KPMG

CTO Insights - Issue Spotlight

Digital taxation: International focus, individual doubt

September 2019

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.

Digital tax debate in full swing

When it comes to tax planning, a major challenge facing CTOs is uncertainty regarding how the international tax rules will change to address the digital economy, as governments are discussing proposals that would change the allocation of profits for all companies, regardless of how digital.

The digital taxation debate stems from a side effect of the growth of the digital economy: tax base disruption. In many businesses, digital activities such as e-commerce, data-driven analytics, and digital marketing are key drivers of profit. But some governments think that the existing international tax framework—in which businesses are taxed based on the physical location of offices and facilities—does not adequately address some business models that can create value in markets where they are not physically present. As a result, governments worldwide are seeking to change how they have traditionally taxed businesses to better reflect how value is created in today's digital world.

While general agreement exists that the current international tax rules should be changed, there is no simple solution. As the Organisation for Economic Co-operation and Development (OECD) seeks a long-term, multilateral solution by the end of 2020, individual tax authorities—including France, the United Kingdom, and some 25 other countries—have enacted, or are considering unilateral actions, creating myriad short-term measures.

This lack of consensus and absence of formal guidance is making it difficult for CTOs to move forward with effective, proactive tax planning. Questions about how changes to existing rules will unfold—on a country-by-country basis and across the international tax system—are causing CTOs to lose confidence in their long-term forecasts and become hesitant to carry out planning opportunities.

All companies affected

But in all likelihood, change is coming, and CTOs must be prepared. Changing international tax laws are poised to increase tax costs and compliance burdens for nearly every industry and company—not just the most obvious players.

The technology industry, namely e-commerce companies and online platforms, is most commonly associated with the digital tax debate. However, digital taxation doesn't only apply to technology companies. Today, nearly every business has "gone digital." Manufactured products are full of digital components. Brands are built on the backs of online advertising and social media. Financial transactions are completed over the internet. Employee teams collaborate virtually. Supply chains are digitized.

That being said, the exact tax status of individual companies isn't always clear. Digital retailers, platforms, and advertisers are in-scope for most current digital tax proposals. But it is less certain whether other types of businesses—such as those that embed digital components in nondigital products, offer cloud-based business services, or process digital transactions—are subject to new taxes, let alone where or how much.

Progress toward a multilateral consensus

On an international level, the OECD recently adopted a work plan to develop a multilateral consensus solution that focuses on two pillars. The first pillar will explore solutions that grant countries taxing rights even if a company did not have a physical presence and may allocate greater profits to jurisdictions where customers are located. The second pillar will pursue changes to the design of the international tax system to ensure cross-border arrangements bear a minimum level of tax.

CTOs are now focused on understanding how global action taken across these broad pillars may ultimately affect their companies. They are also concerned about the impact of the OECD agreement on conflicting unilateral digital tax laws in single jurisdictions. For example, CTOs question if current digital services taxes that have been implemented in a number of European countries will be repealed once consensus is reached on broader global tax policy. Likewise, they wonder if new federal tax provisions under U.S. tax reform (for example, the "GILTI" and "BEAT" provisions) will ultimately be amended to align with global decisions regarding how to tax the digital economy.

Tax audit activity on the rise

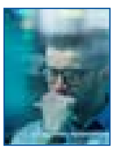
Despite continuing uncertainty on international plans for digital taxation, it is a key focus of certain tax authorities.

With many tax authorities seeking to increase revenue, CTOs note a rise in audit activity in industries which have a digital element and have also experienced high growth margins in recent years, such as the technology sector. As tax authorities move digital tax issues to the top of the agenda, CTOs say their businesses can be mischaracterized as taxable digital business models based on the digital activities their companies undertake or the intangible digital assets they hold.

To reduce this risk, many CTOs are engaging with policymakers through their organizations' government affairs and lobbying functions as well as external industry groups. The goal is to find clarity about where their businesses fit within current definitions and, therefore, what new taxes they legally owe. Many CTOs are also reviewing the digital portions of their businesses to determine what strategic and operational changes might reduce their tax footprint long-term, once consensus is achieved and global rules are formalized.

For further information

Explore the resources below for deeper insights on the topics in this edition of *CTO Insights*.

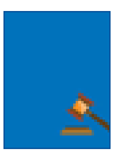


Tax Challenges of Digitization

Insights about the potential impact of proposed reforms on the taxation of the digital economy.

KPMG's international tax reform analyzer

Helping tax functions model the potential impact of the new U.S. tax legislation.



KPMG's Global Tax Disputes Benchmarking survey

The survey takes an in-depth look at the issues faced by those in charge of managing their company's tax disputes, and the processes, practices, and resources they have in place to meet these challenges.

Questions to consider

- How do unilateral digital tax laws affect your organization's taxable income?
- How are you tracking developments in the worldwide digital tax debate?
- How are you accounting for evolving digital tax proposals during tax planning?
- Should tax rules for the digital economy be determined globally?

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

Follow KPMG's U.S. Tax practice on Twitter @KPMGUS_Tax

Contact us

Jeff LeSage
Americas Vice Chairman, Tax
T: 212-872-2100
E: jclesage@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia