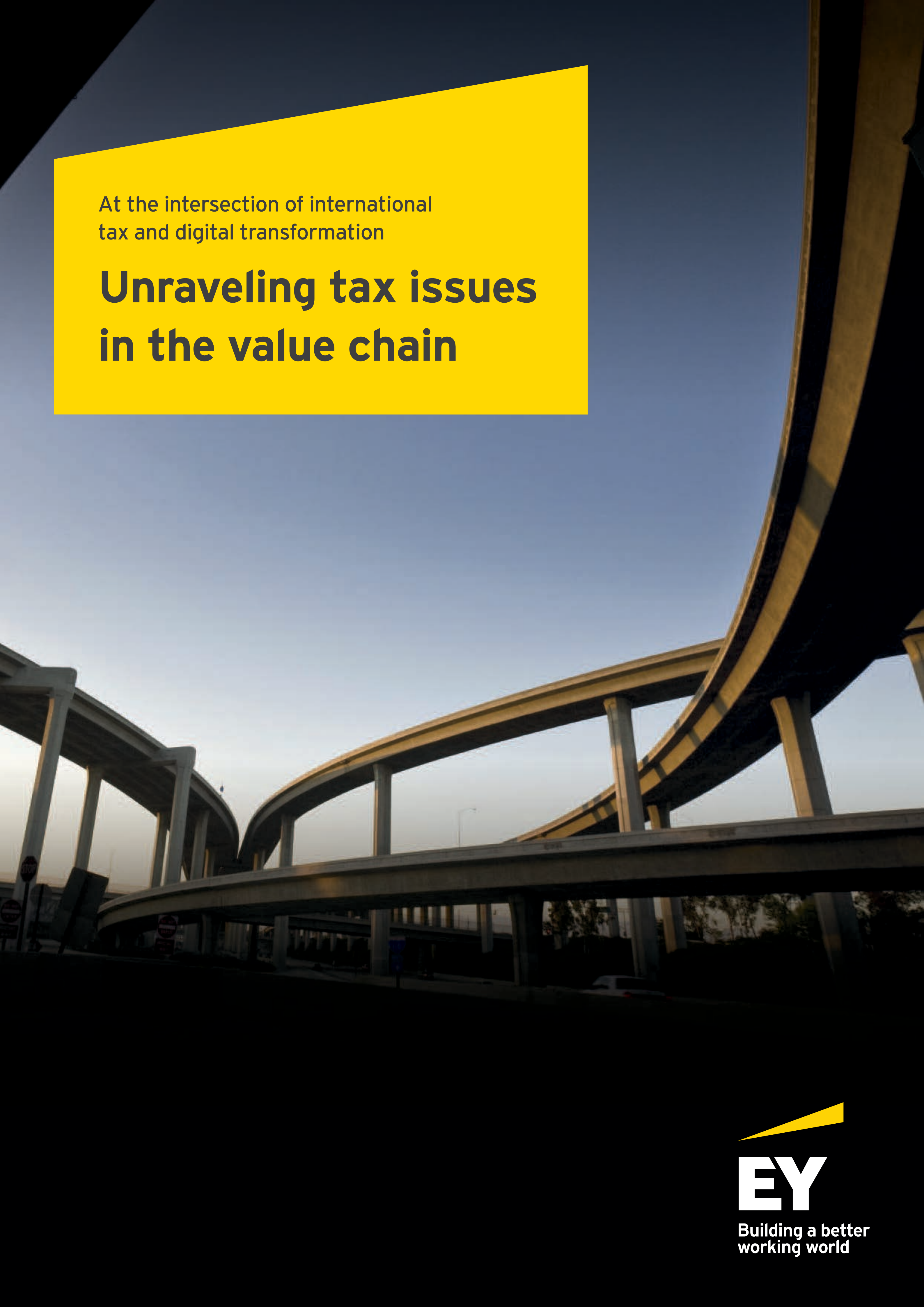
At the intersection of international tax and digital transformation

Unraveling tax issues in the value chain



Building a better working world

At the intersection of international tax and digital transformation

Unraveling tax issues in the value chain

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 2015 CCH.

In this edition

These local country and international dynamics present fundamental considerations for tax practitioners and international finance executives:

1. They need to understand the level of uncertainty they face as they monitor and prepare for ongoing change in technology taxation worldwide.
2. They should always keep in mind the current context of potentially varying tax treatment from country to country.
3. They should map the tax treatment of intellectual property (IP), transfer pricing, research and development (R&D) and other technology-related issues to their business models from the very outset, as they first develop their strategies and build in flexibility for the long term.

Overview

For all the bright promise of technologies like cloud computing to improve companies' global operational efficiency and catalyze a thriving digital economy, today's debate over international tax policy is often fueled by a dimmer view.

In the ideal, multinational corporations are seen leveraging the state-of-the-art to compete at the top of their game, prosper and deliver innovation across the world. The dim view is that they could use digital technology to game the system and tweak performance based on artificial tax advantages, as they shift cost and profit allocations from one country to the next.

Whatever the view — across the spectrum of input into various policy initiatives on taxation for the global digital economy — the fact is that many current proposals are preoccupied with protecting against potential digital tax manipulation. The downside for technology companies could range from the cumbersome (as in more compliance and documentation) to the chilling (as in favoring the status quo over introducing tax risk by implementing technological innovation).

In the meantime, there is heightened uncertainty until policies are finalized – mixed with hope that ongoing deliberation among government, public interest groups and industry will strike the right balance for a fair, workable international tax system.

This edition of our column focuses on global digital business operations and their taxation, as we look inside multinational groups and the way they are taxed on their intra-group/ intercompany cross-border sharing of services, IP, data and other important aspects of the value chain. Also in this column, we note rising digital-specific taxation, including a US proposal to target overseas affiliates' digital income.

Highlights and takeaways

Tax update	Technology impact	Ask yourself
Recent growth in multinationals' intra-group/intercompany services draws greater scrutiny from tax authorities.	Cloud-based, borderless business models are driving this growth.	Have you assessed the compliance and risks of your material intra-group/inter-company service transactions – in all pertinent jurisdictions? How rigorous is your allocation and documentation?
Israel's tax authority takes an increasingly aggressive approach toward the overseas migration of IP.	Technology sector post-merger integrations are of particular note, as is supply chain management.	How do you calculate your company's value – accounting for IP? How robustly do you document transfer pricing and intra-group/intercompany agreements?
The Obama administration has proposed taxing companies that operate in the digital realm, by eliminating deferral of overseas income associated with certain digital transactions.	The proposal appears to contradict OECD draft guidance last year against "ring-fencing" digital business for specific taxes.	Are employees at your overseas affiliates making a "substantial contribution" to the IP at the heart of your digital income?
US tax authorities issue guidance on determining whether there is a tax rate disparity for sales of goods manufactured overseas.	US technology companies with global supply chains may need to take note.	Should you actually be analyzing any of your sales branches' taxable income through the lens of more than one jurisdiction?
A French government-affiliated think tank raises provocative digital questions on tax nexus and ownership of personal data.	The ongoing debate over data flows in global value chains spikes anew.	Are you monitoring these developments and your own tax profile in light of them?
Silicon Valley sets a high standard for meals and entertainment.	US tax authorities respond with a full menu of tax requirements.	Food for thought for any company, anywhere.

Item 1: Scrutiny increases on multinationals' shared services fees

Cross-border intra-group/intercompany services are an integral element of the global operations of multinational enterprises (MNEs) — and increasingly so in an environment of borderless, cloud-based business models. Such services provide group entities with uniform quality of services and standards; they also achieve optimization of operational costs across the group.

The growth in such services has resulted in greater scrutiny from tax authorities. They are particularly concerned in today's international tax environment that the fees associated with these services are eroding the tax base in their jurisdiction.

Consequently, there has been a significant increase in the number and type of challenges raised on tax audits with respect to cross-border intra-group/intercompany service charges.

Uncertainty amid complexity

In response to this increased attention, several supra-national organizations are taking steps to provide guidance.

- At the leading edge is the Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) Project, where the focus is on proposals for a new simplified transfer pricing regime for intra-group services.
- Meanwhile, at the United Nations (UN), work has already started on drafting a new chapter on intra-group services for the UN Transfer Pricing Manual.
- The European Union Transfer Pricing Forum is also an active contributor to the debate.

The digital dimension of these organizations' concerns is evident in a 2014 report by the European Commission's Expert Group on Taxation of the Digital Economy. Specifically, the task force noted that: "Current transfer pricing rules aim to attribute a multinational's overall profit to the various taxable presences in the world based on a division of functions, assets and risks. For the digital economy that operates largely in a borderless world, however, such a division is almost by definition arbitrary and hence prone to manipulation." It is uncertain whether a consensus will emerge from these various initiatives, leaving MNEs in doubt as to how to proceed.

To add to the complexity, intra-group/intercompany services transactions involve multiple tax aspects, all of which need to be managed coherently, such as: transfer pricing; permanent establishment/nexus risks; withholding taxes; indirect tax laws; and deductibility for corporation tax purposes. This requires MNEs to carefully analyze their service transactions in order to avoid exposure to costly and unexpected tax bills.

Identifying cross-border intra-group services

Frequently, there are difficulties in identifying whether a particular transaction actually falls within the term "services" because there is no uniform definition or common understanding of that term in existing model tax conventions. The "service" definition varies according to the type and nature of the tax law under consideration (e.g., transfer pricing, withholding tax, and indirect tax). There are also differences between countries and even within countries between domestic definitions and treaty definitions. This adds another layer of complexity (and likely a degree of uncertainty) in any analysis of intra-group services before deciding the ultimate tax treatment of such a transaction.

Examples of intra-group/intercompany services include:

- MNE group shared service center providing services to all the members of the group
- Centralization of costs which are then shared across the group according to use
- Cross-border provision of service through secondment or deputation of employee
- Provision of technical, management and consultancy services
- Rental services for industrial, commercial, scientific equipment or services
- IP management fees
- Providing services through software (e.g., maintenance services involved in the provision of software)
- Service embedded in transactions of sale of goods or grant of intangible rights.

Impact of the OECD BEPS project

Developing countries and international organizations have identified base erosion caused by potentially excessive payments to affiliated companies with respect to service charges, management and technical fees as one of the key issues to be addressed as part of the OECD BEPS Project.

The OECD has sought to take the debate forward in its discussion draft on BEPS Action 10 by carving out a category of low-value-adding intra-group services which are supportive in nature and proposing an elective simplified charging mechanism for them. The proposed guidance is described as intending to achieve a balance between appropriate charges for low-value-adding services and head office expenses and the need to protect the tax base of payer countries.

Recent country developments

The selected examples below illustrate how global trends are being translated into specific action at the individual country level.

- **Brazil.** The Brazilian Federal Tax Authority has broadened the definition of technical services for the purpose of assessing withholding tax on cross-border payments made by Brazilian taxpayers to nonresident entities. The definition has been expanded to include general administrative assistance and services which are provided with the use of automated systems. The new definition may be wider than the existing tax treaty definition of technical services.
- **China.** China's State Administration of Taxation (SAT) has been investigating the significant amount of service fees and royalty payments remitted by Chinese taxpayers to overseas related parties from 2004 to 2013. The SAT is assessing the reasonableness of such intra-group service payments by applying tests of both business purpose and commercial substance. And on March 18, the SAT announced that, as of that same date, four payment categories would no longer be deductible:
  1. Fees paid to overseas-related parties that do not perform functions or assume risks and do not have substantial operational activities;
  2. Fees paid for specified services received from overseas-related parties that are considered not to directly or indirectly benefit the Chinese enterprises;
  3. Royalties paid to overseas-related parties that merely own the legal rights but have not contributed to the value of the intangible assets;
  4. Royalties paid for "additional benefits" received by Chinese companies to overseas-related parties in a jurisdiction where enterprises often establish a holding company or financing company for public listing purposes.

- **France.** In February 2013, the Paris Administrative Court of Appeal disallowed management fees paid by a French company to its Netherlands shareholder entity by holding that the taxpayer could not prove that it had benefited from the services rendered by the Netherlands entity; such services were determined to be unnecessary since the taxpayer was already availing itself of similar services from third party service providers in France.

- **Greece.** In April 2015, Greece implemented new legislation imposing a withholding tax on foreign persons for goods and services. While the Greek Government has not provided information on how the law will work in detail, it appears targeted at several relevant technology and digital economy transactions and requires analysis once detailed administrative rules are available. As of press time for this edition, the law had merely been announced; we plan on covering the impact and implementation of this new tax in our next edition.

- **India.** The Delhi High Court recently held that transfer pricing benchmarking is necessary for evaluating whether service fees charged on an "at cost" basis satisfy the arm's length test. Further, the court stated that it needs to be examined whether the cost charged by a service provider is appropriate or deliberately inflated.

- **Nigeria.** The Nigerian revenue authorities require companies to withhold tax on technical services fees and other contractual services fees paid to nonresidents, even where an applicable tax treaty does not provide for withholding taxes.

- **South Africa.** In June 2014, South Africa asked all nonresident taxpayers to furnish an income tax return with respect to services that have their source in South Africa — irrespective of whether there is a tax treaty protection. The existence of a tax treaty and any protection under the treaty does not shield the nonresident from the administrative requirements, such as filing a return.

The implications for current developments are complex and significant, with each aspect requiring particular attention. It is clear that tax controversy with respect to services fees is on the rise — especially with respect to the satisfaction of the benefit test. The following actions are suggested for MNEs:

Greater focus by governments and tax authorities

- As already noted, many countries are now prioritizing intra-group services in their MNE tax audit programs.
- *Action:* Undertake a risk assessment with a focus on those countries in which the group undertakes material intra-group service transactions.

Deductibility

- The deductibility of service fee payments for corporate income tax purposes is often questioned on the grounds of business necessity or commercial expediency.
- *Action:* Maintain adequate documentation to demonstrate the business need for and the actual performance of intra-group services.

Transfer pricing

- Tax controversy with respect to satisfaction of the benefit test in relation to intra-group service transactions is increasing.
- Many organizations find it difficult to allocate costs among MNE entities which are service beneficiaries.
- *Action:* Document the benefits of intra-group services in your transfer pricing documentation.
- *Action:* Develop an effective methodology and process to allocate costs using appropriate allocation keys.

Withholding tax obligation

- Withholding taxes at source are viewed as an effective tax collection mechanism for cross-border transactions in the global economy. There is a rising trend among countries to expand the scope of source-based taxation to maximize the collection of withholding taxes. In addition, deduction of the expense may be disallowed or heavy interest and penalties applied if there is a failure to withhold tax.
- *Action:* Develop and review your methodology to identify withholding tax obligations with respect to services and to make sure that such taxes are properly withheld and timely remitted by the recipient of the services.
- *Action:* Ascertain that the recipient of the service fees has full view of the taxes withheld and is in a position to take proper credit for the withholding taxes.

Permanent establishment (PE) risks

- Tax authorities often allege that PEs are created through short-term business travelers or cross-border deputation, secondment or similar temporary reassignment of employees.
- *Action:* Undertake a PE risk assessment with respect to short-term business travelers or employees deputed to other group entities to provide services in different countries (and beware of the ones that do not require any deputation).

Indirect tax

- Cross-border intra-group services may attract a variety of indirect taxes in the country of the service recipient (value-added taxes, or VAT, as well as goods and sales taxes, etc.), together with the associated compliance requirements, or even result in the generation of irrecoverable VAT for the recipient since "exported" services are not necessarily without VAT.
- *Action:* Don't overlook the indirect taxes! Review the indirect tax consequences of intra-group services both in the receiving and dispatching countries, especially where services are bought into the center for allocation to user group companies.

Currency and exchange control risks

- Providing services to various jurisdictions, an MNE is faced with the denomination of fees to be charged to the group entities. Invoicing each jurisdiction in its local currency will create the need for complex currency risk management at the service provider and its associated tax consequences. Invoicing in a central currency may mean that tax authorities may seek to disallow foreign exchange losses associated with service fee payments. In addition, certain jurisdictions may apply exchange control restrictions on overseas remittances.
- *Action:* Assess the currency risks and regulatory aspects of the remittance of intra-group service fees.

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Item 2: Israeli authority tracks IP migrations

The Israeli Tax Authority (ITA) is taking an increasingly aggressive approach toward the overseas migration of IP — particularly in the context of post-merger integrations, but also as a factor in efficient supply chain management and other tax planning for today's changing business models.

In general, multinationals acquiring technology companies tend to centralize their IP within an IP hub. Similarly, the acquirer of an Israeli company would typically migrate that company's IP abroad.

The ITA recently tightened related IP provisions by applying draft guidance on transfer pricing from the OECD BEPS Project. This tax change, combined with earlier ITA guidance related to business conversions, makes it more important than ever for Israeli technology companies to ensure robust documentation of transfer pricing and intra-group/intercompany agreements at any stage of the business life cycle.

ITA groundwork laid in 2010

Tax controversy in this area has been on the rise since 2010, when the ITA provided guidance for identifying and assessing transactions related to business conversions. This guidance appeared to coincide with M&A activity in which certain Israeli technology companies were acquired by multinationals and then transferred risks and intangibles to foreign related parties during post-merger integration.

In these situations, prior to the business change, the Israeli company realized (or would have realized) taxable income from the sale of products. Subsequent to the transfer of risks and assets, however, the Israeli company functioned as a service provider remunerated for services on a cost-plus basis. By virtue of ownership of the transferred intangibles, the foreign related party would now have had the right to income associated with those assets.

New BEPS-related change ups the stakes

The more recent BEPS-related change maps to Action 8, *Guidance on Transfer Pricing Aspects of Intangibles* (released in draft in September 2014), which contains amendments to the arm's length principle and guidelines for transactions involving the development, enhancement and exploitation of intangibles. Now, when IP is transferred, the ITA investigates what the Israel-based company contained prior to the transfer and what it contains post-transfer, to determine the value of the IP transferred. In essence, the ITA takes the acquisition price and subtracts its calculation of the company's value after any IP is removed. The difference indicates to the ITA the value of any intangibles transferred.

Considerations

Business conversions in Israel are expected to attract increased tax authority scrutiny along these lines. Therefore, while the ITA considers only the before and after values, it is important to appeal by looking at the four different segments that make up the value of a company (price-to-book ratio, price-to-earnings ratio, price-to-earnings growth and dividend yield). Even more essential is an overall focus on robust documentation of transfer pricing and intra-group/intercompany agreements.

Tax inspectors will be looking at documentation of economic and business substance to support any transaction, as well as transfer pricing documentation to support intercompany pricing of both the transfer of assets and future intercompany transactions. In addition, it is important to review any relevant intercompany agreements to verify that any sale of IP or other change of business model would be reflected properly in these agreements from an Israeli tax standpoint.

Finally, companies should look carefully at their previous years' activity, as well, to identify potential exposures and consider steps to mitigate them.

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Item 3: US reprises proposal targeting overseas affiliates' digital income

"Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes." This statement was the crux of the OECD's September 2014 report on the digital economy, under BEPS Action 1.

Notwithstanding the OECD's position, certain countries are either proposing or implementing separate sets of rules to tax digital income. The US is no exception: the Obama administration has proposed a provision to tax companies operating in the digital realm, by eliminating deferral of overseas income associated with certain digital transactions. Specifically, in its 2016 budget proposal, the administration laid out the creation of a new category of income under Subpart F of the US tax code for transactions involving digital goods or services.[1]

Generally speaking, US companies are not taxed on certain active trade or business income earned by their controlled foreign corporations (CFCs) until that income is repatriated in the form of a dividend. The Subpart F rules provide exceptions to this general rule and require US companies to include in income on a current basis certain types of CFC income.

The proposed new category of Subpart F income, known as "foreign base company digital income," would generally include income from the sale or lease of a digital copyrighted article or from the provision of a digital service. It specifically applies when a CFC uses intangible property developed by a related company (including property developed under a cost-sharing arrangement) to produce income but does not, through its own employees, make a substantial contribution to developing the property or services that give rise to the income.

An exception would be provided when the CFC earns income directly from customers that are located in the CFC's country of incorporation and that use or consume the digital copyrighted article or digital service in-country.

Considerations

This proposed new form of Subpart F income carries potential tax implications for the technology sector and for all companies with significant IP offshore. Such companies should carefully evaluate their operations to determine whether the activities performed by the employees at an offshore IP company make a "substantial contribution" to the intangible property giving rise to digital income. Notably, this proposal was also included in the administration's 2015 budget bill and could fall short of passage this year as well, amid ongoing US tax reform debates.[2]

Still, a trend is emerging. The US administration's proposal is in line with OECD BEPS drafts, in at least one respect, that is, it envisions the phase out of structures with minimal substance and high profits at low or zero tax rates.

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Item 4: US IRS addresses taxation of foreign sales branches

US technology companies with manufacturing operations overseas should reevaluate their applications of the tax rate disparity test in light of recent guidance from the Internal Revenue Service (IRS).

Background
Generally speaking, income earned by a CFC from the sale of products gives rise to an inclusion in the US federal income tax return as Subpart F income if (i) it is acquired from a related party and (ii) it is sold outside the CFC's country of incorporation. Nevertheless, pursuant to an exception to this rule (i.e., "manufacturing exception"), income from the sale of products that the CFC manufactures is excluded from the definition of Subpart F income (and therefore not subject to inclusion in the company's US federal income tax return). The Subpart F rules provide a caveat to the manufacturing exception rule, whereby a tax rate disparity (TRD) test is applied.

A general legal advice memorandum (GLAM) dated February 9, 2015 outlines the way in which the TRD test, as applied to a sales branch, should be determined. Companies should calculate the actual effective rate of tax and the hypothetical effective rate of tax, then divide both by the hypothetical tax base determined under the laws of the CFC's jurisdiction (i.e., the laws of the manufacturing jurisdiction).

Potentially broad implications
The specific scenarios to which this guidance applies are available in our detailed analysis online.[3] In this column, we will devote our attention to its broader implications.

The main purpose of the guidance seems to be to specifically address the application of the TRD test with respect to jurisdictions that allow for the exclusion of certain items from the tax base, such as territorial tax systems. In effect, any income exclusions in the sales branch jurisdiction that are not available also in the CFC's jurisdiction (the manufacturing jurisdiction) drive the sales branch's effective rate of tax lower and increase the chance of a rate disparity. Additionally, the guidance addresses when the sales branch's effective tax rate increases because the sales income of the branch is subject to tax not only in the sales branch's jurisdiction but also in the CFC's jurisdiction.

The potentially broader implications of the guidance relate to the computation of the hypothetical tax base and the introduction of a new calculation based on the TRD gross income. While not apparent as a result of the relatively simple facts of the memorandum, certain sales branches may need to consider whether their deductible payments – most notably in the form of royalties or interest – should be taken into account, and in what amount, for purposes of computing the effective rate of tax. Additionally, the memorandum states that in computing the hypothetical tax base, expenses that are allocable and apportionable to the TRD gross income must be calculated, but it does not provide a mechanism for that allocation and apportionment.

Considerations
The expansive language of the memorandum could be read to indicate that every aspect of a sales branch's taxable income (deductions, credits, exclusions, etc.) must be analyzed, not just under the sales branch's jurisdiction, but also under at least one other foreign jurisdiction – that of the CFC or manufacturing location. In effect, tax departments could be required to ask themselves what would happen to the taxable income under the laws of either country. Technology companies with manufacturing operations overseas (e.g., semiconductors, computer peripherals, etc.) should reevaluate the application of the rate disparity test in light of the GLAM.

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Item 5: French think tank offers ideas for taxing data flow in value chains

The ongoing debate over data flows in global value chains was summed up last year by the European Commission's Expert Group on Taxation of the Digital Economy.

"The existence of data alone is not sufficient to generate value; the value comes from maximizing the efficacy of use from the actual data; but the challenge is deciding at which point and where the value is created," the group wrote in a working paper. "Furthermore, the data that is the lifeblood of the digital economy is increasingly being generated by users, rather than the companies themselves."

The debate resurfaced in a big way in February, when France Stratégie, a think tank affiliated with the French Government, issued a report titled Taxation and the digital economy: A survey of theoretical models. The report, also available on the European Commission's public website[4] was authored by a group of economists and advances ideas published in a 2013 French expert report that received significant attention and is widely known by the names of its authors (Pierre Collin and Nicolas Colin).

The France Stratégie report recommends a three-tiered approach to taxing digital economy companies:

1. Adaptation of nexus rules on the taxation of profits (i.e., the definition of a permanent establishment) *via* international negotiations;
2. If and as long as the previous approach is not implemented, adoption of an *ad valorem* tax based on revenue (e.g., advertising revenue) generated in the jurisdiction; and
3. If and as long as neither of the previous approaches is implemented, adoption of a tax based on a yet-to-be-defined measure of activity (e.g., number of users, flow of data, or number of advertisers).

The report recommends that the tax rate should differentiate between those revenues generated by accessing the platform and those generated by exploiting users' data and that the rules be structured to encourage platforms to offer varying degrees of data protection to users. The report concludes that additional work is still necessary to quantify the optimal tax rates and the impact on competition and markets based on both empirical and theoretical studies.

Considerations

So far, neither of the French reports has resulted in Government action. That said, the fact that the France Stratégie report now resides on the European Commission's website provides an interesting insight into the ongoing importance of this debate in Europe. The Commission has started 2015 in vigorous fashion, issuing a new package of tax transparency measures. With a second phase of activity scheduled for summer 2015 centering upon the promise of an "Action Plan on Corporate Taxation," it will be fascinating to see whether ideas in the France Stratégie report gain favor among Commission members.

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Item 6: US IRS offers menu of tax rules for Silicon Valley-style M&E

The Silicon Valley approach to employee meals and entertainment (M&E) has become something of a phenomenon, as viewed from afar, with its free offerings of everything from boxed lunches to full-service espresso bars and haute cuisine menus.

Likewise, the tax rules for this model — designed to produce payoffs in everything from employee recruitment to time savings, collaboration, service reliability, and corporate culture — can also be eye-opening.

The US Internal Revenue Code (IRC) approaches the deductibility of M&E expenditures with a complicated framework of rules, exceptions, exceptions-to-exceptions and limitations that can sometimes make the meals at issue unpalatable to companies' tax diets. As expenditures on employee meals and snacks have increased, the IRS has also increased its audit scrutiny of how taxpayers account for these costs when computing their tax liability.

Specifically, the IRC provides a straight-forward 50% deduction for M&E costs that is subject to few requirements, aside from a business purpose and certain documentation evidencing the expenditure. A 100% deduction is available, but at the cost of greater technical and administrative complexity. Some companies with increasing expenses are finding the compliance cost worth the effort.

IRS audits of employer-furnished meals often focus on characterizing the meals as income to employees and then attempt to penalize employers for failing to make the proper withholdings. Taxpayers can potentially protect their deduction — and shield their employees from excessive taxation — by using three key statutes.

General M&E deductions (IRC Section 274)
If the company can show that the meal or entertainment was directly related to the active conduct of its trade or business, the expenditures may be eligible for a 50% deduction. Such expenses cannot be "lavish or extravagant," and documentation requirements are strict.

Employer-operated eating facilities (IRC Section 132)
Company cafeterias (as well as other food and beverage items provided to employees) often qualify as fringe benefits, which are expressly excluded from gross income. Various provisions apply but generally, as long as the meals are not taxable compensation for employees, an employer may deduct the entire cost of its eating facility.

Protecting employees from tax liability (IRC section 119)
The value of employer-furnished meals may also be excluded from an employee's income if the meals are provided on the employer's premises for a substantial non-compensatory business reason, such as difficulty obtaining access to alternative eating establishments during a reasonable time frame or due to a restricted time frame or keeping employees on-site for emergency situations that may occur during meal times (e.g., cloud service providers eager to prevent outages).

Considerations
In all cases, the devil is in the details, which are extensive. The subjective nature of many elements that taxpayers must prove to support a 100% M&E cost deduction, and to exclude the amounts from the income of their employees, often causes the IRS exam teams to focus persistently on this issue.

Any company offering Silicon Valley-style M&E would be well advised to establish convincing arguments in support of treating their meal expenditures as serving non-compensatory business purposes as early as possible – in advance of any audit. Once non-compensatory reasons for the meals are established, taxpayers should carefully craft a policy that describes the circumstances that would lead to fully deductible M&E expenditures, and how such circumstances are identified and measured. The early establishment of these two procedures can save time, effort and difficulty when seeking to resolve an audit that includes an examination of M&E costs.

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Note: The views expressed in this column are those of the authors and do not necessarily reflect the views of the global EY organization or its member firms. Check with your local EY tax advisor for the latest information regarding these rapidly developing topics.

Endnotes:

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[4] Taxation and the digital economy: A survey of theoretical models, February 26, 2015
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