FOCUS

The future of tax

Ibrahim Mohamed Al-Mofleh
Director General, Department of Zakat and Income Tax, Saudi Arabia
Page 48
Change characterizes the tax landscape: for many, the future of tax is unclear. Where will the journey lead?
Tax is catching up with the future

In the past years, tax has climbed to the top of the corporate agenda, and it is clear that the current focus on tax is here to stay. Every stakeholder – whether it is the public, politicians, media, nongovernmental organizations or corporations – has different viewpoints and concerns. Amid this very public and noisy debate, one critical point keeps getting lost: with rapid advances in technology and ever increasing globalization, commercial models are necessarily complex and so too are the cross-border tax rules applicable to modern global businesses. The appropriate taxation of global business is an issue with technical, legal, policy, economic and, yes, fairness dimensions. It is not an issue that can be addressed in a sound bite. This will be the challenge for all stakeholders as, together, we shape tax policy and laws for the years ahead.

This issue marks the launch of our new-look magazine, Tax Insights. It is full of stories and ideas that will help business leaders have the most relevant information to make decisions in these challenging times. We also hope to assist our readers in the general public – who are more closely following the tax debate – gain a clearer understanding of the key issues.

For our first edition, we have chosen the theme of the “future of tax”. Defining the future is, of course, an elusive task at any time, not to mention this transformative moment. That’s why we examine some of the most important global issues. Tax law, for example, is changing quickly around the world as governments seek to modernize their tax systems in order to attract investment and boost compliance and revenue. Corporate taxpayers need to engage actively in this debate to help improve the understanding and acceptance of these new laws – which need to be both practical and feasible to implement. Finally, we also explore the impact of key trends in the world of tax.

Given the increasing importance of tax on the global landscape, Tax Insights will also “go global” with its next issue, which will be devoted to a single topic – tax transparency, one of the seven key tax trends we introduce here.

There is no going back. The tax transformation that started with the 2008 global financial crisis has really only begun. Businesses need to prepare and adapt for their journey on the admittedly uncertain road ahead.

It is time to get started.
Seven trends relevance ranking

What does the future hold? We do not profess to own a crystal ball, but here are our predictions for the top trends that will influence tax policy and tax bills going forward. Page 30

<table>
<thead>
<tr>
<th>Relevance Ranking:</th>
<th>Impact on companies:</th>
<th>Current relevance ranking</th>
<th>Relevance ranking outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>remaining</td>
<td>increasing</td>
<td></td>
<td></td>
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<tr>
<td>rising</td>
<td>lessening</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Cooperative compliance
Page 34

Legislation
Page 36

Transparency
Page 38

Professionalism
Page 39

Big data
Page 40

Tax competition
Page 42

Balancing conflicting interests
Page 44

Comprehensive tax control framework
General anti-avoidance rules, interest deductibility changes, transfer pricing, hybrid structures, double non-taxation and treaties
Disclosing tax information to stakeholders, internal transparency of tax-related functions, strong governance and risk management processes
Tax authority administrators are better equipped to deal with complex tax issues
Advanced data and analytics capabilities
Corporate tax rates keep falling
Managing the diverging interests of stakeholders
“We believe in greater transparency towards tax authorities, and we think the right way to do that is via the enhanced relationship.”

Mark Melzer
Director Global Tax Policies & Processes at Heineken
The future of tax

“Tax law is very interesting because there are procedural issues, and there is also an important international dimension.”

Mathieu Ferré
Student at the Université Toulouse 1 Capitole, named EY’s Young Tax Professional of the Year 2013

See page 28
Base Erosion and Profit Shifting Action Plan

The OECD’s Base Erosion and Profit Shifting (BEPS) Action Plan reflects its view of weaknesses in the international tax system. For business leaders, the project is an opportunity for proactive engagement with tax authorities. It is also a call to action to review tax policies and ensure systems and processes are in place to address additional transparency requirements.

Industry-specific
- Address the tax challenges of the digital economy

Transfer pricing
- Consider transfer pricing for intangibles
- Consider transfer pricing for risks and capital
- Consider transfer pricing for other high-risk transactions

Technical response
- Neutralize the effects of hybrid mismatch arrangements
- Limit base erosion via interest deductions and other financial payments
- Prevent treaty abuse
- Counter harmful tax practices more effectively, taking into account transparency and substance
- Strengthen controlled foreign corporation (CFC) rules

Execution
- Making dispute resolution mechanisms more effective
- Development of a multilateral instrument for amending bilateral tax treaties

Transparency
- Re-examine transfer pricing documentation
- Require taxpayers to disclose their aggressive tax planning arrangements
- Establish methodologies to collect and analyze data on BEPS and actions addressing it
- Prevent the artificial avoidance of permanent establishment status

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Credit: EY
The future of tax

Insights for business leaders

Tax

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Preamble

4 Tax has moved to the top of the agenda for governments, media and corporations. And trends like transparency and data analytics are here to stay. This issue is devoted to the future of tax.

Debate

10 Will the future be fair? Tax fairness is a problematic concept to define, let alone implement. Looking forward, will calls for more transparency lead to tax fairness?

Infographic — G20 taxes

16 Tour the diverse tax landscape in selected G20 countries.

Change is in the air

18 An overview of the changes that came out of several important meetings and reports in 2013. What does it mean for the year ahead?

Tax on trial

22 Much is at stake when companies must take tax disputes to court. A tour of select world courtrooms.

Tax — as young people see it

28 Young people need new skills for a tax career – not just technical tax skills, but also team-playing and critical-thinking skills. Meet EY’s Young Tax Professional of the Year.

Seven Tax Trends

30 Tax is undergoing a transformation. What awaits companies on the road ahead?

Closer cooperation

34 Trend one: is cooperative compliance the way to go? Heineken has used the model to build trust. Q&A with Mark Melzer from Heineken.

Legislation plays catch-up

36 Trend two: authorities are modernizing outdated tax regimes. They are also sharing more information.

Transparent taxes

38 Trend three: governments and the public are pushing for greater tax transparency. What does it mean for companies?

Tax professionalism

39 Trend four: tax officials are investing in skills and tools for their workforce, as part of a push for better enforcement.

Big data

40 Trend five: as processing power rises and data sets get even larger, what changes are in store for the tax function?

Tax competition

42 Trend six: governments take different approaches to tax, often to attract corporations to their territory. Maarten Boudesteijn of Royal Cosun talks about the impact.

Stakeholder management

44 Trend seven: firms face a balancing act in the quickly changing tax environment. For some, this may mean reconsidering tax policy with the support of the board.

Feature

46 Stephan Kuhn, EY’s EMEIA Tax Leader, says it is not an option to close doors and hope the debate on transparency and fairness will go away.

Ibrahim Mohamed Al-Mofleh

Can tax ever be fair?

By Paul Kielstra

In the growing debate over tax – and who pays what – “paying a fair share” has become one of the clearest rallying calls for both governments and the wider public. But for organizations, working out what constitutes their fair share can be hugely problematic.
The list of major companies facing criticism for paying what is perceived by some to be too little tax—either overall or in specific jurisdictions—has been expanding rapidly. Scrutiny by the public at large, as well as legislators, has been directed at large multinational companies—many of them household names—on both sides of the Atlantic.

The problem is not one of illegality. The companies involved have always insisted that they obey existing tax laws and the authorities have not disagreed. The issue is much more difficult to address: fairness. The overarching question is how the existing tax legislative framework, whose fundamental principles were developed many decades ago, can apply effectively to multinationals operating in today’s globalized environment. In particular, this relates to the issue of moving profits between subsidiaries in jurisdictions with differing tax rates. In some cases, it is not even clear which country has legal power over income.

In addition, in the public mind, fairness is at the source of a number of tax-related issues at the domestic level. This should not be surprising. The perception of fairness has long been an important consideration in tax policy. As far back as 1776, Adam Smith, in his Wealth of Nations, describes four principles that should characterize taxation. He puts equity or fairness first among these: “The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to the revenue which they respectively enjoy under the protection of the state.”

If anything, current economic conditions are increasing the importance of this element of a desirable tax system in public eyes. Jeffrey Owens, Senior Tax Policy Advisor at EY, notes that most developed countries are engaged in austerity programs to reduce debt, and higher taxes form an important element of many programs. “This brings an increasing emphasis on all taxpayers having to pay their fair share. That has become a political issue,” said Owens. John Christensen, Executive Director of the Tax Justice Network, an NGO, agrees that austerity has focused attention on the debate about a fair share of tax, but believes that longer-term issues are also at play. “Until about a decade ago, there was very little public recognition that tax competition was even an issue,” he says. “As globalization has extended its reach, there has been a deeper understanding that tax laws have played an important part in shaping it.”

In that way, the debate over a fair share of tax is part of the broader discussion about how globalization should proceed in the years ahead.

What the law expects
Fairness is a powerful ideal, but a very difficult one to define, let alone implement. It is also a highly subjective concept and even a basic understanding of it tends to vary over time.

Taxation arises from legally created and defined obligations. As Owens says, at the end of the day, governments decide what is fair through legislation. The difficulty then becomes determining what fairness means in the context of a given set of laws.

One key element of this is fairness to individual taxpayers as they try to negotiate the rules. Several court decisions are...

“Laws adopted in the early part of last century have not evolved... They have fallen massively behind the reality of the new economy.”

John Christensen is co-founder and Executive Director of the Tax Justice Network and directs its London-based International Secretariat. Trained as an auditor and development economist, he has worked in a variety of the world’s poorer countries, in offshore financial services with Touche Ross and as an economic advisor to the Government of Jersey.

Credit: Chris Gloag
The future of tax

regularly cited to summarize one important view—that as long as the taxpayer stays within the letter of the law, it is unfair to demand more unless the government goes through the trouble of changing those rules. In Britain, in the Duke of Westminster case of 1936, Lord Tomlin said: “Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate acts is less than it otherwise would be. If he succeeds ... then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.” Around the same time, a distinguished American jurist, Learned Hand, noted in a 1935 case: “There is not even a patriotic duty to increase one’s taxes. Over and over again the courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible.”

The payment of tax, however, is not merely an individual activity. It involves discharging a responsibility to the state and, ideally, through the state to the broader society.

This inevitably involves considerations of fairness to other taxpayers who share the burden of funding the government — and to fellow citizens who may benefit from state spending. Accordingly, the letter of the law has never been the only consideration in the courts. The substance of a taxpayer’s activities has always been as important as the form.

Professor Graeme Cooper of the University of Sydney Law School said, “I don’t know that people ever would have been well advised to think that, as long as I can put together the right kind of form, I can survive scrutiny. The legal system doesn’t work that way.”

Indeed, it is ironic that Hand’s quote arose from a case, Gregory vs. Helvering, which established in the US the Business Purpose Doctrine—which is that transactions taken for no reason other than to reduce taxes could be disregarded by the authorities.

In recent years, the substance—or intent—of the law itself has become of ever-greater importance in deciding what taxpayers should be able to do. Owens points out that one of the major shifts in the OECD’s 2011 Guidelines for Multinational Enterprises was that in tax matters, corporations, while complying with the letter of the law, should also consider the intent of the law. Judith Freedman, Professor of Taxation Law at the University of Oxford, notes that many countries are introducing general anti-avoidance rules (GAARs): “Yes, you look at the law, but you have to look at it in a purposive way. You can even look at shortcomings in the legislation. You can no longer say that, even if the law says something really stupid because of a technical problem, it will be the last word on the matter.”

From a legal point of view, then, fairness seems currently to boil down to taxpayers being allowed to take advantage of intended benefits in legislation when genuinely engaged in behavior that was meant to attract those benefits.

Societal norms

This is far from the full story, though. This argument assumes that the government got it right and that the law itself, when

“You can no longer say that, even if the law says something really stupid because of a technical problem, it will be the last word on the matter.”

Judith Freedman is the Professor of Taxation Law at the University of Oxford and a Fellow of Worcester College. She is also Director of Legal Research, as well as a member of the Steering Committee and Advisory Board of the Oxford University Centre for Business Taxation, which she helped establish.
properly applied, should result in fair outcomes. Cooper said, “The problem underlying many of the current controversies over tax havens is not that people are evil, but that the rules are no longer producing outcomes that we like anymore.”

Christensen goes further: “Laws adopted in the early part of last century have not evolved to reflect a globalized economy and the emergence of digitized economies. They have fallen massively behind the reality of the new economy.” Complicating matters further, it is not just companies who may be pursuing aggressive tax planning; countries are also engaging in aggressive tax competition to compete for investment.

Fairness, though, is a social concept even more than a purely legal one. Tax positions that would survive robust judicial scrutiny can appear inappropriate to the public. Companies therefore may need to take steps even when they do not legally have to. Freedman says, “There is certainly a perception among companies that reputation matters, although it may depend on the industry. A retailer, for example, might worry more than others about public opinion, and certain businesses would be quite proud of aggressive tax strategies that make shareholders very happy.”

Owens nevertheless believes that all executives have to think whether they can explain their tax strategy to the citizen in the street, and to consider whether they can argue that their company creates “public value” with their choices. Reputational damage arising from what is seen as aggressive tax planning can affect more than sales. It may make it harder to attract talent and it is increasingly likely to lead to much greater scrutiny from tax officials. Owens says, “A company’s good corporate governance policy has to include good tax compliance.”

A fairer system in future?
Current efforts to improve the “fairness” of tax systems show how difficult it is for diverse groups to come to an agreement on what constitutes a more fair system and how that system should be implemented.

At the international level, the most prominent work in this area is currently being undertaken by the OECD on behalf of the G20. The new Action Plan on Base

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**Graeme Cooper**

is Professor of Taxation Law at the University of Sydney. He has a Doctorate in Law from Columbia University and has taught tax in law schools in Australia, Europe and the United States. His principal research and teaching focus is domestic corporate taxation, comparative tax law and tax policy.

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“These GAARs are like your mother saying, ‘I don’t know what you are going to do and how, but ... you aren’t going to get away with it.’”

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Credit: Aram Anderson
“If one concept will dominate tax in the next 10 years, it is transparency.”

Erosion and Profit Shifting is an attempt to address various arrangements that give companies flexibility in choosing tax jurisdictions (see our later story “Change is in the air”). The plan covers everything from regulatory consistency and administration to information sharing, tougher policies on transfer pricing and treaty abuse.

The problem is not the intent, but the scale of the project. “This is one of the biggest challenges the OECD has taken on in the last five decades. It will require agreement between the OECD countries, the BRICS and others on what should be the international tax rules and how we should apply them in a consistent fashion,” says Owens. Given the difficulties involved here, some doubt whether this will move ahead anytime soon.

“It may happen in my lifetime, but I doubt it,” says Cooper. While recognizing the challenge ahead, some believe that the existing suggestions still do not go far enough. Even if OECD countries reach an agreement, Christensen believes the process will likely produce only “a band-aid resolution that can slightly ameliorate some of the problems,” as he puts it.

Moreover, the issues are far more than technical. The current international system, for all its faults, benefits any number of countries in different ways. Change that threatens these interests will be all the harder to carry out.

In Christensen’s view, the barriers to progress lie at a political level and have been there since the 1930s. “Some countries see a comparative advantage in using harmful tax competition as part of their overall development strategy,” he said.

Meanwhile, at the purely domestic level, the increasing implementation and use of GAARs can be seen as a way to prevent the use of tax positions that are considered to have unfair results. Freedman said, “GAARs align the law as interpreted by the courts and the spirit of the law.” They are easier to implement than multilateral agreements, but also less effective because they cover only national tax law.

It is difficult to discuss GAARs collectively, as details differ. Some, such as the Canadian and British ones, have extensive safeguards and have the potential to help clarify the law. GAARs, however, can create a serious problem in terms of fairness.

In seeking to prevent taxpayers from adopting unfair positions, the authorities may in turn be using a tool that is itself arguably unfair—not least by contributing to an increase in uncertainty.

“These laws are like your mother saying, ‘I don’t know what you are going to do and how, but I tell you now, you aren’t going to get away with it,’” Cooper said of the Australian GAARs experience. “It is inevitable that they are not written in a way that people will be able to see where the boundaries are.”

The use of GAARs can also have unintended consequences for the governments seeking to deploy them.
In Australia, invoking the GAARs in some recent cases has undermined its utility because court judgments tend to define its scope in more detail than the legislation does, notes Cooper. “In order to restore equilibrium, bureaucrats had to rewrite the rule to get back its inscrutable terror.” This may help account for why, in practice, GAARs tend to be used very sparingly in many jurisdictions that have them. (For more on GAARs, please see the EY report GAAR rising: mapping tax enforcement’s evolution.)

Perhaps the least problematic approach to enhancing fairness is one that uses legal requirements in ways that allow social expectations to have greater force. “If one concept will dominate tax in the next 10 years, it is transparency.” Owens says. He added that companies will increasingly be asked to be clearer about where income is raised and their global supply chains, so that tax authorities can have a global perspective.

This may not of itself make it harder for companies to take aggressive legal positions. Cooper says that, when authorities are looking at big business, the problem is not that they can’t find out what is going on, but that they can’t do anything about it.

Increased transparency, along with country by country reporting, should it become widespread, will markedly increase the reputational dangers of aggressive legal positions. Transparency, however, is a double-edged sword. Owens said, “Governments will also have to be transparent in their policy-making and in the way they go about implementing policies.” The next issue of Tax Insights will focus specifically on transparency.

Whether increased transparency leads to more fairness remains to be seen. Fairness has always been a necessary goal of tax, it is an aim that is hugely difficult. The concept itself is problematic; it is a matter of seeking a balance between conflicting interests, rather than a single best solution for all cases.

Even so, governments, companies and individuals will increasingly need to wrestle with the issue, as societies that are now learning to live with less in turn demand that everyone pays their fair share.


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**TD Bank Group**

**Openness as a tax strategy**

Peter van Dijk, Senior Vice President for Tax at TD Bank Group (TD), is well aware of the debate around tax fairness and the challenges it represents. He recognizes that the issue involves points of substance, but adds that it must be seen in its current political and economic context. “Countries need revenue, so people start looking at corporations, which seem to be easy targets. They do not vote and are associated with rich individuals who make substantial amounts of money. Politicians jump on the bandwagon. The reality is that most people who work for corporations and own shares are ordinary people. Treating corporations as villains is a serious issue,” van Dijk said.

In his view, a company’s response should address both the legal and social elements of the current controversy. For TD, this begins with its approach to tax questions. Van Dijk says TD has clearly defined acceptable internal tax-planning rules. “The rules do not just follow the letter of the law. We also try to keep in line with the intent of the law, although that is not always clear,” van Dijk said.

In addition to any legal obligations, TD considers the potential impact of tax strategies on the company’s reputation, should they become public. “We have a fiduciary duty to make sure our shareholders get as high a return as they can, but the lowest possible tax rate is not always necessarily in their best interest,” says van Dijk.

Moreover, the obligations and responsibilities of a corporation go beyond shareholders. TD might still take potentially controversial positions if it felt they were justified for genuine business reasons, but at the very least, in such cases, the company would make sure it could defend the stance publicly, said van Dijk.

This brings up an important aspect of the company’s approach to tax: the need to communicate. For TD, communication begins with transparency toward tax authorities. For about three years, the company has held business awareness sessions with governments wherever it operates. It also shares its internal tax-planning rules, and the substance of any new tax positions, with tax authorities up front. This does not mean that tax authorities always agree with TD’s thinking, van Dijk notes, but at least authorities are kept informed. “It avoids a whole lot of work and improves the relationship. There are always issues, but if you do it right, there is less strain on the business, the tax authorities and the courts.”

Still, van Dijk thinks it is important to engage the general public. “Obviously, it is not an easy topic, but you cannot blame the public because we have never tried to make them understand corporate taxes,” he said. As a result, TD has increased its tax disclosures in its corporate social responsibility report to make its position clearer.

Going any further is tough: simply publishing tax data in the midst of a heated public debate, where the villains are often seen as being the corporations, is a tough sell for any company. Moreover, income tax is often seen in isolation from the other taxes that companies pay and the other ways that firms benefit society. The solution is not to run away, but to engage, believes van Dijk. Listening to all sides is, after all, only fair.

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Peter van Dijk is Senior Vice President, Tax Services, for the TD Bank Group, a worldwide financial services group headquartered in Toronto, Canada. Previously, he was Senior Vice President, Tax, at Sun Life Financial and an International Tax Partner at EY in Toronto.
G20 tax tour

When it comes to determining the most suitable rate of tax, every country takes a distinct path. The following graph provides an illustration of the diverse tax landscape in selected G20 countries.

An overview of major consumption taxes, corporate taxes and public debt across the G20*

**CONSUMPTION TAX 10.0%–14.0%**

**CONSUMPTION TAX 15.0%–19.6%**
The future of tax

The outliers
A selection of some of the lowest and highest corporate tax rates worldwide.

The lows:

- ** Bahamas: 0.0%
- Uzbekistan: 9.0%
- Albania: 10.0%

The highs:

- Angola: 35.0%
- Pakistan: 38.5%
- Cameroon: 127.0%

* Consumption taxes include value-added taxes, goods and services taxes, and broad-based sales taxes. Rates are generally the standard rates applicable. The rates expressed for corporate income taxes represent effective tax rates on corporate income and may incorporate income taxes, as well as other income-based taxes, such as trade taxes or surtaxes.

** Given the impact of tax rates set by local municipalities or regions, the effective tax rate varies depending on the location of the enterprise.

Sources: Tax Foundation; Worldwide Corporate Tax Guide 2013, EY; World Factbook 2012, CIA. VAT and corporate tax are based on the highest rates.
Change is in the air

In many respects, 2013 moved toward a new phase in the history of global taxation, as a series of multinational organizations started working to reform a system that has arguably not kept up with the pace of changes in the global economy. While much work and uncertainty still lies ahead, it is clear that tomorrow’s tax environment will differ meaningfully from before.
What began more than a decade ago as a crackdown on tax havens has evolved into a broad debate about how and where multinational enterprises report income and pay tax. The debate has been playing out worldwide, in council chambers and committees and from blogs to boardrooms. Input has come from tax authorities still struggling to recover from the global fiscal crisis and tax authorities seeking more information for better enforcement. And numerous countries have expressed concern that cross-border tax systems have simply not kept pace with how companies do business in a global economy.

The international community does not easily reach consensus on issues that affect sovereign purse strings. Yet the world’s biggest economies — both developed and developing — have now aligned in their focus on the taxation of cross-border activity and the need for greater transparency with respect to cross-border profits and taxes. In response to G8 and G20 requests, and with the input of its member countries, the Organisation for Economic Co-operation and Development (OECD) has now issued a report identifying focus areas where it intends to develop proposals to provide more tax transparency and address taxation across borders. Some of the recommendations are expected to be anything but minor tweaks: the OECD Action Plan on Base Erosion and Profit Shifting (BEPS) represents, according to the OECD’s Secretary-General, the “most fundamental change to the international tax rules since the 1920s.” Though some of the proposals to be developed will face a long road to individual country legislation, there is no question that change is in the air.

**Transparency and information exchange**

Both the G8 and G20 have called for multilateral automatic exchange of certain tax information rather than merely bilateral exchange on request. These groups have asked the OECD to help develop a proposal toward this end and to issue a progress report.

The resulting OECD report, *A Step Change in Tax Transparency*, was presented at the G8’s June 2013 summit in Northern Ireland. It outlines the steps needed for a “global, secure and cost-effective” model of automatic exchange of information. But while the G8 and G20 called for a multilateral standard, the commitment to automatic exchange more generally is not a dramatic change, says Barbara Angus, EY’s Strategic International Tax Policy Services Leader, as many tax authorities in both OECD and non-OECD countries already receive information automatically from treaty partners. “This particular development is the next step in the ongoing expansion of tax information exchange,” Angus said, adding that “the proposed information subject to automatic exchange is limited.” At its June meeting, the G8 also recommended that tax collectors and law enforcement should also be able to obtain information about the ownership of companies. And, more significantly, it called for the OECD to develop a common template for multinationals to report their income and taxes by country.

It is important to note that the recommendations for information exchange call for the submission of relevant data to tax authorities, not to the general public.

**BEPS — old concept, new acronym**

During the G20’s June 2012 meeting, in the context of the apparently reduced taxes certain multinationals were paying by moving profits out of high-tax jurisdictions, the OECD referred to the process as “base erosion and profit shifting.” This gave birth to the acronym now famously referred to as BEPS. While the OECD BEPS project has taken over international tax headlines, the question of base erosion is not new: in a 1961 message to the US Congress, President Kennedy indicated his concern about growing use by companies of “artificial arrangements between parent and subsidiary” to shift profits in order to lower or eliminate tax liabilities both at home and abroad, a discussion that...
The future of tax

A year of tax action

OECD

The Organisation for Economic Co-operation and Development (OECD) took prolific action in 2013 in the areas of tax transparency. First, in response to a 2012 request by the G20 finance ministers, came the organization’s February 2013 report, Addressing Base Erosion and Profit Shifting, on the global issues of tax avoidance by multinational enterprises. In June, the OECD issued a report prepared at the request of the G8 entitled A Step Change in Tax Transparency, which outlines a standardized, global model of automatic exchange of tax information and specific steps needed to put the standard in place.

At the July 2013 meeting of the G20 ministers, the OECD Secretary-General formally unveiled the much-anticipated Action Plan on Base Erosion and Profit Shifting as promised in the initial February report. The Action Plan contains 15 actions, each of which is linked to specific ambitious outputs that are to be completed in 2014 or 2015. At the July G20 meeting, the OECD Secretary-General also presented a progress report by the OECD-sponsored Global Forum on Transparency and Exchange of Information for Tax Purposes on the effectiveness of information exchange practices.

led to the enactment of the U.S. controlled foreign corporation regime in 1962.

Following a 2012 G20 request for a progress report on the matter, the OECD issued its report Addressing Base Erosion and Profit Shifting in February 2013. The report provided background information on BEPS concerns, identified six key pressure areas and set the stage for substantive work in those areas. The report made clear that the OECD BEPS project is intended to address technically legal structures that take advantage of asymmetries in domestic and international tax rules. “The project is not about a fundamental revision of the existing international standards of taxing rights on cross-border income,” says Mat Mealey, EY’s International Tax Services Leader for UK and Ireland, “nor is it a fundamental challenge to the arm’s length principle.”

On 19 July, the OECD issued its highly anticipated BEPS Action Plan (the Plan) in connection with the July 2013 G20 finance ministers’ meeting. The Plan sets forth 15 actions the OECD will focus on during the following two-and-a-half years, grouped into six target areas:

- Address concerns with respect to the digital economy
- Establish international coherence of corporate income taxation
- Restore the full effects and benefits of international standards
- Assure that transfer pricing outcomes are in line with value creation
- Ensure transparency while promoting increased certainty and predictability
- Address the need for swift implementation

The Plan identifies the form of the expected output and the target date for each of these action areas. High-level government interest in the project means that work is being done on an accelerated timetable and recommendations that come out of it will likely have strong endorsements from member countries.

With all the attention being given to the OECD BEPS project, particularly given its support by the G20 and G8, it might be easy to conclude that the project is the only one tackling base erosion and profit shifting. However, it is closely linked to international tax reform discussions in individual countries, and the project focuses on the same issues that are the subject of hearings and headlines in many countries around the world. Angus said, “Moreover, the G20 communiqué promises parallel country action and the communiqué from the June 2013 G8 Leaders’ meeting also contains a commitment to individual as well as collective action.”

Actions — from countries to companies

All recommendations for action items in the Plan are scheduled to be complete by or before the end of 2015, but even then they will be just that — recommendations. At that point, Mealey says significant work at the individual country level will be required to determine whether, when and how to implement any of the recommendations. “This is a key point to recognize.
Different work streams will have a different impact in different countries over differing timescales, depending on the key concerns and policy objectives of the individual country," Mealey said. "Conversely," says Angus, "the OECD project may well translate into accelerated action in some countries, including potential legislative or treaty activity in advance of final OECD outcomes."

Further, Angus notes that a number of countries have already taken unilateral action with respect to some items in the Plan. "For example, the OECD Action Plan includes a proposal to develop restrictions on the deductibility of interest expense. There are 10 or more countries that have made modifications to their interest deductibility rules in the last five years." Likewise, the Plan calls for additional information reporting with respect to global value chains, something that some jurisdictions, including Indonesia and Australia, have already done.

With unknown time frames and unknown outcomes of all of these developments, companies are understandably concerned about how to react. Other concerns go beyond the proposals themselves. With regard to information exchange, OECD documents stress that great care would be taken to assure that information stays in the hands of tax authorities. Companies are worried, nevertheless, about inherent risks in data security and controls. As a result, Mealey predicts the mere existence of the additional information and its disclosure to tax authorities will have an impact on the behavior of some companies.

"Indeed, the OECD BEPS action items give reason to take a step back and take stock of the tax aspects of any business structures that may be affected by the outcomes of the Plan," says Alex Postma, EY’s International Tax Services Leader. Postma sees three key actions as paramount: first, reviewing current business structures and making an assessment of where and to what extent they could potentially be impacted by some of the OECD action items; second, considering instances where changes to these business structures may be prudent; and third, becoming engaged in the reform process, not just focusing on the multinational company’s home jurisdiction, but in the material jurisdictions in which it operates around the globe.

Businesses can also seek involvement with the OECD BEPS project, since the Plan indicates the intention to consult the business community. "This is essential," Angus says. "The BEPS Action Plan should take into account not only current business models, but also the expected further evolution in the way global businesses operate, particularly in a world where geographic borders are not a relevant or meaningful dividing line for operational or management purposes. The consultation process will be important in helping the OECD develop recommendations that serve governmental purposes, but are also reasonable and practical for companies."

An uncertain journey
All told, the OECD’s Action Plan on BEPS is an extraordinarily ambitious undertaking. It may well be several years before individual countries make final decisions on whether and how to implement the recommendations that are now being developed by the OECD in the 15 focus areas. There are many different points of view across the world about what should change and how. "We are at the very beginning of what will be a long journey," says Angus. And while that journey promises to be a rocky one with an uncertain destination, one thing is clear: change is in the air.

BEPS Action Plan unveiled

G20
At the July 2013 Moscow meeting of the G20’s finance ministers and central bank governors, the OECD formally unveiled its BEPS Action Plan. One headline of the meeting was the G20 ministers’ strong support of the Plan and their expectation that they will receive regular reporting on the development of recommendations to tackle the 15 issues identified within it. The group also encouraged all interested countries to take parallel individual action and indicated its expectation of regular reporting on the development of proposals to tackle the issues within the Plan.

In 2012, the G20 ministers had called for the OECD to work on a model for automatic exchange of tax information and, in April 2013, the G20 finance ministers endorsed automatic exchange of information for tax purposes as the expected new standard. At the July 2013 G20 meeting, the G20 ministers echoed the G8’s call for adoption of such a global standard and called on all jurisdictions to commit to rapid implementation. The ministers also called on all countries to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

G20 finance ministers reconfirmed their commitment to combat erosion of their countries’ corporate tax base following their February 2014 meeting in Sydney. The ministers will present further proposals to enhance international tax provisions for consideration at the planned G20 leaders meeting in Brisbane, scheduled for November 2014.
The future of tax

European Court of Justice, Luxembourg

Ever since it was created, the European Court of Justice has been called on to deliver many judgments on customs and tax matters. In the period 2007–2011 alone, it completed 330 cases relating to taxation and customs issues.
Throughout the world, judiciaries have a significant influence on tax matters. While governments are responsible for deciding how to tax individuals and corporations through tax policy and legislation, ambiguity in these rules often leaves them open to more than one interpretation. Complex legal disputes can then arise that can only be settled within the confines of a courtroom.

The power is in the hands of the judges who must interpret the purpose and intent of the tax laws. The stakes are high for all: one single decision could result in sweeping changes to tax rules, and the loss or gain of significant amounts of money.
The future of tax

Supreme Court, Buenos Aires, Argentina

The Argentinian Supreme Court is the court with ultimate authority to hear tax cases. In one of its recent rulings, it found in favor of the taxpayer, granting the company access to the benefits of a tax-free reorganization.
Supreme Court, Tokyo, Japan

The Japanese Supreme Court is the highest court to hear taxation cases in Japan. Among many cases heard, in an important decision from 2011, the Court affirmed the principle of the rule of law in tax cases.
The future of tax
“Every event in life can have tax consequences.”

INTERVIEW
by Catherine McLean

Mathieu Ferré, a student in business law at the Université Toulouse 1 Capitole, was named EY’s Young Tax Professional of the Year 2013 in Copenhagen in August.
The Future of Tax will be determined to a great extent by the young people who are entering the field today. With this understanding, EY aims to help young tax professionals get a start in the industry by providing hands-on experience, guidance and support in developing skills. Tax Insights magazine talks with the winner of last year’s competition about the importance of in depth tax knowledge and his goals for the future.

**Tax Insights:** Let me start off by congratulating you on your first-place finish at EY Young Tax Professional of the Year TM competition. What were the key lessons that you will take home with you?

**Mathieu Ferré:** One of the lessons that we learned here was that tax is global. Different countries have different conceptions of tax and different rules, but you can find common rules in the framework in every country. You learn that while talking with other contestants from all over the world.

The biggest lesson we all learned from this competition was about communication skills. It is really important because it is a skill that is really needed in the tax profession today if you want to be able to convince people, like the CFO or the CEO, of your tax position. I think that it is really important today to not only have tax knowledge, but also a general knowledge of business law, management, business administration and communication skills.

So what were your strengths that helped you win this competition?

I have a great knowledge of French domestic tax law. When you have that kind of knowledge, you know the main mechanisms of tax issues, and you are able to transpose it into international cases. In this way, you have the reasoning, and it is easier to imagine what the consequence of actions will be in an international context.

What attracted you to the field of tax law?

**What do you like about it?**

I chose tax because, in France, tax is a crossroad between public law and private law. I enjoy both sides of the law, and tax was a good opportunity for me. Tax law is very interesting because it involves procedural issues. There is also an important international dimension. You can even have criminal law in tax — with tax evasion.

It is a very global subject that really fascinates me. Tax is not only about law, but it is also about business. It is really interesting because it is not only a theoretical subject: it is also a very important topic in everyday life for a corporation and even for individuals. Whatever the size, tax knowledge is required for all corporations. Every event in the life of a corporation or an individual can have tax consequences. I think that it is really an interesting thing to learn about.

Where do you see yourself working in the field of tax? Would you be interested in a career with the Government, a corporation or as a tax advisor? Why?

I think I would enjoy all those options because each one has an advantage. But I think I would like to work as a lawyer, because I find it interesting to deal with different problems, controversies and litigation.

Where do you see yourself five years down the road in terms of your career?

I would like to have finished my PhD in five years. I also hope to be a lawyer, and that I will have learned more about local and international taxes, meeting a lot of lawyers around the world to increase my knowledge. And I hope that, in five years, I will perhaps be working for a law firm or a company like EY.

Where do you see yourself working in the field of tax? Would you be interested in a career with the Government, a corporation or as a tax advisor? Why?

I think I would enjoy all those options because each one has an advantage. But I think I would like to work as a lawyer, because I find it interesting to deal with different problems, controversies and litigation. 

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**Winner Mathieu Ferré with runners-up**

This year, students from some 250 universities in more than 30 countries entered EY’s Young Tax Professional of the Year (YTPY) competition. This event has grown rapidly since it was first launched. EY supports the competition to make students more aware of the significant role that tax plays in business and to promote the tax profession by showcasing future leaders.

The competition takes place in two separate stages. The first brings together entrants in their home countries, where professionals with diverse backgrounds judge the technical and commercial abilities of the participants. In the second stage, the country finalists travel to the final, held in Denmark in 2013, with the goal of winning the YTPY title. Contestants are assessed via interviews and case studies on their technical and commercial skills. A panel of expert judges determines the winner.

More information: [ey.com/ytpy](http://ey.com/ytpy)
The future of tax
The future of tax
The future of tax

interconnected. That is the word tax experts believe best sums up the future tax environment around the globe.

Globalization has transformed the business world in recent decades. Whether it is American-style takeout coffee or Chinese telecommunications equipment, firms that once focused on a domestic market now sell their products and services internationally.

Tax is undergoing a similar transformation as policies and trends go global. Countries are looking across borders, exchanging tax expertise and cooperating on audits. International organizations are taking the lead in shaping global tax policy, as highlighted by the OECD’s recent Base Erosion and Profit Shifting (BEPS) project and the G8’s calls for the world to work together toward greater transparency and the closure of tax loopholes.

This increasingly connected world is evident in the key tax trends of the future, which we have highlighted on the following pages.
Chris Sanger, EY’s Global Head of Tax Policy, says: “Tax authorities are more interlinked with each other and sharing information. I think we will see moves to far more common implementation of the various types of taxes. While we may see a lot of changes, they will likely share a common direction.”

Seven trends
Cooperative compliance

INTERVIEW
by Catherine McLean

More tax authorities around the world are entering into cooperative compliance agreements with large corporations. This model, which debuted during the past decade in countries such as the Netherlands, Australia and Ireland, is now being tested through pilot programs in many other markets, including Norway, Italy, France and Russia. The aim is to reduce uncertainty and make the tax filing process more efficient as taxpayers provide full disclosure and, in return, receive a prompt assessment of tax issues.

Tax Insights: Are you having discussions sooner with tax authorities as a result of the cooperative compliance model?

Mark Melzer: If you look at cooperative compliance, there are a couple of benefits. One is that you have certainty and predictability about your tax position. Early in the process, you discuss with the tax authorities what you are doing. Having certainty and predictability about your tax position is, of course, a building block of your tax risk management policy. Secondly, you have less of an audit burden because they rely more on your own controls.

In the end, cooperative compliance is beneficial for both the tax authority and the taxpayer, since they are not interested in having a strained relationship with each other.

What were the concerns about the cooperative compliance model before it was introduced in the Netherlands?

We were one of the first companies that entered into such a formal agreement with the Dutch tax authorities. To be very honest, it was a logical next step for us. We already had meetings with tax authorities where we discussed things we were doing, where the business was going and why we were doing things.

Why did your relationship with the Dutch tax authorities evolve that way?

Some 10 or 15 years ago, we had long discussions with the tax authorities. Some files took very long to complete. At the end, there was awareness on both sides that it should go another way. That evolved into a relationship of proactively sharing information. The tax authorities in the Netherlands were always open for discussion and agreements on technical
issues. That was already part of the culture of the tax authority at the time. It evolved. It was a logical next step to formalize this relationship.

Do you think the cooperative compliance model could work in other countries?
Yes. You see it in the UK, although it is a little bit different. They categorize you as a high-risk taxpayer or low-risk taxpayer. We clearly want to be in the good taxpayer bucket—the low-risk taxpayer bucket—that also releases you from some of the other requirements. There, it works well.

We think it can work in other countries if there is a willingness from both sides to move to cooperative compliance. Sometimes, it takes time. If you have very traditional, conservative tax authorities who, for a long time, have seen the taxpayer as a kind of enemy, it will not change overnight. It takes some time to build up this mutual trust and to see each other as potential partners. You see more and more countries looking at such a model.

What changes would you make if you were in charge of the cooperative compliance model?
Some of the discussion points are: what kind of information and what level of detail do you need to share? What kind of audits do they still want to do? In the Netherlands, the tax authorities rely much more on the companies to comply. In other countries, sometimes the balance is a little off in the beginning in terms of sharing information. It is a kind of give and take.

Do you believe the cooperative compliance model gives Heineken an edge over competitors?
The fact that we have a cooperative compliance agreement with authorities, and that we try to be open, is an asset in our communication about tax. It says something about how we at Heineken look at tax, tax policies and tax planning. Does it help? Our experience with cooperative compliance in the UK and the Netherlands helps us in further rolling it out to other countries, and also strengthens our belief that this is the way forward.

Case HEINEKEN
In 2005, the Dutch Tax and Customs Administration started a pilot program to change the way it supervised corporate taxpayers, based on three main objectives: transparency, understanding and mutual trust. In 2006, Heineken signed up for the new tax program.
The Dutch brewing giant remains today a committed participant in the Netherlands’ horizontal monitoring program. Heineken holds quarterly meetings with Dutch tax authorities, where both sides air their concerns and discuss important issues.
A key feature of the cooperative compliance model is that tax authorities are more reliant on a firm’s internal controls. Heineken has sought to strengthen its global controls with the rollout of a comprehensive tax control framework that outlines the organization of the company’s tax function, including where different responsibilities lie. This model gives tax authorities confidence in the information supplied by Heineken rather than gathered through their own audits, according to Melzer.
While cooperative compliance has various benefits, including a reduction in audit costs and a lower risk profile, firms and tax authorities may still end up agreeing to disagree.

More on cooperative compliance
- Both firms and tax authorities stand to benefit from a cooperative compliance framework, as all cards are on the table; tax authorities can focus more of their resources on high-risk areas and reduce administrative expenses, while firms benefit from more certainty in terms of their tax planning, according to the OECD.
- This model depends on the tax authority’s enforcement strength, according to Richard Sansing, a Professor of Accounting at Dartmouth’s Tuck School of Business. Tax authorities must be able to uncover uncertain tax positions in a tax return in order to ensure firms are compliant. “I do not think it is the case that every firm and tax authority pair will enter into these relationships,” says Sansing.
- Both the tax authorities and multinational companies need to build trust and cooperate to achieve results.
Trend two

Legislation plays catch-up

INTERVIEW by Catherine McLean and James Watson

Key messages

▶ The road ahead is uncertain: the OECD BEPS plan alone will require an “extraordinary amount of work” in coming years (EY Global Tax Alert: OECD issues Action Plan on Base Erosion and Profit Shifting, BEPS).
▶ Legislative changes will focus on the following areas: general anti-avoidance rules, interest deductibility changes, transfer pricing, hybrid structures, double non-taxation, treaties and transparency.
▶ While the OECD has led the way in shaping tax legislation, fast-growing markets such as China, India, Russia and Brazil will have a greater influence on global tax policy in the future, according to Chris Sanger, Global Head of Tax Policy at EY.
▶ Engagement of countries in the process of developing new standards is essential to avoid uncoordinated national initiatives that may result in more double taxation.

One of the key lessons that governments around the world learned from the global financial and Eurozone crises is that tax dollars really do matter. In response, they are focusing on mending and modernizing tax regimes that in many respects have failed to keep pace with the rise of globalization and the digital economy. New laws aim to ensure more money ends up in the government’s treasury. Whether it is the implementation of new general anti-avoidance rules, proposals from the OECD to address base erosion and profit shifting (BEPS) or proposals for country-by-country reporting, firms should prepare for more change ahead.

**Tax Insights:** To start, can you touch on some high-level tax trends that are playing out in South Africa?

**George Trollope:** We are seeing a trend where the tax authorities are passing some of the administrative burden on to us. Very recently, we received from the South African Revenue Service (SARS) something called an agency appointment, where they have appointed us to pay the tax from third parties and from certain employees.

Of course, on the issue of tax disclosure, we found that they have made it more demanding. They have escalated the kind of disclosure that they want: more on transfer pricing and financial services. They want us to provide more information in order for them to better understand and analyze filings.

Another trend is we have suddenly seen a lot more audit activity from the tax authorities globally at Sasol. We have operations in South Africa, Canada, the USA, Europe and the Middle East, and all over, colleagues are suddenly saying there is more audit activity.

The tax authorities have become more active through legislation and through audits. In South Africa, the Tax Administration Act has been introduced, which strengthens SARS. It is putting the responsibility on taxpayers to provide more information, and it has pushed up our cost of compliance.

Can you give more details about how South Africa’s new Tax Administration Act is impacting your business?

In the short period since it has been introduced, we have experienced an increasing likelihood of SARS charging penalties and interest under that Act. In the past, if someone in the organization made a mistake and submitted a VAT return one day late, or the electronic payment did not hit the SARS bank account on 30 June due to some banking problem, but it was in their bank on 1 July, that one-day-late payment could be explained. In the past, SARS would waive interest and penalties in those circumstances. Under the Tax Administration Act, SARS imposes an automatic 10% late payment penalty. If it is one minute late and it is a ZAR100 million payment, they
would immediately impose a ZAR10million (US$1million) penalty. They have used the Act to increase their collection of interest and penalties from taxpayers.

You spoke earlier about this new agency appointment from SARS that is also part of the new Tax Administration Act. How does this work?

It is related to the employees having to submit tax returns. If they did not do that, then the tax authority would raise a penalty on the employee. That penalty is payable by the employee. They have now come to the employer and said, “Please pay this penalty and you can have the hassle of collecting that penalty from your employee.”

SARS have moved collection of these penalties to the employer. The law does provide for this, but is a new practice for us as employers. This is the first year this has happened to my organization. We now have to audit those penalties and say to the employees, “Go submit your tax returns.” It is not a company obligation to submit those returns; it is totally an employee obligation. It has consumed a lot of our tax department’s time in the last four months.

So instead of chasing these relatively small penalties from each employee, which is quite difficult to collect, SARS is focusing its employees on audits.

Are you seeing greater cooperation between South African tax authorities and their counterparts abroad, and what is the impact on tax policy?

There is a greater exchange of information around the world —and not just regarding SARS. We have come across Norwegian tax inspectors who are providing assistance to the Mozambique tax authority. The main function of the assistance was to audit tax returns and also to transfer skills. Norway is an oil-rich country, so they have capabilities in oil and gas. Lately, linking to that, I cannot say it is a direct link, but Mozambique has put forward proposals to introduce new tax laws around oil and gas.

We have noticed the capabilities of the tax authorities have dramatically increased to their advantage in the last two or three years, and I think going forward, we will see more of that. What this will all lead to is probably a greater focus on cross-border transactions. If the 35 African tax authorities are getting together regularly, one can see a greater exchange of important tax information between them.

George Trollope
General Manager Tax
at South Africa’s Sasol,
an energy and chemical company.

Case SASOL

Sasol, a global leader in the production of synthetic fuel and South Africa’s largest taxpayer, is adapting to a tougher tax environment. Legislative changes aimed at modernizing tax laws, both at home from the new Tax Administration Act as well as from foreign tax authorities abroad, are having an impact on Sasol.

Keeping up with these changes can be a challenge, admits Trollope. He points to shifting requirements, including a recently released tax return form from the SARS that requires twice as much disclosure from corporate taxpayers as in the past.

One tool that Sasol is using to address these changes is its tax management policy, which aims to ensure that Sasol’s tax risk management process is transparent for both its employees as well as tax administrations.

Sasol is also reaching out to tax authorities to keep the lines of communication open. During the past three years, Sasol has invited senior officials from SARS to attend its interim and annual earnings report. After the results are publicly released, Sasol’s management sits down with SARS to discuss the report in detail.
The future of tax

Trend three

Transparency

By Rhea Wessel

Boardrooms around the world are now faced with calls for transparency from a growing chorus of stakeholders that includes governments, the media and non-governmental organizations.

These and other groups are asking for more insight and confidence regarding companies’ tax strategies and procedures, as well as questioning the quality of the data from the global operations of multinational companies. As a result, some companies are now considering how, and if, to reveal more about their approach to tax and their overall tax contribution to the economies where they operate.

Carmel Moore, a partner for EY’s Tax Performance Advisory, says, “If companies choose to disclose more, the key is to provide useful information without giving away confidential business information or driving up costs.”

The push for greater tax transparency is expected to grow even stronger in the next years, given the unprecedented strain on government finances, indicates Theo Vermaelen, a professor of finance at the international graduate business school INSEAD. “Governments are capitalizing on populist sentiment to collect more taxes from the rich, and the push for more transparency from companies is part of their efforts,” Vermaelen said. “But more disclosure does not necessarily translate to more tax fairness, and it is not always good for shareholder value.”

Even so, the public appears to have a growing expectation that companies could and should use sophisticated IT tools to make their accounts more transparent, for instance, in the same way they use IT to create transparency in the supply chain.

Moving forward, increasing pressure for transparency means companies can expect an even faster pace of change for the tax function within their organizations. Businesses will need to rethink tax policy and become more vigilant about internal compliance on a global scale. To do so, Moore considers that they will require a deeper understanding of their organization’s tax risk, as well as strong governance and risk management tools and processes.

“I expect to see continued calls for increased transparency,” Moore says. “And it’s inevitable that technology will be an enabler of transparency.”

Pharmaceuticals company GlaxoSmithKline (GSK) voluntarily disclosed its tax strategy in its Corporate Responsibility Report 2012 with a page of explanation entitled “Our approach to tax.” The text commented on issues such as GSK’s transfer pricing strategy, its stance on tax havens and the company’s internal risk management processes. Catherine Fursland, who is Head of Tax Rate Strategy, Management and Risk at GSK, says, “We wanted to find the right balance between providing an explanation of our tax policies and doing so in a succinct and understandable way.”

According to Moore, creating more tax transparency requires strategic and disciplined change management within an organization, since employees must collect and process data in new and consistent ways. It also depends on a more proactive and risk-focused tax function. Finally, companies need to encourage IT to work more closely with tax professionals and provide tax directors with sufficient resources.

“A company cannot provide transparency externally if it doesn’t have transparency internally,” says Moore.

Key messages

▲ In response to ever louder calls for more tax transparency, some companies are considering providing more tax information to stakeholders. Those companies that choose to do so may take a comprehensive approach that sums up the full public value of a company’s contribution to society.
▲ Strategies must be based on greater internal transparency of tax-related functions, achieved with improved business and IT processes, and keeping in mind the changing landscape of regulation. What are the implications of the automatic exchange of information between tax authorities on transfer pricing models and positions taken on permanent establishments?
▲ Companies should engage in the transparency debate on everything from Base Erosion and Profit Shifting (BEPS) to transfer pricing and data exchange.

Note to readers: the next issue of Tax Insights magazine will be devoted to transparency.
Tougher tax administrations

Key messages

▶ Whether it is through education, on-the-job training or cooperation with foreign tax administrations, today’s tax authorities professionals are better equipped to deal with issues arising from complex tax structures and to enforce tax laws.

▶ Tax authorities in fast-growth markets are increasingly looking to tax to fund development. In response, the OECD has launched a program called Tax Inspectors Without Borders to help support and provide assistance to tax authorities staff in these markets on specific audits.

By Catherine McLean

As governments around the world seek a higher degree of compliance with tax laws, they are strengthening the ranks of their tax forces and improving the resources available to their tax authorities. The aim is to enable tax authorities staff to better understand increasingly complex tax structures, as well as handle disputes with corporate taxpayers and enforce tax laws.

In the UK, for example, HM Revenue & Customs (HMRC), which describes itself as one of the country’s largest businesses, is focusing on boosting the skills of its workforce.

As part of that effort, HMRC launched, in 2012, the Tax Academy for its workers. One of its initiatives is a part-time course that lasts four years and leads to a degree in professional studies in taxation from Manchester Metropolitan University.

Demand for the program is high. Currently, some 551 HMRC workers are enrolled in the program, with more than 15,700 applying for the 200 places in 2013, according to an HMRC spokesperson. The aim is to ensure HMRC staff have “the confidence to take on the best of the private sector tax experts in tax disputes,” HMRC said at the time of launch.

Other governments are recruiting additional tax staff in the hopes of enhancing compliance activities. Take Indonesia as an example. “The tax authorities here are in the process of hiring more than 5,000 additional professionals,” explains Ben Koesmoeljana, a senior tax partner in EY’s Indonesian member firm. “These professionals are likely to focus on compliance. Therefore, it’s a good time to review tax policies and processes to ensure compliance and disclosure obligations have been met.”

In Vietnam, additional training received by tax administrators in the area of transfer pricing is already visible, according to Nitin Jain of EY in Vietnam. “They are stepping up their enforcement activities and requesting that foreign-owned firms explain their arm’s length pricing for 2012 and previous years,” Jain said.

Along with these efforts by individual governments, international cooperation is also making tax inspectors more effective at their job. Jeffrey Owens, Senior Policy Advisor to EY’s Global Vice-Chair of Tax, wrote in an article in 2012 for The Bulletin for International Taxation. Countries are increasingly teaming up on audits and submitting requests for information to other tax jurisdictions.

Indeed, the OECD is launching a new program at the start of 2014 called Tax Inspectors Without Borders (TIWB), which will team up experienced tax experts with tax authority staff in fast-growth markets on specific audits, with the aim of improving compliance and, ultimately, collecting more tax revenue.

“The TIWB objective is to enable the transfer of tax audit knowledge and skills to tax administrations in developing countries through a real time, ‘learning-by-doing’ approach,” the OECD wrote in a report in June.
Trend five

Data makes the difference

Key messages

- As companies struggle to collect and analyze data from different business units and in a variety of reporting formats, tax authorities continue to use unprecedented amounts of data and advanced analytics to conduct audits on a global scale.
- Companies with best-practice tax functions are defining strategies and building up their own big data and analytics capabilities to take a more proactive tax stance. The goal is to monitor tax positions on a real-time, transactional basis via tax dashboards.
- Such monitoring makes voluntary disclosures easier and keeps companies prepared to respond to tax inquiries from the public or authorities.

As the media and governments continue to "name and shame" companies for allegedly failing to pay their fair share of tax, companies are considering how they can use the power of data analytics to move from a reactive stance on tax to one that is more proactive and predictive.

Such measures often require a big shift in the mindset of corporations as they adopt a data and analytics strategy that considers the compliance and reporting needs of the tax function at every level of business operations.

In many cases, the first step is to consolidate data already on hand so companies can better defend their compliance processes and tax positions and make voluntary disclosure easier, for instance.

Yet many companies still struggle to collect, consolidate and analyze different data sets from all areas of the enterprise, with data quality often being a significant issue. Assuming control and being accountable for such data in a global organization is a challenge, and centralization—which is often a must—is not easy to achieve. Gaining tax insight from that data can be even harder.

In many cases, this situation can be traced back to chronic underinvestment in the tax function and a lack of cooperation between the tax department and IT. As a result, tax departments may not have use of dashboard-level monitoring of key indicators like their colleagues in finance down the hall. Indeed, surveys show that...
more than 50% of Fortune 1000 companies use Microsoft Excel workbooks for tax-related monitoring.

“Tax departments are playing a game of catch-up with their technology,” says Adrian Hextall, Director of Tax Performance Advisory at EY.

**Advantage with the authorities**
Companies are preparing for a day when tax authorities audit raw data sets from organizations and use their own analytics capabilities—and the massive amounts of data they have legislated for and otherwise acquire—to uncover trends and discrepancies that may even be unknown to a company.

In the end, tax authorities will have an advantage in detecting trends, since the amount of data available to a single multinational would be “small” compared with what governments can access.

Already, tax authorities are meeting at international conferences to discuss best practices for advanced analytics in tax administrations; and they are making it easier to share data among themselves and compare it across a company’s legal entities or across industries. In some countries, for instance, data sets are required to be submitted in the eXtensible Business Reporting Language (XBRL), a standard format for business data that makes it easier to compare. The OECD work on base erosion and profit shifting, and the associated Action Plan, also demonstrates this more coordinated approach to data exchange.

Duncan Cleary, a senior statistician at Revenue—Irish Tax & Customs, said many tax authorities around the world already analyze large sets of data against custom-defined rules to determine which taxpayers they consider to be at risk of non-compliance.

Looking forward, tax authorities are likely to focus on making the use of existing analytics techniques the norm in everyday operations and combining and integrating techniques, such as rule-based monitoring, modeling and outlier detection, Cleary said.

**Data strategies for the tax function**
Likewise, companies increasingly want to make the use of analytics for the tax function more sophisticated by not only consolidating data, but better managing data warehouses and creating the ability to perform high-speed exception reporting.

EY is helping companies develop data strategies, evaluate potential hardware and software vendors and move to the point where data is sliced and diced in a way that useful indicators can be visualized on a dashboard. These include indicators for transfer pricing and direct and indirect tax, and screens for monitoring the management of controversy, compliance and various legal entities.

The Netherlands-based global human resource services company Randstad already uses its large data sets to look for possible deviations and, therefore, tax problems; for instance, in the amount of payroll taxes calculated. Hans van der Kroon, the Managing Director of Group Tax at Randstad, sees these data sets as a place to do more checks and assert more control for tax compliance.

“We look for logical or illogical correlations between salary components, corporate allowance payments, kilometer allowances and these kinds of things. That’s the power of a lot of data. Instead of being in one spot and having a limited view, we are able to have lots of data and a broad overview. We can do many analyses remotely from Amsterdam,” said van der Kroon.

**User expectations**
The way users want to receive such tax data points is shaped by the user experience on everyday websites: users want information to be tailored for desired indicators, mobile, visually driven and super-high speed.

“People expect reports that pull millions or billions of records and previously required two days of number crunching to be available in 10 seconds on a remote laptop, with a pleasing design,” said Hextall.

Such user requirements are a tall order given the disarray inherent in many companies’ data, as well as the data ownership and data privacy considerations in various jurisdictions, says Hextall.

“But it’s not impossible.”

In the end, companies that combine powerful technology solutions with niche advice on fraud, investigations and litigation will be best prepared to use big data and the power of analytics to respond to and prevent litigation and regulatory inquiries, says Hextall.
The future of tax

Trend six

The great tax competition

INTERVIEW
by Catherine McLean

While governments around the world are joining forces when it comes to supervising large taxpayers, they are still very much in competition when it comes to convincing multinationals to move their headquarters to their respective jurisdictions. In recent decades, governments have lowered their corporate income tax rates to less than 26% on average in 2011 compared with 45% or more in the 1980s, according to the OECD. Globalization has been an important driver behind that trend.

Despite their moves to cut corporate tax rates, many countries still see a need to protect firms at home. While free-trade agreements have pared customs duties around the world, they still remain high on "many goods and materials," according to the EY report Indirect tax in 2013, published in March. These duties shield domestic industry and are an important source of revenue for governments.

**Tax Insights:** Is tax competition between countries on the increase?

**Maarten Boudesteijn:** If you refer to the corporate income tax rate, it sure is. Or if you look at the way the UK, for instance, is heading towards a lower corporate income tax rate. Ireland has been there for a while, but now, more countries are reducing their corporate income tax rate. Obviously, it is not only this statutory rate, it is also the tax base on which the rate is charged.

At the end of the day, the question is whether you're better off with a lower tax rate. I think the reductions will come to a stop. Government budgets are under pressure, and there are increasing demands for greater corporate citizen responsibility and more transparency. In the future, do you expect a trend toward higher tariffs around the globe?

Tariffs are already an existing feature. To enter the Russian or Chinese markets, especially in the food sector, you run into high customs tariffs. It is a fact that we run into customs duties if we want to enter into Russia and China as a Western European-based company. That is where you have a disadvantage to local producers on your cost price. Customs duties pose an obstacle for entry to the market.

How much of an impact do these duties have on your business strategy?

Our employees look into tax regimes before we enter a market. They know that, if we do not have free-trade agreements in the Asia Pacific region, we will not be able to enter the market. Our products are highly cost price driven. If you can manufacture for the lowest cost price, you will be able to gain some market share. It is business planning in order to enter those markets. Tax has to assess how we can assist the business to successfully gain market share.

How do you respond to the challenge of high import duties? For example, you mentioned Royal Cosun would like to sell baby food ingredients in China. What approach could you take?

There is potential in the Asian market; what is blocking us now are import duties. We are assessing the possibility of exporting a semi-finished product to
Southeast Asia and finalizing the production of the ingredient locally. That's where business and tax meet. It is interesting, and there are some opportunities in Southeast Asia to do that.

From Southeast Asia, you can go into China, which is the market where you want to be. Next to China, it is India and Korea. But there is an operational challenge to find a producer that is up to our standards in order to sell in these countries. You need to meet very high standards because of the fact it is baby food. It is a work in progress.

What do you think will happen with import duties in coming years?

The ideal outcome is that they will be abolished. Import duties can be an important instrument to protect local business, especially in fast-growth countries. If you look at the fast-growth countries, however, at some stage they have to be realistic; I think custom duties will only further disturb and distort the market.

Additional information

- Corporate tax rates keep falling: nearly a third of 59 countries were expected to cut their corporate income tax rates in 2013, according to the EY report *The outlook for global tax policy in 2013*.
- Expanding the tax base for a variety of taxes will be important to cover existing government deficits, especially as tax rates are reduced.
- Import duties remain a tool for protecting domestic production, as well as raising revenue, and are an example of the shift to more indirect taxation.
- Multinationals should engage in these discussions and keep updated on global developments.
- When individual countries move forward unilaterally with changes to their international tax regimes, rather than act as part of agreed global standards, this can inadvertently cause double taxation and become a barrier to free trade.

“As tariff barriers are removed, there is an increased risk that governments will replace them with non-tariff barriers, including tax measures that implicitly favor domestic companies.”

Jeffery Owens, Senior Policy Advisor to EY

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**Case ROYAL COSUN**

Royal Cosun, an international processor of agricultural raw materials, wants to expand into fast-growing markets to counter a future of weak economic growth in its home market in northwestern Europe.

The increasing middle-class population in China is an obvious target for Royal Cosun, which would like to sell baby food ingredients in that market. But there is a hitch: high import duties for products shipped from the Netherlands to China.

Royal Cosun is now exploring the possibility of shipping semi-finished products to Southeast Asia, where it is already present, in order to produce baby food ingredients at a local factory. From Southeast Asia, the company could ship the baby food ingredients to the Chinese market without high import duties being levied under the ASEAN-China Free Trade Area (ACFTA).
The profile of corporate tax has changed considerably in recent years. Stories about the tax affairs of multinational companies can often be found on the front pages of newspapers around the world. At the same time, given their own financial challenges, many governments are seeking to increase tax revenues through legislative reforms and greater audit scrutiny by their tax authorities.

This increased visibility has stirred the interest of an ever wider variety of stakeholders who want to know how companies manage their tax affairs, in particular, how much tax they pay, and in which jurisdictions these taxes are paid. While corporations, investors and tax authorities have always paid close attention to tax, non-governmental organizations and the wider public have increasingly joined these groups.

Companies must now consider a greater number of interests when managing their tax affairs. While still important, it is no longer sufficient for companies to merely focus on increasing shareholder value and complying with tax laws. Demands from tax activists and the general public that companies pay a “fair” amount of tax are difficult to ignore — especially since social media provides them with a prominent platform from which to advocate for their cause. Governmental and non-governmental stakeholders alike are also calling for increased transparency of tax affairs.

In light of these conflicting interests and demands, a carefully considered and thoroughly implemented tax policy can be a vital tool for companies. Corporate boards should be heavily involved in formulating these policies, and also need to ensure that appropriate governance of the policies is in place once they are implemented.

An effective policy is one that outlines the company’s responsibilities, articulated by the board of directors, to all executives, as well as those employees directly involved in the tax function. Companies must also ensure that the tax policy is understood and implemented uniformly around the globe.

The OECD warned in its report Addressing Base Erosion and Profit Shifting that common and legal tax strategies of the past may need to be reassessed. The OECD report noted that “aggressive tax strategies can be detrimental to shareholders’ interests, particularly in the medium to long term, because they are high risk and the costs of failure can be significant, and also from the point of view of reputation.”

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**Key messages**

- Firms should consider how to address the changing tax environment and diverging interests of stakeholders.
- The development of a comprehensive tax policy, guided by the board of directors, can be a key tool.
- One way to communicate with outside stakeholders is to outline the tax strategy in the annual report. One-fifth of FTSE 100 companies currently do so.
The future of tax
The breadth and pace of change when it comes to tax matters has taken everybody by surprise. In just a few years, tax has quickly climbed to the top of everyone’s agenda, be it governments, media or corporate leaders.

Companies that rely on tax-planning policies that are entirely legal and, until recently, were widely understood and used in business, can now find themselves strongly criticized in the media for having adopted “aggressive” tax strategies. Governmental bodies, for example, increasingly challenge multinationals on their tax strategies, often in open hearings. Indeed, companies are discovering that their tax bills are now publically scrutinized in this new era of accountability and transparency. Those not viewed as contributing their “fair share” now face the anger of the broader public.

Boards and CEOs are still coming to terms with this new reality. But it is not an option to delay action and hope the debate over transparency and what represents a fair share of tax will stop. It is also no longer realistic to think that a company can merely stick to the letter of the tax laws and ignore other considerations. Doing so puts companies and their shareholders at risk.

As international tax advisors to multinational companies, we are sensitive to this change. We, too, are undergoing a transformation as we consider the broader business implications and reputational risks of the technical tax advice we give to our clients. This is not business as usual anywhere in the world.

So how can companies adapt to this new landscape and best address the different concerns of these very engaged stakeholders? It starts with formally and carefully defining a company’s tax policy, which gives effective guidance from the board to the group tax function on what the company’s responsibilities and
required behaviors are worldwide. This policy needs to take account of the often conflicting interests of various constituencies, such as tax authorities, investors, employees, the media and the general public.

In the future, a business model must adjust to recognize that, while commercial decisions must continue to take account of tax analysis, such analysis itself needs to include wider business risks.

A company’s tax policy will also help in determining how transparent a company wishes to be with stakeholders about its tax affairs. Companies are concerned that stakeholders could misinterpret the complex nature of their tax affairs. More of them recognize that it is important to communicate about how the company contributes to the economies and communities in which they operate – in other words, how much public value they create. Any effective tax policy needs to strike a balance between clearly communicating the risk appetite and approach of the company, while also managing all costs, including opportunity costs caused by its tax approach and its consequences regarding reputation and the risk of controversy.

Companies should be prepared to engage with governments, worldwide organizations such as the OECD and tax activists to discuss how the continual flow of new policies and laws will impact their business. While cash-strapped governments in these austere times are keen to see more tax revenue, they are also very concerned about encouraging economic growth to create jobs. Your views matter.
Future-proofing Saudi Arabia’s business and tax environment

INTERVIEW
by James Watson

Tax Insights: Recent years have seen a range of reforms aimed at modernizing Saudi Arabia’s business environment. What has been the main goal here?

Ibrahim Mohamed Al-Mofleh:
As globalization continues to gather pace, the economies of the Middle East are becoming more deeply integrated into the world economy. And Saudi Arabia is among the countries taking steps to modernize its business environment and attract foreign investment. One of the core goals has been to support wider efforts to diversify our economy by providing a stable and competitive business environment for both local and foreign businesses.

We have made significant progress here already. Overall, we are now ranked in the top 25 countries globally, according to the World Bank’s annual Doing Business rankings, and are showing improvements every year. In particular, when it comes to paying taxes, we are ranked 3rd out of 185 countries in 2013, up from 10th in 2012. This highlights the significant efforts we have invested here, from creating more advanced online platforms for individuals and businesses to handle their business and tax administration, through to an increased emphasis on skills development within our administration. There’s a lot going on in the DZIT, which is also responsible for auditing “Zakat” or charitable giving.

Related to this overall success, there has been a spate of tax-related activity, from cutting corporate tax rates to signing new tax treaties. What has been the core of your focus in all this?

Tax reform is a key element of the Kingdom’s modernization drive, with a series of emerging trends that are changing the tax environment here. As head of the Kingdom’s income tax department, I understand that these developments carry great significance.

As Saudi Arabia seeks to diversify and modernize its economy, creating a modern tax function has been one of its core strategic priorities. Leading this change is Ibrahim Mohamed Al-Mofleh, Director General of the Saudi Arabian Department of Zakat and Income Tax (DZIT), who talks to Tax Insights about the trends and challenges ahead.
“Tax reform is a key element of the Kingdom’s modernization drive, with a series of emerging trends that are changing the tax environment here.”

Ibrahim Mohamed Al-Mofleh
Director General, Department of Zakat and Income Tax, Saudi Arabia
The future of tax

for businesses that already operate and pay taxes here, as well as those that plan to do so in the future.

Related to all this, we continue to work to build capacity in our tax administration, while also fostering closer cooperation with other Gulf Cooperation Council (GCC) states on tax issues. We have been highly focused on applying agreed tax treaties, while also working to ensure more tax cooperation internationally. I also expect further refinement of our legal and regulatory environment to make it more compliant with international standards on transparency and tax-related information exchange. Similar types of efforts are also under way across most of the other GCC countries, so these trends are common across much of the rest of the region too.

We understand that all of this is vitally important for both current and future taxpayers. Solid tax reforms help reduce taxpayers’ compliance costs and enable taxpayers to benefit from our tax treaties. All this provides an environment that is more conducive to foreign investments, which is one of our core aims here.

How are you seeking to change the way that the private sector and other taxpayers interact with your department, for example, through electronic filing?

We have already seen many changes here. All taxpayers have, for some time, made their payments through a government electronic system called Sadad, which is linked to our internal information systems. Our website provides additional information, from instructions on how to register and file for tax through to payments, objections and appeals. We have also launched some important interactive services, such as taxpayer account statements and the ability to amend and send back returns by taxpayers.

How is technology helping your department to facilitate increased tax compliance and administration?

To start with, we have a unique number that has been issued to each taxpayer, which helps us identify relevant individuals and exchange data more easily. DZIT has also implemented a fully integrated, internet-based system, which is linked to the Government’s Sadad system. This allows taxpayers to make payments using a wide range of channels. We are also connected to the “Takamul” channel that connects all government agencies, which expedites data exchange between government agencies. Beyond this, we continue to work to make our website as interactive as possible for taxpayers, as part of our broader efforts in this domain.

How much of a challenge has it been to find the relevant talent needed to support all of these changes?

The changes and developments in our systems and operations have certainly affected the skills we need going forward. At a basic level, all employees have to be sufficiently technology adept, while an expanding local economy means that we need to work harder to compete for the skills we need. As far as tax professionals are concerned, it is a known fact that professional administrators are very rare, so most countries are seeking to try and develop their own tax professionals.

How appealing is a career in tax for young people today, and how is this changing at the moment?

I believe the appeal of a tax career for young people today has been growing in recent years. This reflects the importance of tax administrations to their countries as a source of revenue, as well as the high profile and attention that tax has been receiving in recent years. Added to this, the removal of customs barriers and the need to diversify and expand the Government’s revenue base has made the importance of tax administrations even greater today. Furthermore, globalization, with more international transactions and tax treaties, has added a far greater international dimension to tax administrations, which is appealing to young people. Modern tax administrations are also employing advanced IT systems, which helps put them on a more equal footing with the private sector. All of this is helping boost the appeal of a tax career to young people, and we are working hard to compete for them by providing a dynamic environment in which to work in the years ahead.

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**Ibrahim Mohamed Al-Mofleh**

*Director General, Department of Zakat and Income Tax, Saudi Arabia*

Al-Mofleh was appointed to his role in 2005. He is an economist with broad experience in public finance, building on his prior roles in the Saudi Fund for Development, the Ministry of Finance and the World Bank. He is also the chairman of Saudi Arabia’s Permanent Committee for Tax and Customs Exemptions and a board member of both the General Organization for Social Insurance (GOSI) and the Arab Fund for Social and Economic Development (AFSED). He holds a Master’s degree in Economics from Central Michigan University in the US.
The future of tax

EY – Tax Insights for business leaders

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Your business will only succeed if you build it on strong foundations and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. So our 35,000 talented tax professionals in more than 140 countries give you technical knowledge, business experience, consistency and an unwavering commitment to quality service – wherever you are and whatever tax services you need.

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“Recently, more and more enterprises organized abroad by American firms have arranged their corporate structures ... so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities, both at home and abroad.”

John F. Kennedy
35th President of the United States, in a message to Congress on 20 April 1961

The discussion that John F. Kennedy observed continues today. It relates to the focus of the next issue of Tax Insights magazine: transparency.

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