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International Tax Disruption – Way Forward

Greek philosopher Heraclitus once said that "Everything changes and nothing stands still." What varies, however, is the pace of change. When change is gradual and incremental, it is possible to adapt to it without much difficulty – the last 50 years have seen subtle and gradual changes in international taxation laws. More recently, however, development has gone into overdrive, disrupting the very fabric of international taxation. The rate at which change is taking place is faster than ever before, yet, one can expect that future change will never be as slow as it is today.

International tax issues have never been as high on the political agenda as they are today. The integration of national economies and markets has increased substantially in recent years, putting a strain on the century old international tax rules. Weaknesses in these rules had created opportunities for base erosion and profit shifting (BEPS) – plugging such holes has required bold moves by policy makers, not only to restore confidence in the system but also to ensure that profits are taxed where economic activities take place and value is created. Over several decades, in step with globalisation of the economy, world-wide trade has grown exponentially. The significance of the tax provisions and rules used by tax administrations has increased in light of the growing international trade and the world economic crisis after 2008.

The general attitude and approach towards the ethics of tax avoidance has changed. While earlier, tax evasion was frowned upon, now the global consensus is that even tax avoidance is immoral. World over, citizens and activists, and in some cases even few countries, are pushing governments and corporations to shun sweat-heart deals, lax laws, aggressive tax planning and inadequate disclosure and to instead embrace tougher laws, more transparency and honest payment of "fair" share of taxes. Countries that had built their economy by advertising themselves as tax-havens are now facing pressure to mend their wayward behaviour. There is increasing bitterness towards large multinationals and their rich owners getting away with paying near-zero taxes and stashing money in, often undisclosed, offshore trusts and bank accounts.

This brings us to the first of many disruptions that the world has recently faced in the sphere of international taxation – increasing transparency and threat from whistle-blowers. The signing of tax information exchange agreements between many countries with counterparts that are known for harbouring tax evaders, unnamed offshore accounts and shell companies has resulted in tax administrations having access to more information regarding tax planning and possible evasion done by taxpayers. When legal channels of getting information fail, or when conflicts of interest prevent information from getting out, whistle-blowers leak the data, often to devastating effect to the parties involved. Sometimes, other countries also purchase such data illegally and share it with other countries.

The outcry over tax evasion has been exacerbated by recent events which rocked the world – the "Liechtenstein Leaks", "Lux-Leaks", "Panama Papers", and "Portcullis Leak". These events shocked people, not only the ease by which tax evasion and avoidance had been taking place, but also by the scale of such practices and the involvement of politicians and other high profile figures. These leaks not only revealed how prevalent tax malpractices around the world are, they also showed that the very people expected to prevent such things from happening were often involved, to varying degrees, in their perpetration.

In the Lux-Leaks case, two former PwC employees passed on documents exposing Luxembourg's secret, sweet-heart tax agreements with multinationals to a journalist. Their earlier conviction by a lower court for leaking the documents has been appealed by their lawyers, who want them exonerated, arguing – as have tax campaigners and even Europe's competition commissioner – that they provided a valuable public service in divulging deals that deprived other countries, including Luxembourg's neighbours, of tax revenue. The case highlights weaknesses in protection for whistle-blowers. It has also spawned big changes.

One is a push to strengthen those protections. There is a fine line between leaking information about misconduct for moral reasons and for personal gains or to help the competition. Increased whistle-blower protection should be accompanied by more accountability and transparency in corporate and parliamentary governance. There should be inbuilt safeguards and maybe even incentives, for people to voluntarily come forward and report misconduct to independent bodies within the organisation or Government. Financial incentives however, may not be enough. Eliminating the fear against prosecution and ensuring protection from retribution by the exposed will go a long way in helping whistle-blowers make the decision of whether to come forward.

It would be bad for everyone if misdeeds only came to light through scandalous leaks to the media – the public trust in Governments and corporations would fall, and Governments and corporations would be unable to trust their officials and employees to handle confidential information with sensitivity. What the future needs is the creation of proper channels and mechanisms for those who obtain information that indicates or proves illegal or unethical activities to be able to report or pass on such information so that it can be investigated and that appropriate action can be taken.

Another fallout from information leaks is the backlash against corporate tax-trickery, which has sparked investigations into Apple, Amazon and others, and forcing tax havens to close egregious loopholes. While some of it may seem politically motivated, such as the European Commission's targeting of tax-deals given to US corporations, it cannot be denied that near-zero taxes paid by multinationals on profits of billions of dollars is a trend that deserves to be reversed. Scandals such as Petrobras-Odebrecht in South America, Samsung in South Korea, Rolls Royce in Asia and Europe, to name a few have added to the mistrust that the middle-class and poor have against "Wall-Street" and the "One Per cent".Politicians like Donald Trump and Narendra Modi have been able to leverage this sentiment to great effect. The impact this has on international taxation is that it forces Governments to take aggressive stances against even otherwise legitimate tax planning for the sake of electoral support.

The erosion of secrecy is another consequence. Governments are now being pushed to reveal information on their tax agreements with big companies and also give up previous withheld information regarding shell companies, trusts and bank accounts. Many argue that disclosure of information by tax-havens is not enough – they demand the complete dismantling of unfair tax practices that are having adverse consequences on the amount of tax collected, and therefore the amount that can be spent by the governments on infrastructure, healthcare and the economy. The days of tax evasion through use of unnamed and untraceable bank accounts or layers of shell companies and trusts, are numbered. While protecting whistle-blowers does not necessarily require international cooperation, improving transparency and tackling tax-havens would fail without joint global efforts.

One such significant global exercise was the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS). The far reaching consequences of the BEPS project on the scene of international taxation were not anticipated when the project was announced in 2013. Although the G20 leaders agreed that measures had to be taken to counter aggressive tax planning, there was a great deal of scepticism whether such an ambitious project, requiring the consensus of so many countries, with many conflicts of interests, could be reached on the wide array of proposed measures. However, as it has been seen, despite the initial uncertainty and even outright derision for the effectiveness of the OECD's approach, many recommended provisions are already adopted in domestic legislation of numerous countries. The initiative by the OECD, which included the 15 'BEPS' Action Plans and the recently concluded "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS" (or the Multilateral Instrument "MLI"), was a giant step in consensus based, multilateral action against tax evasion. Earlier, multilateral co-operation at this scale and with such urgency had been reserved for preventing wars, protecting the environment and combating pandemics or famine. The coming together of so many countries that agreed to make wholesale changes so that tax laws are more standardised, consistent and more rational has disrupted the international tax paradigm.

Aside from addressing the increasing base erosion and profit shifting due to practices of global corporations, the initiative also seeks to tackle the challenges posed by the digital and technological revolution sweeping across the global economy. Governments and global organisations are increasingly concerned that some large digital companies are exploiting the mobility and intangible nature of digital platforms and goods to sidestep taxes. The BEPS project is part of a global drive to close the tax gap posed by the digital economy that looks set to transform tax collection worldwide. Future tax laws need to ensure that appropriate taxes on revenues derived from digital trade are levied and collected. However, if these laws are anything like the complicated hotchpotch that results from policymakers' hasty attempts to devise laws to "correct" perceived imbalances, they will make it more difficult and costlier to acquire digital technologies, conduct internet based business and significantly reduce the impact that digitalisation can have on global economic growth.

The BEPS Action Plan serves as a consensus-based guide for Governments on how to change tax laws with suggested minimum standards and measures and also as a commentary on what is acceptable and what is not. It is also an indication to corporations, on what lies ahead. The BEPS Action Plan and the MLI have successfully initiated a global change in tax laws and bilateral treaties. In addition to exhaustive guidance on taxing the digital economy, the BEPS Action Plan contains rules and measures designed to deal with a wide gamut of issues affecting international taxation such as transfer pricing issues, thin capitalisation, controlled foreign corporations, taxation of complicated transactions involving intangibles, improving transparency in reporting by corporations and tax administrations' access to information and documentation, improving dispute resolution mechanisms, preventing abuse of tax treaty provisions and limiting (or regulating) access to benefits under tax treaties.

India has already implemented several such changes in the past few years – introducing the Equalisation Levy, a Thin Capitalisation regime, Secondary Adjustments in transfer pricing, Country-by-Country Reporting requirements, Place of Effective Management Rules, and General Anti-Avoidance Rules. Other countries have also followed suit by adopting measures dealing with BEPS into their domestic laws. Corporations doing business globally obviously have to rethink their strategy and way of doing business in light of such changes.

Had a single country tried to take on such changes independently within such a short span of time, the likely disruption to other countries or to global corporations would not have been significant. However, when numerous countries, especially those large economies on which the economies of most other countries are dependent, agree to make these changes simultaneously, it is bound to cause serious disruption.

Bilateral DTAAs, which take years to negotiate and then to amend, were simultaneously amended when several countries signed the MLI. A significant number of signatories did not have bilateral agreements with other signatories to the MLI – they were spared the arduous task of having to negotiate them. Especially for those countries with smaller economies, negotiating treaties is a difficult task given their lack of bargaining power – being a part of the MLI gave them the position of an equal at the negotiating table. The MLI has potentially standardised and amended almost 3,000 treaties at once, helping to tackle treaty abuse. Global corporate structures that have been built with a view to take advantage of beneficial provisions under specific tax treaties would become redundant if such provisions are done away with or if they become available under all treaties. The benefits companies foresaw in creating a presence in favourable jurisdictions only to avail preferential treatment to capital gains and dividend could be wiped out, significantly affecting the profits or returns which were otherwise expected to be earned.

The impact of the BEPS Actions and MLI will not be felt only by corporates whose tax planning will be made obsolete. The countries which have so far centered their economy on multinational companies setting up shop on their inviting shores due to available tax arbitrage will face great upheavals when these multinationals decide to pack up and shut shop in light of the loss of future tax advantages. Unless these Governments have already come up with or can swiftly devise something to offer other than lower taxes and convince companies to stay, the post-BEPS hangover will leave behind a severe headache.

While multinationals and companies are facing concerns over the manner in which they conduct their global business, they are also increasingly coming under attack for just being global. A wave of anti-globalisation and protectionist nationalism is sweeping across the world. It started with the surprising decision by the UK to leave the European Union. Before the world had time to come to terms with Brexit, the proponents of free-trade, global integration and 'internationalism' were dealt another blow with the election of Donald Trump as the President.

On one hand, companies are facing increasing pressure to be more transparent in their global dealings, to stop resorting to aggressive tax planning and pay their fair share of taxes; on the other hand they are being bullied into sacrificing profits and the interests of their shareholders in favour of national interest. The concept of letting market forces and comparative advantage decide where capital should flow and how trade is done is being ignored. The increasing popularity of anti-globalisation and aggressive populist nationalism is being seen in countries like France, Netherlands, Germany, and Italy. Even in India, the strategy employed by Patanjali Ayurveda, the FMCG company promoted by Baba Ramdev, compares "foreign" MNCs to the East India Company and declares a war on them for trying to drain India's wealth. The popularity and ready acceptance of such rhetoric is testament to the power of nationalism, which can bring decades of marketing strategy and brand building to its knees. This outlook which allows Donald Trump to threaten the building of an actual wall at the Mexican border has the potential to disrupt not just international taxation, but international trade also.

Global trade is no longer driving global growth like it once was. In 2016 it grew at just 1.7%, lagging world economic growth for the first time in 15 years and for only the second time since 1982, according to the World Trade Organisation. 2017 is expected to see a further slowdown. The decline in cross-border lending and FDI and increase in protectionist measures will have profound implications for cross border trade and capital flows. If more countries follow suit and embrace anti-globalisation and nationalistic stances, there is no telling what damage can be done.

There is also increasing pressure on public finances, post the financial crisis of 2008, which had a lasting impact on economies, leaving several countries with problematic budget deficits. Governments are struggling to fund public spending in critical areas such as education, healthcare and infrastructure. Several governments have required bailouts from international financial institutions, compromises with bond-holders and even resorted to selling government assets. With countries unable to afford more debt and stimulate domestic savings and investment, raising tax collections through rate increases or base widening appears to be the only option. Against the backdrop of an increasingly globalized economy, governments have decided to establish a more integrated worldwide tax framework and re-examine many branches of international tax law.

Corporate tax rates across the world are falling by themselves as economies mature, the cost of collection of tax and administration falls, and the domestic tax base widens. However, tax advisors and corporates must accept the fact that the era of complicated structures and zero-taxes is gone. Only embracing the disruption and changes and adapting their practices to suit the reality of the future rather will enable them to deal with the changes. Implementing leaner and less complex structures that are more flexible to changing global tax laws and trends are more suitable than multi-layered, complicated structures of the past.

While some disruptions are affecting the principles of taxation, another disruptor will change the way tax administrations work. Till now, tax administrations could afford to adopt a wait-and-see approach to innovations and technological advances – there was never a real urgency for tax departments to heed technological disruptions. Today however, that luxury is no longer available.

Information, or data, is power is today's world. Taxpayers constantly upgrade technology and adopt digitisation and have access to greater quantity and better quality data which is far superior to that at the taxman's disposal. Today, those who possess the ability to gather data quickly and accurately, manipulate it and turn it into knowledge will be better placed to reap the benefits from this era of unprecedented innovation. The tax industry is fair game for disruption. Technology has already shaken up and revolutionised several industries. Taxation is no exception. Those in the tax field must now brace themselves to disrupt or be disrupted.

One only has to look at the many tax administrations that are already embracing technological change today with the goal of improving data collection and ultimately boosting tax revenues. Countries in the emerging markets, including Russia, Mexico and Brazil, have taken the initiative in embracing digital to help with their tax efforts. The trend is also visible in developed countries such as the UK, which has declared its plans to make its tax system fully digital by 2020.

The outcome of technology is that the tax function is now being disrupted by what was once thought of as an effective, but rather sleepy governmental agency. Tax authorities have moved swiftly from paper tax returns to e-filing. The next natural step is to move to e-accounting, e-matching and e-auditing. Some are now at the beginning of e-assessments, where traditional tax returns will be replaced by digital tax accounts. This is all possible because of real-time and large scale data collection and analysis digital tools. Brazil planned to go live in 2016 with its e-Social programme, a module of its standardised public digital bookkeeping system, which will require companies to file electronic books with payroll information to capture data faster and to assess real-time.

Digital automation advances, through process automation, will see software programmes replace people in performing repetitive, form driven tasks. Those people, in turn, will be leveraged to perform less standardised assignments. Further, cognitive artificial intelligence will bring more change, putting high level planning decisions in the hands of computers boosting the efficiency and capacity of e-assessments, grievance-redressal and also reduce costs of tax administration. Errors will reduce. Analysis will improve. Reduced human interaction will reduce the scope of corruption and harassment. Global co-operation will be improved, with tax administrations able to share information and insights at the click of a button.

In the current scenario, international taxation is undergoing numerous, significant disruptions, that too simultaneously. While the recent disruptions in the field of international taxation have had both positive and negative impacts on Governments and corporations, one clear winner has emerged – professionals in the field of taxation. The experts who have built their business by assisting corporations with structuring, tax planning, setting up and conducting business and in navigating the often rough seas of global tax and corporate laws greatly benefit from the scale and pace of disruptions. Lawyers have benefitted from rising litigation and legal compliances required by increasingly complex regulations around the world. Accountants who understand the various reporting and disclosure requirements across jurisdictions and are able to be creative within the bounds of the law are in great demand. However, professionals also face the danger of backlash if they are seen as promoting "corrupt" practices and helping their corporate and HNI clients get away with "theft". The mantra of innovate or perish has never been truer for tax professionals.

It is important to choose the right strategy for the future when the pace of change in business models, regulation and technology continues to accelerate. The answer to riding the wave of changes is adopting the right technology, processes and people. Tax departments can no longer afford to pursue a wait and see strategy when it comes to adopting the latest technological advances. While many disruptors of international tax are from within the field, some are external.

Dealing with the internal disruptors such as increased data sharing and transparency due to tax information exchange agreements, the BEPS project and MLI, etc. will largely require dealing with changes in the law. These changes, though significant, will be easier to deal with since they will take place mainly on the basis of taxation considerations. Dealing with external disruptors such as technology and digitisation, changes in geo-political and socio-economic outlook and attitudes, and every changing global supply and value however, will be less straightforward since these changes will be driven or guided primarily by non-tax considerations.

Heraclitus was correct in saying that change is inevitable. The way forward is trying and anticipating the direction of change, being prepared for when such changes eventually occur, and by being nimble enough to deal effectively with the unforeseeable changes. The only way to beat the disruptions, however, is to cause or be the disruptor yourself.