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How to Keep Up With New Complexities in Tax

WHITE PAPER

Pressures on the tax function are everywhere, and they are growing in number and intensity. Here's how tax professionals should respond.

New tax compliance challenges are unavoidable, and the pace of change is only accelerating. Consider what is happening at a macro level that produces massive and unending complexity for tax departments:

- Commerce is increasingly global, with supply chains and business models transcending physical borders.
- Political winds have prevailed in the direction of protectionism, and nobody knows where they will stay on that course and accelerate, versus where they will snap back and blow in the opposite direction.
- Technology has evolved to a point where automating many manual or repeating business processes is not just possible — it is now expected.

One noteworthy consequence of all of this is that tax authorities are being pressed from multiple angles. Not only must tax authorities help fund the operations of their jurisdictions and maintain a regulatory and enforcement approach that is fair, consistent, and predictable, they must strive to achieve a sensible balance between these two sometimes-dueling objectives.

In certain cases, it is becoming easier for tax authorities. Some countries have moved or are moving to the real-time reporting of indirect tax, which helps their tax authorities regulate and enforce indirect tax policy fairly and quickly. In the United States, a new legal precedent (*South Dakota v. Wayfair*) gave new power to tax authorities to enforce tax collection on online sales.

This is an example of a shift that is a positive development for tax authorities, but one that does not do much to simplify how tax departments can achieve compliance, scale operations, and deliver deeper value to their businesses.

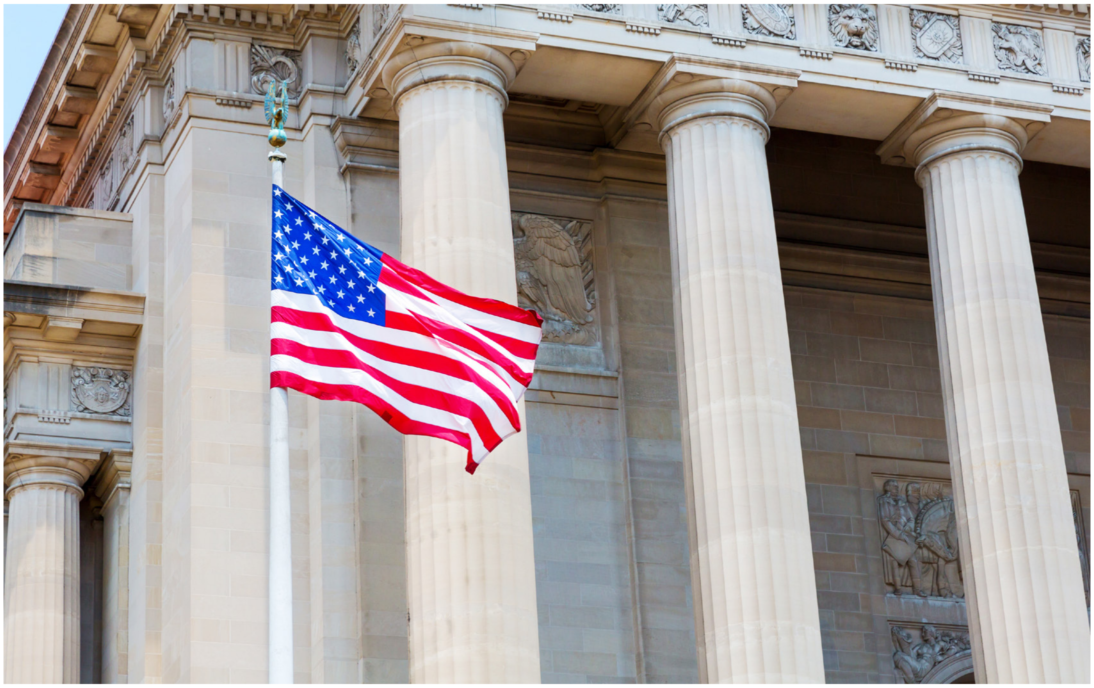
In other cases, tax authorities are tasked with generating more revenue by either increasing rates or imposing new taxes. This has a direct and obvious effect on corporate tax departments; those that sufficiently automate tax determination generally won't feel any pain from this complexity, but those that don't, will.

In still other cases, political risks are producing what one might call "unknown unknowns" for tax authorities. Protectionist trade measures affect supply chains and commerce patterns in unpredictable ways, and they can create a rationale for more rate changes. No one knows what the business consequences of Brexit, for instance, might be because Parliament has been unable to reach a consensus on terms of the withdrawal from the European Union. This is an example of an uncertainty that massively impacts tax departments by making it challenging for them to plan.

What can get lost in discussions about macro complexity and the tax function is that greater certainty for tax authorities does not necessarily equate to greater certainty for tax departments. In fact, many instances of a tax authority's job becoming easier can mean a tax department's job becoming more difficult, if (and only if) the right technology isn't in place to solve for those new demands via automation and intelligence.

New sources of complexity

Right now, three sources of complexity stand out as being particularly noteworthy: the *Wayfair* matter, new VAT regimes, and Brexit.



Wayfair

South Dakota v. Wayfair is a US Supreme Court decision that established a new definition for nexus. Prior to *Wayfair*, a company was required to collect sales tax if, and only if, it had a physical presence in the state where the transaction occurred.

Before *Wayfair*, the concept of nexus was already complex and open to different kinds of interpretation. Essentially, the *Wayfair* matter materially expanded the definition of nexus beyond the "physical presence" threshold to include economic nexus. So, while it gave more clarity to states as to when they can require sellers to collect sales tax, it created additional complexity for tax departments in the process. It did not produce a unified and consistent definition of nexus. While Congress has the power to set a unified, national standard, no legislation has yet garnered sufficient support to pass.

Instead, *Wayfair* opened the door for tax jurisdictions to write new tax laws (or re-interpret existing laws) based on their respective interpretations of the new precedent. Now, every state that has a sales tax has either changed their definition of nexus or has pending legislation to do so.

Brexit

For tax departments, the question with respect to Brexit is whether and on what timeline it will pull the United Kingdom out of the European Union's single market, thereby creating the need for a drastically different tax framework for both imported and exported goods and services.

The Value Added Tax (VAT) in the EU is a general, broad-based consumption tax assessed on goods and services purchased or sold for use or consumption within the EU. VAT is not charged on goods or services exported outside the EU. Simply put, if the UK remains in the single market, this tax treatment can, in theory, remain consistent. But if the UK leaves the single market, the current treatment of cross-border transactions will be replaced with something else, and there is no consensus as to what a new solution might be.

Leaving the EU with a transition agreement is referred to as a "soft Brexit," while leaving without any transition agreement in place is referred to as a "hard Brexit." The current deadline for Parliament to act is October 31, 2019. If there is no transition agreement in place by that date, and no further extension granted, then the UK will default to a hard Brexit, with potentially drastic consequences for businesses.

Value-Added Tax, in EU and Elsewhere

Brexit highlights, among other things, just how important value-added taxes are to today’s global business environment.

Right now, VAT is not a perfect system. EU members lost nearly €150 billion, or more than 12% of the total revenue forecast from VAT in 2016 to tax fraud, evasion, and avoidance, according to the European Commission. This “VAT gap” shows how out of sync tax systems are with the ways companies go about scaling and growing in today’s business environment.

Tax regimes, however, are stepping up their game. For the EU, part of the solution might include more harmonization of cross-border trade and more autonomy for member-states to adjust rates. Ideally, this would be achieved without disrupting business processes, but it would be risky to assume closing the VAT gap is not the top priority in tweaking the EU VAT regime.

And VAT is not an EU-specific tax framework. Members of The Gulf Cooperation Council, an economic union of states of the Persian Gulf, began to implement a VAT framework in 2016. Three now have VAT in force, and the other states are expected to implement a VAT in the coming years.

A trend towards the real-time reporting of indirect taxes is another part of this story, as it would allow these tax jurisdictions to monitor compliance in real time. And because most every jurisdiction will have differences in how this real-time reporting gets done at a technological level, it produces additional complexity for tax departments as it helps tax authorities.

How we see it

It is not going to get any easier for corporate tax departments. Complexity is growing, both in the number of trends that produce it as well as the intensity of the consequences for tax departments that it creates. Tax teams produce significant value to their companies — and nearly everyone wants to automate processes because doing so reduces risk, lowers cost, and makes the work of tax more dynamic and exciting.

Having the tools in place that allow teams to respond quickly and thoughtfully to these landmark changes will be more crucial as this complexity increases. Automation with tax technology ensures that your team has real-time access to accurate content, updated as soon as regulations change, so that your team doesn't have to spend time constantly updating and reacting to the latest information. And the best tools feed this content directly into your calculations. Instead of scouring sources for how and when rates and rules are changing, you can feel confident that you're getting tax right the first time, every time.

The pace of change in our connected world will only intensify as time goes on. More than ever, it's important to have a solution that can take care of the manual tasks and get you the information you need faster, so that your team can focus on more strategic, value-added work.

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