Threat or strategic opportunity: the indirect tax story

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In brief

Tax is rarely out of the news these days, with hot topics such as how to tax the digital economy, US tax reform, State Aid, fair levels of taxation and employment status amongst some of the more headline-grabbing acts in recent times. However, away from the headlines for the most part, the world of indirect tax - value added and sales tax, customs and excise duties - has been constantly evolving and growing in importance over the last two decades. Now the accelerated tempo at which significant changes are enacted across the globe presents increasingly difficult challenges for businesses to manage.

At a high level, we see three distinct indirect tax trends:

- the growing importance of indirect taxes, and in particular VAT/GST, as a source of revenue within the overall tax mix
- significant challenges regarding the collection of indirect taxes on the continuously growing volumes of goods and services purchased online by private consumers from foreign suppliers, and
- the proliferation of new, technology-based, tax-reporting obligations implemented unilaterally at a national level, together with the automatic exchange of information between tax authorities.

This Bulletin elaborates on these trends and sets out three practical steps to help businesses control their indirect tax environment more effectively.

In detail

Three recent trends

Trend one: The growing importance of indirect taxes

The spread of VAT/GST continues apace with more countries either in the process of, or considering implementation. Beginning with France in the 1950s, VAT/GST systems have now been implemented in over 165 countries around the world, with Angola and Bahrain set to join the club in 2019. In other parts of the world - notably Brazil, India and China – significant VAT/GST reform is under way in order to improve enforcement, effectiveness and efficiency, whilst Brexit could have a major impact on the UK's VAT landscape in the years to come. At the same time, whilst the spotlight tends to focus on direct taxes, such as corporate tax, destination-based indirect taxes are increasingly being used in a number of different ways to generate additional revenue with businesses experiencing a marked increase in the number of audits, disputes, penalties, as well as aggressive challenges to VAT/GST recovery.

From a customs duty perspective, although many companies have not paid much attention to import duty rates given their steady reduction over the past few decades, the recent punitive tariffs of up to 25% in the China-US trade spat, as well as the potential introduction of a customs border between the UK and the EU, has put these types of indirect taxes very much back on the boardroom agenda.

Trend two: Taxation of the digital economy

It is evident that VAT/GST law has not kept up with commercial developments, particularly when it comes to how best to collect VAT/GST in the context of modern and rapidly digitalising supply chains. A particular area of focus right now is how to collect import VAT/GST on the supply of low-value goods facilitated by the internet. As of 1 July 2018, Australia has taken the bold step in imposing GST on the import of low-value goods, whilst New Zealand and Switzerland are proposing legislation for similar regimes to take effect in 2019. With significant complexity inherent in this area due to the wide variety of new and constantly evolving business models, as well as the interaction with customs law, the rest of the world is watching these developments with keen interest.

Online marketplaces and intermediaries are increasingly being held responsible for the VAT/GST due on transactions facilitated by their platforms. Whilst this provides a potentially neat solution from a government perspective (focusing their attention on a handful of big players rather than across the entire supply chain), in reality this will mean more compliance obligations for platforms, notwithstanding the fact that they may lack structured data as to the exact nature of the items sold, the value of the items and any subsequent price adjustments, as well as difficulties in identifying the place of supply if the platform is not responsible for distribution and delivery.

Tax policy concepts are also beginning to shift for other taxes as more transactions move online. In June 2018, the US Supreme Court's historic ruling in the South Dakota v Wayfair case changed the landscape of US sales tax collection for remote sellers, permitting states to replace the traditional concept of taxation linked to physical presence with taxation linked to economic presence (i.e., where consumption takes place) thus also allowing states to impose sales taxes on e-commerce routes to the US market.

Trend three: VAT/GST compliance and reporting

The pace and magnitude of business development has exposed glaring holes in the worldwide VAT/GST framework that governments are desperately trying to close. In addition, VAT/GST systems are susceptible to instances of fraud, since suppliers are in a position to collect tax from customers and then disappear without having passed on the customer's tax to the relevant authorities. In the EU alone, it is estimated that every year €50 billion is spirited away in such fashion by fraudsters. As a result, many governments around the world are taking unilateral administrative measures to assert greater control over their national VAT/GST systems, while also exchanging more data more often between each other.

VAT/GST practitioners are becoming familiar with an increasingly long roll call of different compliance obligations. There's real-time reporting, sales and purchase reporting, mandatory e-invoicing, standard audit file for tax (SAF-T), control statement, and split payment mechanism, to mention a few.

The 2019 Paying Taxes report prepared by PwC and the World Bank Group includes a case study comparing and contrasting Spain's SII real-time reporting system with Poland's SAF-T system. It's an interesting read and highlights the fact that there is no common regional or global VAT/GST reporting standard, and even SAF-T (originally conceived back in 2005 by the OECD) does not conform to a single standard. Every new reporting obligation requires new thinking and resources from businesses as to how to comply, and with greater volumes of information and advanced data analytics at their disposal, governments are now increasingly able to identify filing errors and impose significant penalties.

What can we expect next?

The speed and scale at which countries around the world are announcing changes to their VAT/GST systems in order to address these challenges is giving even the biggest and best-resourced businesses a serious headache. We anticipate a future move to consolidate and simplify the global indirect tax system using technology that will transform the collection of tax almost beyond recognition, and allow for even greater exchange of information between countries compared to the current patchwork approach; but we're not there yet. For now, the steady march of new regulation will leave businesses grappling with a proliferation of indirect tax compliance obligations. They will have to find ways to deal with the growing burden, in efficient and cost-effective ways that do not overly influence or inhibit their commercial aims.

Getting indirect tax right should be part of every business strategy and businesses are beginning to adopt increasingly sophisticated approaches to managing their indirect tax environment. However, it's probably fair to say that most senior business leaders are still not as engaged with indirect tax concerns as they are with corporate tax issues. This approach feels increasingly risky given the potential size and scope of exposure in this fast paced and constantly changing environment. A clearly defined approach to indirect tax mitigates the risk of costly errors and reputational damage as well as ensuring that companies have the right tax information at hand to inform their investment decisions. This is where the three-step plan comes in.

Three steps you might take

Step One: Knowing the impact of indirect tax

The first step is to understand the impact indirect taxes have on a company's revenues and profits so that they can become part of or, complementary to, the overall business strategy, rather than merely an unhelpful afterthought. Everything a company buys and sells, the way it structures itself and its supply chain, the location and status of its counter-parties, every entry into a new market (whether it's a new product or country), comes loaded with indirect tax implications. If you don't know the different rules in place for your specific product in each country to which you sell, or you don't have the right people, processes and systems in place to manage the different and increasing administrative burdens, controlling your indirect tax landscape is an incredibly daunting and nearly impossible task.

Subscription services such as PwC's Global VAT Online can help companies keep track of indirect tax regulations around the world on a daily basis. Other tools can help businesses calculate the total indirect tax under management in each country, model cash flow and actual indirect tax costs, identify potential areas for improvement or optimisation, and track the timing and status of filing obligations. The key to staying on top is to first map your indirect tax world and its impact, and then commit to understanding in real time what changes are coming your way and when.

Step Two: Clean data and processes

The second step requires more granular analysis. With a growing number of governments requiring businesses to transfer to them more and more indirect tax data with less and less delay, it is becoming a critical requirement for businesses to review and correct their data either before submission or, failing that, post submission with a view to quickly correcting errors and prioritising the resolution of systemic issues. Data analytics can help – tax authorities have been using them for a number of years and businesses are now in the position of playing catch up. The key to an effective tool, such as PwC's Data Ignition, is being highly flexible, capable of being tailored precisely to your business needs and focused on genuine errors and outliers, rather than offering too many possible avenues for investigation.

For many years, businesses have employed a just-in-time approach of implementing bolt-on IT solutions and patches to meet specific national VAT reporting requirements. This, for many, is proving an untenable approach due to the pace of change. More sophisticated companies are looking to deal with any immediate issues in parallel with a more holistic strategy and a vision to build a fully flexible and scalable reporting environment,that is more tech enabled, and that can adapt more easily to new obligations as and when they arise.

Many companies have also heightened their indirect tax risk by downsizing and outsourcing their finance function to shared service centres where an intimate understanding of the day-to-day functioning of the business is difficult to achieve at a distance. Accordingly, powerful data analytics allied to simple dashboards, reporting capability and reminders are critical to enable a business' often lean indirect tax function to have enough insight to stay in control.

Step Three: Strategic planning

Step three is to align the map of your indirect tax world with your data in order to make evidence-based decisions, not only to ensure that the right amount of indirect tax is paid in the right place and on time, but also to check that all of the necessary data is being captured and to inform business decisions about where to deploy resources and capital so as to minimise risk and maximise return on investment. No small task, but if the groundwork of mapping has been done, and the right data dashboards are in place, strategic planning becomes easier.

Navigating the transformation of the global indirect tax environment is a significant challenge for multinational businesses right now. As this period of change continues and even grows in intensity, businesses must be prepared for how this impacts their evolving models, operations, and structures. When it comes to financial planning and analysis, senior business leaders will be well served to ask the right questions about indirect tax. An indirect tax strategy that identifies the true cost of operations, and where possible keeps structures tax neutral, can make the difference between the successful execution of a business plan and outright failure, when unexpected indirect tax bills squeeze margins at best, or wipe out predicted profits and more at worst.

The takeaway

In response to three distinct indirect tax trends and upcoming changes, three practical steps may help businesses control their indirect tax environment more effectively:

- access to timely and reliable information to assess where taxes are due, together with their potential impact
- the use of advanced data analytics to continuously review liabilities and improve a business' strategy for meeting the growing number of compliance obligations, and
- strategic planning to determine how and where best to deploy resources and make informed investment decisions.

Let's talk

For a deeper discussion of how these issues might affect your business, please call your usual PwC contact. If you don't have one or would otherwise prefer to speak to one of our global specialists, please contact:

Stef van Weeghel, *Amsterdam*
+31 (0) 88 7926 763
stef.van.weeghel@pwc.com

Aamer Rafiq, *London*
+44(0)20 721 28830
aamer.rafiq@pwc.com

Pam Olson, *Washington*
+1 (202) 414 1401
pam.olson@pwc.com

Phil Greenfield, *London*
+44 (0) 20 7212 6047
philip.greenfield@pwc.com

Edwin Visser, *Amsterdam*
+31 (0) 887923611
edwin.visser@nl.pwc.com

Will Morris, *London*
+1 (202) 312 7662
william.h.morris@pwc.com

Dave Murray, *London*
+44 (0) 7718 980 899
david.x.murray@pwc.com

Jo Bello, *London*
+44 (0) 7843 326017
jo.bello@pwc.com

Daniel Anghel, *Bucharest*
+40 742 394 208
daniel.anghel@pwc.com