The Perfect Storm Around Global Tax Planning Risk:

Written by Henry Martin on 12 September 2016.

How the Right Technology and Effective Planning Can Keep You Afloat

Global tax planning has never been smooth sailing, but it is arguably one of the most value-added functions performed by tax departments in multinational enterprises (MNEs). Recent shifts in international fiscal and tax policy, such as Brexit, EU State Aid investigations, and the OECD Base Erosion and Profit Shifting (BEPS) Actions, will have potentially long-lasting impacts on the global economy and trade. Each one of these on its own is momentous enough to have a profound effect on foreign direct investment, trade, banking, corporate taxation, and the exchange of tax information between jurisdictions; considered together, however, their impact is exponentially greater.

The worldwide tax landscape has irreversibly changed, putting MNE tax departments and the global tax planning they have relied on for so long in the centre of a proverbial super typhoon. Only through careful navigation and the help of powerful tools will MNEs weather the tax planning storm and effectively manage tax liability and reputational risk. CEO Insight recently spoke to members of the Chief Tax Office at Vertex Inc. about these global developments and their impact to MNEs.

Brexit

“The precise political, economic and supra-constitutional implications resulting from Brexit cannot be predicted until such time the nature of the UK’s reformed relationship with the European Union (EU) becomes clear,” explained George Salis, Senior Tax Compliance Principal and Certified Business Economist (CBE) at Vertex. Salis continued, “After triggering the necessary Treaty exiting provisions of Article 50 TEU, pointers regarding the country’s future domestic tax and trade trajectory will also be an indispensable aid in coming to determine the lie of the land.”

It is apparent, however, that, regardless of their domicile, companies with interests in the UK can expect to be affected due to the likely impact on tax exemptions currently enjoyed by virtue of the UK’s EU status. Potentially affected exemptions include the ability to claim derivative benefits, investments by EU taxpayers into UK companies becoming subject to the controlled foreign companies rules (CFC-Rules), and other applicable directives from which the UK must now withdraw.

With respect to the UK's continued popularity as a holding company hotspot, while the autonomy to set attractively low domestic tax rates may exist post-Brexit, this must be offset by the fact that some of the benefits are to be found in EU law. For example, the Parent–Subsidiary Directive and the Interest and Royalty Directive, which prohibit withholding taxes on intra group interest, dividend and royalty payments, could be affected. Meanwhile, with regard to taxation of UK dividends, there is no reason to believe that the double tax treaties concluded by the UK won't remain in place.

In terms of maintaining reciprocal tax rules, much depends on what form the UK's new relationship with the EU takes. Will it borrow from any of the Norwegian, Swiss, Canadian or Turkish models, or will a wholly new and customised state of affairs be struck? Will it retain access to the common market, contribute to EU spending? Will it engineer an ongoing customs union with the EU, an all-encompassing customised free-trade agreement, or even a series of agreements relating to specific sectors?

"Without knowing all the externalities involved, one has to factor in the possibility of taxation on capital repayments and cross-border restructurings, as well as potentially escalating exit-tax burdens," said Bernadette Pinamont, Director in the Chief Tax Office at Vertex. "In addition, if Brexit means that the Directive on Administrative Cooperation and the Arbitration Convention no longer applies to UK MNEs, there could be a significant impact on dispute resolution due to disparate burden of proof requirements," she added.

All told, while it is the case that EU directives implemented by statute will remain part of UK law unless subsequent UK statute supersedes it, one can nonetheless see how important it is for corporate leaders to assess the extent to which they use UK companies to access the EU, in order to craft fully informed contingency plans and potential strategies to meet any challenge.

"It is the hope of Brexit supporters that leaving the EU will allow for a more flexible UK tax policy and more competitive regime. It's certainly true that the UK will no longer be obliged to further the harmonisation of its corporation tax rules, nor comply with the proposed Anti-Tax Avoidance Directive, which exceeds the scope and ambition even of the OECD's BEPS measures," commented Nancy Manzano, Director in the Chief Tax Office at Vertex.

The UK will also be free to embrace State Aid and bring forward other legislation in it hopes will provide an advantage over its continental neighbours, bringing it to bear on infrastructural initiatives, such as the Northern Powerhouse. In addition, it should come as no surprise if there are significant changes to rates of duty, as the UK looks to leave the customs union and negotiate new free trade agreements, preferably under the auspice of the World Trade Organisation (WTO) system. No doubt, this will be a consequential adverse selection that Britain (and the EU) will have to contend with in the months to come.

It is worth remembering that the UK will remain a member of the OECD, G20, and WTO, and therefore will continue to be a part of efforts to harmonise international trade and business practices. In this way, just like the EU, the UK is committed to implementing the BEPS recommendations tackling international tax avoidance, and will continue to subscribe to the Common Reporting Standard (CRS) and other transparency initiatives, as well as participating in the US FATCA reporting regime.

BEPS

The OECD's BEPS initiative is set to transform the global tax environment, ushering in of an era of full disclosure, onerous compliance, and an unprecedented level of transparency. This will cause the restructuring of the international tax system and implementation of guidelines that are more consistent. "These new international standards will demand the attention of MNEs and governments alike, since they have the capacity to significantly influence the fortunes of all, and what economists call 'the Social Cost,'" said Salis.

As well as explicitly impacting the tax operations of MNEs, KPMG noted that changes resulting from BEPS will also affect, among other thing, the management of tax reputational risk, customs processes, key treasury and finance metrics, forecasts, and the valuation of proposed mergers and acquisitions.

"The most effective response to the increased tax compliance challenge for MNEs should be to formulate a clear BEPS strategy at the earliest opportunity, involving expertise at both global and local levels. Some MNEs are even considering posting their tax risk strategy and code of conduct for compliance online to minimize reputational risks and public criticism," said Manzano. "In so doing, the impact on tax footprints, as well as the risk of increased auditing and penalties, will be minimized, and the MNE's goodwill reputation assured," Manzano added. A recent study by Deloitte found that tax has become more strategically important as a result of BEPS, with tax management now being considered a Board-level concern.

At this time, the BEPS trajectory appears to be largely unaffected by Brexit; however, the new global tax landscape is set to be marked by heightened levels of costly scrutiny and intensive risk exposure. "As such, it is imperative that affected parties sit up, take note, and conduct their global affairs accordingly," remarked Pinamont. "Failure to do so could see an MNE's overall transfer pricing strategy, for example, undergoing an exponential increase in audit risk. In addition, CEOs, CFOs, and other global corporate leaders will have to contend with a variety of fiscal and legal ramifications emanating from this new global tax environment," added Pinamont.

EU State Aid

The EU's position that previous legal tax agreements between individual EU countries and MNEs may be recharacterised as unlawful state aid is already causing uncertainty and tax reputational risks. “From a business perspective, state aid investigations are creating more uncertainty for CEOs, CFOs, treasurers, and tax executives – at a time when they are already contending with uncertainty stemming from the global economic environment, BEPS compliance, and the risks and perils created by sharing tax and financial data,” said Salis. “MNEs should be wary when considering expansion into other countries. Planning is more critical than ever, but also more difficult than ever.”

"Until some EU States Aid cases resolve, scenario planning and technology will be key factors in making strategic tax decisions and running business operations."

Technology

“The best technology solutions for MNEs will have data management at their core. Coupled with advanced analytics, these solutions will provide increased transparency of the data to enable tax scenario planning and improved governance in a post-Brexit/BEPS world,” stated Pinamont. She continued, “Such predictive data analytics and algorithm-driven knowledge generation applied to decision-making is set to prevail across organizations, so it is essential that tax departments become fully aligned with this revised way of conducting global business.” MNEs can mitigate risk (both liability and reputational) and capitalise on gains by embracing the concept of data management; nowhere is this more important than in the tax department.

When it comes to large volumes of data, “quality,” not “quantity,” is the watchword. Quality data can be leveraged to keep abreast of the constant stream of changes to tax legislation and business operations. To realise this vision, the tax department needs to evaluate automation technology designed to consolidate transactional data stored across multiple systems. While deep analytical skills are an essential pre-requisite for identifying and applying the meaningful data contained in the mass of information flowing into organisations, those skills are meaningless without the right complementary tools.

Advanced technology like Vertex® Enterprise can help to solve transaction-level data management challenges of even the most complex MNEs with multiple entities and multiple financial systems. At the heart of this technology is the Vertex Tax Performance Engine™, a sophisticated data management platform built with an open architecture and designed to unify, validate, enrich, and provide access to the massive amounts of global data needed for every stage of the tax lifecycle—for all tax types.

“In short, utilizing powerful tools to bring data-driven decision-making into strategic business advising provides competitive advantage, and should be considered a top priority for MNEs,” stated Manzano. She continued, “it will liberate companies from time spent on manual data manipulation and reporting, thereby allowing for greater focus on strategic planning and forecasting. In this way, trends and patterns can be identified, risks addressed, productivity boosted, and value added.”

Beyond gauging the potential tax impact of transactions or acquisitions which data analytics offers, other technologies such as data imaging technology can be used to extract unstructured data and transform it into readable electronic form. Meanwhile, synchronicity between systems can be achieved through consolidating tax data into a data warehouse, while data management tools allow for the collection and transformation of data from disparate sources into a standardised format.

Another noteworthy development is the use of portals which can support connections to external applications or third parties and, in so doing, make pertinent data available to investors, customers, C-suites or tax administrations.

All signs point to advanced tax technology strategies with data management at the centre of the future global tax lifecycle. The worldwide tax landscape will continue to evolve, requiring MNE tax departments to leverage technology to shore up their tax liability and reputational risk — especially with respect to the emerging requirements around transfer pricing and tax transparency, including EU State Aid rulings, CbCR, and other BEPS actions outlined by the OECD in a post-Brexit world.

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