Global indirect tax outlook

2017 and beyond

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While businesses are well-versed in dealing with indirect taxes such as value added tax (VAT) and goods and services tax (GST), they face new challenges as economic, political and technological forces drive rapid changes in indirect tax regimes around the world.

As we look ahead to the remainder of 2017 and beyond, we expect the pace of global indirect tax reform to continue unabated, in light of impending and prospective VAT/GST reforms, potential impact of customs and trade developments, and the influence of technology on both indirect tax policy and compliance.

Long-awaited reforms will finally arrive

We anticipate a raft of long-awaited indirect tax reforms will be implemented in a number of jurisdictions in 2017 and 2018.

Among them, a nationwide GST system will be implemented in India, currently expected to be effective on 1 July 2017. Under this reform, GST will apply both at a federal and state level to transactions within each state, and an integrated GST will apply to imports and inter-state transactions.

This new GST regime will replace most of the existing federal and state indirect taxes and it is expected to bring uniform tax rates and provisions to simplify the compliance requirements across the country, supported by automated systems and processes. It is expected that five different rates of GST will exist under the new system, ranging from a 0 percent rate to a 28 percent rate, for different types of goods and services. A surcharge on top of the 28 percent high rate will also apply to certain luxury and 'sin-tax' products, such as high-end cars and tobacco. We foresee that the very short lead-in time will pose a significant challenge for businesses.

Meanwhile, the Gulf Cooperation Council (GCC) countries of Saudi Arabia, Qatar, Oman, United Arab Emirates, Bahrain and Kuwait will introduce a harmonized VAT system in 2018. Historically, there has been no VAT/GST in this region, but VAT is being adopted to provide more reliable and diverse sources of revenue and to reduce the region's dependence on oil incomes. The GCC VAT framework was published in the Saudi Arabia Official Gazette in April 2017 and each country's own VAT laws will be based on the requirements set in the framework. The GCC VAT arrangement is expected to be similar to the EU system, with VAT (at a rate of 5 percent) applying to most goods and services, with certain exemptions. Tax authorities and businesses with operations in the region are gearing up for this significant reform.

For more information on GST reform, please visit: kpmg.com/IndiaGST.

For more information on the introduction of VAT in the GCC region, please visit: kpmg.com/MESATaxCenter.

The debate on potential reforms will continue

While reforms in India and GCC will take effect shortly, other potential indirect tax reforms are still being debated and therefore should provide longer lead-in times.

For example, the European Commission published its VAT Action Plan in 2016, which provides a roadmap for modernizing the European Union's (EU) current VAT system. Detailed legislative proposals have already been published in relation to business-to-consumer (B2C) online sales of goods and services, which if adopted would principally take effect in 2021. There is also a proposal to reduce VAT carousel fraud by extending the scope of the VAT reverse charge accounting mechanism on domestic transactions in certain countries. The European Commission is due to publish further legislative proposals throughout 2017, including ones relating to reduced VAT rates and the VAT regime for small and medium enterprises (SME). Perhaps most significantly, they intend to propose a definitive regime for the taxation of business-to-business (B2B) intra-EU sales. These proposals generally require unanimous approval by the EU member states before they are adopted. This is notoriously difficult to achieve and therefore, the practical implementation of most proposals is likely to be some years off. However, there is clearly appetite in Brussels to drive the reform agenda.

US tax reform is also firmly on the agenda. Some key Republicans in the House of Representatives have proposed replacing the current corporate income tax regime with a so-called destination based cash flow tax (DBCFT). Although this proposed reform would apply to US companies' corporate income tax position, the proposed DBCFT would have some similarities to a VAT, which taxes imports and relieves tax on exports. However, unlike a VAT system, US labor costs incurred in producing goods and services would remain deductible as under a corporate income tax. If pursued by the US government, this reform is likely to spark scrutiny of its permissibility under World Trade Organization (WTO) rules.

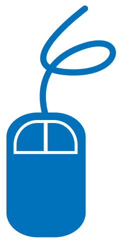
For more information on the outlook for US tax reforms, please visit: kpmg.com/us/tax-reform.

Businesses must prepare for global supply chains disruptions

Many businesses have developed their international supply chains on the assumption of a liberalized trade model. However, this assumption may be challenged in the coming years in a number of regions.

Following the United Kingdom's (UK) vote in 2016 to leave the EU, the UK triggered the official start of the exit process on 29 March 2017. The Brexit negotiations over time will determine the UK's future trading relationship with the remaining EU member states. Once Brexit is complete, sales of tangible goods between the UK and the EU could require customs formalities, and could incur additional duty expenses and VAT cash flow costs. Also, the UK could possibly no longer automatically benefit from existing trade deals with other countries and may have to negotiate its own trade accords. These negotiations will be closely followed around the world.

To stay on top of the latest Brexit conversations, please visit: kpmg.com/brexit.



In the US, the potential impact of tax reform on global trade will also be intensely monitored and could cause companies to fundamentally re-examine their supply chains. While a US withdrawal from the North American Free Trade Agreement (NAFTA) seems unlikely, US President Trump's administration appears firmly committed to renegotiating the terms of NAFTA, with its primary focus on Mexico. Shortly after taking office, President Trump also announced the US withdrawal from the Trans-Pacific Partnership (TPP) discussions, indicating a preference to instead negotiate terms with specific countries. The void created by the US withdrawal from the TPP, however, appears to have encouraged China and other countries to liberalize trade and investment around the world, especially in the Asia-Pacific region.

Technological change will drive indirect tax reform

Current VAT/GST rules often predate recent technology developments and the rise of new disruptive business models, and lawmakers are now playing catch up.

In 2015, the Organisation for Economic Co-operation and Development's (OECD) International VAT/GST Guidelines proposed that all services should be taxed in the country where the customer is located. This is particularly relevant to digital services and intangibles, which are frequently sold across borders. Under this model, non-resident vendors (or in some case the platforms through which they operate) may be required to register for and charge local VAT/GST particularly on B2C sales.

The EU already applies VAT on B2C supplies of telecommunications, broadcasting and digital services in the place of consumption, regardless of the supplier's location. In recent months, countries such as India, New Zealand, Russia, Taiwan and Serbia have implemented similar rules. Australia will also do so in 2017, while other jurisdictions are considering comparable rules.

The digital era poses challenges to implement VAT/GST on tangible goods, which are increasingly sold on-line and shipped across borders to consumers. Historically, many countries allowed consumers to import goods below a certain value, without payment of local VAT/GST. However, many countries are considering removing these low value reliefs to help create a level playing field between domestic brick-and-mortar vendors (who must apply VAT) and foreign online vendors. For example, Australia will likely apply GST on low value imports of goods effective 1 July 2017. The EU has also proposed removing the low-value VAT relief for imports into the EU, which if adopted, could take effect in 2021.

While introducing local tax obligations on non-resident vendors is one thing, enforcing them is another. With this in mind, we expect to see more administrative cooperation agreements between countries aimed at collecting VAT/GST. Tax administrations will also look more closely at imposing VAT/GST collection obligations on online retailers, sales platforms and logistics companies involved in the sale and delivery of goods and services.

Technology will transform indirect tax compliance

Technological developments also allow tax authorities to change the way they collect and enforce a tax. Traditionally, a business prepared and filed regular paper-based VAT/GST returns, based on printed invoices issued and received by the business. Tax authorities carried out infrequent and time-consuming paper-based audits to ensure compliance.

This historic model of VAT/GST compliance is changing. In recent years, many countries have adopted electronic VAT/GST filing and payment requirements, and have accepted the increasing use of electronic invoicing. These developments help modernize compliance and have been largely welcomed by businesses. We expect this trend to continue. However, having access to electronic data allows tax authorities to carry out much more effective reviews of a taxpayer's VAT/GST compliance position. For example, some Latin American countries have implemented mandatory e-invoicing, where e-invoices are verified and certified in real time by the tax authorities. The roll-out of these rules will likely continue in Latin America and is under consideration in many other countries.

Technological change has also given tax authorities the impetus to require more frequent and in some cases, real time reporting of VAT/GST. This enables tax authorities to know when a transaction takes place and how it is being treated. For instance, with effect from 1 July 2017, certain Spanish taxpayers will be required to electronically report specific sales and purchase invoices within four days of issue and maintain their VAT books and records on the tax authority's website.

Tax authorities increasingly use technology and data and analytics (D&A) techniques to improve their audit capabilities. To assist with this, some countries require taxpayers to maintain their records in specific data formats such as the standard audit file for tax (SAF-T). This new requirement may also trigger the submission of specific SAF-T reports in addition to traditional VAT returns, resulting in an increased compliance burden for business.

As a consequence of these developments, VAT reporting is no longer solely a matter for the tax or the finance department in a business. It now also requires focused involvement by the IT department. Finance systems and tax engines must be adapted to these new requirements and controls put in place to identify tax determination and reporting errors.

Staying apprised of tax reforms to enable a coordinated business response

While this summary of current and pending policy changes provides a flavor of the indirect tax landscape, further changes to indirect tax regimes across the world are inevitable. Despite the uncertainty these proposals may at first create, well-prepared businesses can weather the winds of change. To do so, they should remain alert to the current trends and stay well informed of the potential impacts of unfolding developments. By closely aligning their internal teams and functions around the necessary implementation steps, businesses can be well-positioned to respond, adapt and potentially gain advantage from the reforms of 2017 and beyond.

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Designed by Evalueserve
Publication name: Global indirect tax outlook: 2017 and beyond
Publication number: 134362-G
Publication date: May 2017