Surviving regulatory and policy change in indirect tax

Getting down to business with indirect tax

KPMG International

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Value-added taxes (VAT) are now in place in 160 jurisdictions, and many of these countries are increasing their reliance on VATs as a revenue source by increasing rates, broadening the tax base and enhancing audit and compliance functions. For international companies with large transaction volumes and high VAT throughput, managing indirect tax compliance amid rapid global regulatory change may seem overwhelming — but their company's profitability, or very survival, can depend on it.

Help is at hand. This article aims to show indirect tax leaders how they can deal with rapid regulatory change by putting in place a practical framework to predict, assess, manage and influence it.

Complexity spirals as reliance on VATs rises

Taxes on general consumption raised an average of 20.2 percent of total tax revenue in member countries of the Organisation for Economic Co-operation and Development (OECD) in 2012 (compared to 11.9 percent in 1965). Of this amount, VAT accounted on average for 19.5 percent of total tax revenue.[1] As governments increase their reliance on VATs for higher proportions of revenue, a number of forces are at the same time increasing complexity and driving regulatory change:

— Tax authorities are enhancing the revenue-raising capacity of VATs by stepping up efforts to improve VAT compliance and combat fraud and avoidance.

— Growing global trade and rising cross-border flows of goods and services are significantly complicating indirect tax compliance.

— Advancing technologies and disruptive business models (e.g. UBER, Airbnb) are creating uncertainty over how existing VAT rules apply and whether governments will respond with regulatory change.

— International tax regimes worldwide are being amended as countries implement the recommendations arising from the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS), with significant implications for VATs. Examples include: requirements for non-resident suppliers to account for VAT on supplies of e-services made into a country; changing concepts of permanent establishment, and; differing VAT registration thresholds (see the related article by KPMG's Global Indirect Tax Services, *Don't underestimate BEPS' impact on indirect tax*).

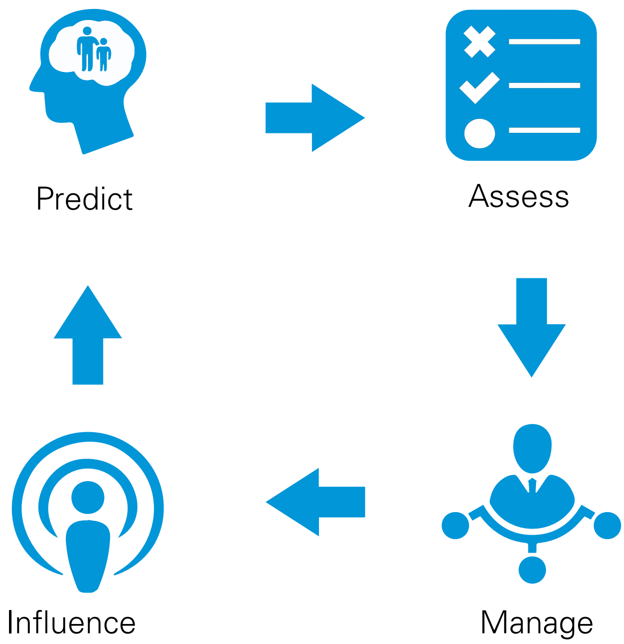
— In some jurisdictions, notably the European Union, the difficulty of amending VAT legislation creates uncertainty as emerging case law increasingly prevail over current law.

Dealing with regulatory change: a practical framework

— Indirect tax regulations are rarely static, and, in light of the above forces, it seems likely that companies will be dealing with considerable regulatory flux for at least the next several years. In this reality, indirect tax managers cannot afford to fall behind or risk being blindsided. Based on experience helping companies worldwide cope with changing VAT and other laws, indirect tax professionals with KPMG's network of member firms advise taking a proactive approach by developing processes to enable four key activities:

1. predicting regulatory change
2. assessing the impacts
3. managing the impacts
4. influencing regulatory change.

[1] Organisation for Economic Co-operation and Development, Consumption Tax Trends 2014, at p. 9.



Source: KPMG International, 2016.

1. Predicting regulatory change

You don't need a crystal ball to predict some regulatory developments. Changes arising from case law, government consultations, fiscal regime changes and the activities of lobby groups usually come with some amount of warning and lead time. But other developments can occur at random, brought on by unpredictable events like media leaks, whistle-blowing, incidents of fraud and avoidance, changing trade flows and technological disruption.

Indirect tax leaders of international companies cannot possibly cover all the bases for predicting regulatory change. But you can take steps to ensure you are aware of pending change as early as possible.

One step is to ensure you understand and monitor the long-term triggers of regulatory change that are relevant to your business. These include policy statements by politicians and officials, tax court proceedings, trends in VAT law that are mimicked from country to country, and proposals on your particular industry's agenda.

A second step is to set up a network of 'spotters' and 'catchers'. 'Spotters' can include an internal group of indirect tax, finance and other professionals across the business who gather regularly to discuss what might be on the horizon and brainstorm potential responses. External spotters include professional advisers, lobby groups and industry associations, and your indirect tax peers in competing companies. 'Catchers' can be appointed to filter information and flag potential change as part of their specific role.

Building a strong bellwether network can vastly reduce the potential for surprises and give you more time to assess your response to change. As we'll see later in this article, this network will also be crucial to your ability to influence change before it occurs.

2. Assessing the impacts

Once potential or pending regulatory changes are identified, their potential impacts need to be assessed. Impacts should be assessed in both quantitative and qualitative terms:

- **Quantitative impacts** include effects on systems and compliance costs, margins and forecasts. This part of the evaluation should be led by the finance function, using financial modeling to capture and assess all impacts across the value chain.
- **Qualitative impacts** include effects on employees' work load, compliance risks (e.g. potential for errors) and the market (i.e. customers, competitors). The indirect tax team should lead this part of the evaluation, ideally in collaboration with other affected functions, such as sales, procurement, and legal teams.

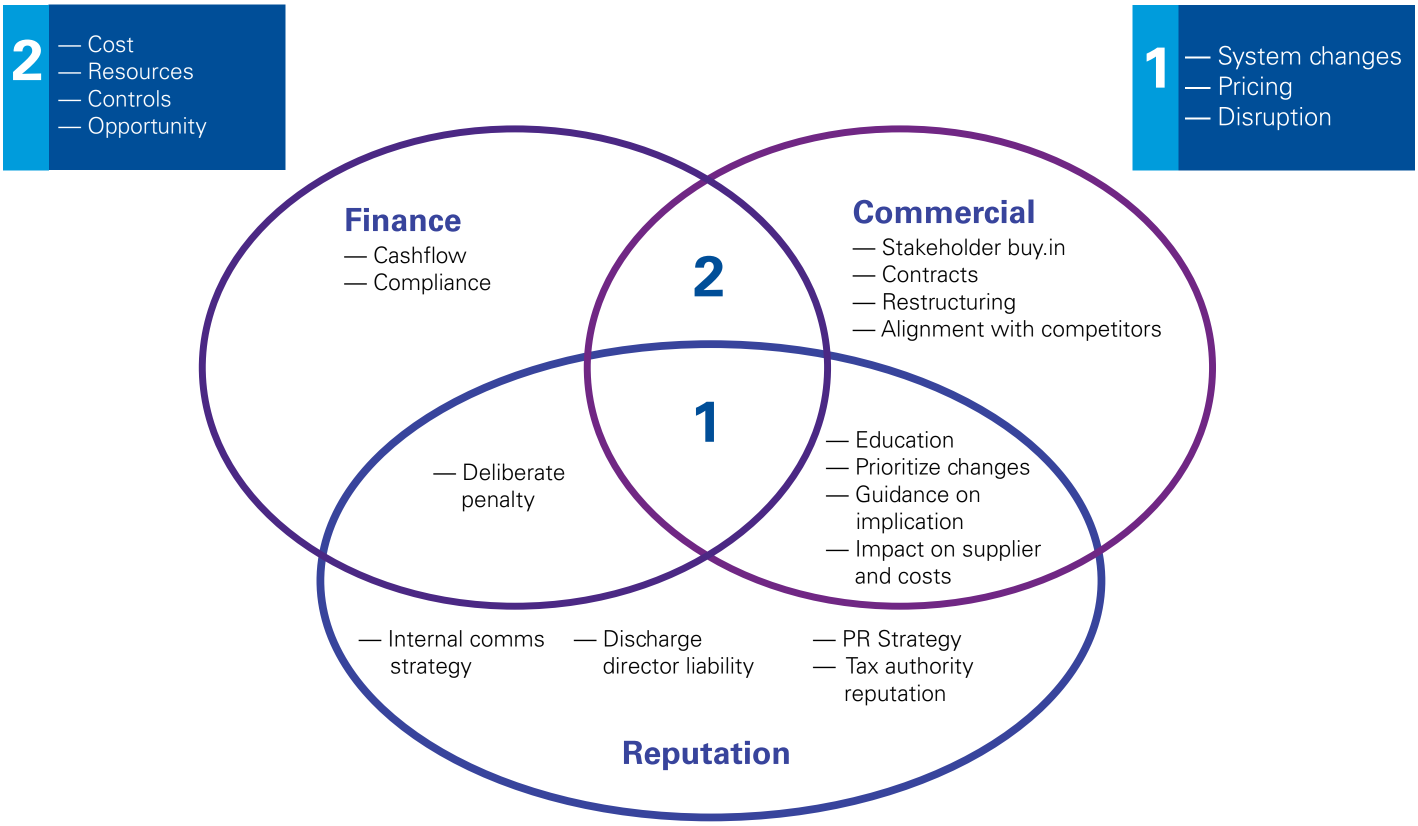
Regulatory change will have different and varying degrees of financial, commercial and reputational effects, and it is useful to begin evaluating potential issues through these lenses:

- **Financial impacts:** What is the impact of the change on cash flow, resources and compliance processes? These impacts are primarily quantitative.

— **Commercial impacts:** What does the change mean for products and services in the market? Could it make a product or service more or less competitive — or no longer viable? Are the terms of contracts with suppliers or customers affected? These are a mix of quantitative and qualitative impacts.

— **Reputational impacts:** How could the change affect the company's relationships with employees, suppliers, customers and the tax authorities? To what extent would non-compliance create reputational costs? Could the change create liability issues for directors? These impacts are primarily qualitative.

Once qualitative and quantitative impacts in these three areas have been evaluated, the next step is to plan potential responses. For greater efficiency and effectiveness, responses for all three areas of impact should be reviewed together to determine where responses overlap.



Source: 2016 KPMG Global Indirect Tax Forum.

Responses to financial and commercial impacts of regulatory change can entail changes to cost structures, resource needs and sourcing models. Responses here can also involve taking advantage of any opportunities, for example, to develop or reengineer products, renegotiate contracts or restructure the supply chain.

Responses to commercial and reputational impacts often involve training staff, educating affected business functions and communicating with customers and suppliers. Where responses to financial and reputational impacts intersect, a cost-benefit analysis may be needed to determine priorities. For example, the financial costs of complying with a change may be so high that the company may decide instead to accept penalties.

Responses common to all three areas include company-wide systems changes, price restructuring or actions to address business disruption.

3. Managing the impacts

Once you have determined the impacts of regulatory change on your organization and how you will respond, it's time to assemble a cross-functional team to put the responses in place. The response team's first task should be to develop a comprehensive project plan, setting out key deliverables, milestones and timelines.

The team should then decide how to communicate the plan to internal and external stakeholders, including affected staff members, customers and suppliers, and tax authorities. The plan should also call for regular updates for stakeholders as the project progresses.

The team would then take charge of executing the plan and, once completed, conduct a post-mortem evaluation, along with ongoing monitoring and follow-up.

4. Influencing regulatory change

In addition to mastering your organization's responses to regulatory change, you can also work to help shape these changes in ways that benefit your business and industry or at least mitigate any potentially adverse effects. In setting your processes for predicting regulatory change, you should already have a good understanding of the long-term triggers of regulatory change that are relevant to your business. Now, you can begin using this knowledge strategically to ensure your organization's business issues are taken into account and bring forward potential solutions for consideration.

For example, in response to the OECD's BEPS consultations on electronic commerce and cross-border transactions, the OECD received responses from over 60 potentially affected businesses. These submissions went a long way toward ensuring the OECD's final recommendations in the area took practical business considerations into account.

You can build your indirect tax function's strength in influencing regulatory change by:

— tapping your network of spotters and catchers to keep up with opportunities to contribute your views to lobbying efforts, working groups and government consultations

— joining similarly affected organizations in lobbying groups and forums or, if no such group exists, by creating your own group or forum dedicated to influencing change

— developing collaborative working relationships with government and regulatory officials by taking time to understand their positions and by contributing your industry knowledge and experience

— determining whether you would be better positioned by entering a change dialogue early in the process or by watching and waiting (e.g. for formal consultations) to gain more information about the issues being considered and how things may unfold

— knowing how to pick your battles so you do not put undue time and energy into efforts that are unlikely to succeed

— supporting your positions and recommendations with strong, objective evidence, such as lessons from other jurisdictions or detailed economic analyses that model a change's potential impact.

Setting up and maintaining a framework for dealing with regulatory change can do a lot more than avoid having regulatory change catch you off-guard. It can also help your indirect tax function preserve and enhance value by giving you a complete view of a change before or as it occurs, how the change affects the financial, commercial and reputational aspects of the business, and what would be the most efficient and effective ways to respond. And by getting involved with the people, institutions and processes that drive and define regulatory change, you might be able to help shape new indirect tax rules and regimes in ways that contribute to your company's long-term success.

Contacts

Tim Gillis
Head of Global Indirect Tax Services
Partner
KPMG in the US
T: +1 202 533 3700
E: tgillis@kpmg.com

Author

John Bain
Regional Leader, Americas Indirect Tax
Partner
KPMG in Canada
T: +1 416 777 3894
E: jbain1@kpmg.ca

kpmg.com

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Designed by Evalueserve.
Publication name: Surviving regulatory and policy change in indirect tax
Publication number: 133702-G
Publication date: October 2016