

# Analysis

## Indirect tax management and globalisation

To understand business globalisation, it is important to have a grasp of the political environment that has underpinned it for more than half a century because, as much as globalisation manifests itself in the business world, it has been essentially a politically designed and sponsored structure and process. We often think of globalisation as being a comparatively recent phenomenon but it has, in fact, been happening (at least on a political level) since the end of World War II, when politicians started planning for the breaking down of international borders in order to increase prosperity and decrease the chances of another global war. A critical step in this process was the Bretton Woods conference of 1944 which, in turn, led to the establishment of the World Bank and the International Monetary Fund (IMF), two of the powerhouses behind global financing and economic and monetary policy. Another, later step on the road to globalisation was the creation of the European Community and then the other trade blocs that now exist around the world. The highest-level rationale behind all of these organisations and groupings has been broadly the same – to build interdependence between nations and so render global conflict an ever more remote possibility.

When we talk about globalisation from a business or tax perspective, however, we are not usually referring to the political machinations of the last 65 years but rather the inexorable growth and expansion of companies around the world to the point where we now have thousands of major corporate entities that have a truly global operational reach. While their incentive for international expansion is generally recognised as being in the pursuit of market share, regional dominance and profit, the process is largely made possible by the reduction and/or elimination of tariffs, the easing or even removal of controls on capital and the relatively free movement of people.

From a tax point of view, however, the political framework around globalisation has always been something of a contradictory position in that, while Governments have expended great efforts to build trade blocs and develop common regulatory systems, such as those seen in the EU, they have never really been able to loosen their grip on the compliance requirements on those taking part in the process. This has resulted in the situation of Governments creating free markets but then seeking to place ever greater burdens and controls on the companies operating in those environments. It is entirely understandable why this should be so when one takes into account the often vexed issues of fiscal sovereignty and overall control and compliance. It has, nevertheless, led to the current invidious position where most multinational companies are faced with a hyper-regulatory environment in which they have to operate.

The term 'hyper-regulatory' in a tax context refers to changes in existing tax laws, case law and

**SPEED READ** In-house indirect tax specialists working in multinational environments are well aware of the enormous challenges they face in managing their global transaction tax positions. One of the prime reasons for this has been globalisation, a politically sponsored process that has opened up worldwide trading opportunities at the cost of additional risk and compliance administration on the part of those companies wishing to operate globally. A possible solution to today's hyper-regulatory situation is international co-operation between tax authorities to reduce the burden and the adoption of emerging technologies that will become an essential element in the management of indirect taxes.



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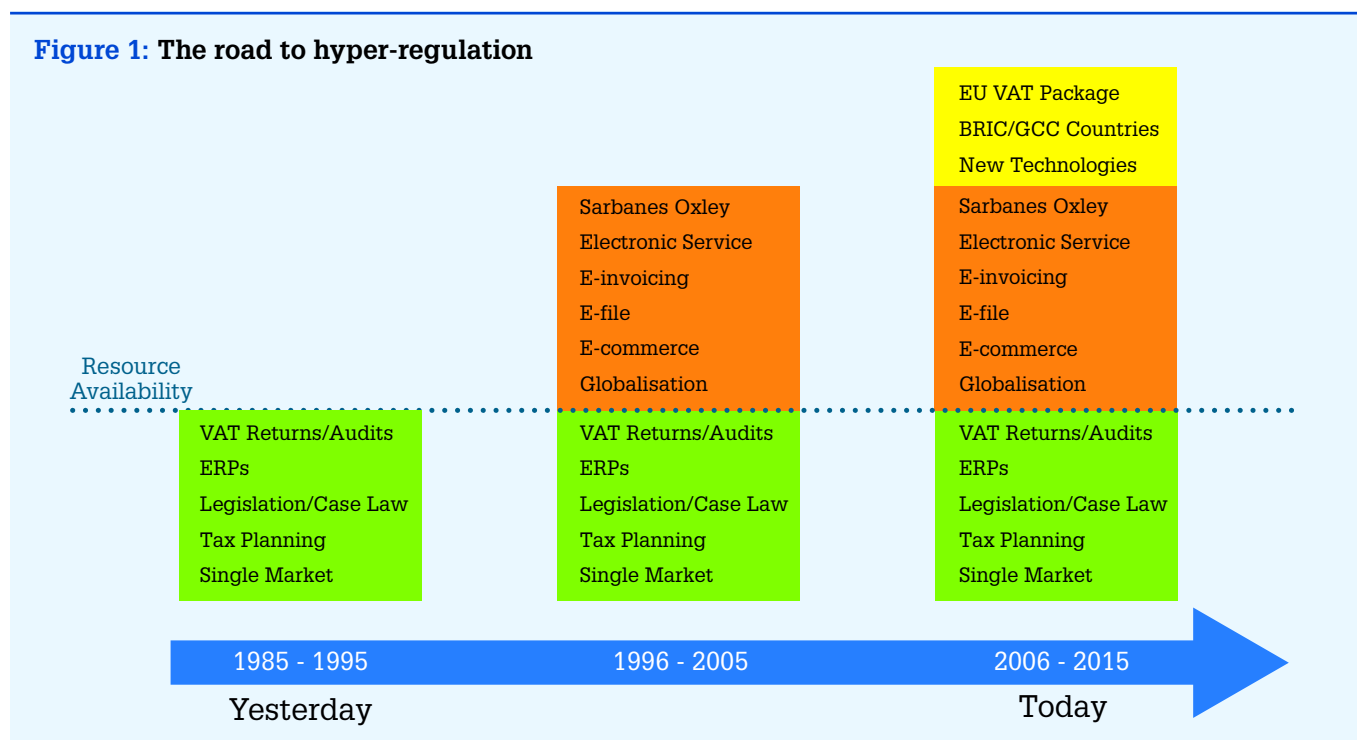
official policy positions and the introduction of new legislation occurring so frequently, so fast and in so many tax jurisdictions that it is virtually impossible for most businesses to maintain effective processes and controls in that area of their operations. It is not difficult to see the irony of Governments both encouraging businesses to act globally and at the same time burdening them with administrative requirements in order to do so. The trouble is a lack of any broad-based harmonisation between countries.

### Differences within the EU

Even within the EU, one of the longest established and most advanced of the world's communities, there are innumerable differences between tax requirements in the various Member States, with little prospect of those gaps being closed any time soon. Such gaps run the gamut of tax calculation, administration, reporting and compliance. It is telling that the Commission's very limited indirect tax harmonisation efforts have only extended as far as VAT and customs duties, with excise duties and environmental taxes still relatively untouched and the VAT origin system being long ago abandoned. Even legislation intended to bring about greater harmonisation fails to make a significant impact due to optional clauses in the legislation and derogations being granted to those who cannot or will not comply. In fact, looking at the disjointed way that EU Member States are going about the introduction of e-filing right now, they look set to be creating yet more gaps before they start any meaningful harmonisation process. Due to these and many other factors that can be traced back to Governments that are unwilling to ease

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**Figure 1: The road to hyper-regulation**



their grip on businesses, the workload on most multinational companies' in-house indirect tax specialists has grown exponentially.

#### Different business models

Often, the more overwhelming problems with managing indirect taxes around the world are focused on or concentrated in particular business models or activities. Central among these are companies that operate shared service centres, where accounting and tax functions are centralised for multiple jurisdictions. Centralisation of this sort is a common and logical by-product of globalisation, as the cost savings that can be realised in comparison to a decentralised model are significant. However, this process also creates tax management issues, including:

- The removal of local tax managers in favour of more generalist resources based in a foreign country tends to lower the overall level of subject matter expertise;
- Relationships that have been built up over years between the company's local operation and the tax authorities in that country are broken:

- There can be issues over the location and inspection of business records, especially when tax audit time comes around;
- Centralised resources can never be as close to a tax environment as local managers, so the issue of maintaining accuracy and compliance within an accounting system becomes more difficult as problems start to arise over tax research processes, including updating legislative changes, case law developments and local policy/interpretation matters.

#### Multiple taxes

Further problems arise in the indirect taxes space when some of the more complex countries, such as the USA, Brazil, India and China, are brought into the mix. The issues with such countries range from the multiple tax types that can apply to transactions to the simple fact that there are hundreds and, in some cases, thousands of taxing jurisdictions that exist (especially in USA and Brazil). Grappling with these kinds of operational obstacles can test the strongest of in-house tax professionals. But worse than that is the fact that most multinational companies' current tax technology resources (ie, their Enterprise Resource Planning or ERP systems) are inefficient at dealing with these countries because they only provide a framework in the form of blank master tables within which to calculate indirect taxes. While this may be fine to manage a European country where only VAT has to be calculated and reported at a federal level, it does not suffice in these more complex jurisdictions, where extensive tax data, jurisdictional identification processes and taxability logic are necessities.

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## Mergers and acquisitions

Another of the key business activities that generates major indirect tax management issues is mergers and acquisitions, which in many cases is the life blood of the business globalisation process. The acquisition of another business operating in a different part of the world is one of the quickest and most effective ways of 'going global' and gaining market share where none previously existed. While that sounds like a good template for globalisation, it is not without its challenges from an indirect tax point of view. The most obvious of these is that, before the ink is dry on the sale contract, the acquiring company is faced with taking on responsibility for the tax affairs of the target business. If, as is often the case, the tax managers of the acquiring company have little or no previous experience of the tax regimes in the countries that they have taken on, this can sound some serious risk management alarms and ushers in a potentially difficult transition period that can stretch the in-house tax team in many aspects of their responsibilities.

## The hyper-regulatory environment

Returning to the greater issue of the global hyper-regulatory environment in the indirect tax space, the question that needs addressing is whether this situation has any prospects for improving or whether things will continue as they are and eventually descend into a destructive spiral of excessive demand from tax authorities around the world. The answer would appear to be that we are unlikely to see any meaningful improvement for the time being but there is some cause for optimism. At one level, we are starting to see the development and emergence of new audit methodologies, such as statistical sampling and horizontal monitoring, from some of the more forward-thinking tax authorities. This indicates that we may be in the early stages of heading down the road to more strategic, high level co-operation between taxpayers and the authorities and moving away from the detailed, painstaking, invoice-by-invoice auditing methods that we have seen in the past. This, in itself, is likely to provide some relief for those companies that are able to refocus their compliance efforts in this way. For others, the pain is likely to continue.

Probably the best hopes for a global slowdown or even reversal in hyper-regulation lie with the OECD expanding its membership so that its work could have an increased worldwide impact or the World Bank and/or IMF taking a more active role in driving simplification and harmonisation into the tax world. None of these events are outside the realm of possibility and would, in fact, be in line with such global organisations' interests in the development of more synchronised tax policy and collection which, in turn, drive the delivery of services to citizens and the construction of more sustainable tax policies. However, this is not going to happen any time soon, so businesses must look

for ways to manage their increasingly complicated tax footprints by whatever means they can in the meantime.

## Where technology comes in

Recognising the difficulties that multinational companies face in managing their indirect tax positions, many of them have started turning to new and emerging technologies to help them move from manual processes and accounting systems that require human intervention (such as native ERP tax functionality) to increasingly automated environments, such as those found within bolt-on applications such as external tax engines. As noted earlier, ERP systems can often struggle to cope with the world's more complex indirect tax regimes such as those found in USA and Brazil but they are also constrained by the fact that the only tax data and logic that is found in such applications is that which users themselves enter into and then maintain. This leaves the users with an ongoing research effort in order to keep the ERP data content up to date and compliant, even for the more straightforward tax jurisdictions. That can be a tall order when a company may be trading in dozens of countries and buying and selling a wide range of goods and services.

For most businesses facing this issue, the answer for can be found in tax-sensitised business intelligence solutions and external tax engines which are pre-populated with tax data, taxability logic and reporting capabilities. In a perfect world, such solutions would cover every tax type in every country in the world. While that is still some way from becoming a reality, even today there are tried and tested applications available that represent a huge upgrade from native ERP functionality in respect of the management of VAT, GST, Sales Taxes and other transaction taxes around the globe. With each new release, these technologies become more comprehensive and more valuable.

In conclusion, despite the significant obstacles that globalisation has thrown at tax professionals, the outlook for in-house tax departments is slowly becoming brighter as the OECD's efforts in the field of tax synchronisation makes the first, small steps onto the global stage and as we see the emergence of technological solutions that are making sense of an increasingly impenetrable body of tax law, precedence and policy interpretations. There can be little doubt that the process of globalisation has broadly met many of its original objectives – the interdependence of nations and the avoidance of global conflict – but there remain many lower-level, operational issues around actually working in the environment that has been created. It seems likely that the best hopes for a resolution to those issues are inter-governmental co-operation through OECD and similar bodies and through the adoption of tax-sensitised technologies that will become an essential part of the worldwide management of indirect taxes. ■

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