

Tax policy and administration – Global perspectives
June 2013: The trend for governments to raise more revenues through indirect taxes seems set to continue. The resulting shift from direct to indirect taxes will give multinationals fresh challenges. Your company may need to take a different approach to tax management in the future.

Shifting the balance from direct to indirect taxes: bringing new challenges



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The shift from direct to indirect taxes: What are the challenges for business on the horizon?

I am pleased to share with you the second publication in our series of themed global perspectives on tax policy which also doubles as the third publication in our series on 'Shifting the Balance'. We're making the distinction between direct and indirect taxes for the purpose of this report in a very straightforward manner. Businesses act as unpaid tax collectors for indirect taxes and we're focusing on those businesses, with only limited comments on the impacts for consumers who ultimately bear the tax.

Wherever you stand on the definitional arguments, we want to focus on the characteristics that affect business. We're looking ostensibly at the ratio of taxes levied directly on profit/income, wealth and property to those levied indirectly on the expenditures that the income and wealth finance (the main consumption taxes, including some taxes often described as environmental taxes although others are more direct in nature). It may be more difficult to tell whether some of the more marginal taxes fall on one side of the line or the other but the challenges for business of indirect taxes arising from these taxes are broadly similar to those for indirect taxes generally. Some of the formal metrics depend on the specific definitions used but the trends are useful for our purposes.

The spread of Value Added Tax (VAT) or Goods and Services Tax (GST) across the world is continuing at a rapid pace. From this point onwards in this report, we shall use only the term VAT for simplicity. The design of these taxes is constantly under review too for those who already have them. There are fundamental reforms being contemplated by India and China, with China moving rapidly to the transition from business tax to full VAT. The US is still considering VAT, but no major change is expected in the near future.

Customs and excise duties and other trade charges/ levies are also gaining profile. Typically these costs are not identified as taxes in the traditional sense and are buried in the cost of goods.

Until now, the impact of environmentally-based taxes and charges on business has been relatively small. While these impacts are still not comparable with those of traditional indirect taxes such as VAT, they're surely set to rise.

One thing is clear: unless you consider the make-up of your tax bills in future, you won't be geared up with the right systems and resources to manage them effectively. It might require some fundamental rethinking of the structure of your tax function as well as your broader finance and procurement departments to make sure you actually identify the costs which need to be controlled.



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Snapshot of the current global landscape

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Design of tax systems and the expectations of stakeholders

The financial crisis has made countries look very carefully at the composition of their tax revenues. Governments have also argued about the best way of introducing austerity measures. In particular, should rates of taxes tied to consumption be reduced to help taxpayers by increasing disposable income or increased to garner much-needed tax revenues? The International Monetary Fund (IMF), the Organisation of Economic Cooperation and Development (OECD) and the European Commission all promote the shift from direct to indirect taxes to help solve the crisis, by reducing costs on business to make them more competitive.

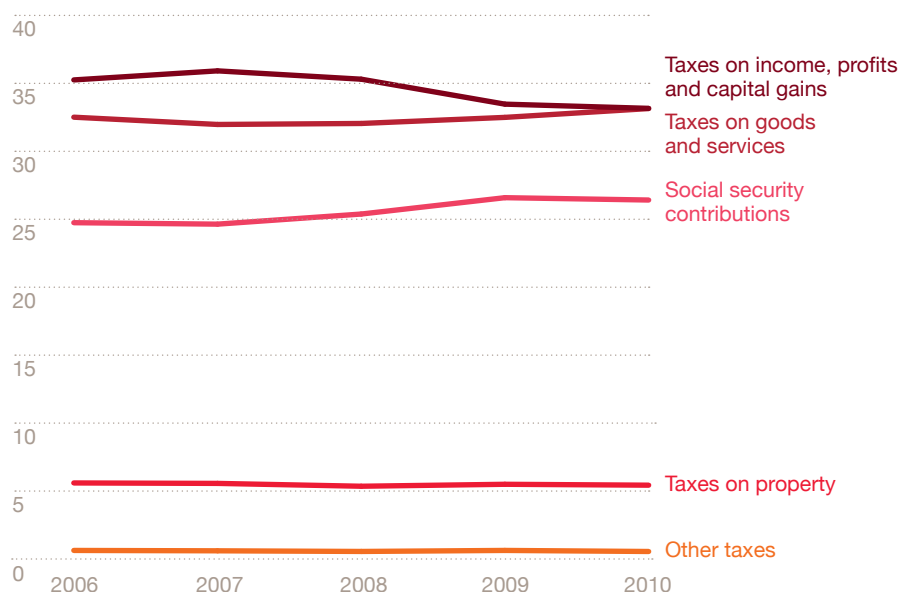
In his opening address to the OECD's first Global Forum on VAT, Pascal Saint-Amans (head of the OECD's Centre for Tax Policy and Administration) noted that VAT in the OECD countries now accounts for around 20% of total tax revenue, a 70% greater share than in the mid-eighties. With excise duties at 11% and other taxes contributing smaller sums, revenues from taxes on goods and services are now very close to revenues raised from personal income tax (25%), corporate income tax (8%) and other direct taxes such as those on capital gains. This trend has clearly had an impact on business, as we've previously noted in our 2007 paper *Shifting the balance – the evolution of indirect taxes* and our 2011 update *Shifting the balance – the changing landscape*¹.

Much has been spoken about taxes, charges and fees aimed at controlling or influencing eco-friendly behaviour (we call them 'environmental taxes' here) but little has yet been raised in revenues relative to other indirect taxes.

The spread of VAT systems around the world has continued, whether as a new tax or as a replacement for other narrower forms of consumption tax. Our 2013 *Paying Taxes* study with the World Bank showed that it was used in 154 (84%) of the 184 countries surveyed². The number of countries with only a sales tax (like the US' sales and use taxes), a unique consumption tax (like Japan) or no real substitute for a VAT (like Greenland) is shrinking. The members of the EU VAT system and the 127 or more other countries with a VAT system already are being joined by those (like Malaysia) fairly committed to a VAT system and those (like the Gulf Cooperation Council states³) actively considering VAT plans. These changes pose particular challenges for business operating in those countries, as we discuss further later.

It's arguable whether the Financial Transactions Tax proposed for the EU as a whole, but now to be taken forward only by a number of Member States under an enhanced cooperation procedure, is an indirect or a direct tax. It will have a substantial impact on financial institutions that have to collect it and those who ultimately bear the burden (whether that is pension funds or others may differ depending on the final design of the tax and other factors). It may also have a wider impact on policy makers.

Taxes as percentage of total tax revenue for the OECD countries



Data extracted on 28 May 2013 15:13 UTC (GMT) from OECD.Stat

¹ <http://www.pwc.com/gx/en/tax/indirect-taxes/shifting-balance.jhtml>

² <http://www.pwc.com/payingtaxes>

³ Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates (Jordan and Morocco have been invited to join the council)

Corporate income tax is least growth friendly, while VAT and real property tax are most growth friendly

**Growth-friendly approach
primary driver for ratio changes**

Apart from the general economic crisis giving governments the desire to explore just where more revenue can most easily be identified, there are perhaps some underlying theories that explain why they chose various indirect taxes.

One of a number of OECD studies entitled *Economic Policy Reforms: Going for Growth* (the 2006, 2009 and more recently the 2012 study⁴) indicate that corporate income tax is least growth friendly, while VAT and real property tax are most growth friendly:

“... several policies may entail a trade-off between reducing income inequality and raising GDP per capita ... Shifting the tax mix to less-distorting taxes – in particular away from labour and corporate income taxes towards consumption and real estate taxes – would improve incentives to work, save and invest, but could undermine equity.”

Further, globalisation has brought with it increased mobility of capital and income. The OECD 2012 report mentioned above also states that VAT is neutral as to where economic activity is located (which is generally true but there can be exceptions if VAT recoveries take too long or are impossible to achieve) whereas high rates of corporate income tax discourage investment. It continues that VAT is also neutral as to where income is located whereas the higher the corporate tax rate, the bigger the incentive to shift income to lower tax jurisdictions.

Apart from the influence of this kind of thinking put forward by academics, economists and the supranational bodies like the OECD, the UN, the World Bank and the IMF that promote them, an additional factor is the increasing influence of multi-territory indirect tax systems.

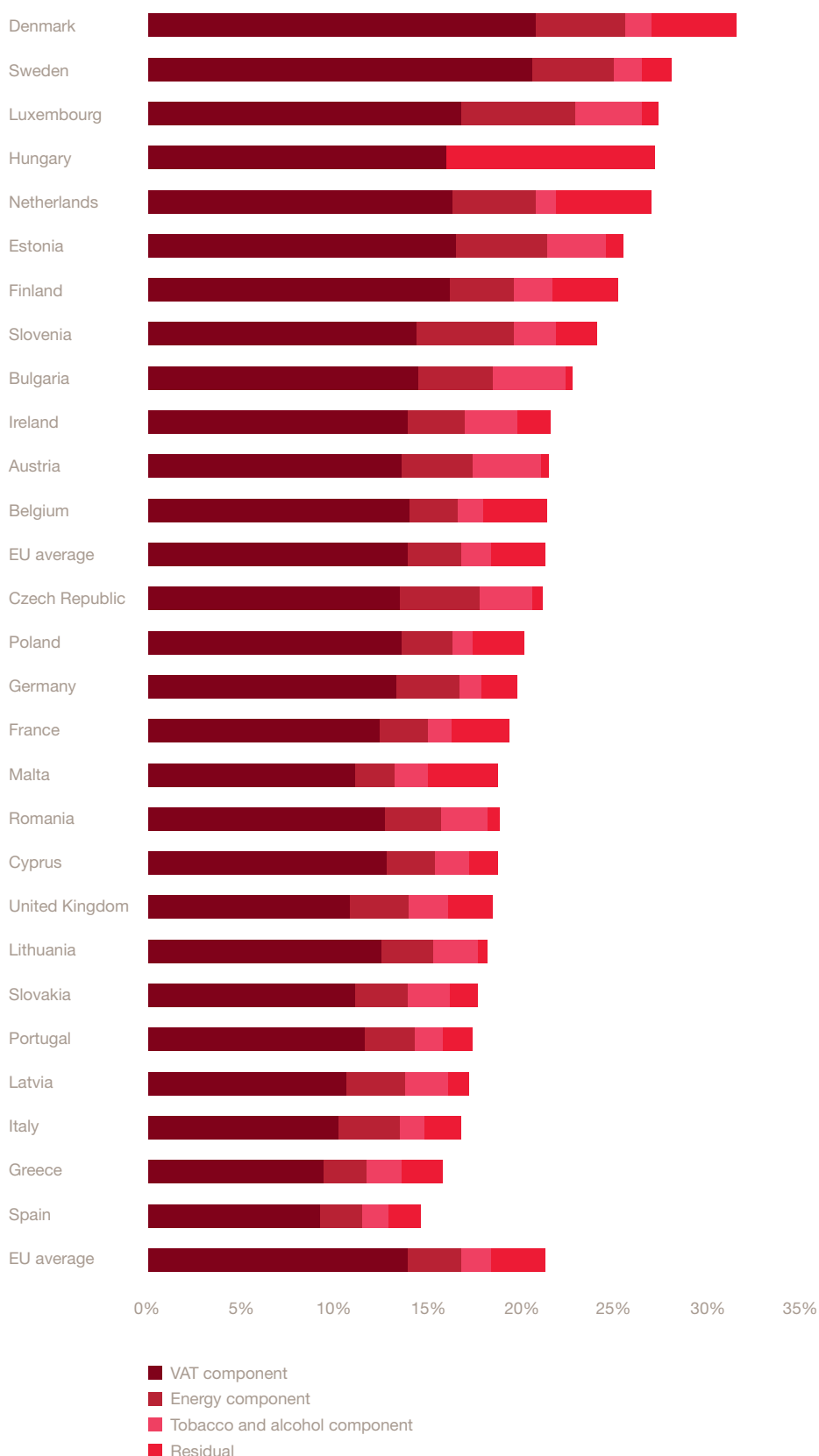
The application of the EU VAT regime is a requirement for EU membership, so existing Member States are tied in and new accession states must comply if they wish to join. Joint VAT action is also envisaged by, for example, the Gulf Cooperation Council (as mentioned above), and the Commonwealth of Independent states made up of Russia, Kazakhstan, Ukraine and other neighbouring states. These types of bi-lateral and multi-lateral agreements add complexity to an already complex set of rules.

⁴<http://www.oecd.org/eco/labourmarketshumancapitalandinequality/49421421.pdf>

Countries vary considerably as to how much they see the potential in taxing consumption. For the EU, the report of June 2012⁵ by the Directorate General for Taxation and Customs Union (DG TAXUD) and the Directorate General for Economics and Fiscal Affairs (DG ECFIN) highlights that implicit tax rates (ITRs) on consumption as a whole vary from less than 15% (Spain) to more than 31% (Denmark). The table, reproduced here, also allows you to compare the relative shares of that ratio for each of the taxes comprised in it. Analysis of those ITRs shows that VAT still accounts for more than half of the overall indirect tax revenues in every Member State but its share is much higher in some Member States than others. For example, non-VAT taxes account for only about a quarter of indirect taxes in Sweden but is moving toward one half in the United Kingdom, essentially due to the UK's high use of zero rates. The study also points out that:

“Taxes on energy (typically, excise duties on mineral oils), tobacco and alcohol make up, on average, around one quarter of the revenue from consumption taxes. The differences in consumption of excisable goods are such that their revenue effects go well beyond the spread in tax rates: in percent of GDP, Bulgaria raises from alcohol and tobacco excise duties about five times as much revenue as the Netherlands.”

Implicit tax rates on consumption



Source: European Commission Taxation Papers – Working Paper N.34 2012

⁵http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_34_en.pdf

Maximising revenues and the increased burden on the unpaid tax collector

While tax authorities will sometimes point to the use of indirect taxes to reduce their compliance burden, what they're often doing is displacing that burden from the tax authorities to businesses. Business, by definition, operates as an unpaid tax collector in relation to indirect taxes.

The complexity of the legislative regime has to be absorbed by business. It's often cost pressures on the tax authorities that determine how much business must do to comply. The way in which tax authorities then enforce the regime is similarly affected. Business has to shoulder its share of checking the status etc of its customers to determine liability, place of supply and even who has to pay the tax due.

The burden varies hugely from one country to another. For example, in EU countries, where there is a common legal framework for the VAT system, the time needed annually to comply with consumption-type taxes still varies, being the least in Finland and Luxembourg, around one sixth of the highest, in Bulgaria, according to our latest *Paying Taxes* studies carried out with the World Bank⁶. Comparatively, the time our case study company (a plant pot manufacturer) took to comply with consumption taxes compared to other taxes varied between the EU and other regions, but on a world average marginally exceeds the time devoted to labour taxes and substantially outweighed the time spent on corporate income tax. The absolute number of hours will differ and the ratios probably also vary, with the size of the organisation, but are still a broad indicator of the relative burdens imposed on businesses in their role as tax collectors and payers.

The extent to which administrative procedures contribute to this was considered in a previous PwC study,

*The impact of VAT compliance on business*⁷. The time our case study company took to comply increased by an average 54% in economies where monthly VAT returns are required, compared to those whose returns are less frequent, either bimonthly or quarterly. And the time needed for each return increased by over 100% where there were more than 20 boxes to complete on the return. The compliance burden also increased where invoices have to be submitted with VAT returns: there was an average increase of 70% in the time needed where invoices have to be submitted.

In the EU, where the content, filing mechanisms, payment methods and deadlines, are left to the discretion of Member States, the European Commission has identified the need to reduce the differences. Estimates suggest that a 10% reduction in differences in VAT procedures could boost intra-EU trade by up to 3.7% and EU GDP by up to 0.4%. We have completed a study which was published on 8 March 2013 on the feasibility of a common VAT return for use in all Member States for the EU Commission⁸. The cost saving could be €9.5 billion if the common EU standard VAT return is mandatory for Member States and optional for businesses that are registered for VAT in multiple Member States; potentially increasing to €17.2 billion if the common EU standard VAT return is mandatory for all taxpayers; and up to €20.6 billion, if companies can freely choose between their national VAT return and the common EU standard VAT return.

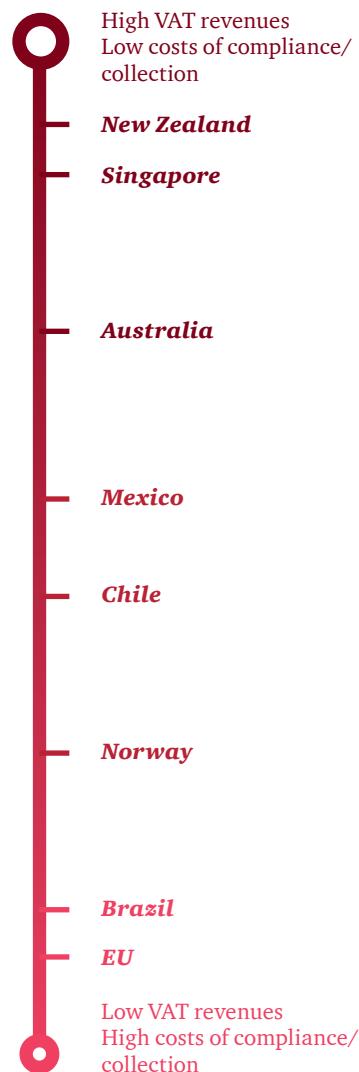
How countries compare depends on a number of factors contributing to a high or low compliance burden, as illustrated in our diagram.

In particular, where business is unable to obtain a refund of VAT there is a cost to the business, while there is a time value of money or a missed opportunity cost in not obtaining a refund on a timely basis. Our practical experience of this is that business will move, stop or change the operations they carry out in a country where VAT recovery is potentially a problem.

Factors contributing to a high or low compliance burden

High revenues/Low costs

- Single VAT rate/few exemptions
- Neutral
- Simple obligations
- Effective collection/enforcement
- Fast refunds
- Proportional penalties
- Few disputes



Low revenues/High costs

- Multiple VAT rates and exemptions
- Not neutral
- Complex obligations
- Ineffective collection/enforcement
- Late or no refunds
- Burdensome fines
- Many disputes and litigation

Source: PwC Analysis

⁶ <http://www.pwc.com/payingtaxes>

⁷ <http://www.pwc.com/gx/en/tax/indirect-taxes/impact-vat-compliance-business.jhtml>

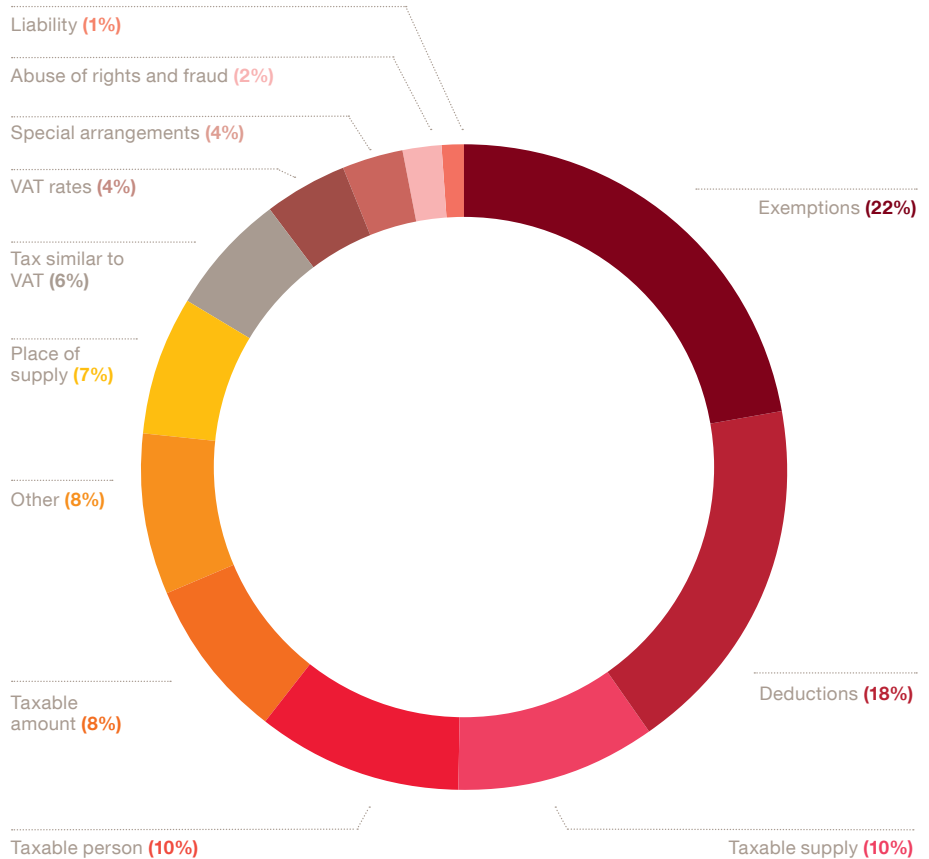
⁸ http://ec.europa.eu/taxation_customs/common/publications/studies/index_en.htm

Where the interpretation of legislation due to complexity requires court intervention, the business will incur significant costs. An indication of the number of cases brought before the Court of Justice of the European Union provides an idea of the areas of the EU VAT systems that have given rise to problems in the period from 1974 to March 2013. Reforms currently being considered by the EU Commission, as noted below, should focus on a reduction in those areas of difficulty.

More efficient use of technology can also lower costs of collection and compliance. Electronic invoicing has now become the global norm. Interest is growing in the concept of electronic auditing by tax authorities of a business's financial records and systems, with countries such as France now systematically applying these techniques. More territories are adopting tools that can interrogate such records on the basis that they must support the standard audit file for tax (SAF-T) methodology⁹. Singapore is encouraging businesses to adopt the SAF-T standards and is helping to fund projects in cases where the business has an appropriate internal indirect tax control framework to manage GST risks, as noted in our country profile. Brazil, notably, requires a business to hand over all its electronic financial records.

The network of agreements for the exchange of information between territories has grown substantially since the OECD's publication of a list of countries not co-operating in applying its information standards. It's now exploring further opportunities for automatic exchanges of information. The possible extension of joint audits including elements of indirect taxes, with tax authorities in different countries directly collaborating in planning and carrying out an audit, is another interesting potential development, which is already taking place within the EU.

Issues decided in The Court of Justice of the European Union (CJEU) cases from 1974 to 30 April 2013



Source: PwC Analysis

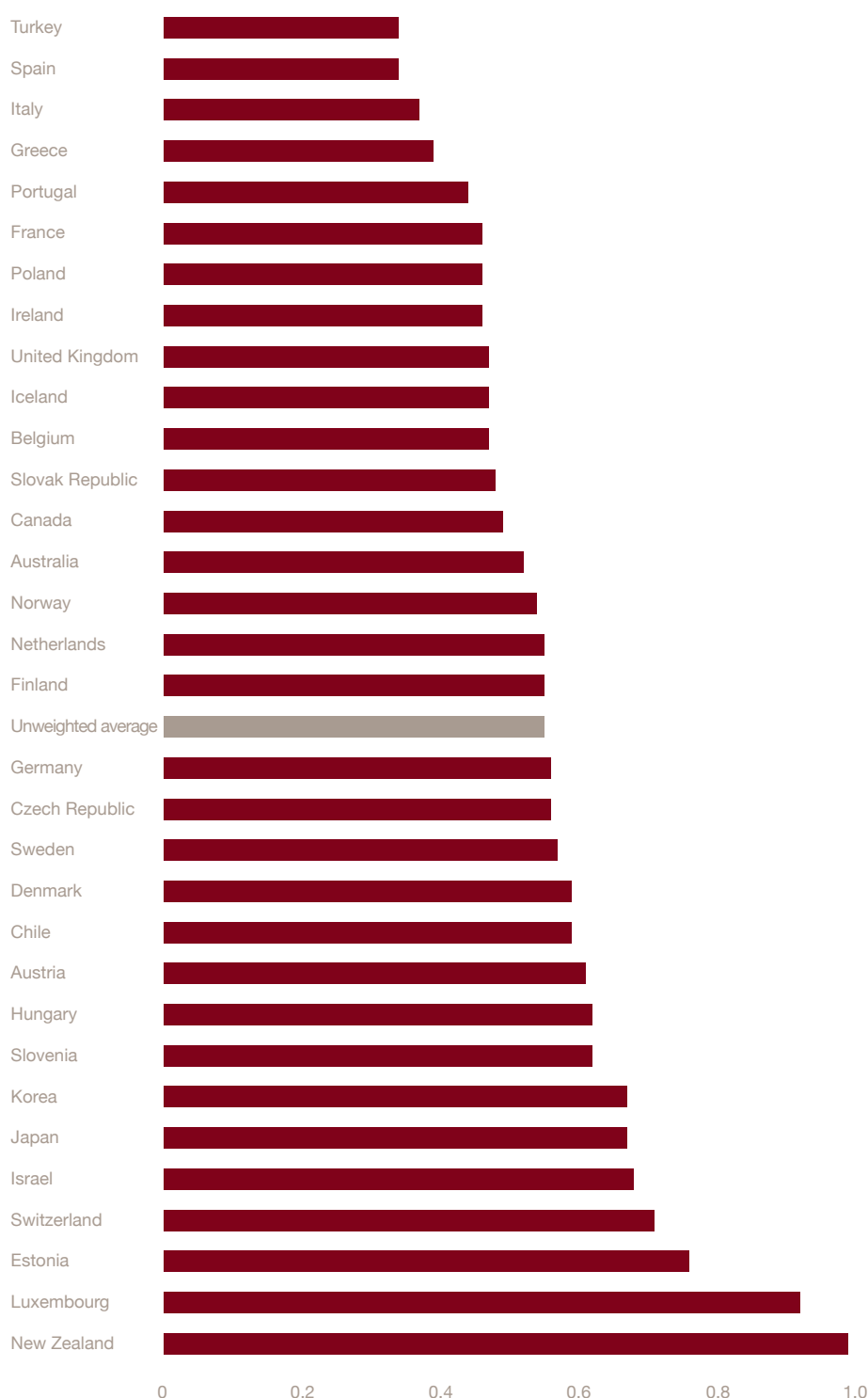
⁹ <http://www.oecd.org/ctp/taxadministration/34910277.zip>

VAT/GST rates increasing and base broadening

Over recent years, VAT rates have risen in a number of countries. It should be noted that there is no cap to the maximum normal VAT rate that can be applied in the EU and Hungary's main rate is now 27%. It's interesting though that, globally, the normal rate of VAT is not synonymous with the extent to which a country relies on VAT in relation to other taxes as a source of tax revenues. For example, Chile and New Zealand have had relatively low standard VAT rates of 19% and 15% even though, in 2010, revenues from VAT as a percentage of total tax revenue were 38.7% and 30.2% respectively (compared to an overall OECD average in recent years of around 20%).

Only half of theoretical VAT revenues are collected across all OECD countries, though. A measure used by the OECD to determine the efficiency of a country's VAT system is to look at the actual VAT receipts compared to the theoretical VAT receipts that a certain level of final consumption should produce – the VAT revenue ratio. The indicator shows that in 2009, exemptions including zero-rates, reduced VAT rates, avoidance and fraud/evasion resulted in only a little over 50% of the theoretical VAT revenues being collected in the OECD. As shown by the *OECD Consumption Tax Trends 2012* report the differences are substantial. The OECD is, in particular, concerned as to whether the generally falling ratios represent greater difficulties in collecting monies rightly owed or Government policy not to tax certain consumer spending, e.g. the UK with its extensive application of zero-rates. Governments will also be looking at these ratios to determine their country's capacity to raise more VAT revenue.

VAT revenue ratios within the OECD (2009)



Source: OECD's Consumption Tax Trends 2012

Note: The most recently available figures from the OECD, available in the Consumption Tax Trends 2012 publication, still use 2009 national account figures.

The size of the problem over fraud and evasion and its impact on VAT revenue ratios is uncertain. This efficiency ratio needs to be considered carefully though as there are policy differences between Member States which help explain the position. For example, the high New Zealand ratio is probably caused largely by the policy of using a broad base with few exemptions, the apparent regressivity in the VAT system being addressed through the benefit system and personal taxation. At the other end of the scale, Mexico employs zero or reduced rates on a wide range of supplies and, the OECD suggests, experiences a low compliance rate.

Best practice in determining the ‘base’ which attracts VAT/ GST is being scrutinised in many countries. Those introducing new regimes are keen to start out with the best model for growth and efficiency. The major reform of the EU’s VAT system will be the result of a new strategy, following substantial consultation seeking in part to broaden the tax base. More widely, the OECD has been looking to see whether greater strides can be made towards aligning global best practice. Some countries are looking towards a more harmonised approach – see for example, our profiles on Canada and China. Indirect taxes are not just about VAT/ GST. More governments are using indirect environmental taxation to achieve objectives, beyond just raising tax revenue.

Complex patchwork of environmental taxes has materialised

The issues of sustainable development, climate change, resource scarcity and energy security have not escalated up the corporate agenda perhaps as quickly as expected. No doubt the global financial crisis has had a huge role to play in this. But these environmental challenges are still widely recognised from a social, economic and political perspective and governments, and businesses alike, are aware of the need to respond even though the policy landscape remains unsettled.

Over the past 12 months we’ve seen more governments – at a national and sub-national level – introduce new environmentally-based taxes and other pricing mechanisms, regulations and a host of incentives. At present, countries are employing different approaches with some opting to tax ‘bad’ behaviours and others to incentivise ‘good’ behaviours. Any form of international harmonisation is still a long way away though, as progress towards a global approach proves to be painfully slow.

In the meantime, governments are attempting to address these sustainability and environmental challenges in their own backyards, meaning layer upon layer of environmental taxes and charges are appearing, leaving businesses to operate under a complex patchwork of taxes and regulations. Policies are being introduced at an unprecedented pace and sometimes changed even before they’re implemented, as was the case with the UK’s Energy Efficiency scheme replacing the original Carbon Reduction Commitment and France’s carbon tax, with work underway on a replacement. Staying on top of these changes and managing their impact can be an overwhelming task for business.

Environmental taxation is not only a way for governments to drive taxpayers away from environmentally harmful behaviours, but is increasingly seen as an easy way to raise tax revenues.

Best practice in determining the ‘base’ which attracts VAT/ GST is being scrutinised in many countries.

One could say that environmental taxes are relatively unusual in that they are in fact designed specifically to change behaviour. This does though rely on taxpayers/consumers recognising that they're suffering these taxes. If that is the case and the taxes are then set at the right level, they should create the economic incentive for taxpayers/consumers to reduce their negative behaviours – for example, emitting carbon dioxide, disposing of waste to landfill, etc – and in doing so, erode the environmental tax base. It does of course beg the question: “are governments treating environmental taxes as non-sustainable revenue?” It's arguable that environmental taxes could be set at rates that raise predictable amounts of revenue, much like other taxes on vices or fuel excise taxes. But those rates are not likely to be the same rates required to drive the changes governments want to see to, for example, decarbonise their economies. Indirect taxation, in the field of customs duties and levies, is also changing. Although tax rates are falling, the role of the customs administrations is rapidly evolving.

A changing landscape in international trade

While the main roles and responsibilities of customs authorities around the globe have remained largely the same for the past decade or so, the manner in which such roles and responsibilities are executed has changed significantly in recent times, mainly due to the following factors:

- heightened international awareness (and quantification) of the costs associated with complying with inefficient and outdated border formalities;
- increased investment by the private sector in modern logistics, inventory control, manufacturing and information systems, leading to increased expectations for Customs to provide prompt and predictable

- processing of imports and exports;
- increased use and availability of new information and communication technologies moving towards a real-time or 'just-in-time' regime;
- greater policy and procedural requirements directly associated with international commitments (such as accession to the World Trade Organization);
- increased international competition for foreign investment;
- proliferation of regional trade agreements that significantly increase the complexity of administering border formalities and controls;
- increased awareness of the importance of good governance and sound integrity within Customs services;
- a significantly heightened awareness of the need for Customs administrations to play a more meaningful role in protecting society from a range of threats to national security (the Port of Rotterdam is a particularly good example of an administration that has developed high levels of pre-screening and evaluation of shipments).

As a result of these changes, many countries, especially developing ones have come to realise that effective customs administrations can bring significant benefits in the form of social and economic progress and are taking steps to achieve that goal. Drivers for such a transformation include the desire to increase country competitiveness (e.g. more efficient customs clearance processes and procedures may attract greater foreign direct investment) and attain effective revenue collection.

This effectively will result in two things.

- Border controls will become stricter for any trade that has not passed pre-inspection tests or does not comply with the conditions of trade facilitation programs. The focus of such controls will be on security and illegal trade, and its impact on supply chain movement is likely to be severe.
- Revenue related controls will continue to be delinked from border clearance, with an increased focus on post-import examinations, e.g. periodic audits at company sites, to enforce compliance. Customs authorities around the world are increasing their commercial and legal knowledge and post-importation audits will become much harder to deal with for those companies that are not well prepared. On the flipside, knowledgeable and prepared importers should find more professional Customs administrations easier to deal with.

With either fewer or more advanced controls at the border, faster customs clearance times should offer greater flexibility and the potential for 24/7 operations without Customs interference. Yet this will come with greater accountability for importers and exporters, even if the border operations of those importers and exporters are outsourced to customs brokers, freight forwarders or other intermediaries. In countries where post-importation behaviour by the authorities is commercial and predictable, this will be a great boon; in other countries, it will carry greater risks.

The world of international trade has expanded immensely and become ever more complex. Managing cross-border compliance effectively and efficiently will require businesses to be better prepared.



Greater cooperation between tax authorities on indirect taxes

There are probably three main areas for further cooperation in indirect taxes between tax authorities in the near future:

- transfer pricing and customs valuation;
- compliance and enforcement, including information exchange and risk management; and
- capacity building, i.e. developing a team of civil servants with the right knowledge, skills and tools to administer a viable tax system.

Apart from individual territories, and the EU which operates a Customs Union, the World Customs Organization (WCO), which now has 179 members, continues its partnership approach to promote its global customs standards as essential measures to facilitate regional integration and cooperation.

The first meeting of the OECD's Global Forum on VAT in November 2012 (attended by tax authorities from both OECD member and non-member countries plus a delegation from BIAC, the business and industry advisory committee) identified that strategies to address VAT fraud need to be aligned and operated in conjunction if they're to have the desired success. That was also part of a wider recognition that countries could (and probably should) collaborate more, both on specific issues and in establishing best practice in VAT administration and compliance. There are particular challenges to address, it was agreed, on applying VAT in international trade. There was also discussion of the *OECD International VAT/GST Guidelines* to develop and broaden consensus and a chance for non-OECD economies to input before the work is finalised by the end of 2013. Those guidelines, being finalised after the recent consultation, will deal with the following:

- VAT-neutrality: what does it mean and how to ensure it in practice?
- applying the destination principle on cross-border supplies of services and intangibles between businesses (B2B) – a main rule and specific rules;
- applying the destination principle on cross-border supplies of services and intangibles to final consumers (B2C);
- anti-abuse provisions; and
- mutual cooperation and dispute resolution.

Insofar as the Forum's mission was to organise a structured dialogue with non-OECD economies and other relevant stakeholders on VAT design and operation based on the OECD standards, it was largely successful.

Within the EU, the EUROFISC mechanism for Member States to enhance administrative cooperation in combating organised fraud also covers many of the repetitive situations and joint EU audits would encompass aspects of indirect taxes, including customs duties. Collection can be improved significantly in the EU if studies are correct: an estimate of the VAT gap by Reckon LLP in 2009¹⁰ of euro 107bn annually is commensurate with an International VAT Association estimate in 2007 of euro 60-100bn, though the Commission believes it may be considerably higher. Not all of that is due to fraud, the VAT gap which represents the difference between accrued VAT receipts and the theoretical net VAT receipts for the economy as a whole is estimated by identifying data from national accounts which may be subject to error. The gap does not exclude insolvencies and legitimate VAT planning. It does though help to explain why audits have become more aggressive and e-auditing and data-mining look increasingly attractive to tax authorities.

The on-going redesign of the EU VAT regime involves investigation of a range of proposals to see that they provide the necessary safeguards for business and tax authorities in all these respects to substantially reduce the significant VAT gap.

¹⁰ <http://go.reckon.co.uk/a29587>

Timeline for the redesign of the EU VAT regime

EU Presidency: Ireland & Lithuania	EU Presidency: Greece & Italy	EU Presidency: Latvia & Luxembourg	EU Presidency: Netherlands & Slovakia	EU Presidency: Malta & UK	EU Presidency: Estonia & Bulgaria	EU Presidency: Austria & Romania	EU Presidency: Finland
2013	2014	2015	2016	2017	2018	2019	2020
Proposal on new VAT rate structure	Report back on anti-fraud measures	Introduction of mini one-stop-shop arrangement	Broadening the one-stop-shop arrangement				
Review and analysis of destination principle for goods	Proposal for definitive regime	'Art.12 report'					
Proposals for broadening the tax base – including proposal on public bodies							
Proposal for standardised VAT return	Standardisation of other VAT obligations, such as registration and invoicing						
Further investigation of new tax collection methods and SAF-T							
Feasibility of cross-border audit team and broadening of automated access to information							
Publication of VAT Committee guidelines and explanatory notes on new legislation before the new rules enter into force							
Continued creation of an EU VAT web portal							

- Simpler VAT system
- Destination principle
- Efficient VAT system
- Robust and fraud proof

Source: PwC Analysis from Commission Communication of December 2011.

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States will compete for investment differently in future

Traditional state-by-state goods and services tax (ICMS) incentives have finally been ruled out by Brazil's Supreme Court. This 'tax war' has been a constant feature of the Brazilian tax system for decades. Although tax incentives were granted without the necessary approval from the other states, many companies decided to install themselves in, or even move to, states offering benefits.

Political agreement is being sought to alleviate the problems this might cause. For those on the receiving end of special treatment in the past, this Supreme Court judgment could mean a hefty bill for tax 'lost' to the administration.

It will be interesting to see how innovative states can be in terms of attracting future investment.

Complexity continues to be a concern for business

There are still four different indirect taxes that business has to contend with, even though Brazil has not yet ventured down the road of introducing environmental taxes (though there is no shortage of regulations in some areas). Apart from ICMS levied at state level, the legislation governing the federal VAT/excise tax and two different social contributions remains complex.

There is a very high compliance cost for business in dealing with these taxes. Legislative interpretation is difficult and disputes are common. The Brazilian Revenue Authority has focused on computerisation of administration and e-invoicing, e-forms, digital financial records and electronic payment are already the norm, counteracting the otherwise onerous burden created by the volume of the requirements.

The digitisation of the indirect tax system may well have an increasingly positive impact in future. Tax audits will become increasingly sophisticated with the development of cross checks within the system and the establishment of benchmarks against which to measure data trends. Once tax authority staff have been trained to a sufficient level, there should be a time saving for both business and the administration in focusing effort on where it's most merited. But there is a concern that the level of detail at which enquiries are directed could be driven increasingly wider, adding further to complexity.

Growth in indirect taxes not a shift from direct taxes

Revenues from ICMS and the federal VAT/excise tax and two different social contributions have continued to grow.

There are two specific factors which have come into play. We expect both to continue having an impact in the short term.

Both federal and state administrations have been focused on increasing efficiency in collection of taxes. While the informal or hidden economy remains high, indirect tax compliance among other taxpayers has improved. We expect this trend to continue.

The global financial crisis has perhaps not hit Brazil as badly as it has some countries. But companies' profitability has been hit with a consequent reduction in direct taxes. On the other hand consumption-based taxes have not suffered as much. Overall, the impact has been to increase indirect taxes as a share of total taxes.



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Combination of federal GST and provincial sales taxes becoming even more confusing

Tax payers will be faced with difficult decisions when locating parts of their supply chains in Canada. Indirect tax compliance will be equally difficult where the place of supply of goods or services is in Canada, particularly when made from one province to another. Attempts to introduce a harmonised sales tax (HST) across the ten provinces have so far proved extremely difficult.

Currently, the federal GST at a rate of 5% (reduced by 2% during the last five years) is 'topped-up' to a level of around 12%-15% in the five provinces that are running with the HST. Four other provinces add a local tax, which in three provinces is a kind of retail sales tax (similar to the US sales and use tax) and in the other (Quebec) is a form of VAT. The final province (Alberta) doesn't have a provincial tax.

Environmental taxes on the rise

A complex patchwork of environmental taxes, fees and charges now exists across Canada. They're typically levied at a provincial level – designed to encourage environmentally positive behaviours – but are also significant revenue-raisers for governments.

Two provinces, British Columbia and Quebec, have had carbon taxes in place for some time now.

In addition to carbon, packaging and waste disposal is high on Canadian provincial governments' agenda.

Uncertainty in the financial sector

The financial sector is certainly the area facing the greatest level of complexity and uncertainty. New rules for intermediary services have broadened the tax base while adding to the uncertainty of the proper tax treatment. Pension plan rules are extremely difficult to comply with. As is the case in several other jurisdictions, Canada is now performing a conceptual review of its set of rules in the financial sector.

Tax audits are more sophisticated but fraud remains a problem

The tax authorities are becoming more geared to e-audit systems and results. An initial download of taxpayer data is all very well but without the improvements we're starting to see in statistical sampling, they wouldn't be able to see the wood for the trees. The advances in the programs being used to detect potential areas of difficulty are being matched by the advances in the techniques applied.

The complexity inherent in the indirect tax system, as noted above, means that errors are not uncommon. There is less concern about abuse or avoidance involving these taxes right now.

The 'black market' with businesses falling out of the tax net altogether is, though, recognised by tax authorities as a major problem. They can't audit what they can't initially identify and locate. The extent of evasion, particular GST and sales tax frauds, will continue to attract attention. The focus on particular sectors is likely to remain the most prolific approach.

A Canadian 'Foreign Trade Zone'

Various provisions in Canadian law relating to customs duty and GST provide companies with the opportunity to import goods temporarily without customs duty (and in some cases GST) being collected on these goods. The Canadian government is promoting this bundle of provisions as the equivalent of a 'free trade zone', like those which are found in the United States, but with the added benefit that these provisions can be used "anywhere in Canada": that is, a company does not have to locate within a designated FTZ to use these programs.



China

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Expansion of B2V Pilot Program to all of China

The announcement by the State Council on 10 April 2013 of the expansion of the “Business Tax to VAT” (“B2V”) Pilot Program nationwide with effect from 1 August 2013 marks another milestone in China’s tax reform.

The B2V Pilot Program is currently in place for certain Pilot Industries in certain Pilot Locations.

With the announcement, not only will the Pilot Industries be subject to VAT instead of BT in all of China, the State Council further extends the scope of “Modern Services” to include the production, broadcasting and distribution of media and cinematic productions. In addition, China has also decided to subject railroad transportation, postal and telecommunications services to VAT instead of BT at the appropriate time.

Overall, China still aims to complete its B2V transformation within the 12th Five-Year Plan (2011 to 2015).

The “balance” in China is clearly in the favor of Indirect Taxes, with Direct Taxes accounting for less than 30% of the nation’s tax revenue. As China forges ahead with its tax reform, tax compliance will be particularly challenging for doing business in China. Indirect tax risks are likely to be higher than direct tax risks, and this introduces a whole new paradigm for tax risk management for many taxpayers.

Carbon trading pilot to supplement environmental levies

The Chinese government has wanted for some time to beef up its mixture of levies and regulations to control environmentally unfriendly activities. China has committed to cut carbon intensity by 40-45% by 2020, from 2005 levels.

In 2010, it was reported that China intends to replace its current fee-based pollution levies with an environmental tax. It was reported that sulphur dioxide and wastewater will be the first to be subjected to the new tax, but details of such a tax remain unconfirmed.

Attention has now shifted to the province of Guangdong and the cities of Shanghai and Beijing as they kick-off their respective pilot carbon trading programmes. Four more provinces and cities are expected to launch similar experimental programmes during 2013, in advance of a planned nationwide scheme from 2015.

Tax rates are generally high but targeted incentives are abound

China has historically done quite a lot of research on how other countries have approached taxes before deciding what it thinks is the best model. It also looks regularly at the activities which it needs to promote or incentivise.

The main rate of VAT on goods is 17%, although under the pilot programme the 6% and 11% rate categories were introduced; Business Tax for services is 5-20% on entertainment (but otherwise 3-5%) and Consumption Tax on alcohol, jewellery, cars, etc adds between 1 and 45%. Payers of these taxes also contribute an additional percentage of that combined tax burden in urban construction and maintenance tax (up to 7%), education surcharge (3%) and local education surcharge (2%).

While the structure of VAT has changed little over the years to date – and the main rate remains the same – incentives are available but are carefully targeted. Export VAT refunds vary for a range of goods (and now some services) so that the effective rates can come down to zero, though the credit can only be carried forward – there are no VAT refunds except for exports and special concessions. Qualified offshore outsourcing services are exempt from Business Tax. Help has also been forthcoming from the state while the financial crisis has hit specific businesses, particularly labour intensive industry.



Germany

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Serious about environmental considerations but tax is not there yet

Germany regards itself as one of the ‘best in class’ in relation to establishing, and reaching, targets for environmental sustainability. But this is not yet reflected in the tax system, either in terms of government objectives or, given the amounts of revenue at stake, taxpayer focus. While it does address a wide range of sources in energy taxes, there are few other environmental taxes and they collect little money. Germany still appears in the lower third of EU Member States as regards environmental taxes as a proportion of gross domestic product (GDP) and one of the lowest as regards the share of total revenues from taxes and social contributions.

Keen on harmonisation but unresponsive to competition

Germany considers its position at the heart of the EU very seriously. It will continue to do so and to play a significant role in the development of the current consultation toward a better EU VAT system. German taxpayers are keen to ease the uncertainties and difficulties in cross-border trade, and many support the idea of one ‘representative’ tax authority in the EU to achieve that goal.

Germany is very strict in relation to application of EU VAT Directives. As a result, it has made use of very few derogations and there are few exemptions from VAT in the tax system. This will influence Germany’s input to a more standardised EU system and its subsequent application. Germany will continue to hold its position even under pressure from competition in other Member States.

Clear focus on VAT issues in Revenue Authority audits

Germany is unlikely to move significantly toward a data download from taxpayers to the Revenue Authorities. Germany supports the OECD’s SAF-T (see earlier) so that it can ‘interrogate’ taxpayers’ enterprise-wide data systems and will probably continue to rely on this method alongside other techniques. It’s aided by the fact that financial and accounting systems are well developed and indirect tax compliance is nearly 100% electronic.

The greater focus in audits over recent years has clearly been on VAT as opposed to corporate profits taxes. That has been the case within the ‘permanent audits’ carried out for companies every three to four years. On top of that the number of special VAT audits – both at federal level and in local tax authorities – has grown considerably and is likely to continue at those high levels.

The government is strongly aware of the need to tackle VAT fraud. It also believes that collection is hampered in the case of entrepreneurs struggling with the financial crisis. Customs duties are not seen as causing as much of a headache and perhaps as little as 4-5% escapes the fiscal net.



India

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GST needed to resolve goods and services problems

Proposals for a Goods and Services Tax (GST) were to be implemented in April 2010, then 2011 and then 2012. It may have been shelved for now, possibly until after the next election in 2014. But pressure for it to return will continue to grow.

The current system is essentially one of Central and state sales taxes on goods with a separate services tax. That means different rules can apply between states (particularly in terms of VAT 'holidays') and competition for investment is intense. Five or six of the 28 states are very aggressive in this regard. Goods or components are often moved on between states, each attracting a separate charge and it's not uncommon for some of that to 'stick'. GST is seen as a panacea but when?

Fiat judgment casts uncertainty on excise values

The Indian Supreme Court, in a case concerning Fiat, recently restarted arguments concerning the excise value of goods. Once a contentious issue, a large number of amendments in Indian excise law and the related rules had reduced the scope for ambiguity and disputes on the issue of valuation.

It will be interesting to see how the Revenue Authorities interpret this decision. The narrowest interpretation is that all new product launches (which are typically priced at a level that would be profitable when volumes pick up) should be valued at full 'cost plus' rather than the transaction value. There is a concern though that the Revenue Authorities may argue that every advantage accruing to a business must be valued and excise duty charged on such value.

Need to align law with administration

India has steadily streamlined its indirect tax regime over the last 30 years. The law has increasingly become simpler and easier to interpret and administer. But there is a huge gap between the law and the manner in which it's implemented.

While the intention has always been to free export of services from domestic taxes, it has been a challenge to implement this. There are many reasons for delays and rejections of refunds, including the nexus between inputs/ exports and documentation requirements.

Another area in which business faces challenge is the payment of taxes in the last quarter of the financial year. There is clearly nothing in the law that provides the authorities with the power to require a factory to pay excise duty on the gross value of production and not take CENVAT credit. But this happens each year in order for the Revenue Authorities to meet revenue targets.

We expect the Indian government to address the working of the tax administration machinery. We anticipate acceleration of the move to automate periodical compliance procedures like electronic filing of sales tax (and later GST) invoices, e-payments, electronic generation of movement documents etc. Concerted action ought to be taken to clamp down on administrative laxity.



Russia

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WTO accession to add to changing composition of indirect taxes

With customs duty representing such a large share of tax and related revenues, Russia's accession to the World Trade Organisation in July 2012 will have a significant impact in future. Rates will have to come down from 10% to around 7.8% with significant cuts in some strategic sectors. Duties on electrical equipment, drill pipes and bulldozers will have to be cut by as much as half by 2015/16.

Alongside that, increased takings from the mineral resources tax and excise tax were designed to represent a 3% change in the composition of other tax revenues during 2012. But only one third of that represents a shift from direct tax, reducing corporate income tax. The mineral resources tax accounts for nearly half of those other revenues. Russia has abundant supplies of oil, gas and other natural deposits and reliance on these is high in tax terms. Increases in rates are though, to an extent, matched by a new mechanism to help the work on new fields and provide tax breaks for them. This trend is set to continue. The dynamics of the growth in rates of excise taxes in 2012 compared to 2010 show how targeted they have been.

We expect further increases in future years.

- Alcoholic products – increases of between 40% and 70%.
- Tobacco products – increase of 60% for pipe tobacco, cigarillos and cigars and 90% for cigarettes.
- Motor fuel – increases of between 75% and 170%.
- Diesel fuel – increases of between 150% and 260%.

Compliance and enforcement are having an impact

There is a focus on narrowing the tax gap, particularly within indirect taxes. But at the same time the tax authority is becoming less aggressive and more reasonable about compliance in many respects.

Wider use is starting to be made of technology, including the introduction of electronic VAT invoices. This was introduced in May 2012 on a voluntary basis. It's either good or neutral for businesses in Russia and has largely been welcomed. The tax authorities also see it's a win-win situation. This is symptomatic of attempts to remove previous delays (e.g. delays in VAT refund) and formality in the system.

There is a stated intention to employ more analytics to the tax audits too. Nothing concrete has yet emerged though and business is not convinced how long it will be before there are firm proposals. There are discussions about the feasibility of interrogating financial systems but so far activity is limited to requesting electronic versions of key documents.

Audits are starting to focus on transfer pricing and this could have a major impact on customs duties from as early as June 2013.

The burden of compliance is still regarded as unreasonable in many cases but business is hopeful for the future.

VAT system needs greater harmonisation

The Russian VAT regime is fairly similar to that within the EU but with some notable exceptions. Although fine tuning is likely, business would like to see more fundamental reform.

The lack of VAT grouping is a substantial detriment to business.

Another feature of the Russian VAT system is that there is no support for the export of services. Many services are out of scope and supplies lead to input VAT cost.



Singapore

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Risk-based approach to compliance and audit

The recently-introduced GST Assisted Compliance Assurance Programme (ACAP) is intended to bring savings in time and money for well-organised businesses as subsequent tax audits will be reduced for these businesses. On a voluntary basis, MNCs and other businesses can conduct their own holistic risk-based review to endorse the effectiveness of their GST systems, processes and controls. Accredited GST specialists, like PwC, will test these controls and report their compliance with agreed standards.

The benefits of being part of ACAP could be substantial in the period to April 2016. A business receiving 'premium status' will be less likely to have to undergo an extensive Revenue Authority GST audit. The business can also benefit from the waiver of penalties if it does have to disclose GST errors which don't arise as a result of fraudulent behaviour. Since 50% of the costs of achieving the ACAP status will be funded by the state up to S\$50,000, there is a major monetary incentive for taxpayers to participate in this cooperative compliance initiative.

This risk-based approach serves to enhance other voluntary programmes which taxpayers can also consider. The Revenue Authorities offer taxpayers the opportunity to have e-audit techniques used to try to reduce the level of manual investigation work. Tools are then used to interrogate financial systems using the OECD's standard audit file for tax (SAF-T) methodology. There is also a voluntary disclosure programme (partial amnesty) under which there is a reduction in the substantial penalties which could otherwise be charged in relation to GST errors.

First class trade controls for a small range of goods

There is scope for the government to consider the range of customs and excise taxes. But Singapore prides itself on being a very open economy and a substantial increase in trade controls is unlikely. It also has good trade relations with other countries.

Controls are applied to an extent through the fact that TradeNet, Singapore Customs' nationwide electronic data interchange (EDI) system for import, export and transshipment documentation processing, handles virtually all affected transactions. Its recent upgrade was aimed at helping the trading community and, in particular, aligning it with international standards for processing.

While Singapore monitors what other countries are doing in this area, the government will probably seek to maintain what it sees as a competitive advantage, tackling only those areas where it needs to influence social behaviour – petrol, liquor and tobacco being paramount.

National climate change strategy driving environmental change

Businesses are as focused on social responsibility in relation to the environment as the government and the public. While 86% of Singaporeans feel that they play a part in taking action on climate change, and 74% are concerned about climate change, the question the government has struggled with is how this awareness can be translated into positive action. The National Climate Change Strategy 2012 (NCCS-2012) suggests some answers and provides an insight into the future direction of tax and other policy in this area. Singapore's policies and measures aim to reduce emissions by 7% to 11% below 2020 business as usual (BAU) level, a projection without policy intervention. Singapore has also pledged to reduce emissions by 16% below 2020 BAU level if there is a legally binding global agreement.

In his National Day Rally address on 26 August 2012, the Prime Minister made clear that Singapore's taxes will have to increase "sooner or later" as social spending increases. But he didn't indicate which areas of taxation would be impacted. Besides raising the current GST rate of 7% which is considered low by international standards, could environmental taxes have an important role to play in achieving the objectives set out in Singapore's NCCS-2012, and at the same time close this fiscal gap?



South Africa

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Stable and straightforward VAT system at risk from external factors

South Africa currently has a VAT system which works smoothly with a small number of exemptions and a rate which hasn't changed since 1993. And that rate is, at 14%, far less than many countries around the world. The system is based loosely on New Zealand's VAT regime and is regarded as far less complicated than the EU variant.

But there are two clouds on the horizon. The healthcare system which the government is set to introduce will need to be funded: one of the suggestions has been to increase the take from VAT, probably largely through higher VAT rates. South Africa has also proposed the introduction of a carbon tax during 2015: lessening the burden on poorer households could involve playing around with VAT exemptions to target typical spending patterns.

Environmental incentives and the carbon tax

The South African government seems to see itself as a trendsetter in its environmental goals. But the biggest challenge lies ahead with the planned introduction of a carbon tax. Reaction from taxpayers has been mixed.

Electricity producers have relied on cheap coal for domestic use as has South Africa's extensive mining and heavy industry. South Africa's electricity industry contributes to 55% of its total emissions. It has been one of the highest global polluters in this regard. The major concern of business is the impact on the competitiveness of South Africa's energy intensive industry.

The regressive effects of a carbon tax on households is also unknown, but an option is to offset increased electricity costs with cuts in the price of goods and services through the application of wider VAT exemptions.

Compliance boosting initiatives patchy but more good intentions

South Africa's tax authorities have been focusing in recent years on improving tax administration. The Tax Administration Act which took effect on 1 October 2012 modifies some outdated procedures, providing the foundations for a better future.

The introduction of e-filing for VAT is effectively complete. As a result we've seen some real benchmarks established in the way that taxpayers have been selected for enquiries. Trends analysis can now be carried out in such a way that one can expect questions to be raised if there is a 3% difference from the 'norm'. We expect this process to continue and for more sophisticated variables and ratios to become the next key trigger points.

The trials of wider e-audits have, though, been less successful. South Africa appears to be a bit behind many of the other leading nations in terms of audit strategies for indirect taxes. There are far-reaching goals which the tax authorities have set themselves but progress toward them is slow. The IT14SD which requires taxpayers to reconcile across different tax types is a prime example of an initiative which has failed to deliver the expected benefits. It's too simplistic and the requirement for companies reporting under this process of reconciliations between figures used for VAT and those used in income tax and PAYE returns provides little assistance in the audit process.

The tax authorities have also started to look at customs values more closely. One idea focuses on the legal requirements for valuation in the Customs Act to see whether they're correctly being observed and adhered to in respect of transfer pricing adjustments. The continued modernisation of the customs regime, including a full e-clearing system, is seen as a positive objective. This should at least see an end to the lengthy delays some taxpayers have experienced through stoppage of some shipments while paperwork is reviewed and business checks carried out.



United Kingdom

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Broad VAT exemptions continue but some narrowing to correct anomalies

The extent of the UK's broad use of the exemptions and zero-rating permitted by the EU VAT regime is well-known and is set to continue. There has though been some narrowing of scope in order to address what the tax authorities regarded as anomalies.

Environmental taxes firmly on the agenda

The government is focused on a number of environmental objectives. In that respect it has set out its definition of 'environmental taxes', i.e. those which have as a primary objective to encourage environmentally positive behaviour change, and are structured to promote progress towards environmental objectives. Current environmental taxes include principally:

- Climate Change Levy (CCL)
- Aggregates Levy (AGL)
- Landfill Tax (LFT)
- EU Emissions Trading System (EU ETS)
- Carbon Reduction Commitment Energy Efficiency Scheme (CRC), and
- Carbon Price Support (CPS).

Betting and gaming duty changes

A new Machine Games Duty (MGD) came into effect on 1 February 2013. The MGD regime shares many common features with the VAT regime which it's replacing. It includes group registration and procedures for agents to manage the registrable person's MGD obligations and for UK representatives to act for non-UK registrable persons.

Regulations also provide for electronic communication between the tax authorities and MGD businesses.

The MGD return will not be too onerous for businesses to cope with, as most of the figures will have to be calculated anyway in order to establish the correct liabilities at the standard (20%) and reduced (5%) rates.

Modernisation of customs and excise duties

In 2013 there will also be a modernisation of customs and excise law including how civil penalties should be proportionate to the offence. In part, this will see a continuing alignment of UK law with EU customs legislation. The overriding aim is to reduce administrative burdens, better protect the UK's borders and deter the non-compliant.

The themes of most interest to respondents involved in the consultation which took place in 2011 were the simplification of the legislation (and removal of duplication); the need for UK law to reflect the Single Market; and the decriminalisation of more minor offences. There will also be new powers though to detain goods pending investigation of their duty status.



United States

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Impact of sales and use taxes down to political considerations over a federal VAT/ GST

The result of the last Presidential election provided some clues as to the speed at which the debate over a federal VAT or GST regime may progress. There is little political enthusiasm on either side but the economic crisis may force the issue. If public spending can't be cut sufficiently to provide a safer navigational path, the need for the additional revenues may force the US government to more seriously consider some form of federal consumption-based tax.

If it does happen, it's unlikely that individual states will give up their constitutional rights to impose sales taxes. As a result, a bifurcated system of federal and local taxes seems inevitable. It's possible that the levels of different taxes could be constrained within certain limits. You can foresee difficulties of the types experienced by India in introducing a GST and by Canada in trying to maintain and harmonise a dual system.

The need for additional revenues is not new, of course. Federal legislation has been proposed to target internet sales slipping through the state tax net; broadening of the sales tax bases and higher rates for sales tax is another potential scenario (as discussed further below).

Collection of taxes is already tightening up

The days when companies shipped furs, artworks and other goods through 'no tax' states have passed, although arguments now rage about things of the modern age like internet sales and whether digital downloads are sales of software or information services. States are gearing up to pursue the issue of whether there is sufficient nexus between the entity making internet sales and the activities which could attribute a physical presence in the state.

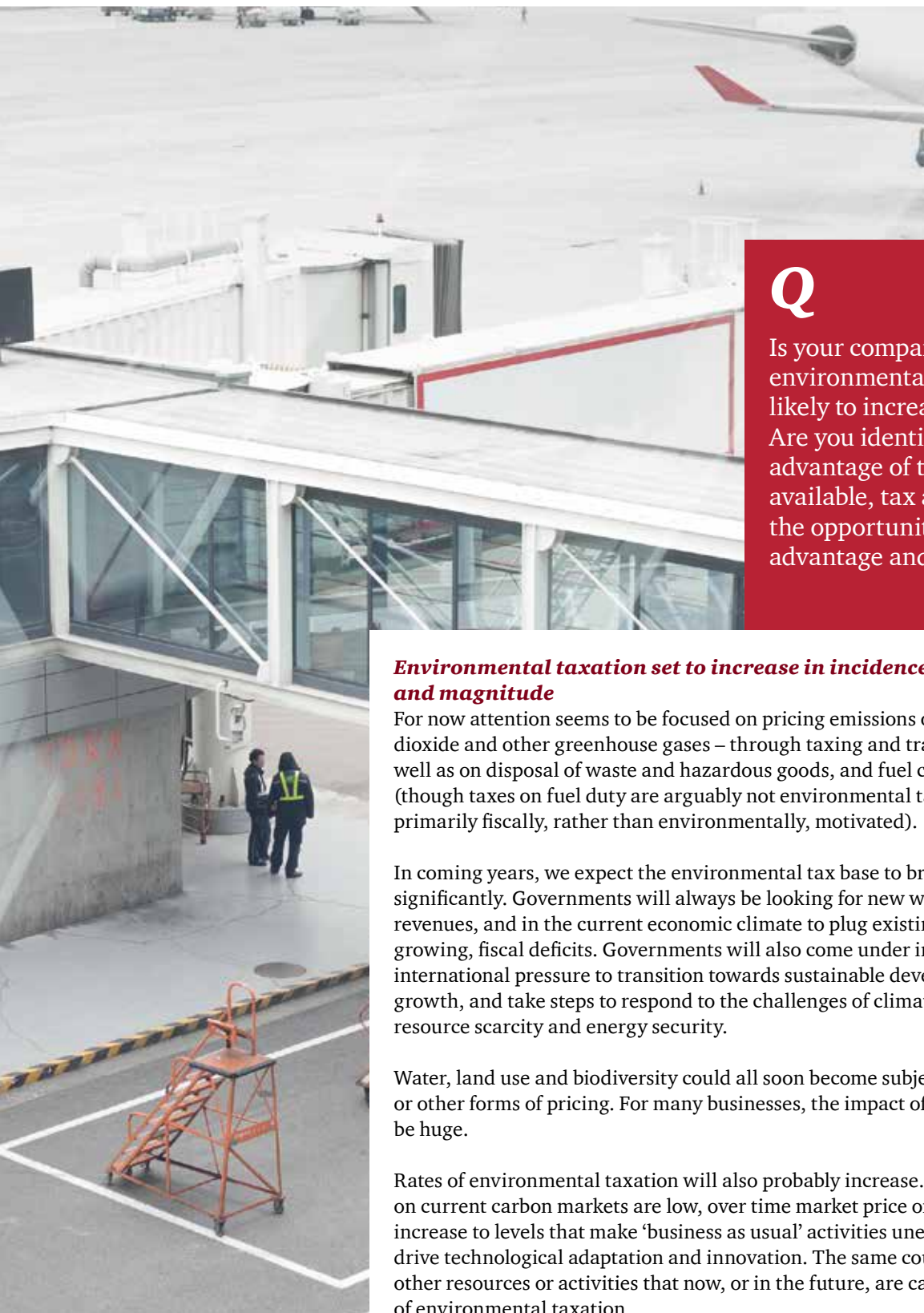
Environmental taxes and spending at a crossroads

There has been massive support in recent years on environmentally friendly investments. Policymakers have tended to favour 'carrots' rather than 'sticks' in their efforts to drive behavioural change. While alternative and renewable energy incentives have been around since the 1970s, the landscape changed when the government expanded the support levels for 'going green' by US\$100bn a few years back and broadened eligibility for these incentives.

The introduction of a federal carbon tax in the United States still seems some way off. A carbon tax had been modelled by the recent administration's federal deficit reduction committee, alongside modelling of a GST, but the carbon tax concept was shelved before even reaching the proposal stage. On carbon, the state of California is taking matters into its own hands, with its state-wide carbon trading market having begun late in 2012 and becoming fully operational on a mandatory basis from 1 January 2013.

A photograph of an airport tarmac. In the foreground, a white jet bridge with a glass-enclosed walkway extends from the left towards the center. The bridge has a series of white structural supports and a dark frame around the glass. The tarmac is a light gray concrete surface. In the background, a large white aircraft is visible, along with some ground service equipment and a tall white pole. The sky is overcast and gray.

What are the pivotal challenges on the horizon?



Q

Is your company managing environmental costs which are likely to increase going forward? Are you identifying and taking advantage of the many incentives available, tax and otherwise, to seize the opportunities for competitive advantage and growth?

Environmental taxation set to increase in incidence, scope and magnitude

For now attention seems to be focused on pricing emissions of carbon dioxide and other greenhouse gases – through taxing and trading – as well as on disposal of waste and hazardous goods, and fuel consumption (though taxes on fuel duty are arguably not environmental taxes as they are primarily fiscally, rather than environmentally, motivated).

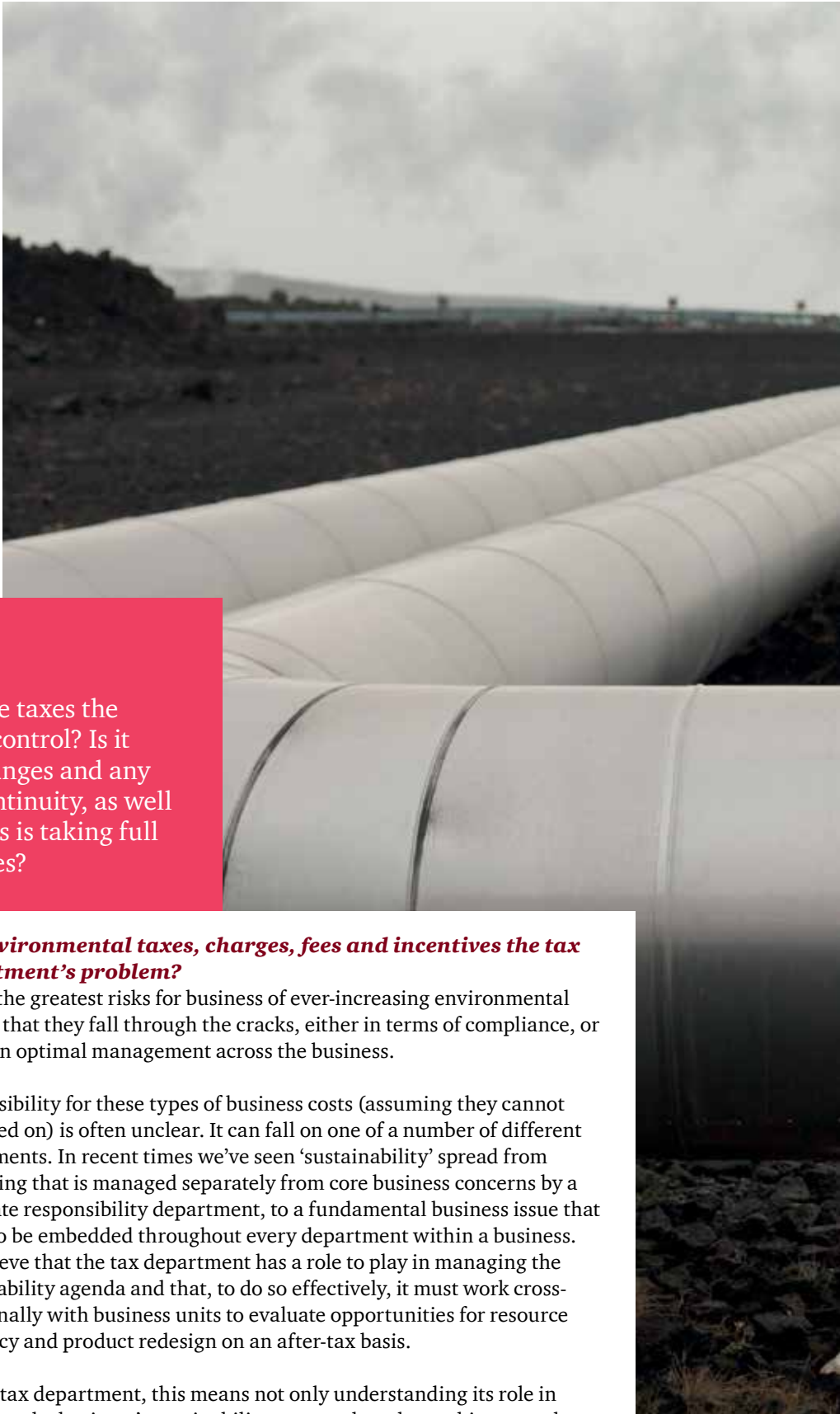
In coming years, we expect the environmental tax base to broaden significantly. Governments will always be looking for new ways to raise revenues, and in the current economic climate to plug existing, and growing, fiscal deficits. Governments will also come under increasing international pressure to transition towards sustainable development and growth, and take steps to respond to the challenges of climate change, resource scarcity and energy security.

Water, land use and biodiversity could all soon become subject to taxation or other forms of pricing. For many businesses, the impact of this could be huge.

Rates of environmental taxation will also probably increase. Although prices on current carbon markets are low, over time market price or tax rates could increase to levels that make ‘business as usual’ activities uneconomical and drive technological adaptation and innovation. The same could also apply to other resources or activities that now, or in the future, are caught in the net of environmental taxation.

In the absence of a global solution to the challenges of sustainable development, climate change and resource scarcity, we expect sub-national, national and regional policymakers to continue to add to (and adjust) the existing suite of environmental taxes, fees, charges, regulations and incentives. The vast array of policies that businesses will be required to operate under will only become more complex.

One thing is clear. Environmental tax and regulation policies will continue to play a significant role in shaping business strategies and operational decisions going forward.



Q

Is your tax function aware of the taxes the business needs to manage and control? Is it geared up to identify future changes and any potential threats to business continuity, as well as making sure that the business is taking full advantage of available incentives?

Are environmental taxes, charges, fees and incentives the tax department's problem?

One of the greatest risks for business of ever-increasing environmental taxes is that they fall through the cracks, either in terms of compliance, or less than optimal management across the business.

Responsibility for these types of business costs (assuming they cannot be passed on) is often unclear. It can fall on one of a number of different departments. In recent times we've seen 'sustainability' spread from something that is managed separately from core business concerns by a corporate responsibility department, to a fundamental business issue that needs to be embedded throughout every department within a business. We believe that the tax department has a role to play in managing the sustainability agenda and that, to do so effectively, it must work cross-functionally with business units to evaluate opportunities for resource efficiency and product redesign on an after-tax basis.

For the tax department, this means not only understanding its role in achieving the business' sustainability strategy but also making sure the business is paying the right amount in environmental taxes.

Businesses are beginning to wake up to the fact that they typically have no idea what they're paying in environmental taxes locally, let alone globally. Environmental taxes can be a hidden cost to business. They tend to be lost in invoices which never make their way out of the accounts payable department or never get embedded in the supplier's costs. These costs represent threats and opportunities, and currently they're going unnoticed by the tax department.



Q

Are you drafting new contracts to include appropriate language dealing with the VAT/ GST consequences of the underlying transaction or at least requiring the parties to amend the contract in good faith in case VAT/ GST is introduced or substantially amended in different countries?

Transitioning to new VAT/ GST regimes

As we've seen from our country profiles, some countries are in the process of changing substantial parts of their tax regimes towards a more VAT/ GST-focused approach. In particular, China is piloting a move from Business Tax to VAT for various services and India is likely at some point to introduce the VAT regime on which it has been working for some time. Comments from senior Malaysian government officials suggest that Malaysia is committed to introducing a GST regime in the next few years. There are other countries around the world that are equally transitioning toward a system in which VAT/ GST is being introduced or substantially amended.

Some of the tax-free or tax light attraction for entities and transactions in the Middle East is set to change. As we noted above, the six-members of the Gulf Cooperation Council aim to introduce harmonised VAT systems. There has been considerable discussion – both within the GCC and outside it – about whether the loss of attractiveness in the short term of introducing VAT would be outweighed by the potential help these economies may experience in diversified growth. When implemented, the system is due to include both goods and services. For now, the GCC countries have delayed the application of the planned VAT. It seems likely that it may be introduced at some point between 2014 and 2018.

There are some key changes in the EU regime for B2C supplies of certain services from 2015 onwards and, following the white paper on redesigning the system, fundamental reform is expected to come. The OECD's work on best practice might also result in changes in VAT/ GST systems across broad swathes of the globe.

Q

Will you continue to be able to import and export your products? Will you be using the most advantageous import tax deferral or exemption facilities? Will the lowest possible import taxes be paid?

Customs and trade considerations in business structure changes

The rapidly changing world economy is forcing many multinationals to critically assess their operations and priorities around the world. Often, this leads them to conclude that significant restructuring is required, either to address a shift in economic activity towards the emerging world, to rationalise an organisational structure that has grown so fast that it has become unwieldy or inefficient, or other business reasons.

Typically, the planning process to effect such change considers many aspects of the business. What does the sales and marketing department say are the best opportunities? How does the logistics department suggest the supply chain is constructed? Who does the procurement department recommend sourcing from?

One part of any business impacted by all these considerations, but with rarely a seat at the planning table, is the one that deals with customs and trade. Yet any change in business structure is most likely to be first impacted when a container gets stuck at a border or an executive is detained at the border for alleged smuggling of a technical drawing in his briefcase.

It would be wise therefore to have answers to these questions before embarking on a restructuring journey.

Q

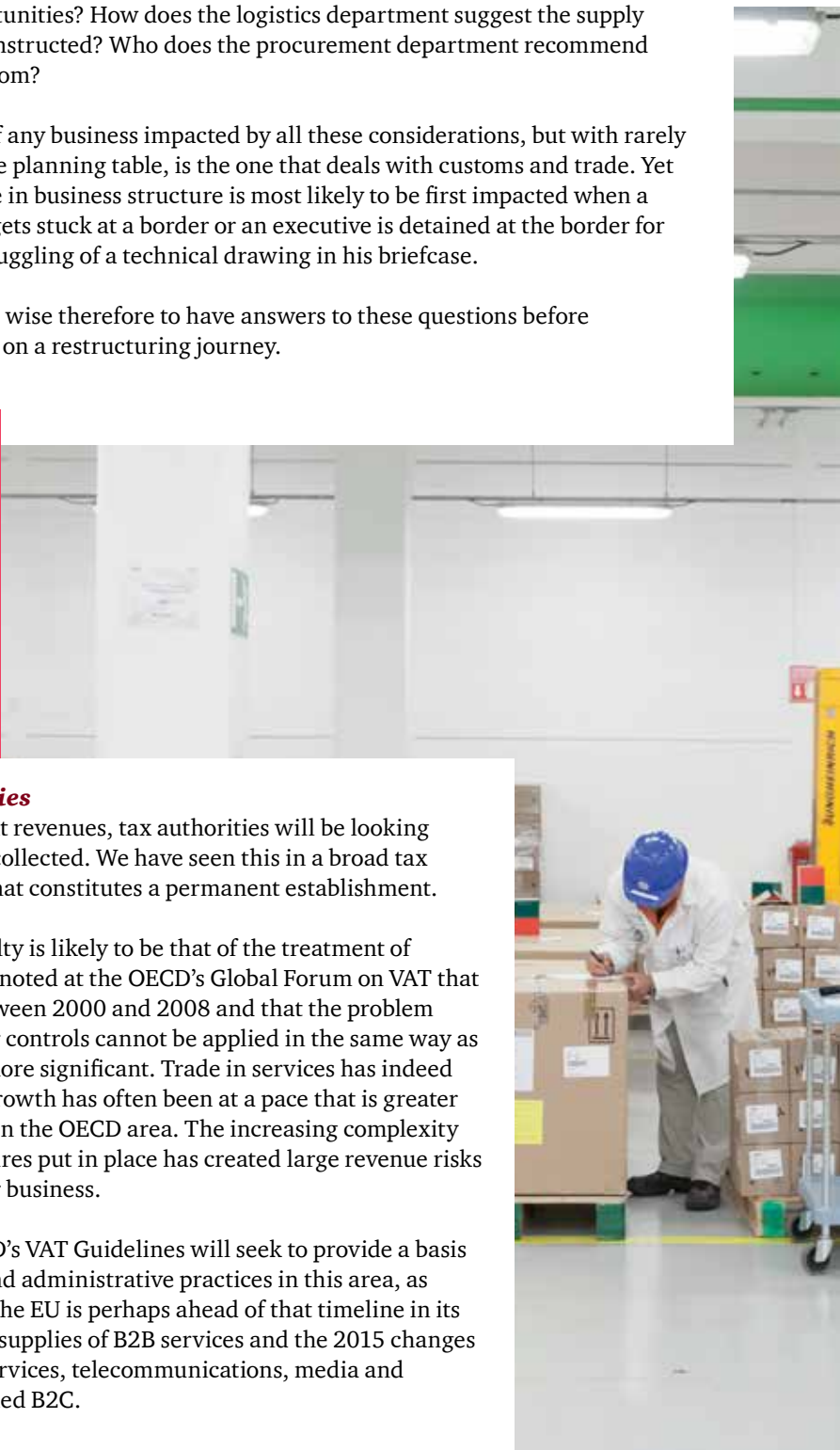
Are you prepared for the arguments you may face from different countries trying to establish taxing rights over the services you provide? Have you considered how this may change in the medium term?

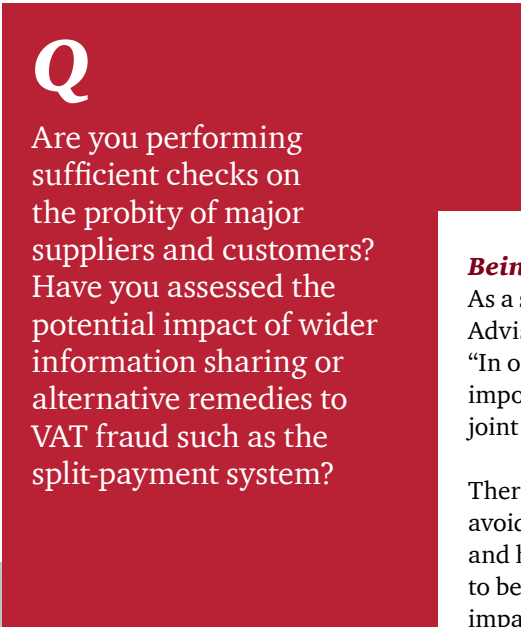
Approach of tax authorities

In times of falling government revenues, tax authorities will be looking at ensuring all taxes due are collected. We have seen this in a broad tax environment in relation to what constitutes a permanent establishment.

One particular area of difficulty is likely to be that of the treatment of services. Pascal Saint-Amans noted at the OECD's Global Forum on VAT that trade in services doubled between 2000 and 2008 and that the problem caused by the fact that border controls cannot be applied in the same way as they are for goods was now more significant. Trade in services has indeed continued to grow and that growth has often been at a pace that is greater in emerging economies than in the OECD area. The increasing complexity of the administrative procedures put in place has created large revenue risks and high compliance costs for business.

The development of the OECD's VAT Guidelines will seek to provide a basis for countries to frame laws and administrative practices in this area, as well as other areas by 2014. The EU is perhaps ahead of that timeline in its current rules on cross border supplies of B2B services and the 2015 changes for electronically-provided services, telecommunications, media and entertainment services supplied B2C.





Are you performing sufficient checks on the probity of major suppliers and customers? Have you assessed the potential impact of wider information sharing or alternative remedies to VAT fraud such as the split-payment system?

Being innocently caught up in tax fraud or attempts to combat it

As a slide discussed by Will Morris (Chair of the Business and Industry Advisory Committee to the OECD) at the OECD's Global VAT Forum stated "In order to minimise fraud revenue loss, tax authorities [are] increasingly imposing blanket rules on legitimate businesses: onerous reporting obligations, joint and several liability".

There is a need for proportionate and targeted measures by governments to avoid an increased burden on legitimate traders. Businesses need to be vocal and help identify the impact of such broad anti-fraud measures; this is a subject to be covered in the EU's VAT Forum. Governments should also do a thorough impact assessment of such measures and consider changing their approach to risk management, e.g. better screening of VAT registration applications (considering who it is that is trying to enter the system) and fraud detection.

One possible solution that has been put forward in relation to some of the VAT fraud problems is the so-called 'split-payment' method. Instead of paying the VAT to the supplier, it would be paid direct to the tax authorities, as for example is currently the case in Austria for non-established taxpayers and which has appeared to work in Estonia. This would clearly have a major impact on many businesses' systems.



Does the global board regularly discuss strategy on indirect taxes? How prepared is your organisation to see you actively involved in debates raised by supranational bodies like the IMF, OECD and European Commission?

Indirect taxes should be on the board agenda

Unless businesses engage in policy making on indirect taxes, they will find themselves increasingly used as unpaid tax collectors with less certainty and higher costs of compliance.

Indirect taxes currently represent an amount which is at least 25% of an MNC's financial throughput. Even though business has accepted its role as tax collector, there are significant risks that mean it may find itself shouldering the burden of taxes which are supposed to be neutral for business. With such large numbers potentially at stake the impact can be significant.

Many governments now see indirect taxes as so closely tied to economic growth that such taxes are increasingly drawn into the political debate. If they're on governments' agendas they should also be regularly reviewed at the highest levels in business.

If your organisation is not actively putting forward its views on the global holistic changes likely to take place over the next few years in VAT/ GST, environmental and other indirect taxes, it may find itself struggling to comply with rules designed to suit others.

Q

Are you actively pursuing infraction proceedings in the EU in respect of unwarranted delays in making VAT repayments, as this is against well established case law of the CJEU? Is there action you can take to tackle these kinds of difficulties in other territories?

Cashflow impacts on business

A number of countries are managing their cash by postponing refunds in respect of valid deductions and reliefs. For example, in the EU some Member States like Italy and Spain have taken this stance on a number of VAT-related issues. Italy also asks for bank guarantees.

The OECD advocates that VAT should not be a cost to business but should be neutral, a principle reconfirmed on numerous occasions by the Court of Justice of the European Union (CJEU). Indeed this principle should, by its very nature, be applicable to all indirect taxes.

The action often required by businesses to get what is rightly due to them can be onerous. So it's not just a question of the cashflow impact but one of weighing up the costs of court action where that might be the only or a speedier route to recovery.



Q

Have you checked that your financial systems appropriately reflect legislative requirements in each country that may give rise to an indirect tax liability? Do you operate suitable controls over data?

The quality of the data being processed by your financial systems

Tax compliance will become, and should become, more automated. But for that to happen, businesses need top quality data going into their financial systems in the first place. They then need that data to be processed for indirect tax reporting in an efficient and effective fashion.

It's not just a question of getting the numbers right when inputting data for indirect tax purposes. Categorisation of that data into supplies which are in or out of scope, taxable or exempt and subject to tax at the appropriate rate is critical. This applies both to the tax being accounted for as the taxpayer makes supplies to consumers and to any creditable tax.

The financial system has to reflect the latest legislative developments. The people inputting data need to be appropriately trained and supervised. The capture of information at point of sale needs to be correct. There are a host of possible ways in which mistakes can enter the process.

In some territories, senior tax or accounting personnel may now or in the future be required personally to provide assurances to their tax authorities about the quality of these systems.

Q

Has your business assessed how well it's geared up to react to change? What is the risk of something going wrong? How well resourced is the Tax function and does it have the necessary support?

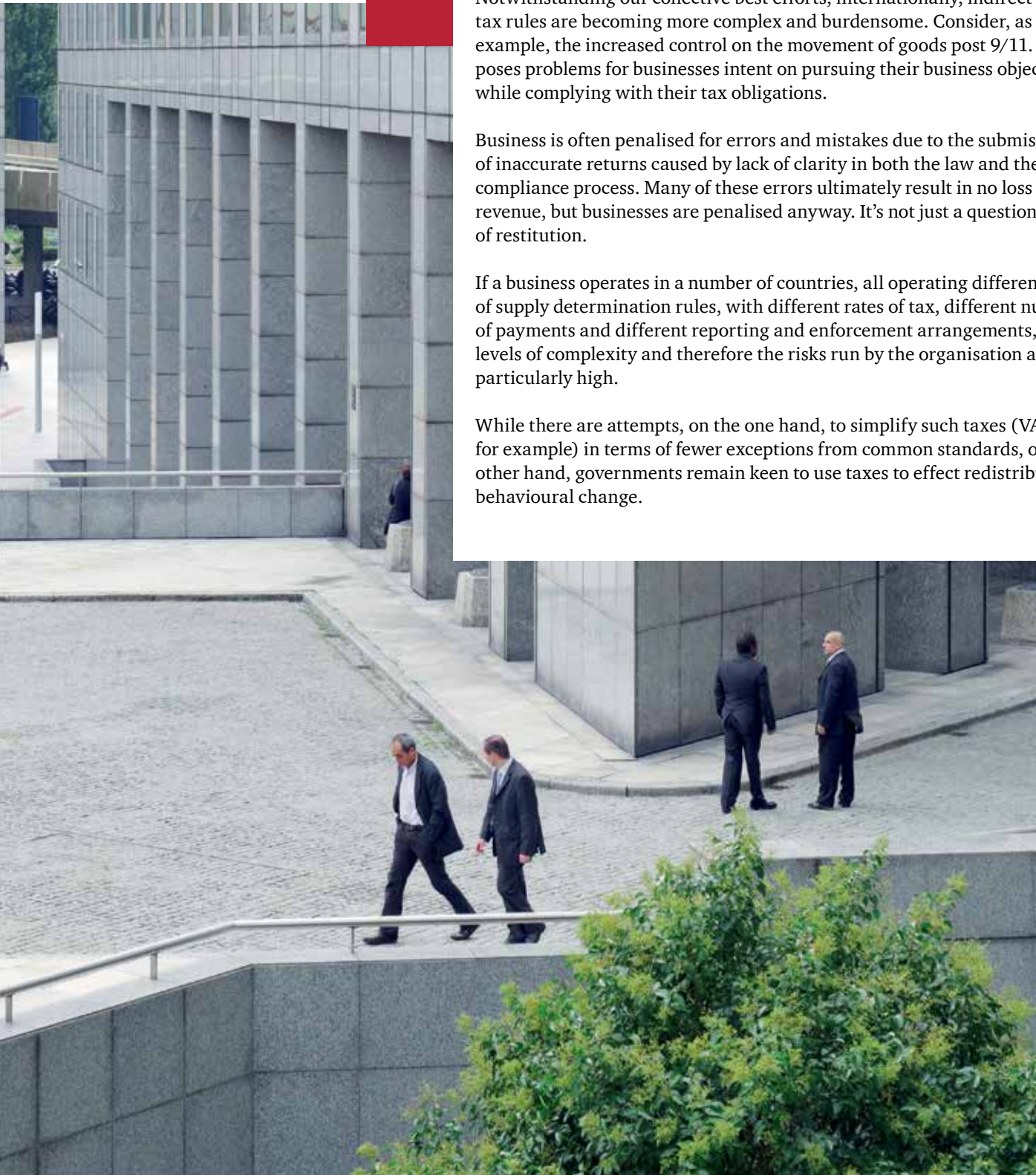
Complexity versus compliance

Notwithstanding our collective best efforts, internationally, indirect tax rules are becoming more complex and burdensome. Consider, as an example, the increased control on the movement of goods post 9/11. This poses problems for businesses intent on pursuing their business objectives while complying with their tax obligations.

Business is often penalised for errors and mistakes due to the submission of inaccurate returns caused by lack of clarity in both the law and the compliance process. Many of these errors ultimately result in no loss of revenue, but businesses are penalised anyway. It's not just a question of restitution.

If a business operates in a number of countries, all operating different place of supply determination rules, with different rates of tax, different numbers of payments and different reporting and enforcement arrangements, the levels of complexity and therefore the risks run by the organisation are particularly high.

While there are attempts, on the one hand, to simplify such taxes (VAT, for example) in terms of fewer exceptions from common standards, on the other hand, governments remain keen to use taxes to effect redistribution or behavioural change.



Let's talk

How can PwC help?

PwC's Global Indirect Tax (ITX) Network can help you address and resolve your company's challenges using strategic global planning and local tactical implementation.

We have an extensive global network of indirect tax professionals and have strong relationships with tax authorities and policy makers.

We take a multi-disciplinary approach to indirect taxes, integrating with our specialist industry networks. We have dedicated teams to co-ordinate our global client service and commit to execution within agreed timeframes. We use technology to deliver and connect with our customers.

The ITX Network works closely with the Tax Policy and Administration Network in helping you reach solutions that also take into account current trends and forward-thinking expertise. Our relationships and knowledge involving supranational bodies, policy makers, and tax administrations can help you gain valuable perspectives when managing tax controversy challenges.

For more information, please do not hesitate to contact the members of PwC's Global Indirect Taxes (ITX) Network and Tax Policy and Administration Network.

The details of the indirect tax leaders for each of the profile countries are included with the analysis on their respective country. For a full list of other indirect tax contacts, see www.pwc.com/itx

Otherwise the following members of the Tax Policy and Administration Network will be pleased to assist you.

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