Autumn 2022
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ITR

Why pillars one and two are on shaky ground

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Pillar one too complex

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Tax saves the world

IFA CONGRESS
Digital tax here to stay

REAL ESTATE
ESG strategy for funds

ITR

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Pilloried

‘Complex’ is the word that comes up time and time again when we ask tax directors and advisers about pillars one and two. For one, data requirements seem particularly onerous when it comes to computing Amount A under the first pillar.

A global head of tax tells us that a company of his size may be forced to consider hundreds of thousands of data points, illustrating the scale of the task. Perhaps it’s no wonder, therefore, that those at the forefront of corporate tax don’t believe pillar one will even get off the ground. There is more optimism for pillar two, but only just.

This is just a brief summary of the cover story in this issue, which shows that the two pillars are on shaky ground right now. Just like the pillars themselves, taxpayer views are far too complex to boil down into a few words, so we’d recommend reading the piece in full to get a clear understanding of corporate taxpayers’ concerns.

It’s not just a place for people to moan about the state of play, however – it should worry policymakers that even those with the most intimate knowledge of tax affairs are unable to get their heads around the proposals.

In reality, the critical mass of countries needed to support both pillars is missing, and it’s easy to see why. Something will have to give if the proposals are to get over the line in the next couple of years, as planned.

Ed Conlon

> “Something will have to give if the proposals are to get over the line in the next couple of years”

While the pillars are the main talking point, there is much more to delve into. The PDF also includes some of *ITR*’s best Q&A interviews with tax leaders and provides a snapshot of our coverage from industry events, including our Global TP Forum.

As always, you can choose from a selection of expert analysis and sponsored content as well. We hope you enjoy everything on offer.

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MEET THE TEAM

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Abe Advogados promotes partner to practice

Brazilian firm Abe Advogados announced the promotion of one of its team to tax partner. She will lead the firms tax practice in her new role.

Maira Cristina Madeira has been with the firm for more than six years, having previously spent more than five years with the team between 2010 and 2015. In the interim she worked for Godoi & Zambo Advogados Associados.

Madeira's work is focused on judicial and administrative tax litigation before the State and Federal Courts, the São Paulo Tax Court and the Administrative Council of Tax Appeals. In addition, she has experience with tax consultancy and the preparation of opinions and consultations, especially regarding indirect taxes, and M&A-related risk analysis and due diligence.

Mazars welcomes partner to financial advisory team

International audit, tax and advisory firm Mazars appointed a forensic investigations and compliance partner to its UK team.

Rachael Hart joins the team from FTI Consulting, where she had acted in a senior role for three and a half years, including as managing director. Prior to that she had spent more than 19 years with KPMG, most recently serving as a director.

Hart's role in her new firm will be to develop forensic investigation and compliance strategy and be part of the financial advisory team focused on disputes and investigations. Her work has seen her focus on risk consulting, fraud and financial crime, as well as technology development and operational management.

WTS Taxise bolsters tax controversy practice

WTS Taxise, the Singapore office of international tax consultancy network WTS, announced the addition of an experienced tax litigator to its office.

Ma HanFeng joins the team from the Inland Revenue Authority of Singapore (IRAS), where he had served as a senior legal specialist for more than four and a half years. Prior to that role he had also served as the senior legal counsel/state counsel for the Ministry of Culture, Community and Youth, and as a deputy public prosecutor for the Attorney-General's Chambers.

Ma's work is primarily focused on litigation matters, having conducted several civil tax cases as a lead counsel for the IRAS as well as prosecuting multiple criminal cases before the Singapore High Court.

Two partners promoted at ForrestBrown

UK-based R&D tax credit consultancy ForrestBrown announced to promotion of two senior members of it's Bristol team.

Jennifer Tragner has been appointed as the head of policy for the firm, having specialised in the field since 2007. She has been with the team since 2015, having previously worked at Alma CG UK and spent more than 10 years as an R&D tax relief tax manager with KPMG.

Tom Jones has been promoted to director, having been with the firm since 2016. Prior to joining ForrestBrown he had worked at PwC for more than eight years, most recently serving as a global mobility tax manager. He has more than 15 years' experience in tax and currently leads a team in supporting clients in preparing claims to secure benefits from investment in innovation. He also provides support to ForrestBrown Global Services, helping the US businesses access funding.

Orrick expands Bay Area tax practice with partner addition

International law firm Orrick Herrington & Sutcliffe announced the addition of a tax partner to its offices in Palo Alto, California.

SeoJung Park joins the firm from DLA Piper, where she had been for more than eight years, having previously also worked for Simpson Thacher & Bartlett. Her work is focused on private equity, M&A and venture financings in the tech and life sciences sectors. This includes working with both domestic and international PE funds in all phases of their operations, as well as advising companies, banks and financial institutions on the US tax aspects of various financings, capital markets, cross-border mergers and other transactions.

Dentons appoints tax partner to Dutch offices

International law firm Dentons announced the addition of a partner and associate to its Netherlands tax practice.

Sebastiaan Wijsman joins the firm from DLA Piper, where he had worked as a tax advisor for almost 13 years. Prior to that, he had served in roles as an accountant with De Hooge Waerder Accountants for two and a half years and with Deloitte for more than three and a half years.

Wijsman brings with him more than 17 years of tax advisory experience, where he has had a particular focus on the real estate sector. His work includes advising multinationals, real estate funds and project developers on Dutch VAT, transfer tax, financing, tax due diligence, as well as other tax matters. He also has experience in structuring complex real estate projects, joint ventures and investments.

Associate **Joost Boon** joins Wijsman at the firm, also coming from DLA Piper where he had been for almost two years.

Andersen expands offering in US national tax practice

Andersen, the US arm of international tax consultancy network Andersen Global, announced the addition of two managing director to its District of Columbia office.

Richard Larkins had previously spent more than 18 years with EY up to 2020 and brings with him more than 30 years of experience in both government and private practice.

Bob Crnkovich joins the firm from the IRS, where he was special counsel in the office of Chief Counsel, Passthroughs and Special Industries. He also served as senior counsel in the Office of Tax Policy at the Treasury Department.

Morgan Lewis bolsters London tax offering

International firm Morgan Lewis & Bockius announced the addition of an experienced partner to its London offices.

Todd Smith joins the firm from the Abu Dhabi Investment Authority, where he had been for almost 11 years. He previously held roles with KPMG, Baker Botts and Davis Wright Tremaine.

Though based in London, Smith's work will be focused on US and international tax matters for sovereign and other institutional investors and multinational businesses. He brings with him experience of advising on the legal, tax, and commercial aspects of a variety of international investments – including private equity, infrastructure and real estate – in the Americas.

Chamberlain Hrdlicka expands San Antonio tax offering

US law firm Chamberlain Hrdlicka announced the addition of three new practitioners to its San Antonio, Texas offices.

Patrick Martin joins as a shareholder, with associates **Anuar Estefan** and **Luz Villegas-Bañuelos** also coming into the team. Martin brings with him more than 30 years of experience in the field, with a focus on international tax treaty planning strategies as well as worldwide investments and financing plans.

Estefan joins the team from Procopio Cory Hargreaves & Savitch, where he had been for more than five years as an associate attorney, and has previous experience working for a number of firms in Mexico City. Villegas-Bañuelos is also originally from Mexico and her work is focused on assisting multinational individuals and families with a wide range of international and US tax law issues, including pre-immigration planning, expatriation, as well as international estate and tax planning.

Simpson Thacher & Bartlett adds tax partner to London practice

International law firm Simpson Thacher & Bartlett announced the addition of a partner to its tax practice in London.

Sarah Lindley joins the team from Linklaters, where she had been for more than 14 years and had served as partner since 2018. She will join the firm's global tax practice and will focus on work across corporate transactions, including M&A, dispositions and asset sales, corporate restructurings and tax planning.

Andersen appoints Dallas managing director

Andersen, the US arm of international tax consultancy network Andersen Global, announced it has appointed a managing director to its practice based in Dallas.

JeAnna Parker joins the firm from PwC, where she had been for more than 18 years and served as partner since 2009. She brings with her more than 28 years' experience in public accounting and has advised a number of multinational companies in that time.

Parker's work is focused on the federal and international aspects of accounting for income taxes, including both acquisition and disposition tax accounting.

Andersen Global continues to grow presence in Africa, Europe, the Caribbean and Asia

International tax consultancy network Andersen Global announced the addition of a number of new offices globally, continuing to expand its presence in multiple markets.

In Africa, the group signed a collaboration agreement with Maj Consulting in Rwanda, a move that strengthens its presence in the East Africa region. Led by managing director **James Muigai**, Maj was established in 2015 and operates as a full-service tax and business advisory firm.

Also in the East Africa region, the network signed a collaboration agreement with Lawhill and Co Advocates in Tanzania. Based in Dar es Salaam and founded in 2019, it is led by managing partner **Hadija Kinyaka** and offers tax, corporate and commercial law services across a broad range of industries.

Moving further north, the group also added a collaborating firm in Tanzania. Founded in 2015, HIMA is a firm led by managing partner **Nabiyu Feto** and based in Addis Abada.

It also saw a development in its capabilities adding collaborating firm Akouna in Chad. Founded in 2019, the firm is based in N'Djamena and is led by **Leopold Ngarlenan Docdejengar**, former Minister of Finance and Director of General Taxes, and **Theodore Mossengar Milengar**, a former 10-year alumnus of PwC.

In Europe, the network signed a collaboration agreement with Squair Law in France. Established by **Olivier Lopez** and **Damien Gorse** in 2019, the firm provides services across a broad range of practices and expands Andersen's presence in the country with five offices located in Paris, Nantes, Lyon, Bordeaux and Aix-en-Provence.

The group also expanded its presence in Eastern Europe, specifically in the Baltic region, by signing a collaboration agreement with LEXTAL Legal. The firm has offices in Estonia, Latvia and Lithuania and includes 21 partners and more than 75 professionals across its different locations.

In the Americas, Andersen has bolstered its offering in the Caribbean and North America. In Montserrat, it signed a collaborating agreement with LAS Legal Consultancy & Law, a firm founded in 2015 and led by managing partner **Lovetta Silcott**. It also added collaborating firm Guardian Business & Accounting Services to its island presence, an accounting and consultancy practice led by managing partner **John Skerritt**.

Elsewhere in the region the network signed a collaboration agreement with Guadeloupe-based law firm InWest Avocats. Based in Pointe-à-Pitre, it has been in operation since 2016 and is led by managing partner **Frédéric Fanfant**.

The group has also expanded its presence in Canada by signing a collaboration agreement with Toronto-based Trowbridge Professional Corporation. Led by partners **Todd Trowbridge**, **Arun Nagratha** and **Wayne Bewick**, the firm offers a broad range of international tax services and offers a global footprint with offices in India, Germany and the UK.

In Indonesia, the network signed a collaboration agreement with full-service law firm Armila & Rako. The firm was formed in 2018 by a merger between the existing offices run by co-managing partners **Eva Armila Djauhari** and **Michel Rako**.

Carpenter Box appoints experienced VAT director

UK-based chartered accountants, chartered tax advisers, business consultants and independent financial advisers Carpenter Box announced the addition of a VAT director to its Gatwick office.

Thomas Mobee joins the team from Buzzacott, where he served as an associate director for almost six years. He brings with him more than 30 years' experience in the market and has a focus on the charity/not-for-profit, social enterprises, financial services, technology, land and property, investment and corporate sectors.

ForrestBrown expands tax offering in Scotland

UK-based R&D tax credit consultancy ForrestBrown announced the addition of a senior tax manager to its offices in Glasgow.

Angela Banerjee joins the firm from Leyton, where she had served as a senior consultant and then manager in the past three years. Prior to that she had roles with French Duncan, EY and KPMG.

Banerjee brings with her more than 12 years' experience in providing business advisory services including coordinating innovation incentives across large group structures. Her work has a particular focus on sustainability.

ESG and tax insights for real estate fund managers

Real estate fund managers must consider the tax aspects of environmental, social and governance policy to meet investor expectations, writes Nick Crama, director at Alvarez & Marsal.

Nick Crama

Investors increasingly expect real estate fund managers to take an active approach to tax as part of their ESG commitments.

A majority of the large institutional investors in Europe has focused on responsible tax in their investment decision-making. This was a trend well before ESG investing gained the momentum that it has today.

This focus on responsible tax is directly correlated to the role these investors – typically pension funds and insurance companies – play as organisations that people need to trust.

Reputational risks and tax contributions to society need to be carefully managed. This often translates into institutional investors developing their own tax policies and testing their investments against certain tax principles that align with their approach to tax and tax risk appetite.

In case a real estate fund structure contains elements that conflict with these tax principles, the decision is either made not to invest or the identified issues are resolved.

In most European jurisdictions, considering responsible tax when making an investment decision can be voluntary, but there are jurisdictions like the Netherlands where this is subject to regulatory supervision for certain institutional investors.

European real estate fund managers typically have strong experience in dealing with investor expectations from a responsible tax perspective. However, only a minority of real estate fund managers have a formal tax policy.

Evolution of tax within the ESG imperative

Institutional investors are making it increasingly clear that they expect a strong commitment to ESG factors when assessing real estate fund investments. This is not only driven by investors embracing ESG criteria, but also a result of EU regulations and pressure from the media and general public.

Considering the UN's Sustainable Development Goals, tax policy plays an essential role in achieving those goals. This has led to an increased focus on tax as an ESG item, which has been made clear in publications from the World Economic Forum's International Business Council, the UN-backed Principles of Responsible Investing and the European Association for Investors in Non-Listed Real Estate.

Within a real estate fund context, tax is featured across all three ESG elements:

- **Environmental** – Tax is generally a tool to drive sustainable real estate investments, e.g. through fiscal incentives.
- **Social** – Tax is an important factor to determine how a real estate fund manager views its role and tax contribution to society. This is generally described in a tax policy that includes the fund manager's tax strategy and tax principles that guide its decision-making and management of items like tax compliance, structuring and transactions, seeking and accepting tax incentives and maintaining relationships with tax authorities.
- **Governance** – To give a tax strategy and tax principles substance in practice, the governance aspect becomes evident. It is important that tax is properly governed


Many investors have greener growth on their minds

within the fund manager's organisation. Relevant items in this respect are, for example, the role and accountability of the board of directors, the roles and responsibilities of the fund manager's tax function, and how key tax risks are timely identified and managed.

Tax transparency, a new dimension

As interest in ESG investing grows, institutional investors are also taking more public positions on tax, such as the publication of tax policies, to help support their goals of responsible tax behavior in their investments and through their investment partners.

A good example is the Tax Code of Conduct designed and voluntarily applied by some of the largest Danish institutional investors. There is also an increase in tax transparency among investees to demonstrate to investors that their approach to tax is responsible and sustainable.

This can range from limited disclosures on one end, e.g. sharing a tax policy with investors, and detailed qualitative and quantitative public disclosures at the other end, particularly how tax policy has been applied in practice. This would include tax contributions and activities in accordance with country-by-country reporting (CbCR).

This development towards more tax transparency is especially witnessed among multinational enterprises. Many companies want to respond to the public perception that they abuse the international tax system to avoid paying their 'fair share' of tax. One of the most used voluntary frameworks for tax transparency is the Global Reporting Initiative's Tax Sustainability Reporting Standard.

There is also a trend towards more regulation in the area of tax transparency. For example, the EU's Public CbCR Directive and the European Commission's Communication on Business Taxation for the 21st Century.

The latter includes a recommendation for an EU directive requiring large enterprises to publish their effective tax rates. Meanwhile, the EU's draft report on social taxonomy suggests standard reporting metrics to enhance tax transparency.

Tax policy considerations and best practices

As the recognition of tax within ESG is growing, real estate fund managers find themselves in a position where they have to actively manage their approach to tax. This is crucial to meet investor expectations.

More investors are reviewing the social aspect of tax, i.e. the fund manager's tax strategy, as well as the governance aspects of tax in a real estate fund.

Designing or re-assessing a tax policy is the starting point for real estate fund managers that want to implement and integrate the social and governance aspects of ESG into their organisation.

In this respect, the following considerations and best practices can be relevant:

1) **Role of the board** – When tax is considered a core part of corporate responsibility, it is a best practice that tax governance in general is overseen by the board of directors and that the board is accountable for the execution of the tax policy. This does not only serve to ensure that a tax policy has authority and recognition within the fund manager's organisation, but it also supports the connection of tax to broader ESG initiatives already being deployed and to also ensure that other departments and business units are on board (e.g. the communications department in case of public scrutiny involving tax and the finance department regarding tax disclosures from an accounting perspective).
2) **Top-down approach** – For most real estate fund managers, the starting point for integrating ESG tax into their organisation is the design of a tax policy. In this regard, it is a best practice to apply a top-down approach. This means designing a tax policy by starting off with defining the organisation's tax strategy, also commonly referred to as an approach to tax, then defining the organisation's guiding tax principles to achieve this tax strategy, codification of the tax governance structure, the tax function's roles and responsibilities, and finally defining the organisation's key tax risks, control objectives and control measures (to be implemented). A complete overview of tax risks and control measures is typically part of a separate tax risk and control framework document, which goes into a lot more detail and practicalities than a tax policy. The benefit of applying a top-down approach is that it allows for a holistic view on tax that can subsequently trickle down into all relevant tax areas. A bottom-up approach typically starts with identifying all relevant taxes, tax risks and control measures and so on, and from this overview designing a tax policy. However, in practice you can never oversee and control everything in the realm of tax, which means it is pretty much a given that a bottom-up approach will get you stuck in the details, whereas a tax policy should in principle only formulate an organisation's view on the tax topics that really matter.
3) **Tax strategy** – It bears no surprise that investors have a spectrum of views on tax issues, depending on their investment beliefs, risk appetite and culture. There are typically three types of investors: those who consider tax efficiency leading, those who consider responsible tax leading and those who also put tax fairness into the equation. These different views warrant careful consideration when defining a tax strategy, as a tax strategy should not only cover the fund manager's own organisation, but also the approach to tax applied to the real estate funds it manages. A common approach and possibly best practice in this respect is to align the tax strategy with the fund manager's corporate strategy and core values.
4) **Test tax principles** – Formally adopting tax principles via a tax policy leads to the expectation that such principles are met throughout the real estate fund manager's own organisation, as well as the funds and entities that it manages. A common pitfall is the formalisation of tax principles without first considering the practical implications (e.g. without first testing the principles against fund structures). Tax principles that do not capture the fund manager's actual tax risk appetite can unintentionally restrict commercial transactions. The biggest challenge usually lies in capturing a proper scope of the so-called 'business rationale'-principle. This principle typically entails that tax should follow the business and not the other way around, meaning fund structures and entities should be driven by commercial considerations and real business activity.
5) **Substance in practice** – Tax policies often contain tax principles without elaborating how these principles are given substance in practice. An example is the compliance principle, which usually reads 'we comply with the tax legislation of the countries in which we operate and pay the right amount of tax at the right time, in the countries where we create value'. From an ESG perspective, investors are becoming keener on understanding how tax principles are de facto applied by a fund manager (i.e. the governance aspects of ESG). It therefore adds value to also describe how a tax principle is applied in practice. In a compliance context, this could cover positions, procedures and views on tax filings, disclosures to tax authorities, tax planning, uncertain tax positions and the arm's-length principle. This does not only demonstrate towards investors how tax principles are applied, but it also helps the fund manager's own organisation understand the practical implications of the tax principles that have been adopted.
6) **Transparency and narrative** – Tax transparency can range from the publication of a tax policy to what is commonly referred to as 'tax contribution reports'. Tax contribution reports typically provide periodical updates on items like the effective tax rate and taxes paid at country level, key issues related to the tax policy, description of the business activities to understand taxation thereof, explanations for changes to the group structure and the existence of entities in low-tax jurisdictions, positions on tax advocacy, and so on. Tax contribution reports are very labour-intensive and especially observed among large multinational enterprises already subject to CbCR and likely to become subject to the EU's Public CbCR Directive in the near future. As tax is complex and often difficult to understand, multinational enterprises tend to provide a detailed narrative when publishing tax data (e.g. to allow stakeholder to understand the effective tax rates and taxes paid at country level). Among real estate funds, it is a best practice to ensure that a certain level of narrative is included in the annual financial reports of the real estate funds under management. This narrative should allow investors to broadly understand the tax positions and taxes due in the jurisdictions where a fund operates.
7) **Re-assess** – ESG tax policy is constantly developing. Public opinion of certain tax mechanics can rapidly change. The same holds true for a fund manager's own views on tax issues and its own tax risk appetite, which are ultimately driven and determined by the people working within its organisation. It is therefore recommended to re-assess a tax policy regularly.

Your company's tax policy should reflect your organisation from a tax, strategic and governance perspective. Designing or updating a tax policy is a good opportunity to understand the standards published by, for example, industry associations, the EU and OECD.

A tax policy can also help to gather internal support to achieve certain strategic tax goals, such as digitalisation of tax processes and more control over compliance.

Pillar two
The need for simplification

Pillar two will change the international tax system forever. Here, Christian Kaeser, global head of tax at Siemens, looks at how businesses and tax administrations can simplify pillar two compliance.

One of the most anticipated discussions at the International Fiscal Association's 74th Congress in Berlin was the OECD panel chaired by Porus Kaka, senior advocate at Field Court Tax Chambers. The spotlight was on Pascal Saint-Amans, head of the OECD's tax policy centre, and Achim Pross, the OECD's head of international tax cooperation.

This was no surprise given the fact that the roughly 1,500 attendees wanted to hear news about the two pillars from the horse's mouth. But the biggest news of the day was the fact that Saint-Amans will be leaving the OECD.

The key takeaway was the increasing recognition that the two pillars will be introducing a new level of complexity into the international tax system. This made it clear that taxpayers and tax administrations need a way to simplify the pillar two rules.

In the follow-up panel to the OECD seminar the discussion focused on the issue of capacity-building and ways to simplify or 'de-stress' compliance, especially with pillar two.

'De-stress' compliance

Tax authorities in developed and developing countries are faced with severe administrative issues. Assessing and auditing pillar two tax returns will require not only deep understanding of the respective domestic tax systems and international tax matters.

It needs to be complemented by expertise in international accounting standards because the pillar two calculation is rooted in book income, according to accounting standards. This includes the complex sphere of deferred taxes. Finally, the specific mechanisms of pillar two needs to be understood and applied.

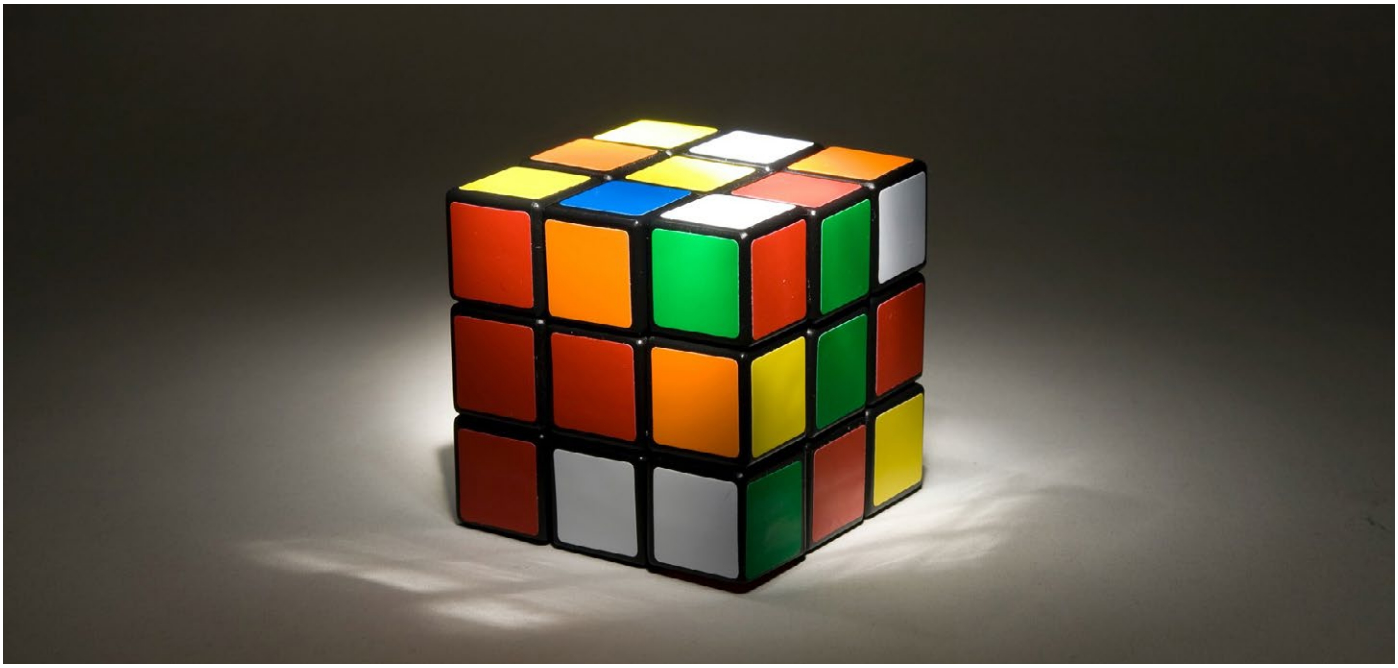
Taking into account that massive amount of data points from enterprise, resource, planning (ERP) systems and pre-systems need to be compiled, manipulated and analysed for any tax administration an understanding of the respective system landscape of its taxpayers seems to be a must, too. This will require investment in resources and capacities.

It seems like a gargantuan task if tax administrations start to build up these capacities on their own. The much better approach seems to be a cooperation between all parties impacted by pillar two: policymakers, tax administrations and taxpayers.

Taxpayers know international accounting standards (at least, they better should know them) and their respective ERP systems. Tax administrations need to get up to speed about these issues rather fast and policymakers should have an interest to get direct feedback on what works out nicely and where real problems are hiding.

Taxpayers might be tempted to refrain from any capacity-building exercises. Although it's important to build a trusted relationship with the tax authority, the benefits of capacity-building may seem remote since businesses will need to improve resourcing.

At the same time, taxpayers filing pillar two returns for the first time are the first party involved to be face these rules. This combines international accounting rules, domestic rules and the pillar two specifics.



Complexity doesn't have to be the price of reform

These complexities relate to the interpretation of the rules, as well as to the factual exercise of compiling, manipulating and analysing the data required to apply pillar two.

The obstacles and difficulties in complying with the rules may vary from taxpayer to taxpayer. However, all taxpayers are concerned about not being able to reach 100% compliance. This is due to the complexity of the rules.

Taxpayers are rightly afraid of the potential penalties that might result from non-compliance. But these concerns may be overcome in favour of mutually beneficial cooperation on pillar two.

The feedback matrix

When filing the first pillar two return taxpayers could be offered the option to fill out a 'feedback matrix' on the application of the pillar two rules. Such a matrix is in essence comparable to an information return and should:

- Ideally not be obligatory but discretionary, because if a taxpayer is able to file the pillar two return with ease there should be no additional burden by any information return. Plus, the feedback matrix should allow for some relief and not create more concerns;
- Cover all the pillar two rules to get holistic feedback – but, it is up to the taxpayer if they want to give feedback to each aspect of pillar two;
- Allow for a 'traffic light' rating system (e.g. green, yellow, red), so that taxpayers in scope of pillar two could specify whether a rule is easy, difficult or close to impossible to apply. With such a high-level rating policymakers get an easy to access overview of the complexity of these rules, or to say, a pillar two complexity landscape. Plus, individual feedback can be tested against the overall feedback to check for outliers;
- Allow for feedback, so that taxpayers can describe in detail what the respective problem in applying a specific rule was, how they tried to overcome the issue and, if they believe, the result was an accurate pillar two return. This should be the core element from a taxpayer perspective, because this disclosure would justify any potential relief for the taxpayer disclosing the issue;
- Describe which resources were required to comply with the specific rules. This should allow policymakers to get an overview of the administrative cost of compliance;
- Describe whether the application of the rule could be automised or needed to be handled manually. This might serve as an indication for best practices.

Other topics, such as a field for general feedback, could be included, too.

Taxpayers filing the feedback matrix as an attachment to their pillar two return should get penalty relief. This would be in cases where errors are being uncovered within the tax assessment or tax audit process.

The feedback matrix would serve a similar purpose as taxpayers disclosing their deviating interpretation of a tax rule to the tax authorities when filing a tax return. In most jurisdictions, this kind of disclosure shields against penalties and criminal charges.

The difference with the feedback matrix is that the issues disclosed would mostly relate to practical and factual difficulties of applying the rules.

This would allow for broad-based feedback and the creation of a holistic landscape of the difficulties in applying the pillar two rules. This could be help improve and simplify pillar two and its application.

Greater transparency could help build the necessary trust for all parties involved, particularly the difficulties taxpayers are 'battling' with the new rules. These new rules are a challenge for all parties involved, businesses, tax administrations and policymakers.

Christian Kaeser is the global head of tax at Siemens and the president of the German branch of the International Fiscal Association.

CHILE

PwC Chile


Nicolas Foppiano and Juan Pablo Marambio

Tax Reform Bill seeks to revamp the Chilean income tax system

On July 7 2022, the new Chilean government presented a Tax Reform Bill for discussion in the Chilean Congress. The proposal follows several tax reforms in the past decade, including those passed in 2014, 2016, and 2020.

One of the most important modifications proposed under this latest Tax Reform Bill is the full "disintegration" of the Chilean income tax system. This change is proposed for all companies except those owned by residents in a country with which Chile has a double tax treaty in force.

The aforementioned implies a paradigm shift in the Chilean income tax system, which is traditionally based on the integration of both corporate and final taxes through a credit mechanism. Note, though, that such a paradigm was already weakened due to the partial "disintegration" of the Chilean income tax system introduced by the tax reform of 2014.

In such a context, the Tax Reform Bill proposes to introduce a new capital income tax, which will apply to dividends or withdrawals made from a company without granting any kind of corporate income tax credit.

The current tax system for capital income

At present, common taxation rules apply to dividend distributions or withdrawals made from a company to its shareholders. Accordingly, corporate income tax applies at a 27% rate at corporate level, and, at the shareholders' level, the relevant final tax will apply, which is global complementary tax (progressive rates on individual residents in Chile) or additional tax (35% withholding on foreign residents). Final shareholders will then have the right to use – totally or partially – as credit the corporate income tax already paid by the entity paying the dividend or making the profit distribution.

The reform bill proposal for capital income

If the Tax Reform Bill is approved as originally proposed, final shareholders will be subject to a new tax, the so-called capital income tax, at a 22% rate on the shareholders' withdrawals, remittances, or distributions, on the net amount being distributed.

In such regard, taxpayers resident in Chile will have to pay the new capital income tax, at a 22% rate, which will be withheld by the paying entity on a net basis and will not grant any credit to be deducted from such amount. The latter would lead to a 43% total burden in the case of the highest marginal tax rate.

On the other hand, a dual system will apply on the taxation of foreign taxpayers. For those foreign taxpayers resident in jurisdictions without a double tax treaty in force with Chile, the same taxation described above for final taxpayers will apply, resulting in a compound rate of 43%.

Nevertheless, for taxpayers resident in countries with which Chile has a double tax treaty in force, the current fully integrated system is retained, which means that the total tax burden is maintained at a 35% rate, since the corporate income tax credit will be fully creditable against additional tax.

What comes next?

The Tax Reform Bill set forth that the capital income tax will enter into force as of January 1 2025 and is to be applied on income paid or accrued from that date. That is, of course, provided the bill is passed by the Congress as it is now. However, there is still a long way to go, and bearing in mind that the Chilean government coalition does not have a majority in the Congress, amendments are expected in order to move forward with the discussion.

In a nutshell, for those foreign taxpayers resident in countries with which Chile does not have a double tax treaty in place, the new tax reform would imply a full "disintegration" of the Chilean corporate tax system, and represent a paradigm shift from the current Chilean income tax system. Hence, the parliamentary discussion should be closely monitored by foreign and domestic taxpayers, who may need to take action to adapt to these changes.

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US

KPMG in the US


Mark Martin and Thomas Bettge

Renewed IRS focus on foreign corporations' US tax return obligations

If a foreign corporation has a US trade or business, it is required to file a US income tax return – Form 1120-F – reporting the income effectively connected with that trade or business. Figuring out whether a US trade or business exists is not always easy, and even when it is, the foreign corporation may be unaware that its US activities give rise to a filing obligation.

For instance, if a bilateral tax treaty exempts the income from US taxation, this does not mean the foreign corporation does not need to file a US return; rather, the Form 1120-F must be accompanied by another form (Form 8833) or a statement detailing the treaty position. It is therefore not surprising that some entities that are required to file Form 1120-F do so late, or not at all.

Enforcement efforts

Right now, Form 1120-F issues are a focus of Internal Revenue Service (IRS) attention. The IRS Large Business & International (LB&I) division has four active enforcement campaigns related to Form 1120-F.

Two touch on substantive issues: refunds for withholding at the source, and claims for certain deductions.

One is aimed at non-filers: LB&I is using external data sources to identify foreign corporations with likely filing obligations, and sending out soft letters before initiating examinations.

The fourth Form 1120-F campaign deals with delinquent filings, and, in particular, the ability of a delinquent filer to claim deductions and credits to offset against the income effectively connected with its US trade or business.

Under Section 882(c)(2) of the Internal Revenue Code, a foreign corporation can only claim deductions and credits against its effectively connected income if it files a US return. Treas. Reg. § 1.882-4(a)(3) adds a timeliness requirement: the return must be filed by 18 months after the due date (or, for corporations that were required to file a US return in the preceding year and failed to do so, by the date the IRS contacts the taxpayer regarding the current year's missing return).

In *Adams Challenge (UK) Ltd. v. Commissioner*, which KPMG discussed in a prior article, the Tax Court articulated another timing rule, which it found implicit in the statute: a taxpayer can no longer file a return claiming deductions after the IRS prepares a substitute for return in lieu of the missing filing.

Waiver process

Fortunately for taxpayers, Treas. Reg. § 1.882-4(a)(3)(ii) permits the IRS to waive the timeliness requirement if it considers the taxpayer to have acted reasonably and in good faith, a determination that is made based on several criteria (for example, whether the taxpayer exercised reasonable due diligence but was unaware a filing obligation existed).

In 2018, the IRS adopted procedures for determining whether a waiver is appropriate, and in July 2022, it released a practice unit that instructs LB&I examiners on the waiver process.

In the case of an untimely Form 1120-F filing, the LB&I exam team is directed to provide the taxpayer with information on the waiver process. The taxpayer can choose whether to request a waiver (which requires that it cooperate with the IRS' efforts to accurately determine its US tax liability).

> "Consideration should be given in suitable cases to requesting a waiver"

The exam team recommends acceptance or denial of the waiver, but the ultimate decision is made by the relevant IRS director of field operations for Cross Border Activities, sometimes in consultation with a Waiver Committee that helps to ensure consistency across determinations.

Considerations for foreign corporations

The IRS enforcement focus on Form 1120-F issues should serve as a reminder for all foreign corporations with US activities to evaluate whether those activities may give rise to US income and a US filing obligation.

When US trade or business status is uncertain, it is generally advisable to file a protective Form 1120-F reporting no income, as the protective filing will entitle the taxpayer to claim the benefit of deductions and credits, should the IRS later determine that US trade or business income exists.

The protective filing also starts the statute of limitations period and allows the company to avoid failure-to-file penalties. For taxpayers that come under IRS audit for a delinquent return, consideration should be given in suitable cases to requesting a waiver. Engaging with the IRS in a cooperative manner can be particularly important where overlooked filings are an issue for successive years as well.

The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of Section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP, the US member firm.

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How tax can help solve climate change

Mala Kapacee, director of the **London Tax Network** and founder of the **London Tax Society** looks at the challenge of climate change and how tax can help prevent the worst outcomes from happening.

Mala Kapacee

Climate change is a global issue that disproportionately affects the younger generations, though awareness across all generations is higher than ever. With this in mind, London Tax Society invited Paul Howard, tax expert and self-proclaimed eco-warrior to discuss climate change in the context of tax and generate a discussion of how our tax system could be used to achieve net zero. This article draws on Paul's talk.

The definition of climate change is not solely restricted to the temperature, though this is where we feel the effects most sharply. For example, the heatwave in mid-July across Europe saw temperatures in the UK reach over 40 degrees Celsius for the first time on record.

Climate change means and increase in CO2 emissions to the point that the earth begins to heat up. As a result of the increased temperatures, the icecaps melt causing an increase in sea levels and this threatens coastal cities and towns. This problem is not restricted to developing countries, Cardiff will be mainly under water within the next 30 years.

The sea will become acidic because of the amount of carbon dioxide absorbed by oceans and converted into carbonic acid endanger marine life. Sea levels also threaten coastal wetlands because they become salty and acidic.

Aside from temperatures unendurable for humans and land being threatened by the sea, an increase in atmospheric pollution is another danger to health, ours and that of other land-based species and there is a loss of biodiversity. Land and marine species are part of finely balanced food chains. A small change in that balance can result in huge effects. A number of animal species have died out and at some point. This could be us in the future.

Most people recognise that fixing climate change will require a significant reduction in consumption, in particular plastic. Aside from the obvious, that plastic is generated from oil and turning it into a usable material releases a huge amount of carbon dioxide into the atmosphere, the end product has a huge impact on the animal on our planet as well.

Plastic is a problem in the oceans as creatures eat it and most animals including humans have microplastics circulating in their bodies. As yet, the level of danger micro-plastics can cause in our bodies is still being researched. It is unlikely that ingestion of such synthetic products offers any benefit.

If we stop buying plastic bottles or using carrier bags, demand falls and the products are less likely to be produced. After the plastic bag charge was introduced in October 2015, demand reduced significantly by July 2016.

The plastic bag charge was not a tax and proceeds from the charge did not go to the government. As such, we saw increased contributions by supermarkets to environmental campaigns and consequently, shoppers were educated as to the good deeds.

Unfortunately, questions relating to tax policy and climate change are not always so simple. One of the biggest questions in relation to climate change and tax is who should bear the cost of implementing the changes and for governments, how can they make policies to protect the environment while keeping that party in power?

Those who don't have a stake in the future of the planet would probably not want to change comfortable lifestyles 'just' to help younger generations. Those who will have a stake in the future, may not be old enough to vote for or apply for the changes, instigate the changes or, (the very youngest) to even understand there is a problem.

Similarly, those in the developing world are disproportionately affected by climate change, which is caused by the consumers, the majority of whom are in the West. To solve the climate crisis, we are reliant on most people being willing to make sacrifices for others. When it comes to tax, this is not always a vote-winner.

Then we have the government – bearing in mind that vilifying the use of fossil fuels in exchange for renewable sources of energy, may not only lose them voters but also financial support. What the government needs to look at therefore is threefold: 1) how to reduce consumption, and 2) encourage the use of renewable resources, while 3) retaining voting power and funding.

The 10 point plan

The 10 point plan was developed by the UK government in 2020 to help the UK in reaching net zero by 2050. The ideas in the 10 point plan are sound, but the plan does not discuss how each step could be funded. There was a July court case taken by Client Earth, Friends of the Earth and the Good Law Project that determined that the government's plan did not comply with the Climate Change Act.

Further, there seems to be little understanding of the effects of all these steps. For example, step four suggests a shift to electric vehicles, without a discussion of how to offset the carbon emissions caused in their manufacture.

On the other hand, there may not be enough lithium to build the requisite number of batteries so the answer might lie in moving away from private vehicles and having suitable and efficient public transport infrastructure.

The government is focusing on use of the R&D tax credit as a driver to encourage research and development of greener

Tax is a key part of solving climate change

products and fuels. This in our view needs to be combined with a tax on the generation of energy from fossil fuels, with certainty that the cost will not be passed onto the consumer or retailer. The windfall tax (energy profits levy) would have been ideal for this had it not provided a rebate for research into finding more gas or oil reserves.

Other than the R&D tax credit and ensuing that motor related tax changes remain up to date given the move to electric cars, there is little mention of how taxes can be used to help implement the 10 point plan or whether it might be better to use grants rather than tax to encourage change in behaviour.

In October 2021, the Chartered Institute of Taxation responded to the 10 point plan and set out a tax policy roadmap. Broadly speaking, the roadmap highlighted that the government's 10 point plan did not set out how taxes could be used for funding the recommended changes. Some key points that would need to be looked at in relation to climate change and tax policy are:

- Should carbon allowance schemes and environmental taxes be used to generate income?
- Are changes to mainstream taxes appropriate? This goes back to the economics of climate change – who should pay for it?
- Should balance simplicity with effectiveness. As we have seen in the past, over-complicated tax laws make it more tempting and arguable easier for taxpayers to find loopholes. If the intent here is to change behaviour, the rules should be clear and unequivocal as far as possible.
- Balance sticks with carrots. As mentioned above, the ideal would be to encourage the use/development of renewable energy, for example, while penalising the use of fossil fuels.
- Need visibility of carbon price and environmental taxes. The more transparency there is, the better. For example, if food packaging stated clearly that a particular item cost more in tax to offset carbon emissions from its production. And then ensure the money was used in such a way that benefited the environment, such as planting additional trees or protecting natural habitats.
- Cross-border issues – carbon leakage and harmonisation. Global warming is as the name demonstrates, a global issue. Moving production out of the UK to reduce UK carbon dioxide emissions to net zero will not benefit the planet at the end of the day. In moving production to achieve our climate goals, we have passed the problem to other nations who are unlikely to give up their new capacity to make money.

Existing climate change taxes in the UK

In the UK, we have a range of taxes that relate to the environment. These include the climate change levy (CCL), paid by industrial, commercial, agricultural and public service businesses on electricity, gas and solid fuels. We also have a landfill tax, an aggregates levy, a plastic packaging tax, air passenger duty to name a few.

On the other side of the coin, we also have a number of reliefs available to encourage businesses to reduce emissions. This includes:

- Carbon price support rates of the CCL, which encourages industry to use low carbon technology (paid by owners of electricity generating stations);
- Capital allowances on energy efficient items, i.e. 100% for electric vehicles;
- Zero vehicle excise duty for electric vehicles with zero emissions;
- Reduced benefit in kind rates for electric cars.

The problem with a lot of these policies, i.e. domestic carbon pricing and plastic packaging, is that they are apply to UK resources and therefore, businesses can simply shift production to another jurisdiction with a cheaper carbon tariff or no plastic property tax to reduce the UK liability. This does not change consumer behaviour so the products are still produced, and nor do they encourage more sustainable forms of manufacture.

Global warming is an international problem and governments need to react to it in the same way as they did to terrorism threats. Almost overnight, we were restricted to one plastic bag of liquids each up to 100ml per plastic bottle or tube on flights.

In the same way, climate change is an almost immediate threat, but it is one that is foreseeable and manageable. This does not make it any less dangerous. If anything, the fact that it affects the whole world means that it should be seen as more of a threat and action needs to be taken cohesively and immediately.

Governments need to consider whether it is time to tax on a global basis with international tax systems. This requires consensus between governments, which is very difficult, though not impossible if every country has the same goal.

One country acting alone is limited in what it might achieve. If for example, the UK unilaterally imposes an emissions levy on imported goods, this will be seen as a tariff which is illegal under international law. If every country does this, production of lower carbon materially will increase.

As tax systems become more transparent and given initiatives like the global minimum corporation tax rate, the framework is in place to implement global levies. Perhaps a global minimum corporate carbon levy or a global minimum requirement to offset all carbon emissions.

And if it means consumers consume less overseas manufactured products, perhaps that's not such a bad thing. The government's aim at this stage is to ensure that the disparity between rich and poor does not grow as a result, but this is a discussion for another time.

Capitalism vs the climate

Climate change is an emotive issue and who should bear the cost of it is a very difficult question. The answer will depend very much on who you ask and really there is no right answer unless everyone has the same goals.

Industrialisation has created a disconnect between humanity and the environment to the point that lawmakers and large corporates may not ever have seen a farm or understand the delicate balance of our eco-systems.

Education is crucial, but change with education alone will not be quick enough. At the same time as educating, governments can implement policies with the aim of changing behaviour short term and attitudes in the long term.

The good news is that reversal of the effects of climate change could happen quickly if Governments and people are united in their goal. One of the biggest benefits of COVID-19 was how quickly rivers began to flow cleaner and the skies around more polluted cities cleared when we (humans) stopped polluting our planet.

So fixing climate change may not take long if there is a global shift in how we perceive our environment. However, it will require a globally cohesive attitude from all governments. On that basis alone, it might be a while before we start.

The 10 point plan

1) Advancing offshore wind

- Transform energy system with more network infrastructure

2) Growth of low carbon hydrogen

- Scale up electric heat pump market
- Hydrogen powered transport

3) New and advanced nuclear power

- Small modular reactors
- Production of hydrogen and synthetic fuels
- Complement investment in carbon capture
- Develop regulatory framework and UK supply chains

4) Accelerate shift to zero emission vehicles

- End sale of petrol and diesel vehicles by 2030
- Ensure tax system encourages uptake of electric vehicles and revenue from motoring tax keeps pace with change

5) Green public transport, cycling and walking

- Transition to more active and sustainable transport
- Invest in rail and bus services
- Enhancements to rail network, reopen closed rail lines
- Electrification
- Simpler franchise system

6) Jet zero and green ships

- Drive uptake of sustainable aviation fuels
- R&D to develop zero-emission aircraft
- Develop infrastructure at airports and seaports

7) Greener buildings

- Move away from fossil fuel boilers
- Develop UK heat pump manufacturing base
- Green homes grant

8) Investing in carbon capture, usage and storage

- Capture 10mt of CO_2 by 2030 in underground stores under the North Sea

9) Protecting natural environment

- Capturing and sequestering carbon long term
- Safeguard cherished landscapes
- Restore habitats for wildlife and combat biodiversity loss
- Creation of new national parks and AONBs
- Protect and improve 30% of UK land by 2030
- Investment in flood defences

10) Green finance and innovation

- Raise R&D investment to 2.4% of GDP by 2027
- Net zero initiative portfolio
- Ambition to commercialise fusion energy technology
- Sovereign green bond
- Financial disclosures – reporting climate-related financial information

Why pillars one and two are on shaky ground

Businesses and tax advisers are concerned the OECD's two-pillar solution may create more problems for them, from data management to tax disputes, as *ITR* reports.

Danish Mehboob

The tax industry is worried that the OECD's two-pillar implementation plan is still undecided because custom data management controls are required for compliance activities.

The OECD's October report on pillar one administration and the tax certainty aspects of Amount A highlights that it is important for multinational groups to ensure that their data management methods for determining taxable revenues are reliable.

Service providers have been working on tools to help tax directors parse through different kinds of raw datasets to find relevant information on group revenues. KPMG developed pillar one and pillar two models with Microsoft Power Apps to help with the tax determination process.

Robbert Hoyng, partner and technology expert at KPMG in the Netherlands, says the two-pillar solution's legislative delays in some countries gave large businesses more time to model what the global tax framework means for their supply chains and reporting systems.

"Many [stakeholders] are still waiting to see what the US and European countries implement first because the tax reforms do not work without their participation," says Hoyng.

"These delays bought time to model the implications of a global minimum tax and revenue reallocation formula on group operations and organisational structures," he adds.

While Amount A under pillar one only targets multinationals with €20 billion ($19.4 billion) in global revenue and over 10% profitability, the GloBE rules under pillar two target a much wider range of businesses with at least €750 million in annual revenue.

Simplicity needed

Those who have undertaken the financial modelling exercise with pillars one and two say the regulations pose several challenges around data categorisation.

Tax directors in groups large enough to be in scope of the regulations will likely be tasked with managing information on revenue in the supply chain, including data from hard-to-find third-party clients.

One manager of TP at pharmaceutical company Boehringer Ingelheim in Germany says the sourcing rules must be simplified to be more widely accepted.

Boehringer Ingelheim is in scope of regulations under both pillars as the business reported revenues of €20.6 billion in 2021 – just above pillar one's target of €20 billion.

"We need to have the data on our systems already, which is difficult to guarantee," says the manager.

"To find where that data is to compute Amount A, for example, we did an exercise to list of all the different definitions under pillar one, and the process is not even over yet," he adds.

"We are still working with thousands of data points that need categorising and sorting," he explains.

Mohamed Sherif, CFO at Banque Misr in Egypt, says tax directors are always looking for efficient ways to report to authorities and must sometimes find unique sources to get the relevant data.

"The tax team is a huge consumer of data – they require vast datasets for reporting information on group structure, financial results, inter-company transactions, and more," says Sherif.

"All this data feeds into highly diverse technical disclosures including tax provision calculations, SAF-T filings, country-by-country reports, and soon, pillar two returns too," he explains.

Data points that are being used for one document should ideally be reused, but some groups collect the same data from a different source for other reports – potentially leading to material differences.

Tax authorities used to demand more data exchange, but many are now relying on direct access to a business's systems to scrutinise the integrity of controls governing the data.

This brings up questions in groups about which department should be responsible for the data and its quality in the future.

Under pillar two there are three income statements for groups to generate, including financial statements, corporate tax returns, and GloBE income. Alongside pillar two tax returns, there are extra tax filings in the EU and public country-by-country reports due in 2024.

Deluge of data

Christian Kaeser, global head of tax at Siemens in Munich, says installing a new reporting system is a complex and delicate matter for the overall business – there could be more details to account for than expected and thousands of extra data points to classify.

"I think there were some 200 categories to consider in the OECD drafts, but open-ended rules can be very complex and only look at one data point at a time at a high level," says Kaeser, who also undertook a data exercise for pillars one and two.

"However, when you break it down across our large organisation then you could easily end up with 2,000, 20,000, or even 200,000 data points instead," he adds.

Some pillars stand the test of time better than others

Revamping reporting systems is a sensitive matter for tax authorities too because there are difficulties in policing whether a company's data sourcing is accurate without an audit trail.

Tax authorities that are not prepared to catch a group's filing inconsistencies when the two-pillar solution begins could face years of uncertainty, especially when any changes to a group's approach to gathering and reporting data can only take place in the next financial year at the earliest.

Under pillar one, taxpayers have a legal safeguard in the form of an advance review process under which a group of tax authorities checks that the multinational group's systems are set up correctly in relevant countries.

Safeguards are important as data gathering in some cases is impossible when third-party sellers are not responsible for providing extra information to the group to justify commercial activities and sources of revenue in the main supply chain.

"I do not think pillar one will be adopted because of its complexity," says Kaeser, who adds that the result is clear from difficult modelling and the complex data exercise involved in finding Amount A.

Disputes ahead

There are concerns among tax professionals that the two-pillar solution will raise litigation risks, especially in certain jurisdictions prone to tax disputes.

Porus Kaka, senior advocate in India and barrister at Field Court Tax Chambers in London, said at the IFA Congress in Berlin in September that there could be several court cases in the future on both pillars.

"I can see a Supreme Court case every four lines of the legislation, but that is just me," said Kaka.

For example, the compliance approach in the OECD's latest report on pillar one streamlines filing using a standard Amount A tax return and a common documentation package, but these are only useful after a group's tax director can optimise in-house data.

"Data management is increasingly looking to be one of the most important aspects," added Kaka.

While a lot of data is available at a group level, it may not provide all the necessary details for local filings, so tax teams must rely on other data sources at a regional level too.

There are also intra-group concerns over which department should be responsible for transactional data and its quality upkeep, which is another potential legal matter.

If complex tax data issues were not enough to stop the two-pillar solution, there is also a lingering concern that the US and other high-income countries will not support the framework, which depends on a critical mass of countries to work.

Pillar two is more likely to be enacted than pillar one, as many countries are already drafting legislation on GloBE rules, while Amount A safeguards are still under discussion at the OECD.

Pillar two 'chaos'

Alison Lobb, tax partner at Deloitte in London, says the latest OECD report on pillar one does not cover some difficult technical areas of Amount A, including the treatment of withholding taxes, the marketing and distribution safe harbour, and how to eliminate double taxation.

> **"Pillar two is going to happen – it may be a little slower – but it is going to happen and the chances are that it may happen in a chaotic way"**

"The progress of pillar one is [that it's] a formal treaty that needs to be ratified by every other government, and that looks like a long way off.

"Pillar two is going to happen – it may be a little slower – but it is going to happen and the chances are that it may happen in a chaotic way, which means the impacts are going to be even larger," adds Lobb.

There is also the matter of simplifying the reports for developing countries, but development across countries is so varied that it is difficult to give the same level of help everywhere, according to advisers.

The two-pillar solution may be reserved for the largest multinational groups, but the data challenge will probably extend to smaller entities too. All companies, regardless of size, will have to adapt to the rules and anticipate more data protection policies in the next few years.

Asian business concerns

The problems around pillar two are as global as the project's reach. Some Asian companies, for example, fear the way pillar two will be implemented in the region as it could roll back key incentives, especially in insurance and manufacturing.

Malaysia held a consultation on pillar two legislation in August. The way the minimum tax is implemented affects the number of incentives that will be cut back or removed entirely in the wider region.

Tanu Anand, tax director at insurance company Swiss Re in Singapore, said during an *ITR* conference in August that the time factor and lack of technical detail added to the complexity of responding to the Malaysian consultation.

"It was a broad, 50-page consultation on BEPS with a tight two-week period for industry to comment," he told the Asia Tax Forum 2022.

The consultation's questions included how to define the set of companies in scope of the regulations and what incentives the government should be looking at. Both are non-specific inquiries that have left the burden of finding technical issues in pillar two and local laws to tax experts.

Anand said Swiss Re's input was that the definition and details align closely with the OECD's version to help standardise corporate processes. Her team also asked for a longer timeline than 2023, as most other countries are expecting to implement legislation in 2024.

"We asked for extra benefits and incentives – even non-tax incentives – to lessen the burden on industry," added Anand.

"This is going to be a hard hit on the insurance industry, as we have incentives that can bring our rates way below 15%, so we will see a very visible increase in our tax cost," she said.

Taxpayers will feel the impact of the two pillars

Only a few countries in Asia-Pacific have introduced pillar two legislation, including Hong Kong SAR, Japan, Malaysia, New Zealand, South Korea, and the UAE.

The top concerns for multinational companies are data readiness, tax controversy, arm's-length requirements, post-filing adjustments, interactions between different tax systems, and resourcing costs. The compiled responses came from 'big four' clients in Asia.

"The biggest problem in Asia is that mainland China has not announced anything yet, and that could become a more visible problem in the coming months," said one tax manager at an investment management firm in Singapore.

"Depending on your exposure to China, this could be concerning because it means that you have less time to deal with things as they arise – we will just have to wait and see," he explained.

Modelling for outcomes

Meanwhile, big four advisers said incentives could change depending on how the minimum tax is implemented, and whether it is part of national income tax law or has its own legislation.

If it's part of the income tax regime then there could still be credits and other incentives available that are capped at the 15% minimum rate, and tax professionals could treat the new income tax similarly to other taxes under the same band.

Multinational companies within scope of pillar two need to monitor national developments and how they may affect future tax costs. Chester Wee, international tax and transactions services partner at EY, said that the big four have already received a lot of requests to model the outcomes.

"When you start reading the rules you soon realise that they are highly complex," said Wee.

"You might need a supercomputer to get through the calculations to arrive at your effective tax rate," he joked.

Each jurisdiction has unique deferred tax calculations to find a company's effective corporate tax rate – and these are based on local regulations. "So how are you going to automate the process for 137 countries?" asked Wee.

Hybrid accounting provisions that bridge generally accepted accounting principles and international financial reporting standards could cause trouble for how companies use credits and deductions.

"The more entities you have under your group structure then good luck to you. For each you will have to do an ETR calculation along with the GloBE [global anti-base erosion] income and covered tax adjustments – and this is just one layer of calculations," said Wee.

At least two or three calculations per entity is a high compliance burden, and companies with hundreds of entities and several more permanent establishments should brace for a series of costs.

Advisers suggested that countries could take a non-technical approach, like Switzerland has done, to implementing the framework with single reference statements in their draft legislation to commit to the OECD's rules.

However, this approach to pillar two is a dangerous policy path as it introduces all the GloBE rules – including the income inclusion rule (IIR), undertaxed payment rule (UTPR), and subject to tax rule (STR) – all in one go at the beginning of 2024.

If Asia-Pacific countries follow this approach, it would force Singapore and neighbouring nations, including mainland China, to introduce the IIR.

This move is to avoid companies headquartered in those countries from paying top-up taxes in other jurisdictions via the UTRP because they may have a significant presence. Plus, the top-up tax is not refundable once it is paid, warned Wee.

"Pillar two could defy whatever incentive is introduced; many jurisdictions use tax holidays and special economic zones to attract investments and those could easily be nullified to draw in 15% on corporate income in those key markets," said Wee.

"When you look at costs and benefits on an overall group basis, then how do different pillar two legislations change the equation without the incentives you currently enjoy?" he asked.

"If you are in Thailand or Vietnam enjoying a tax holiday and that goes away, then what can those countries do for you? That becomes an important question in the region," he added.

Insurance and manufacturing companies will not just feel the pinch from higher tax costs – tax directors can see limited product offerings, slower M&A deal-making activities, and tight technology budgets restricting business operations for several years after the legislation is implemented.

Insurance case study

Insurance groups are among the big four's most profitable clients in Asian markets that are affected by incoming changes. Advisers are already recommending them to review how the model rules apply to acquisitions and due diligence, as the provisions could have a material impact on profits.

Anand at Swiss Re highlighted that her team got serious about dealing with pillar two between the end of 2021 and the beginning of 2022, with a high-level assessment of the impact on the group.

"We did not have time to decipher each deferred tax calculation, but we took a step back and asked what the impact could roughly be," said Anand.

"When we found the impact could be material, we took the results to our C-suite with what the changes could mean for our business, the long-term life contracts we sign, and our pricing options," she added.

Anand and her team managed to secure a high-level budget, but there was not enough funding to hire international consultants and pool resources to scrutinise how legislation may differ in each market.

"We started with decoding every deferred tax, and every law item had to be broken up across the team members, and we are still doing some of that," said Anand. "But we now have an adviser that comes in to look at what we have done and tells us if this is the right approach."

Anand's team is also dealing with the more pressing matter of IFRS 17, a set of principles for all aspects of accounting for insurance contracts, which starts on January 1 2023.

As a result, her team is monitoring the tax technology market for automation solutions to both incoming tax laws, particularly the fixes advertised by the big four firms.

> **"You might need a supercomputer to get through the calculations to arrive at your effective tax rate"**

"We have more than 400 members in our group, so how are we supposed to handle pillar two and IFRS manually? The truth is that we cannot," said Anand.

"We have systems today, but they are not geared to do ETR calculations the way it is required under the GloBE rules," she added.

Anand's team is deciding between manually building an Excel spreadsheet to sort the relevant data points for each jurisdiction's legislation and buying software off the shelf from a service provider.

"It will most likely be the second option that we ultimately have to go for," said Anand.

Executive-level concerns

Other conference sessions on the OECD's two-pillar solution also highlighted that several in-house professionals elevated concerns to their companies' C-suite executives to discuss long-term budgets to address the incoming changes.

Annie Pan, tax director at pension fund company Caisse de dépôt et placement du Québec in Singapore, said that she and other group tax leaders are concerned about how incentives that promote foreign direct investment will change.

Pan also serves as a board member and membership committee lead for in-house tax advocacy group Tax Executives Institute's (TEI) Asia chapter.

Members of the TEI are keen to understand how Asian countries have typically provided tax incentives to promote foreign direct investment as government contributions span trading, treasury, and IP operations, according to Pan.

Pan recalled when the Inland Revenue Authority of Singapore (IRAS) invited some TEI members for a series of discussions on pillar two, formally and informally, and members expressed three areas of concern.

First, the question was how sustainable regional incentives such as the foreign tax credit regime, shipping credits, and income tax exemptions are – how these are going to survive and whether the IRAS or other regional authorities will discontinue them.

The second focused on whether there would be any grandfathering relief for companies or an interim transitional rule. This is important for how multinational companies should be reacting to the changes.

Third was about how quickly each country will react to the 2023 deadline as many companies are not able to implement the necessary ERP adjustments, including upgrades to account for the 130 to 180 data points that are needed to perform compliance tests that underpin GloBE rules in national legislation.

Pan said that while there is limited time to restructure, especially post-BEPS, there have been related discussions such as whether to move the global treasury function to another competitive jurisdiction to minimise the compliance burden because it would simplify the necessary data collection.

In-house tax professionals are missing key details on how to prepare for pillar two in important markets in the Asia-Pacific region, as most countries are waiting for legislation to be enacted in Europe and North America.

It may be several months before the technical details that taxpayers seek become clearer, but tax leaders recommend that their peers start considering their exposure as soon as possible.

AUSTRALIA

DLA Piper Australia

Adam Smith

Australian court decides that power stations are not land or fixtures

The New South Wales (NSW) Supreme Court has held that three hydroelectric power stations were not 'interests in land' for NSW landholder duty purposes. Accordingly, the acquisition of a company that leased the land on which the power stations were located was not subject to landholder duty.

In 2018, Meridian Energy Australia (Meridian) acquired 100% of the shares in GSP Energy (GSP) for approximately A$160 million ($104 million). At the time of the acquisition, GSP was the operator of the power stations and lessee of the land on which the power stations were situated.

GSP had previously been vested with the power stations, leases, and other related assets of Green State Power pursuant to a statutory vesting order in 2014. Green State Power had originally obtained the same rights, assets, and liabilities under a statutory vesting order made in 2013.

The characterisation of the vesting orders and Meridian's interest in the power stations was critical to the assessment of whether GSP was a landholder under the Duties Act 1997 (NSW).

Meridian argued that its right to use the power stations derived from its ownership of the power stations pursuant to the vesting orders (rather than from the leases). The NSW chief commissioner argued that the power stations were fixtures, being part of the leased land, causing GSP to be a landholder and Meridian's acquisition to be subject to landholder duty of circa A$8 million.

The NSW Supreme Court's ruling

The court held in *Meridian Energy Australia Pty Ltd v. Chief Commissioner of State Revenue* [2022] NSWSC 1074 that the power stations were innominate sui generis property interest (property in a class of its own) to be held in gross, and therefore they were neither an interest in land nor goods for landholder duty purposes.

> "It is always necessary to check the underlying source of the taxpayer's rights"

The court focused on the 2013 vesting order and found that there was a statutory severance of the power stations from the land, due to the way in which the vesting order was framed, including that the power station dams were not listed under the heading of real property or leaseholder property in a schedule to the vesting order, but instead were listed as a separate "thing" (being a catch-all description of tangible property).

This unique interest was not an interest in land, and the 2014 vesting order did not alter the character of this interest. It was further held that the power stations did not become goods simply because the 2013 vesting order caused them to be statutorily severed from the land.

This case serves as a timely reminder that, when seeking to determine the character of an interest for tax and duty purposes, it is always necessary to check the underlying source of the taxpayer's rights.

The complex web of statute that can apply to critical infrastructure and the privatisation of state assets may cause an interest to be created that is so unique, it falls outside the traditional categories of land, fixtures, or goods.

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CHINA

KPMG China

Lewis Lu

China customs refines voluntary disclosure rules

On June 30 2022, the Chinese General Administration of Customs (GAC) issued GAC Announcement No. 54. This refines the implementation rules for the voluntary disclosure regime set out in GAC Announcement No. 161, issued in 2019. The refined rules are valid from July 1 2022 to December 31 2023. In parallel, Announcement No. 161 was voided.

Drawing on international best practice, a voluntary disclosure regime (the regime) was initially introduced by the State Council in the revised customs inspection regulations in 2016.

> "Import/export enterprises are encouraged to set up self-inspection mechanisms"

Under the regime, import/export enterprises may be subject to more lenient penalties where they voluntarily report their tax violations to the customs authorities in written form and rectify them promptly.

Key changes

Since its introduction, the regime has contributed toward enhanced enforcement efficiency. Announcement 54 includes several key changes.

Enhanced access to penalty exemption

Announcement 54 provides that an enterprise may be exempted from penalty (i) where a tax violation is voluntarily disclosed to the customs authorities within six months of its occurrence (regardless of the quantum of arrears); or (ii) where a tax violation is disclosed between six months to a year after occurrence and the taxes in arrears is less than 30% of the total tax payable or less than RMB 1 million ($145,000).

Previously, the time threshold was set at three months and for the second case it was 'after three months', while the underpaid tax threshold was 10% (or RMB 0.5 million).

Customs 'credit rating' impact

The China tax system, including the customs authorities, maintains 'credit ratings' for taxpayers. A low rating (the result of repeated violations) can lead to enhanced scrutiny and reduced access to preferential tax/customs services (e.g., import 'green channels').

Per Announcement 54, where an enterprise voluntarily discloses its tax violation and is subject to a customs warning or an administrative penalty under RMB 1 million, it will not be 'marked down' in the customs credit rating system. Previously, the penalty threshold was RMB 0.5 million.

Clarity on reduction to fines for overdue customs payments

Under the Chinese customs system, unpaid tax can be subject to both penalty and fines for overdue payment. The regime deals with relief from the penalty, but reduction of fines for overdue payment is subject to other regulations.

The earlier Announcement 161 had not made clear how voluntary disclosures on the regime would impact on taxpayer access to procedures to reduce the overdue fines. Announcement 54 now makes clear that this reduction can be applied for in parallel with the process for relief under the regime.

Repeated disclosure

Voluntary disclosure regime abuse is addressed by a new rule providing that the penalty mitigation rules do not apply to a tax violation disclosed twice. This prevents enterprises from dividing a tax violation of more than RMB 1 million into several violations, each with a smaller amount, to improperly access the regime benefits.

Looking ahead

In view of the more lenient treatment under Announcement 54, import/export enterprises are encouraged to set up self-inspection mechanisms to identify potential non-compliance in a timely manner. This will allow them to access the benefits of the new policy within the designated timeframes.

It is expected that the regime will be clarified to cover other non-compliant customs matters, such as quarantine violations.

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HONG KONG SAR

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Lewis Lu and John Timpany

Hong Kong SAR defers implementation of global minimum tax to 2024

The Secretary for Financial Services and the Treasury issued an open letter on August 15 2022 to provide the latest update on the implementation of pillar two under BEPS 2.0 in Hong Kong SAR. The letter can now be accessed via this link.

Key messages of the letter

The key messages of the letter are as follows:

- The implementation of the income inclusion rule (IIR) has now been deferred from 2023 to 2024 at the earliest – the government plans to introduce the necessary legislative proposals to the Legislative Council in 2023;
- As for the implementation timeline for the undertaxed payment rule, the government will monitor the implementation status of other jurisdictions and review Hong Kong SAR's own implementation plan;
- The government originally announced in the 2022–23 Budget delivered in February 2022 that it would consider introducing a domestic minimum top-up tax in Hong Kong SAR starting from year of assessment 2024–25 (i.e. April 1 2024) – this will now also be subject to the implementation status of other jurisdictions;
- In the coming months, the government will continue to closely monitor the OECD's latest timetable on the implementation of BEPS 2.0 and the implementation plans of other jurisdictions, and keep stakeholders closely informed of the implementation progress of Hong Kong SAR; and
- As the OECD aims to release the implementation framework of the global anti-base erosion (GloBE) rules under pillar two in late 2022, the government plans to launch a consultation towards the end of 2022 to collect views on the translation of the pillar two rules into domestic legislation and the relevant requirements.

KPMG observations

We welcome the government's decision to defer the implementation of pillar two in Hong Kong SAR in line with international developments. The timely issue of the letter provides much needed clarification on the government's implementation plan of pillar two in Hong Kong SAR.

Given the likely delay in the global minimum tax implementation in the EU and the fact that some other jurisdictions (e.g. the UK and Switzerland) have now planned to implement the IIR in 2024 instead of 2023, similar deferral in Hong Kong SAR is sensible.

We see no need for Hong Kong SAR to be the first mover on pillar two implementation. The deferral also allows more time for both the government and the in-scope multinational enterprise (MNE) groups in Hong Kong SAR to better prepare for the significant challenges pillar two implementation will present.

> "The government will monitor the implementation status of other jurisdictions"

Having said that, in-scope MNE groups in Hong Kong SAR should recognise by now that it is almost (if not absolutely) certain that Hong Kong SAR will go ahead to implement pillar two and it is just a matter of timing as to when the implementation will take place.

These groups should make good use of the additional time available to prepare for perhaps the most significant changes to the Hong Kong SAR tax system in the past few decades.

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INDONESIA

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Indonesia introduces changes to VAT invoices and export duty

The Directorate General of Taxation (DGT) issued Regulation No. PER-03/PJ/2022 (PER-03) regarding VAT invoices in March 2022. PER-03 requires that VAT invoices to a centralised VAT-able firm (*Pengusaha Kena Pajak*/PKP) should be addressed to the location of delivery, while the name and tax ID number are those of the centralised PKP.

Previously, the VAT invoice was addressed to the centralised PKP. However, it is not clear from PER-03 whether this requirement applies to all taxpayers or only to certain taxpayers.

On August 4 2022, the DGT issued Regulation No. PER-11/PJ/2022 (PER-11) to update PER-03. PER-11, effective from September 1 2022, restricts the requirement to be applicable only to delivery to a branch of a PKP that is registered with a large taxpayer tax office, special Jakarta tax office, or medium tax office that fulfils the following criteria:

- The branch is located in a 'certain area' consisting of:
    - A bonded storage area;
    - A special economic zone; and
    - Other areas governed by a non-collection of VAT and sales tax on luxury goods (STLG) arrangement.

> Previously, the VAT invoice was addressed to the centralised PKP

- The delivery is eligible to enjoy the facility of non-collection of VAT and STLG.

For transactions that do not fall under such restrictions, VAT invoicing must use the address of the centralised PKP.

Article 37, paragraph 2 of PER-11 also confirms that a VAT invoice or certain document that is equivalent to a VAT invoice is creditable provided it meets the requirement to credit input VAT.

Furthermore, there is a transitional provision in Article 38A which provides relaxation whereby a VAT invoice issued in accordance with PER-03 to a centralised PKP between April 1 2022 and August 31 2022 remains valid provided it meets the creditable input VAT requirements.

Export duty and export duty tariffs

The Ministry of Finance (MoF) issued Regulation No. 123/PMK.010/2022 (PMK-123) regarding the second amendment to MoF Regulation No. 39/PMK.010/2022 (PMK-39) concerning the determination of export goods subject to export duties and export duty tariffs. PMK-123 became effective from August 9 2022.

For the first amendment of PMK-39, please refer to our previous article.

The highlights of the changes under PMK-123 are as follows:

- Changes on the determination of export duty tariffs on export goods in the form of palm oil, crude palm oil, and its derivative products; and
- Reference prices are determined by the minister who carries out government affairs in the trade sector.

Changes in reference price between PMK-39 and PMK 123 are shown in the table.

Table 1

Reference Price	PMK 39	PMK-123
Cocoa beans	Average price of cost insurance freight (CIF) price of cocoa at Intercontinental Exchange (ICE), New York	• Average CIF price of cocoa from New York Mercantile Exchange (NYMEX); and • Price from the reference source exchange is based on the closing price (settlement price) for the nearest available month of delivery.
Palm oil, crude palm oil, and its derivative products	Average CIF price from Rotterdam, Malaysia exchange, and Indonesian exchange, with weightings of Rotterdam 20%, Malaysia 20%, and Indonesia exchange 60%	• Free on board (FOB) price of crude palm oil from Indonesia exchange and Malaysia exchange, and CIF price from Rotterdam, less the insurance and freight costs. • Prices from the Indonesia exchange and Malaysia exchange are based on closing price (settlement price) for nearest available month of delivery; and • Price from Rotterdam is based on spot price for nearest available month of delivery.

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Q&A

Siemens India head of indirect tax talks GST

Vikas Garg talks to reporter Siqalane Taho about how regulation, technology and the goods and services tax has affected the manufacturing company.

Siqalane Taho

Businesses in India have faced profound uncertainty since the introduction of the GST in July 2017 and the impact of COVID-19, but companies now face looming national tax audits.

Tax directors have had to learn to rapidly adjust to a multitude of challenges, including regulatory and technological changes, as well as the impact of inflation on workforces.

Vikas Garg, director and head of indirect tax at Siemens India in Mumbai, tells *ITR* about how the company is responding to these key challenges. He also talks about the competitive market for tax professionals in India and what businesses can do to retain their staff.

How has tax technology developed within your organisation in the past in terms of automation and would you say this has helped your business?

We have been very active at Siemens on the technological solutions front. This generally involves benchmarking of technology to find out what we have and need in-house. We tend to also investigate any new solutions that are available in the market for product fit.

We have found that many off-the shelf solutions require a significant amount of customisation. That's usually where we encounter a challenge in finding readily available solutions that a company can simply plug-in and starting using. These challenges have made us less hesitant to develop our own in-house technology solutions in response to these difficulties.

We have also noticed a few additional factors that influence our decision-making about what tax technologies to use. Firstly, we try to be clear about what our output requirements are in terms of specific technology function, the knowledge gap that such tools are intended to plug, and our business pain points.

Another factor is that our internal IT development teams and external service providers can give us a lot of this information. But we keep reviewing things during the development phase to ensure that technology continues to fit the purpose for which it is being developed. This can be seen in how we have managed to develop internal solutions for matching of input tax credits following the introduction of GST.

In a nutshell, technology has had a very positive impact in our business and at one point or other we've explored some of the solutions available in the market. In my team, I already have people who are experts in developing their own tools in Alteryx, Power BI and Qlik Sense. These are some of these new technological tools that few people were aware of only a few years ago.

How has technology helped in managing litigation risks?

We believe that there are three important aspects to be managed in any tax litigation. These include a correct interpretation of the law, ensuring appropriate documents exist for relevant transactions and making certain that these records can be easily referred to when needed. It is crucial that all these factors are in place either from the beginning or nearer the time of the transaction as opposed to when the organisation is involved in litigation.

In addition to strict compliance standards, we have also relied on technology solutions to help manage some of our litigation risks. This is quite a niche area with a limited number of service providers that sell these solutions. Again, these products need to be customised to suit different business needs.

Another issue is that these tools come with licensing models that require yearly subscription payments on top of the initial set-up costs. When we did a cost benefit analysis, we found purchasing one of these tools was not the best use of our resources. Therefore, we developed something of our own internally that has been working quite well for us.

Given the rapid growth of technology, what skills do you think tax professionals will need in the future?

The traditional way of thinking about automation usually focused on the fear that human beings would lose their jobs as a result of being replaced by machines. But consider that if 80% of your work requires routine manual input that doesn't leave you much time for value added tasks.

Automation could free up employee time for these high value activities such as analysing and implementing more sophisticated technological tools in an organisation. In the long run this would be much more helpful both for staff and businesses.

It is important to also bear in mind that humans have an edge over computers in terms of thinking strategically about a company's needs and challenges. Another factor is that professionals need to be able to evaluate workflows and prioritise those tasks that add real value to their organisations.

In cases where there are competing demands on staff time between routine tasks and high-value activities then businesses should consider outsourcing those more mundane functions.

How are you navigating the delicate balance between in-house versus outsourced service providers in your business, particularly when it comes to automation?

In our experience having a hybrid model works well where you have a mix of both in-house and outsourced functions. The challenge with any tax team is trying to do as much as you can with finite resources. There is also the additional consideration of relying on the limited capacity of IT professionals who often have multiple projects on the go at the same time.

There may not been a standard formula as such, but we try to achieve a 50-50 split of in-house versus outsourced suppliers. If more than 50% of your work is being fulfilled by an external solution provider, then balance can be achieved through some sort of customisation.

A business could develop a process for fulfilling those tasks in-house by working together with the outsourced supplier to create clear internal procedures so that you are not re-inventing the wheel, as it were.

However, in a lot of cases it makes commercial sense to use specialist external providers with expertise in fulfilling certain tax tasks for a range of companies rather than trying to do them on your own. It could be that their solutions are much more efficient, faster and accurate.

Vikas Garg

It has been five years since the introduction of GST, how do you think it has gone so far?

Overall, the government has been quite responsive to most challenges to the GST reporting system and filing procedures. This has helped a lot of taxpayers in their efforts to meet their compliance obligations. Also, given the large number of taxpayers in the country, it is unreasonable to expect that every tax person would be fully compliant. In most cases, it seems businesses are adhering to the GST rules. But this is not to say that there haven't been any issues with the new tax system.

For instance, a sore point for many companies has been the rapid pace of regulatory changes and compliance requirements. These frequently happen so it is sometimes difficult to keep up. Also, these tweaks in the law are usually aimed at closing loopholes used by non-compliant firms, but they end up negatively impacting good taxpayers.

It is estimated that approximately 10% of the taxpayers in India contribute about 80% to 85% of government tax collections. This means that compliance regulations have a more burdensome impact on the 10% of businesses that already abide by the law in terms of increasingly onerous requirements.

However, the gap in compliance and the frequency of changes in tax laws also creates mistrust between businesses and tax authorities. In addition, we have seen the government issue hundreds of tax notifications and circulars to clarify their own regulations in the last five years. This raises questions about why there would be a need for such a large number of corrective measures if the law was well-designed and implemented.

The government was much more accommodating to taxpayers during the first three years of the GST regulations. But recently we've noted a marked change in that approach and tax authorities have now become more aggressive in their enforcement procedures.

With looming nation-wide audits, we are wary of authorities taking a similarly tough line with firms despite it being the first audits since GST was introduced. One would hope that the government would recognise the challenges faced by companies in adjusting to this new tax regime and to be able to differentiate between instances of tax avoidance and bona fide errors.

Tax authorities are about to embark on their first nation-wide audits. What are your thoughts on the looming audits?

The audits have yet to begin in earnest, though they are gradually gaining pace. There are expected to be some challenges especially for large companies with operations in multiple jurisdictions in India. It means that audits could overlap or take place at the same time in different states. This could also severely test tax departments that are not adequately resourced and leave them facing significant risks of non-compliance.

It is likely to be a mixed bag in terms of the approaches from different tax authorities with varying levels of accommodation for taxpayers.

But if businesses are confident that they have their compliance documents in order then this should lessen any wariness. Obviously, there might be some errors, which may have some implications. But it's important to just be honest with your tax officer if there are mistakes. Now, there's a fine difference between deliberate tax avoidance evidence versus bona fide errors.

India's experiment with GST has raised costs for businesses

If you look at the GST collections statistics in India, they've been gradually increasing each year. That would not be happening if a large proportion of taxpayers were trying to avoid their taxes. Also, you would think that most companies would try to avoid unnecessary litigation.

This is not to say that there will not be any cases of differences of opinion between taxpayers and authorities on the interpretation of tax rules. But if there are discussions about those varying opinions and an understanding is reached most companies would be willing to provide reasons to justify their interpretation or go to the court to resolve the matter.

It is important to note that companies in India are risk averse when it comes to litigation as it can sometime take five to 10 years to resolve cases in the courts.

What has been your experience with trying to retain key staff amid a global rise in inflation and more competitive employment market?

There are enough opportunities for tax professionals in the market. This means that those professionals with the right skill sets are in high demand across the country. GST has become more prominent since it was introduced in 2017 and this increased awareness has driven business appetite for tax professionals with key expertise in this area.

Businesses are all too aware that they cannot afford to fall foul of GST regulations. This could have a reputational impact and lead to other companies in the market being less willing to do business with a firm that has been found to be non-compliant.

Given the size of the country, tax professionals with the right skills will not be short of employment offers.

What do you think tax directors could do more of to improve their operations and to meet their compliance requirements?

As the global economy continues to reopen following the COVID-19 pandemic, tax teams would do well to adopt benchmarking in their operations. This would involve looking at publicly available information to see what other businesses or countries are doing in their tax processes and to use best practice.

Tax professionals would be surprised to find that the issues they face in their firms are not unique to them, but that companies both at home and abroad might be experiencing the same challenges. This could help companies to find adequate solutions to some of their problems and to tailor them to their specific organisations.

In short, do your benchmarking, look at what works better in another jurisdiction given the scenarios, the specific environments, what you have for your country and analyse it in relation to your situation as a taxpayer. These solutions might involve technology or how to treat specific degree transactions.

Today, there may be numerous practices across the world as far as VAT is concerned. And that's where we can try to achieve a degree of standardisation and to help businesses to improve their processes.

The views expressed in this article are those of the interviewee and do not reflect the opinion of Siemens Limited or any of its affiliates.

Debunking a myth: VAT, foreign suppliers and electronic services in South Africa

Despite what some believe, foreign suppliers of electronic services in South Africa must register for VAT even if they use a local intermediary, say Jana Krause and Jarryd Hartley of Baker McKenzie.

Jana Krause

Jarryd Hartley

There is a popular misconception in South Africa's VAT landscape that foreign suppliers of electronic services (ES) to South Africa do not have to register for VAT if the supplies are made via a South African VAT-registered intermediary who accounts for the VAT. However, this is not supported by law, nor by the South African Revenue Service (SARS). Such a misconception could lead to a foreign supplier of ES finding itself in contravention of the provisions of the Value Added Tax Act, 1991 (VAT Act), which is a penalisable offence under the Tax Administration Act, 2011 (TAA).

Prior to 2014, the VAT Act taxed inbound supplies of services, including those supplied electronically, via its "imported services" provisions, which effectively impose a reverse VAT charge on the domestic recipient who acquires such services for purposes other than making taxable supplies. While this mechanism works reasonably well in a business-to-business environment, it is less likely that the consumer in a business-to-consumer transaction would account for the VAT due, rather than a business with corporate governance responsibilities, especially where e-commerce transactions are concerned.

The Organisation for Economic Cooperation and Development's action plan to address tax revenue losses due to Base Erosion and Profit Shifting contributed to South Africa looking at imposing VAT on e-commerce transactions. In June 2014, the VAT Act was amended to impose VAT on ES. This effectively shifted the onus of accounting for VAT from the domestic recipient to the foreign ES supplier, which now had an obligation to register for VAT in South Africa. This registration was compulsory for foreign ES suppliers whose total supplies of ES to persons in South Africa (that is a South African resident, a person who has a business, residential or postal address in South Africa, or who pays for the service from a South African-registered bank account) exceeded the VAT registration threshold of an initial amount of R50,000 ($2,800) in any consecutive 12-month period.

While only a limited scope of services was included in the 2014 ES definition, further amendments became effective in April 2019. This saw the scope of services that qualified as ES being widened to include any services (subject to a few exceptions) supplied by means of an electronic agent, electronic communication or the internet for any consideration. The VAT registration threshold was also increased to R1 million (from R50,000).

Currently, a foreign ES supplier is regarded as carrying on an enterprise for VAT purposes and is required to register for VAT in South Africa within 21 days of the total value of ES supplied to persons in South Africa exceeding the VAT registration threshold of R1 million in a consecutive 12-month period.

Middle-men

Intermediaries are persons who facilitate the supply of ES on behalf of ES suppliers and who are responsible for issuing invoices and collecting payment for those supplies. Included in the 2019 VAT amendments was a deeming provision that allowed intermediaries to account for the VAT where they are acting on behalf of foreign ES suppliers who are not VAT-registered in South Africa. However, neither this deeming provision nor any other provision in the VAT Act absolve the foreign ES supplier from registering for VAT where it meets the VAT registration threshold, even where it only makes supplies to persons in South Africa through an intermediary, and the intermediary is already accounting for the VAT.

As the law currently stands, a VAT-registered intermediary may account for the VAT on supplies facilitated by it on behalf of a foreign ES supplier only to the extent that the foreign ES supplier is not yet VAT-registered in South Africa. As soon as the foreign ES supplier's total value of supplies to persons in South Africa exceeds the VAT registration threshold, it must register with SARS. Once the foreign ES supplier is VAT registered, the intermediary may no longer account for the VAT and must, in line with the normal agent/principal rules contained in the VAT Act, provide the foreign ES supplier (within 21 days of the end of the month during which supplies were made) with the necessary statement to enable it to account for the VAT in its own VAT returns.

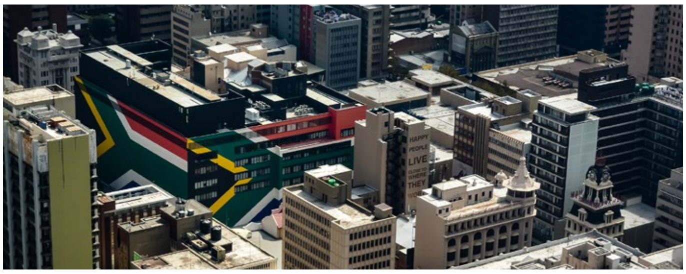
SARS has confirmed this position in its answer to question 26 of its Frequently Asked Questions – Suppliers of Electronic Services (FAQ document), which states that the foreign ES supplier that exceeds the registration threshold but fails to register as a vendor "may be guilty of an offence and remains liable to register and account for VAT on electronic services in the supplier's VAT return". However, there still seems to be a common misconception that the VAT Act provides an exemption from registration for foreign ES suppliers who only make supplies of ES through intermediaries.

Misconception theories

One reason for the misconception could be that SARS published a draft Binding General Ruling (BGR) in or around 2015 in which it intended to rule that a foreign ES supplier would not need to register for VAT in South Africa if it only supplied ES via an intermediary's platform, the intermediary was VAT registered in South Africa, and the foreign ES supplier and intermediary entered into a written agreement confirming that the intermediary would account for VAT on the supply of ES via its platform and be liable for the payment of the VAT on those ES. This ruling was, however, never issued by SARS and therefore does not have any practical application. A second reason could be that it would make sense for the legislation to provide such an exemption because, as it currently stands, it creates an onerous administrative burden not only for the foreign ES supplier but also for the intermediary and SARS itself.

The misinterpretation of, or pure disregard for, the law up to this point has hidden this lacuna in the legislation, which creates various problems for all parties. The first problem is that a failure to register by the foreign ES supplier leads to an unwitting contravention of the VAT Act, which carries possible penalties including a fine or imprisonment of up to two years under the provisions of the TAA.

Equally problematic is that the intermediary must provide the foreign ES supplier with a statement of all supplies made via the intermediary during a particular month, to allow the foreign ES supplier to file its own VAT returns and pay the VAT due. This would require the intermediary to keep records of the taxable supplies of ES provided by each particular foreign ES supplier separately. Many intermediaries either do not keep the information in such amount of detail, or do not have systems capable of keeping such detailed records, or may find it just too onerous to provide



Johannesburg is South Africa's business centre

the information as it would cause a massive cost and administrative burden on the intermediary, who is likely supplying ES on behalf of many foreign ES suppliers at once.

Without the relevant information, the foreign ES supplier would not be able to file its returns and pay the VAT. Even if it finds a way to determine the amount of VAT owed to SARS, paying such VAT while the intermediary is already accounting for it in its VAT return would lead to double taxation. Similarly, this would also cause an onerous administrative burden for SARS, which would need to investigate this complex web of relationships to ascertain who is liable to pay what amount of VAT. In many cases, the information may not exist or be available. This is an unsatisfactory position as far as enforcement is concerned.

The explanatory memorandum on the regulations prescribing ES for the purpose of the definition of "electronic services" in section 1(1) of the Value-added Tax Act, 1991(Electronic Services Explanatory Memorandum) states that the main drivers for these amendments to the VAT Act were the challenges posed by the cross-border supply of ES, since these are provided through the internet and were "largely invisible to tax authorities". Furthermore, the heavy reliance on recipients declaring VAT on imported services in South Africa was problematic because it could not be monitored for compliance and collection purposes.

Problematic position

This undesirable position in the law may stem from the fact that the legislature simply did not have a clear perception of the practical implications where ES are supplied through intermediaries. This appears anomalous considering SARS' published, but not issued, draft BGR which was seemingly abandoned. There could be a valid reason for the requirement that foreign ES suppliers who only supply ES via intermediaries still register for VAT, but it is likely to be a backstop approach by the legislature to allow SARS to have recourse to the intermediary where the foreign ES supplier is not VAT registered.

Either way, the approach is problematic and the legislation needs to be reviewed to counter double taxation and/or tax avoidance, and clarify these uncertainties while also ensuring that there is no prejudice to the National Treasury The mere fact that a foreign entity has an obligation to register for VAT in South Africa but neglects to do so may have greater consequences than just the penalties imposed by the TAA.

In the meantime, foreign suppliers of ES through intermediaries should ensure they are not operating under this popular misconception regarding VAT registration in South Africa and unnecessarily exposing themselves in the process.

Jana Krause is a senior tax advisor, and Jarryd Hartley a candidate attorney, at Baker McKenzie in Johannesburg.

IBFD interview
Why developing countries want more from BEPS rules

Pillars one and two still don't offer enough incentives for developing countries to adopt them, says Belema Obuoforibo in an exclusive interview.

Leanna Reeves

Established in 2016, the OECD/G20 Inclusive Framework on BEPS has always aimed to tackle tax avoidance, create coherent tax rules and boost tax transparency between countries. Six years later, the project is still being debated.

Criticised for focusing too much on developed countries and too little on those that significantly need revenue, the two-pillar solution is no longer just a given. With nations such as the US, Hungary, and Poland having recently put the tax framework in doubt, developing countries are also – still – not fully convinced of the BEPS project's benefits.

One of the cheerleaders of the developing world can be found at the International Bureau of Fiscal Documentation (IBFD), based in Amsterdam. Her name is Belema Obuoforibo.

As we sit down for an exclusive interview with Obuoforibo, who is director of the IBFD's Knowledge Centre, she says that adhering to BEPS rules is more than just a legal commitment – but rather a political one.

"I'm looking at the whole process to see at every stage how the concerns of developing countries have been taken along – why not, and what is being done to address that," says Obuoforibo, in an exclusive interview with *ITR*.

Obuoforibo has worked at the IBFD, a centre of expertise on cross-border taxation that supports tax research and academic activities, for over 13 years. She sits as a member of its executive board and chairs the Centre for Studies in African Taxation, a think tank dedicated to the development of African taxation.

Before joining the IBFD, Obuoforibo was a chartered tax adviser for many years.

Today, she advises African governments on various tax matters, and has learnt that many countries in Africa have expressed concern over pillar one's scope.

"The threshold that has been set would catch the largest companies, and you hear in Africa that it's good catching these countries but the scope is too small and limited," says Obuoforibo.

In September 2021, Nigeria's finance minister Zainab Ahmed explained the country's reluctance in adhering to Amount A of pillar one due to its threshold – which is set to only target multinationals with €20 billion ($19.7 billion) in global revenue and with over 10% profitability.

Amount A is designed to address tax challenges arising from the digitalisation of the global economy by taxing large profitable companies and allocating a portion of their profits to the countries from which their sales originated.

"There is the issue with the number of companies being caught, but also the issue as to how big the pie will be in terms of redistribution," says Obuoforibo.

Compromise and complexity

Aside from its fairness, the pillar one rule has been under fire for its complexity.

On August 25, the OECD published public comments following the release of the progress report on Amount A, and most companies were concerned by the complex sourcing rules and uneven playing field it would create.

The calculation of the profit allocation, for instance, has often raised eyebrows.

"On how to compute Amount A itself, you do see the theme of complexity coming back and how we are going to implement the rule under the ambitious time frame [2024]," says Obuoforibo.

"It's a complex thing to do to make global rules apply to different countries, but not all countries are at the same place when it comes to tax administration or compliance," she adds.

Policymakers and taxpayers are bound to embrace a 'wait and see' approach for the time being. However, developing countries still have the right not to sign up, insists Obuoforibo, particularly as implementing the OECD two-pillar proposals remains a political matter.

While the IBFD director recognises the difficulty of gaining consensus, some compromise must be found to incentivise developing countries to adhere to the two-pillar solution.

The pillar two rule has also been under significant scrutiny. It mainly requires corporations with €750 million ($742 million) in consolidated revenue to pay a 15% minimum global tax.

As most of the corporations in scope include high-tech companies based in the US, developing countries could miss out on foreign direct investment (FDI) because the overseas companies would have fewer funds available.

Also, some countries have high corporate tax rates in place already, so the rate offered by the OECD would significantly reduce their revenues if 15% was standardised.

Nigeria, for example, currently has a 30% corporation tax rate. Meanwhile, before joining the OECD tax framework, Brazil had a combined corporate income tax rate of 34%.

In a Q&A report released in July 2022, the OECD pledged that developing countries will still be able to attract "genuine" FDI through the BEPS project.

Above all, the OECD stressed the necessity for a multilateral agreement to be implemented and deemed the use of unilateral approaches, such as digital services taxes, to be risky.

When asked what the right approach would be to address the pillar one and two concerns raised, Obuoforibo admits she "doesn't know" how the issues can be addressed.

In fact, more complexity could come from a redesign of the OECD proposals.

"I don't see how a lot of this can be resolved without increasing the complexity. How feasible would it be?" she asks.

Balancing act

The OECD's work on reaching a global consensus will remain a balancing act, says Obuoforibo, as tensions will always exist between developed and developing economies.

It is up to policymakers to take into consideration jurisdictions such as African countries, for instance, that may have fewer resources and capacity to bear the increase in complexity and compliance burden.

For now, Obuoforibo will keep a close eye on progress made by the OECD and is confident the IF will continue to take on board criticism from past reports.

"I would like to see that continue," she says. "I would also like to see more engagement from the political leadership of developing countries in this process."

While Obuoforibo calls for leaders in these jurisdictions to take action, gaining political consensus is a team effort: developing countries must push for change, but the OECD has a responsibility to continue considering feedback on the two-pillar proposal.

Currently, the OECD's offer is not enough, it seems.

"We hear a lot about Amount A being the new taxing right – but it is not [for] the OECD to bestow a country's taxing right," says Obuoforibo.

"For it to be enthusiastically embraced, it will have to bring more to the table than what African countries are currently seeing."

LUXEMBOURG

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Transfer pricing, ESG, and the road to net zero

Climate change and sustainability are the shared defining concerns of our time. Governments, policymakers, investors, employees, and consumers are converging with determination towards a net zero economy. In this context, businesses and multinational enterprises (MNEs) are no exception and are also joining forces to fight the current climate emergency.

In July 2021, the European Commission presented "Fit for 55", which comprises a package of proposals to transform the European economy – including proposals on climate, energy, land/building use, transportation, mobility, and tax – with the aim to reduce net CO_2 emissions by (at least) 55% by 2030 compared with 1990 levels. Then, in November 2021, the Glasgow COP26 international climate conference set four goals:

- Secure global net zero emissions ('net zero') by 2050 and slow global warming to 1.5°C;
- Adapt to protect communities and natural habitats;
- Mobilise at least $100 billion in climate finance annually; and
- Finalise the Paris Rulebook to accelerate action to tackle the climate crisis through collaboration between governments, businesses, and civil society.

On this basis, ESG – i.e., environmental, social, and governance – is the common initialism and framework to transform how MNEs operate, produce, buy, sell, and set their sustainability goals. ESG is also a source of new value drivers (for example, brand differentiation, innovation, operational efficiency, capital access, risk mitigation, and talent attraction/retention) and new tax implications.

The list of impacts is broad and includes MNEs' tax strategy, environmental taxes and incentives, R&D credit and tax depreciation considerations, patent box regimes, new reporting obligations, workforce, value chain alignment, and operating models. This article focuses on the transfer pricing implications flowing from the environmental dimension of ESG.

Tax impacts of ESG-driven changes

Considering the scope and particularities of transfer pricing, MNEs should consider the tax impacts of sustainability-driven changes to the value chain and the reorganisation of supply chains and business models. Also, what key transfer pricing issues are linked to these changes?

Some of these impacts include:

- Any transformation to an MNE's operating and business models to integrate ESG objectives and impacts;
- Considerations around brand value and how that might differ between a business-to-business (B2B) and a business-to-consumer (B2C) model and the impact on the MNE's final brand valuation exercise;
- The role of public subsidies from the EU and EU member states, particularly which entity within an MNE is the beneficiary of those funds and what is the respective risk matrix;
- Any change to the MNE's supply chain, particularly its manufacturing footprint and distribution channels;
- The allocation of transformation/implementation costs driven by the green transition and how those should be allocated between associated enterprises within the same MNE; and
- The allocation of future profits and their link with the risks assumed by the various related parties.

With the above impacts in mind, MNEs should give particular attention to business restructuring and operating model transformations driven by ESG goals. Each MNE is unique, but any centralisation or decentralisation of functions – particularly regarding manufacturing and distribution – will necessarily lead to a new allocation of profits/losses and to a new transfer pricing policy that aligns the new business reality and its tax implications.

Special consideration should also be given to the allocation and assumption of ESG-related restructuring costs. For example, it is important to understand if a contract manufacturer located in a particular jurisdiction will reduce its CO_2 footprint due to local requirements or due to a wider MNE green transition led by a principal located in another country. In parallel, consideration should also be given to the EU Emissions Trading System (EU ETS) and Carbon Border Adjustment Mechanism (CBAM), as well as non-EU carbon emission trading systems that may impact the value chain.

Transfer pricing questions

MNEs should also ask themselves the following:

- What are the transfer pricing consequences from any change to the distribution channels; for example, by reducing the geographical distance between producer and consumer markets;
- How will the development of new key performance indicators (KPIs) affect the MNE's transfer pricing policy; and
- When will be the right time to review existing intragroup agreements to include ESG-related clauses, particularly those on the assumption and allocation of risks.

Another key consideration is the creation of an ESG department and the hiring of a department lead. MNEs that are in this process should consider the strategic role of this team and assess the respective tax and transfer pricing consequences. In fact, any MNE with a clear ESG implementation strategy will inevitably rethink its entire supply chain and set of risks. Therefore, the transformation must be reflected in a new or revised group transfer pricing policy.

The green imperative

In a nutshell, many MNEs are being compelled to accommodate ESG goals and consequences into their business strategy as part of their net zero journey. Proper alignment between the green transition and MNEs' tax and transfer pricing position must be part of that journey.

The time to act is now.

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NETHERLANDS

DLA Piper

Jian-Cheng Ku and Rhys Bane

Dutch Budget Day 2023: Impact of tax proposals on multinational enterprises

The Dutch Ministry of Finance presented its 2023 budget to the Dutch parliament on September 20 2022. Draft tax proposals for 2023 onwards are part of the budget and will be discussed by parliament and the Senate within the coming months.

If enacted, the tax proposals are expected to enter into force on January 1 2023. Proposals that would enter into force on January 1 2024 or later have also been announced.

Rebalancing of tax rates

As of January 1 2023, the lower corporate income tax rate of 15% will increase

"The draft tax proposals for 2023 onwards also contain several environmental tax proposals"

to 19%. Furthermore, the lower bracket of the corporate income tax rate of 19% (as of 2023) will revert from €395,000 ($394,000) to €200,000. These changes are accompanied by rate changes in the personal income tax sphere and are mainly intended to bring the effective tax rate of self-employed individuals closer to those of employed individuals.

Expansion of payroll tax exemptions and limitation of 30% ruling

As of January 1 2023, employers can reimburse work-related travel costs of employees tax exempt up to €0.21 per kilometre, up from €0.19 per kilometre in 2022. The government has announced a further increase in this tax exemption to €0.22 per kilometre in 2024.

Furthermore, the government has proposed an expansion of the generic exemption in the work-related costs scheme applicable to the first €400,000 in wage sum from 1.7% to 1.92%. Although the amendment is mainly aimed at small and medium enterprises, the expansion is generic in nature and applies to all employers.

Finally, the Dutch government proposes to limit the 30% ruling, which allows employers to pay 30% of the salary paid to an expatriate seconded to the Netherlands free from Dutch wage tax as a deemed reimbursement of costs incurred by the expatriate employee for moving to, and living in, the Netherlands. For 30% rulings that take effect as of January 1 2023 or later, the amount subject to the 30% tax exemption is capped at €216,000 annually, which coincides with the maximum public sector pay. For 30% rulings that took effect on or before the final payroll tax period of 2022, this cap enters into effect as of January 1 2026.

Other tax measures

The draft tax proposals for 2023 onwards also contain several environmental tax proposals. For instance, the CO_2 levy for industry will have a higher reduction factor, resulting in industrial companies having to pay the CO_2 levy for industry sooner than would otherwise have been the case. This change is intended to encourage companies in the industrial sector to reduce their CO_2 emissions faster than they are.

In order to enable taxpayers to further reduce their CO_2 emissions, the Dutch government is increasing the budget for environmental investment credit (MIA) by €50 million annually and the budget for energy-saving investment credit (EIA) by €100 million annually.

Finally, the government has proposed to increase the real estate transfer tax rate applicable to non-primary residences and non-residences from 8% to 10.4% as of 1 January 2023.

Future changes

There are two relevant future changes that have been announced.

Firstly, the Dutch government announced its intention to put forward a legislative proposal in 2023 that would prohibit one of the Dutch fund vehicles, the fiscal investment institution (FBI), from directly owning real estate as of January 1 2024. Due to the complexity of the legislation and the necessity to review the need for exemptions of real estate transfer tax for forced restructurings, this legislative proposal could not be published in 2022.

Secondly, the Dutch government announced its intention to review tax legislation and to get rid of certain tax facilities that are not being used as intended, are inefficient, or are ineffective. The government aims to raise €550 million on a structural basis with this review. It is therefore likely that this review will result in legislative proposals in 2023 and 2024.

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NORWAY

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EFTA Court rules against Norway on interest deduction limitation rule

As described in our previous article, EFTA case E-3/12 concerns whether the Norwegian interest deduction limitation rule in force from 2014 to 2019 is contrary to the freedom of establishment. The outcome is, however, also relevant for the European Economic Area's (EEA's) compliance with the interest limitation rule introduced in 2019.

Relevant Norwegian tax law

The taxpayer was a Norwegian limited liability company partly financed with equity and partly with debt. The lender was the parent company, which was tax resident in Luxembourg. Deductions for interest were partially refused on the basis of the interest deduction limitation rule (as the rule read in 2014 and 2015). The subject of the dispute before the EFTA Court was whether the refusal of deduction was contrary to the EEA Agreement.

The relevant Norwegian law is section 6-41 of the Tax Act ('the TA'), which in 2014 limited the right to deduct net interest expenses above NOK 5 million ($484,632) to 30% of the company's taxable EBITDA (earnings before interest, taxes, depreciation, and amortisation). The rule applies both to national and cross-border group companies, meaning that there is no difference in treatment under the rule *itself*.

The discriminatory effect emerges due to interaction with the group contribution rules, as mentioned in our previous article. These rules enable Norwegian companies in a group to reduce the interest limitation (entirely or partly) because the 30% EBITDA rule is affected by group contributions received, a possibility that is not available to EEA-based group companies. This makes it more beneficial to establish a group company in Norway rather than in another EEA country.

Most important takeaways

The EFTA Court first had to decide whether there was a *restriction* on the freedom of establishment. The Court of Justice of the EU has previously concluded that a combination of rules (tax consolidation rules and deduction rules) can result in cross-border situations being treated less favourably than national situations (see Lexel (C-484/19) and X and X (C-398/16 and C-399/16)).

The EFTA Court reached the conclusion that the combination of group contribution rules (which apply between group companies with tax liability to Norway) and interest limitation rules (which apply in general) meant that Norwegian borrowers that were in a group with Norwegian companies were exposed to less interest limitation, and therefore paid less tax, than Norwegian borrowers which are in a group with EEA companies. Thus, a discriminatory treatment existed which constituted a restriction on the freedom of establishment.

The EFTA Court also concluded that a Norwegian borrower that was in a group with a Norwegian company was in a *comparable situation* to a Norwegian borrower that was in a group with an EEA company.

> **"Only the consideration of preventing wholly artificial arrangements could be a relevant justification"**

It was not relevant for the comparability assessment that there had been no actual group contribution from the EEA company to the borrower in the case.

The last question that the EFTA Court had to answer was which overriding reasons (in the public interest) could defend the restriction. The EFTA Court assessed the consideration of ensuring a balanced allocation of taxation rights but concluded that this consideration could not justify that a tax deduction had been granted in a national but not in a cross-border situation. When an EEA state grants such a benefit in a domestic situation (and renounces part of its taxing rights), it cannot at the same time argue that the same taxing right is important in the cross-border situation.

The EFTA Court reached the conclusion that only the consideration of preventing wholly artificial arrangements could be a relevant justification. In order for this consideration to justify the restriction, there is, however, a requirement that the taxpayer must be given an opportunity to provide evidence of any commercial justification of the arrangement (that the loan is arm's-length, etc.). The documents presented to the EFTA Court indicated that it was not possible to provide such evidence. Nevertheless, the EFTA Court left it to the national court to verify this.

The interest deduction limitation rule that applied before 2019 applied unconditionally, meaning that it cannot be justified by overriding reasons in the public interest.

Next steps

The case will now continue before the Oslo District Court. In general, Norwegian courts are not obliged to follow the ruling from the EFTA Court, but the courts normally do.

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POLAND

MDDP

Anna Misiak

Tax changes related to employment in Poland from the payer's perspective

New regulations that have significantly changed the Polish tax system for the second time in 2022 came into force on July 1. The tax amendment, the so-called Polish Deal 2.0, modifies the personal income tax (PIT) regulations introduced on January 1 2022.

Below is a summary of the key changes introduced by the Polish Deal 2.0 with regard to the taxation of employment income.

Reduced PIT rate

One of the main changes is the reduction of the lowest PIT rate from 17% to 12%, applicable to income up to PLN 120,000 ($26,000). The change relates to taxpayers settling their taxes under general rules; for example, employees, freelancers, and board members. The new tax scale is to be applied to income for the entire year 2022, whereas tax remitters apply it when calculating advance tax payments on salaries paid from July 1 2022.

As of January 1 2022, the annual tax-free amount for taxpayers earning income taxed under the general rules was increased to PLN 30,000. Although the tax-free amount remains unchanged, due to the reduction of the lowest tax rate, a new monthly tax-reducing amount is lower and amounts to PLN 300 (PLN 3,600 per year).

Elimination of the middle-class relief

With the entry into force of the Polish Deal 2.0, the middle-class relief was repealed. The relief had been in effect since the beginning of 2022, and applied to employees who fell within the appropriate income limit, both on a monthly and annual basis.

However, it was widely criticised due to the complicated algorithms used for its calculation, differing at the monthly and annual calculation stages. Importantly, the elimination of the relief applies to the entire year 2022. Taxpayers can still settle their annual tax for 2022 according to the middle-class relief, if it is more favourable for them.

Elimination of double counting of PIT advance payments

With the introduction of substantial tax changes on January 1 2022, the tax burden of many taxpayers increased significantly. This situation met a fusillade of criticism. To alleviate the situation, the Polish legislator introduced a mechanism of double counting of PIT advance payments.

According to the obligation, a tax remitter paying income to employees and freelancers up to PLN 12,800 per month was supposed to calculate advance payments under the rules binding in 2021 and the rules of 2022 and choose the more favourable option for the taxpayer. The Polish Deal 2.0 repeals the obligation of double counting of PIT advance payments.

Increased remuneration of the tax remitter for timely payment

Until July 1 2022, the remuneration of the tax remitter for the timely payment of taxes to the state budget was 0.3% of the amount of the collected taxes. The remuneration of tax remitters calculating monthly tax advances on income taxed according to the tax scale has been increased to 0.6% of the amount of collected taxes.

Statements affecting the calculation of PIT advance payments

The employer calculates PIT advances using the tax-reducing amount if a PIT-2 statement is delivered by the employee. In response to taxpayers' problems with PIT-2 statements, the legislator has provided a new solution. The taxpayer will be able to submit a PIT-2 statement to a maximum of three tax remitters, indicating that a given tax remitter is entitled to reduce the advance payment by the amount constituting:

- 1/12 of the tax-reducing amount;
- 1/24 of the tax-reducing amount; or
- 1/36 of the tax-reducing amount.

Moreover, the Polish Deal 2.0 will provide for the possibility of applying the tax-reducing amount on a monthly basis to the income of individuals employed under a contract of mandate or contract for specific work. The possibility is reserved only for employees at present.

> **"A B2B contract can be an attractive alternative to the employment contract"**

In addition, the possibility to submit a request to the tax remitter not to withhold PIT advance payments – which is available, among others, to contractors and persons performing specific works – will be extended to employees. Taxpayers are entitled to submit an application if they expect that their annual income subject to the tax scale taxation will not exceed PLN 30,000.

B2B contracts

An employment contract is one of the basic forms of employment in Poland. However, employees are increasingly choosing alternative forms of employment.

A B2B contract can be an attractive alternative to the employment contract. This is the trend in the IT sector in Poland, where over a third of the specialists are working under B2B contracts, and paying, in general, lower PIT than employees.

The Polish Deal 2.0 also introduced many changes for entrepreneurs. One of the main amendments is the possibility of changing the form of taxation of business income (revenue) to the tax scale applied in 2022 during or after the end of the year.

In addition, the Polish Deal 2.0 introduced a possibility of partial deduction of health contributions, depending on the chosen method of taxation.

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ROMANIA

EY Romania

Corina Mîndoiu and Andra Ciotic

No special tax treatment for Ukrainian war refugees in Romania

Approximately 1.5 million Ukrainian citizens have entered Romania since February 2022, according to publicly available information, and more than 87,000 have remained in the country. Some secured employment in fields such as the manufacturing industry, construction, hotels and restaurants, or trade, while others set up small family businesses in Romania.

According to the latest statistics of the Ministry of Labour and Social Protection, more than 6,400 Ukrainian citizens are integrated in the Romanian labour market; out of which, 4,282 employment contracts have a start date that matches the date of the outbreak of the conflict in Ukraine.

What does it mean, from an individual tax perspective, for a Ukrainian citizen to stay more than six months in Romania and what details of the Romanian tax legislation should they pay attention to?

While things are somewhat easier in respect of establishing a legal residence in Romania and accessing the national labour market, thanks to the available legislative exemptions, from an individual tax perspective, a stay in Romania for a period of longer than six months – or, more precisely, longer than 183 days – can translate into additional tax liabilities.

Obligations triggered by a longer than six months stay

As per the provisions of the Romanian tax legislation, any individual arriving in the country and staying there for more than 183 days in any 12 consecutive months, ending in the calendar year concerned, must file an arrival tax residency questionnaire with the Romanian tax authorities.

The questionnaire should be filed only after spending 183 days in Romania. Based on it, the Romanian tax authorities issue a tax residency notification that confirms whether the individual is regarded as a Romanian tax resident.

Ukrainian citizens assessed as Romanian tax residents are taxable in Romania on their worldwide income.

If certain funds have already been transferred to Romania, it is determined that the source of any subsequent income, such as interest income, would be a Romanian one. This leads to the automatic taxation of the income in Romania.

Tax residency in Romania entails reporting and tax payment obligations with respect to any foreign income that the Ukrainian citizen could obtain, as of the first day of presence in the country, including:

- Income from renting out a property owned outside Romania; and
- Income derived from holding and/or transferring shares or other similar investments that the Ukrainian citizen may have outside Romania.

All these additional reporting and tax payment obligations with respect to personal income (other than salary) rest with the Ukrainian citizen. Furthermore, a stay in Romania, by establishing residence in the country, also qualifies the Ukrainian citizen as a payer to the Romanian mandatory social security system and could trigger additional social security payment obligations with regard to personal income.

> “More than 6,400 Ukrainian citizens are integrated in the Romanian labour market”

Salary income

While tax residency status plays an important role in terms of personal income (other than salary) and must be determined based on the procedure described above, the approach is different with regard to salary income.

Ukrainian citizens employed in Romania and undertaking employment activities in the country are subject to full salary taxes (income tax and mandatory social security contributions), but without personal additional reporting and/or payment obligations, similar to Romanian employees. The salary taxes reporting and payment obligations rest with the Romanian employer. This is the case for the over 6,400 Ukrainian citizens employed by Romanian companies and is reflected in the statistics of the Ministry of Labour and Social Protection.

On the other hand, Ukrainian citizens working in Romania while still being paid by a Ukrainian employer have the personal obligation to report and pay the tax liabilities due in Romania, both from an income tax and social security perspective.

The overall picture

In a nutshell, the Romanian tax legislation does not provide for any special exemptions regarding Ukrainian citizens who are war refugees. Moreover, a change of an individual's tax residency to a Romanian one, by fulfilling the legislative requirements corroborated with the provisions of the double taxation treaty between Romania and Ukraine, triggers additional tax liabilities for Ukrainian citizens established in Romania.

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Q&A

Lexmark VAT leader talks inflation and tax strategy

Gorka Echevarria talks to reporter Siqalane Taho about how inflation, e-invoicing and technology are affecting the laser printing firm in a post-COVID world.

Siqalane Taho

The global economic downturn has forced many companies to adjust their operations following the COVID-19 pandemic.

Tax professionals are battling rising inflation, and technological and regulatory pressures, while trying to help their businesses steer a safe course.

Gorka Echevarria, global VAT leader at laser printer company Lexmark in Geneva, is not immune to these strains.

He tells *ITR* how his company is dealing with the challenges of inflation, e-invoicing and technological change.

In the Q&A interview, he also highlights how indirect tax professionals can ensure they have a voice when key decisions are made in their businesses.

Multinationals are experiencing a lot of challenges with the geopolitical situation in Ukraine and rising inflation. How have these affected Lexmark?

Well, I think we're starting to notice that the main effect of inflation is on the salaries of our people. Whether we can really catch up with inflation and pay them according to the market rate is a challenge. And I'm predicting that there will be some attrition in many departments in businesses generally.

Some companies will be able to compensate their employees for this inflation, while for whatever reason, others might not be able to entirely meet all these increased wage demands. In terms of how this is affecting our other activities, there's an increase in the cost that we will be forced to pass on to vendors and customers. And this is tricky because everyone is under a lot of cost constraints.

Obviously, this is not a nice discussion to have with vendors and clients, but it is necessary. Inflation has become a problem. While some governments have reduced VAT on certain goods, inflation has spread all over the world, and it's affecting everyone. We're not the only business that is affected by it.

Are there any challenges or issues that you have at the moment with the EU's legislative proposals for VAT in the digital age?

I believe that the European Commission (EC) is trying to establish order in this chaotic process where countries are implementing their own digital live invoicing requirements. The Commission's efforts are very much welcome.

However, it's going to be difficult to put a brake on the increased digitisation process. Member states are finding that it is very easy to increase their revenue that they collect thanks to all these digitisation initiatives.

And it seems countries do not want anyone to harmonise EU rules – they would rather pass their own individual member state rules.

What the EC is trying to do is extremely complicated. I have my doubts about the level of success they will achieve in trying to harmonise EU rules because of the dynamics in the EU. Member states are able to block the passing of any harmonisation proposals.

Gorka Echevarria

But the discussions still need to be had between countries and the EU. Nations also need to realise that it is very costly for businesses or companies to adapt to all these detailed individual state-level requirements.

What I anticipate is that there will be some common agreement on the mandate in respect to intra-European flows. But with respect to the domestic transactions, the member states will be allowed to do as they please. And that really means that companies like ours will need to still dedicate a lot of resources and effort into adapting to all these requirements.

What steps are you taking within your organisation to try to ease the compliance burden, including your approach to the in-house vs outsourcing debate?

It's clear that you are not able to rely as much on the external parties as before because you're supposed to transfer data to tax authorities in real time.

For example, in Spain, every four days you have to submit all the content of your tax invoices. If you need a third party to do that for you, it means that somebody in your organisation needs to download the data and pass it to somebody else who then needs to send it to the tax authority.

As a business you might not have time to do all of those things. This means that companies now have to own the tax compliance from end to end. Our business has created a captive indirect tax department that is in charge of all those processes, we have been thinking and systematically applying these procedures for years now.

We are in a better position than most businesses in this regard because we have anticipated the regulatory changes for quite a while. However, we do see more companies going down the hybrid model route for outsourcing in the future.

What has your experience with tax technology solutions been like in the past?

I'm an ardent proponent of technology, particularly tax engines [tax compliance software]; I think it's absolutely necessary.

If you don't embrace technology, for example, your accounts payable departments will have to apply the correct tax treatment to a transaction while not being adequately trained to do so on an ERP system.

It means that they will have to sift through a list containing nearly 100 tax codes across different jurisdictions to find the right one. This can lead to a lot of errors. It can lead to dramatically bad results and incorrect accounting.

Companies can lose millions of euros if this process is not properly conducted. It can lead to losing refunds or tax authorities not trusting you because of the mistakes in your processes. So, technology is a big help in relieving tax departments of tax determination obligations on their own.

And this is more important for us on the input side as it's more critical.

On the output side, it is more straightforward to use a tax engine. In the US, it is nearly impossible for a large multinational to operate without the use of a tax engine and to comply with the multitude of taxes in the country.

Overall, I think tax engines are a very well justified investment for businesses especially when viewed in relation to the potential costs of human errors in the tax processes.

How do indirect teams sort work with other teams or departments in the business, and how important is it that they do this?

It's very important for indirect tax teams to be involved and engaged with different parts of the business. Indirect tax can be very transactional, and you need to be in constant discussions with a lot of internal teams such as supply chain, legal, finance and strategy teams.

Essentially, you need to participate in almost every strategic discussion that involves the business. For example, someone might approach you because they want to centralise a service function and they need to ask you whether that is possible or not.

The next day, you can be invited to a discussion about doing a spin-off of a business operation.

Some people can be allowed to be working fully remotely in a different country from where they live. And so then, a couple of days later, you have been instructed to deal with legal or business operations or HR.

It is very important to be able to work smoothly with all these teams, but that's not to say it is always possible.

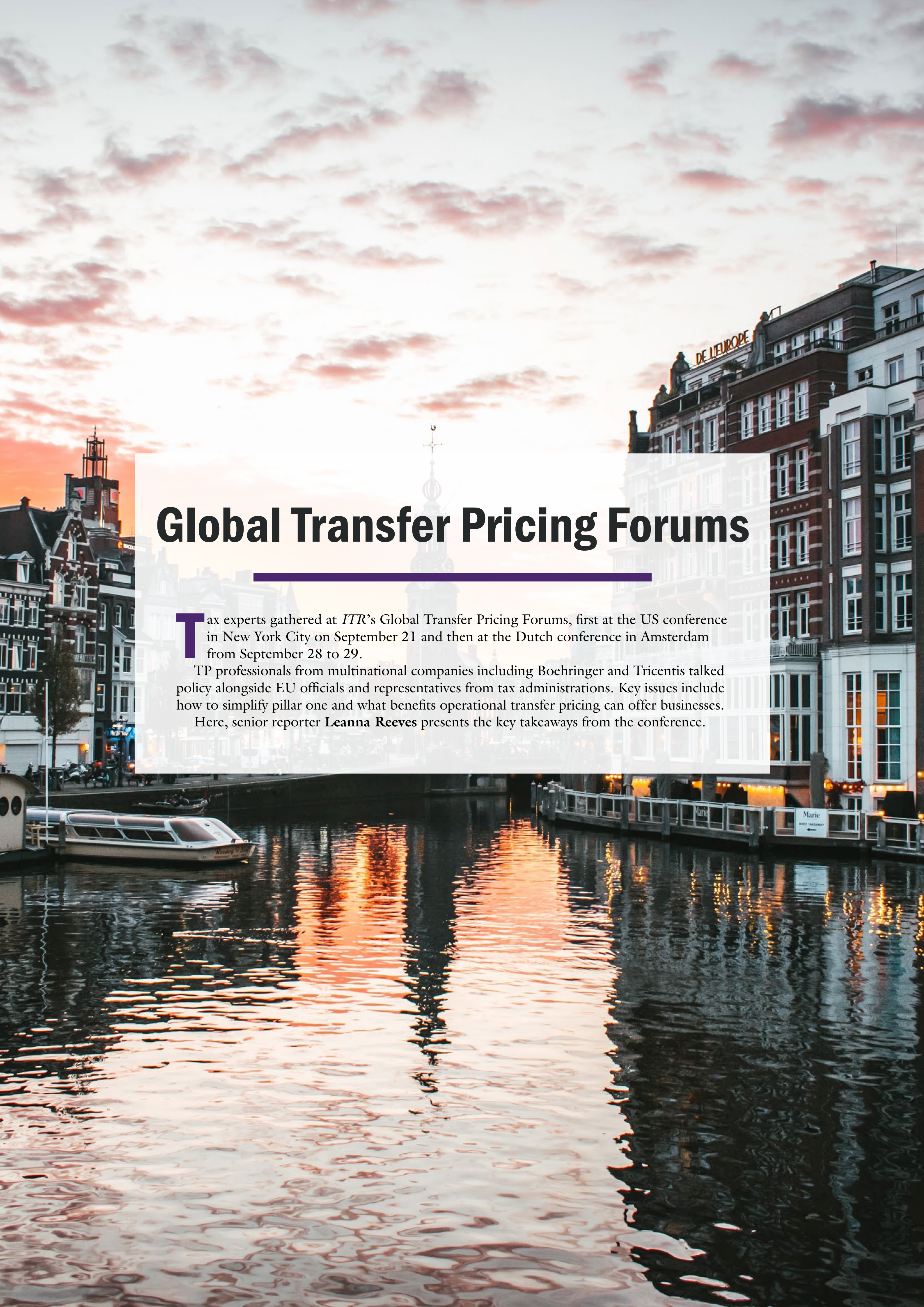
What would you say you like most about your job? And what would you say you like least?

I'm fortunate because I like everything I'm doing. But I think it is also only because of the environment and the quality of professionals that work at Lexmark. This includes how focused they are about their work and staying compliant. It enables [us] to thrive in that type of work culture.

The business gives me a lot of autonomy to decide and to prioritise what is important. But I think it's also important that your managers trust you and are confident that you know your job well and that you produce results.

The thing about our roles in indirect tax is that they are more subtle because we need to try to avoid mistakes that cost the company a lot of money. We need to avoid penalties. We need to be careful with forecasting the tax payments and stay in the loop to make sure transactions are structured properly.

So it's more difficult to quantify the effects of your involvement in your role. But you need to make a conscious effort to try to do that, to say: 'Well, this is thanks to me. My participation in this deal produced this result.'



Global Transfer Pricing Forums

Tax experts gathered at *ITR*'s Global Transfer Pricing Forums, first at the US conference in New York City on September 21 and then at the Dutch conference in Amsterdam from September 28 to 29.

TP professionals from multinational companies including Boehringer and Tricentis talked policy alongside EU officials and representatives from tax administrations. Key issues include how to simplify pillar one and what benefits operational transfer pricing can offer businesses.

Here, senior reporter **Leanna Reeves** presents the key takeaways from the conference.

Tax leaders demand 'simplified' pillar one

Tricentis and Boehringer Ingelheim, along with a European Commission TP specialist, criticised the complexity of pillar one rules and their scope at an *ITR* event.

The OECD's pillar one-related transfer pricing rules remain too complex and the scope should be expanded, according to speakers at *ITR's* Global TP Forum Europe, held in Amsterdam on September 28.

"We think it's really important to have a simplification of the TP rules," said Mauro Faggion, TP expert at the European Commission.

Faggion stressed that the need for simplification provided a "clear mandate" and that there is a "real demand" from businesses.

Other panellists including Vikram Chand, professor of law at the University of Lausanne in Switzerland, agreed with Faggion's comments.

"A lot of people will agree that these rules are not simple to understand at this stage. The way the proposal has been set right now in the progress report looks complex," he explained.

Leanna Reeves

Failure to address the complexity of the rules could jeopardise the success of the OECD's project, particularly if multinationals continue to show strong reluctance.

Jens Krüger, senior manager of TP at pharmaceutical company Boehringer Ingelheim in Germany, explained why the rules needed to be simplified.

"We need to have the data from our systems – to find where they are and compute Amount A and B. What we did is a list of pillar one and two and all the different definitions.

"Then we also did a list where we compared the definition of pillar two, which we might be able to use for pillar one," said Krüger.

"Simplification for us would mean shortening this list. That would be my pledge for simplicity," he added.

Size matters

However, the simplification of pillar one rules is not the only amendment that tax directors expect. Some also demand a wider scope that captures more corporations.

Under the current proposals, pillar one targets the large and most profitable companies. Those subject to the rule must have total revenues that exceed €20 billion ($19.2 billion) and their profitability measured against the total revenues must exceed 10%.

"Neutrality is also about ensuring that the system applies as broadly as possible," said Chand. "From that point of view, you may say that a lot of multinational enterprises are not caught by these rules."

But other corporations fear digital taxes already target companies that are not fully technology driven and that increasing the scope could also create more risk of double taxation.

Marta Pankiv, senior director and head of group tax at software company Tricentis in Vienna, said digital services tax (DST) remained "quite an issue".

"Every time we are trying to figure out whether we can sell in a location, the first thing that pops up would be DST and VAT. When we talk about pillar one allocation – how about other businesses? DST is very broad," she said.

"There are companies that are not necessarily all technology but are selling technology goods – the scope is very broad. It's also double taxation for us," added Pankiv.

In 2021, countries including France, the UK, Austria, Italy, Spain, and the US reached an agreement to implement the DST during the interim period of pillar one's implementation.

These jurisdictions plan to offer tax credits once pillar one is adopted – an initiative that Pankiv has welcomed, but the limited number of countries continues to pose a risk for businesses.

"My hope is that countries are willing to be aware that it's not about imposing tax and getting quick money. I hope there will be some compromise on the road," she said.

Andy Neuteleers, Vikram Chand, Sebastiaan de Buck, Mauro Faggion, Marta Pankiv and Jens Krüger

Speakers hail benefits of operational TP

Panellists said OTP can improve corporations' forecasting and data usage, with one describing improvements as 'night and day'.

Businesses will improve their forecasting if they adopt operational transfer pricing, according to speakers at *ITR*'s Global Transfer Pricing Forum USA in New York on September 21.

"Having that OTP down will get you better at forecasting. With your data, you'll be able to tell your own story," said Troy Siegfried, director of global TP at manufacturing company FMC Corporation, during a panel.

Siegfried ran into an issue in Asia in which products were stopped due to TP issues and it took an extended period of time for the items to be released. This presented a risk for the business as it could have had an impact on sales.

"Not only will your CFO visit you, but your CEO as well," he said.

Leanna Reeves

However, OTP could have minimised that risk, according to Siegfried.

While OTP relates to the management of data, processes, and governance through the use of technology – all these features can enable businesses to gain better forecasts on their operations.

During the panel, Thoihen Heisnam, director of global TP at real estate company CBRE, said that having a "good governance structure around processes" was crucial so that all stakeholders have clear visibility of their responsibilities.

Technology plays a significant role in automating these processes and ensuring they are implemented smoothly, according to Heisnam.

In short, the panel found, corporations must implement technology to improve their data usage.

'Night and day'

Michelle Velez, executive director of tax at manufacturing firm ITT, echoed Heisnam's thoughts, claiming that unless companies had "an army of tax people" they should start thinking about technology.

Two years ago, her business adopted a technology solution and spent a year and a half working with the team. By the time ITT had fully implemented it, however, the company had stopped using it.

Later, her firm spoke to the finance team and agreed to adopt a different vendor. Now that the technology is efficiently implemented, processing data has become a different ball game.

"It's night and day. The amount of time I used to spend sending files and consolidating data – now it all happens so easily and quickly," explained Velez.

"Now, I spent time analysing the data instead of consolidating it," she added.

Siegfried echoed Velez's thoughts, stating that while technology can be costly, the advantages of OTP would recoup the expense.

Technology can be considered a solution to the TP work burden for many companies, and speakers on the panel reiterated the significant human aspect of TP.

Danny McVeigh, TP east leader at consulting firm Crowe, said that while technology had many benefits, the "people process was very critical".

Businesses, therefore, need to think outside the box when recruiting the right skill set to implement technology.

As Siegfried noted, "Data is an important concept – but you will always have data. It's about consistency."

ITR's Global TP Forum took place on September 21 in New York and welcomed more than 100 attendees to discuss the pressing issues of tax and TP.

Sowmya Varadharajan, Thoihen Heisnam, Troy Siegfried, Michelle Velez and Danny McVeigh

IFA Congress 2022

The International Fiscal Association held its 74th congress in Berlin in September, bringing together more than 1,500 people from businesses, tax authorities and organisations like the OECD.

The IFA Congress held panel discussions with leading figures in global tax such as departing OECD tax chief Pascal Saint-Amans, Shell's tax director Alan McLean and a host of officials from the European Commission and the World Bank.

Here, senior reporters **Danish Mehboob** and **Leanna Reeves** report on the discussions at the congress, including carbon pricing, tax morality and the problem of digital tax.

Carbon pricing is the next big project akin to BEPS

OECD delegates Kurt van Dender and Pascal Saint-Amans said that carbon pricing will be the next big project on the intergovernmental organisation's agenda.

Danish Mehboob

OECD delegates Pascal Saint-Amans (director of the Centre for Tax Policy and Administration) and Kurt van Dender (head of the Tax and Environment Unit) said during an IFA panel that carbon pricing policies, including carbon taxes, are set to be the next project on a scale equal to the BEPS actions plan.

An emissions trading system, excise taxes, and fossil fuel taxes are all instruments that provide clear pricing indicators. Carbon prices have doubled since the COVID-19 pandemic started, but pricing variations across countries are large, according to van Dender.

The panel had a bigger public turnout than some of the other IFA sessions because many countries are setting zero-carbon emissions goals based on the Paris Agreement, which are translating into tax obligations in the mid- to long-term scenarios for large businesses.

Most attendees are in favour of a carbon price. Almost 86% of the audience agreed that a widely accepted international standard is required at this late stage of climate change.

Delivering a global carbon pricing mechanism is the OECD's next big tax project

Carbon policymaking

Other panellists at the carbon pricing session, held on Wednesday, September 7, include Tatiana Falcão, international tax lawyer and coordinator at the coalition for climate action at the World Bank in Brazil; Ian Parry, environmental fiscal policy and climate change expert at the IMF in Washington, DC; and David Boublil, deputy head of the indirect tax unit at the European Commission in Brussels.

All said the international challenge is designing a wider standard for carbon pricing. Panellists covered what it means to price carbon, the constitutive elements of a carbon price, border adjustment mechanisms to manage local carbon prices, and the types of multilateral approaches to coordinate the pricing of carbon internationally.

Carbon pricing plays a role in climate change mitigation policy, and the basic design details are critical. Carbon taxes are a natural pricing instrument, and trading systems can set a price floor alongside other regulatory measures.

Countries have taken different approaches to address the risks of climate change via tax policy. Taiwan adopted a carbon tax, the EU has an emissions trading system, and the US has a separate regulatory system.

Other carbon pricing approaches are being developed and implemented in Europe and North and South America. Panellists said the most readily available mechanisms across countries are carbon taxes, emissions trading systems, and carbon border adjustment mechanisms.

Carbon leakage

The various carbon pricing approaches have affected the trade of cement, iron and steel, fertilisers, and electric power for several large companies, from Apple to Deere. Industries focusing on the trade of these resources have a high risk of carbon leakage in their supply chains.

So far, however, regulations have not been strong enough to stem carbon leakage, as companies can still shift production to countries with low carbon options that also allow refundable credits to offset costs. Subsidies, rate reduction, exemptions, special regimes, and tradable performance standards all lower the cost of carbon pricing.

Carbon leakage is the biggest motivator for border adjustment mechanisms.

Carbon prices rose in countries where they were already high in recent months, such as Canada, France, and the UK, but not much in other G20 countries. Argentina, Indonesia, and the US are outliers as low performers. Alongside this trend, the price shock of the Russia-Ukraine was also affected carbon pricing progress in most countries, and price support fell after the event.

To achieve more multilateral carbon pricing, Germany and other countries are creating climate clubs – bloc efforts to align carbon pricing adjustment mechanisms with each other.

The OECD's efforts to lead and enhance policymaking on such climate change actions are slower than delegates expected, but more resources will go to international carbon pricing after the organisation finishes its work on the two-pillar solution to address tax challenges in the digital economy.

Shell's EVP of tax and controller on tax morality

EVP of tax at Shell, Alan McLean, said corporations must adopt a responsible tax strategy that ensures the long-term sustainability of their businesses.

Tax directors must design a responsible tax strategy for their businesses to guarantee their long-term sustainability, as well as increase transparency with shareholders and the public, said Alan McLean, EVP of tax and controller at energy company Shell, while speaking at an IFA panel in Berlin on September 6.

"In business and in normal life, we are faced to make choices. More often, we look at the law and it does not give us a clear answer. It requires us to use our judgement," McLean said.

When considering different choices, tax directors are bound to look at legal consequences and their broader implications,

Leanna Reeves

which inevitably bring value judgement and morality.

"The question of morality is not one I can ignore as tax director," he added.

With responsibility comes judgement

To promote tax compliance, McLean considers it essential that a business have a responsible tax strategy to ensure its choices align with its needs. This will also strengthen relationships with shareholders and the public.

Tax strategies often vary across companies, depending on their history, nature, and relationships with governments, employees and customers. But it is the tax director who will be at the heart of balancing, according to McLean.

"From a legal and regulatory point, it's easy to believe the law does not require [one] to exercise judgement. The UK Companies Act requires the board to exercise its judgement in the interest of shareholders," he explained.

"It implies a requirement to think about morality and the impact of decisions," he added.

The UK law also requires that corporations publish their tax strategies to ensure they remain transparent with their planning and risk approach – a "name and shame" process.

Transparency crucial

While there is a belief that shareholders seek immediate profit maximisation, the rise of ESG has proven the contrary, according to McLean.

"ESG shareholders have expectations about the behaviours of companies in regards to tax," he said. "A prudent approach to tax planning – it implies judgement."

Transparency is essential to building trust, which the OECD currently considers one of the most significant issues regarding tax morality and compliance, as seen in its latest report.

Above all, McLean claims that transparency offers greater tax certainty, and ultimately leads to better tax outcomes.

"We get better tax law, policy and administration. That is in the interest of all of us," he said.

The duty of the tax director therefore lies in determining whether a proposed transaction is aligned with the tax strategy.

Leaders warn DSTs are tip of iceberg in world fractures

Government officials and OECD leaders say digital service taxes are only the first set of unilateral risks to come if there are not enough countries to implement the two-pillar solution.

Danish Mehboob

Tax certainty to avoid fracturing the international tax system is an elusive element of the two-pillar framework. Corporate directors on a panel at the IFA/OECD seminar on September 7 shared similar concerns about double taxation from digital services taxes (DSTs) and other national measures, such as withholding taxes and transactions taxes, which would widen the tax base in several countries.

Gael Perraud, deputy director of international tax and European affairs in the French Finance Ministry, said there is no choice but to succeed at implementing the two-pillar framework.

"DSTs are just the tip of the iceberg," said Perraud regarding the double tax risks to come if global coordination fails and the two-pillar solution does not find the "critical mass" of participating countries it needs to work.

"Waiting for longer does not help developments, we have to conclude the deal sooner than later," he continued, suggesting that negotiations with stakeholders could go on for ages with reviews.

The alternative to the two-pillar solution is a string of unilateral measures, including DSTs, which would likely start a global trade war. This was exemplified when the US issued tariffs and trade restrictions on EU countries for unilateral measures – many started and ended in 2020.

DSTs may only be the first of a series of taxes that target revenue in the digital economy

The other six panellists were Pascal Saint-Amans, director of the Centre for Tax Policy and Administration at the OECD; Achim Pross, head of the OECD's International Cooperation and Tax Administration Division; Lisa Wadlin, head of tax at Netflix; Peter Shaw, head of tax audit and litigation at Maersk; Manal Corwin, tax principal at KPMG in Washington, DC; and Ruth Mason, professor of tax law at the University of Virginia.

"If DSTs are the tip of the iceberg, then governments are on the *Titanic*," said Corwin.

Saint-Amans, who has led many of the ongoing negotiations on the two-pillar framework, said several countries are tempted to enhance their taxing rights alone, rather than wait beyond the deadline in 2024 to implement the final versions of pillar one and pillar two.

Panellists also emphasised that there are risks to not having enough countries implement the two-pillar solution and align the technical rules by the deadline.

Critical mass

Advisers and government officials on the panel said if the requirements are too narrowly defined to get the right critical mass of countries to join, then it does not incentivise participation.

"It's a huge disincentive for any one country to contribute the whole Amount A," said Corwin.

"You need a critical mass [of countries] to move forward and achieve stability in the international tax system," she added.

Attaining that critical amount will pressure other countries to sign on to the tax reforms.

Panellists called the approach a feat of "diabolical engineering" and "devilish logic", with many commending its potential to introduce influential changes in international policy.

Saint-Amans noted that an adequate critical mass for Amount A rules in pillar one's design can be considered later. However, he also said the US must be a part of pillar one, or there will be no critical mass.

Corwin, who has experience in international tax policymaking at the US Treasury, explained that the Biden administration does not consider pillar one a centrepiece of its policy objectives.

However, Corwin also said the administration still supports pillar one, but there needs to be a commercial reason for its rules to materialise in the US market.

"It has not been fleshed out enough to make its way to Congress," she said.

"However, we do not want to rearrange the deck chairs on the *Titanic* either," she added, expanding on the analogy.

All stakeholders want the two-pillar solution to be administrable, reliable and sufficiently grounded in existing international tax principles.

As government negotiations continue and the OECD races against an aggressive deadline to pressure enough countries to adopt these regulations, there is a looming risk of wider fractures in the international tax system.