Never before has the tax department played such an integral role in the success of the business. Chief tax officers (CTOs) are expected to align tax with business goals, drive strategic value, increase transparency, and improve the efficiency of tax operations. KPMG LLP’s (KPMG) CTO Insights is designed to highlight top-of-mind issues for tax executives and ways CTOs are addressing these opportunities and challenges. We are confident that you will find the information in each issue of CTO Insights practical and actionable in demonstrating the value you and your department bring to your organization.
Global glare: International tax reform steals the spotlight

Recent conversation around tax issues in the United States is often dominated by the 2017 U.S. tax law, which introduced sweeping changes to the U.S. tax system and for which the implications are still playing out. However, CTOs in corporations across America are increasingly focused on managing another broad, pressing issue: global tax reform.

As countries around the world implement new taxes to lay claim to a larger share of tax revenue, global tax complexity has never been higher.

The most significant force driving widespread changes to the global tax landscape is the base erosion and profit shifting (BEPS) initiative of the Organisation for Economic Co-operation and Development (OECD). Among its BEPS initiatives, the OECD is seeking a unified approach to address the tax challenges presented by the impact of the digital economy. The organization’s inclusive framework—made up of more than 130 countries—is grappling with the fairest way to tax increasingly important digital value creation streams, from e-commerce to online advertising, but the work has broadened significantly and is likely to impact many industries that are not considered “digital.” The goal is to tax profits appropriately and increase certainty for taxpayers by allocating a larger share of profits to market jurisdictions, thereby changing the historic way taxes have been apportioned across the globe.

The target date for recommendations is currently set for the end of 2020 but the work to define the technical details will likely stretch another year. The OECD must also reach a multilateral agreement on the creation of a consistent process for dispute resolution—a process that could last another few years. Given the extended timeline, numerous individual governments are implementing their own unilateral rule changes even as the OECD seeks a long-term solution.

The uncertainty throughout the global tax system—particularly related to the digital tax debate—is increasing the tax risk—and therefore the significance and workload of the tax department—of nearly every U.S. company, not just those in the technology industry. To a certain extent, most companies today are digitized, whether they sell products online, make products containing digital components, or process digital transactions.

As current digital tax proposals are finalized, these or many other digital activities may affect the tax status individual of companies, potentially increasing the jurisdictions in which they are subject to tax, their tax liabilities, and their financial reporting burden. Indeed, even companies that have a physical presence only in the United States may be affected, if they have sales in other jurisdictions. In an ideal world, major tax department decisions—from tax planning to investments in technology and talent—would be influenced by the impact of digital tax proposals on the business. However, given the lack of details and fast pace of new developments, many CTOs lack a true grasp of how exactly their organization will ultimately be impacted, let alone the appropriate response or concrete next steps.

Though still in the proposal stage, tax department activities are already ramping up to manage the challenges of the digital tax debate. As governments seek ways to more effectively collect income tax from multinational businesses, tax departments are spending growing dollars and manhours collecting and coordinating data to meet dramatically expanded disclosure requirements in each of their markets and jurisdictions.

To deal with the growing operational load on the tax function, CTOs take a variety of approaches. Some partner with regional tax advisers who understand the ins and outs of local rules and can help manage country-specific compliance. Others locate certain teams of tax specialists, such as transfer pricing, in specific regions where costs are lower or expertise is higher. Another approach is developing a robust relationship with a large global firm that can help manage tax work in all markets, rather than managing myriad small relationships in different countries. Regardless of how they structure the global tax function, most CTOs see the value in implementing a common technology infrastructure to achieve a level of consistency across jurisdictions.

Many CTOs are also focused on engaging with the OECD to ensure the voices of businesses are heard as it works through various proposals—often operating independently of peer companies. In debates around tax policy change, individual voices speaking to individual organization challenges tend to carry more weight because they are more specific and nuanced.

Many CTOs are particularly concerned with the unclear scope of a key rule relating to the reallocation of profits.
Recent proposals indicate the reallocation rule will focus on capturing profit associated with revenue from customers, created through direct business-to-consumer (B2C) activities. For organizations that sell to both other businesses (B2B) and consumers, separating these transactions for financial reporting would be a substantial undertaking. In addition, the proposal seeks to include sales by third-party distributors, such as licensees and vendors which interact with the customer on behalf of the company in allocating profits of a company to market jurisdictions.

Questions to consider

— How are you keeping track of potentially transformative changes to the global tax system?

— How are you preparing for evolving digital tax rules and proposals that might apply to your business?

— How will you structure the global tax function to manage more complexity and a broader scope of work?
Official rules for the taxation of the digital economy are still very much in flux, as are other reforms to the global tax system. Yet tax authorities in many jurisdictions aren’t waiting for certainty to take action.

From the United Kingdom to Australia to Korea, many government auditors see the expansion of traditional tax regulations to digital business models as a prime opportunity to collect previously missed tax revenue and are moving digital tax issues to the top of the agenda. Given the country-by-country push to capitalize on rules created to correct tax base disruption, any company with multinational operations could potentially catch the eye of tax authorities. Digital retailers and online advertisers are especially at risk. These sectors are clearly in scope of most digital tax proposals. Equally important, they have also performed well of late: growth in these sectors translates to revenue-raising opportunities for tax authorities.

A key area of focus for many CTOs is the increasing number of aggressive audits seen around the globe. In the past few years, the number of audits initiated and the level of scrutiny of audits have both increased. Officials are asking for more detailed and sensitive materials and documentation. Once an audit is under way, requests for information tend to pile up one after the next. Sometimes, they come out of the blue, requiring companies to scramble to respond.

Complicating matters is the increased collaboration of national auditors. Countries are becoming much more coordinated in delivering tax assessment. In many cases, they have more information than individual companies due to country-by-country reporting and the European Union’s mandatory disclosure rules. When jurisdictions share information with other countries, tax authorities are able to draw broad conclusions and make general determinations about a company based not only on reported company information but also on market data and industry comparisons. This puts pressure on companies to respond to auditors more quickly than before, particularly if they leverage inconsistent tax strategies across the organizational structure.

With tax audit activity on the rise, controversy management is gaining attention of tax leaders. Many CTOs are transforming the global tax department to work more effectively with tax authorities and respond to audits. A key priority is presenting a single narrative to tax authorities. To meet the need for better access to global information, many CTOs are centralizing tax operations. CTOs are also focused on strengthening relationships with tax authorities proactively. One approach is to enhance the knowledge and experience of the people who interact closest with auditors. For example, some CTOs have taken away certain nonvalue-adding compliance responsibilities from regional tax heads so they can better focus on controversy.

Most CTOs accept that the organization will concede a certain percentage of each year’s margin to tax authorities and plan ahead for it. However, sometimes CTOs evaluate the costs of accepting new measures from tax authorities and conclude that litigation is the right path forward. While litigating tax controversies takes significant resources, the potential negative impact of particularly aggressive terms might tip the scales in its favor.

And often, the decision to litigate isn’t solely a financial calculation. Rather, it is driven by the desire to avoid agreeing to future precedents that could incrementally drain resources in a jurisdiction going forward. For example, the monetary cost of compliance with country-specific information requests that result from an audit may be immaterial. However, if agreeing to concessions just to resolve an audit sets an undesirable precedent, it may be in the company’s interest to fight back—especially if the authority is very resolved to get a return and unwilling to compromise.

Of course, litigation has limits. Given resource constraints, it is simply not possible to take every case to court, especially when litigation can often last for years. To proactively manage the costs of tax controversy litigation, most CTOs budget a certain amount for court cases. If cases drag on for longer than expected or rack up higher than expected costs, some organizations pass on any expenses that exceed the budget to foreign affiliates, who decide whether to pay to keep the case going. Others give senior executives the option to settle or continue to fund the fight.
Questions to consider

— How will you prepare your global tax function to manage increased audit activity?

— How will coordination between tax authorities impact your approach to controversy management?

— How will you determine which new tax measures to litigate and secure funding for that litigation?
For further information
Explore the resources below for deeper insights on the topics in this edition of CTO Insights.

Topical resources

Global Tax Reform
Get insights about the implications of BEPS and tax transparency on multinational companies

Tax Challenges of Digitization
Evaluate the potential impact of proposed reforms on the taxation of the digital economy

In Dispute Podcast
Stay abreast of the latest news about tax dispute issues with this KPMG podcast series

For previous editions of CTO Insights, please visit read.kpmg.us/cto-insights

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