The Future of Indirect Taxes—2020 and Beyond!

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Our “Going Beyond the Data” series concludes with a look at future trends in indirect taxes and the part that will be played by the Big Data phenomenon.

Very soon, a value added tax (“VAT”) or goods and services tax (“GST”) will apply in all major economies of the world, with the exception of the United States—a staggering growth of a tax first introduced in France in 1954, applied in only 48 countries by 1989, and then expanded to over 160 countries around the world.

But what happens from 2020 and beyond? In this final article in the series entitled “Going Beyond the Data”, we engage in crystal-ball gazing and predict two global megatrends which affect indirect taxes, and then most importantly, how each of those megatrends will impact on global developments in the use of data and analytics—more specifically, the Big Data phenomenon.

I. First Trend—More Comprehensive VAT/GST Bases

The first global trend is the anticipated shift towards more comprehensive VAT and GST bases.

The Organisation for Economic Co-operation and Development (“OECD”) recently released “Consumption Tax Trends 2014” which highlights the fact that 21 out of 34 OECD member countries increased their VAT/GST rates at least once over the period from 2009-2014, with the average VAT/GST rate amongst OECD member countries now exceeding 19%. The obvious opportunity now is for governments to broaden the base—because their rates may be starting to reach a natural ceiling; to plug revenue gaps most commonly associated with the digitization of global economies; or to continue the shift from corporate taxes to indirect taxes given the relative ease of collection and stability of the latter in times of economic uncertainty.

The uncertainty is whether policy makers can navigate often treacherous political waters to achieve this policy outcome. The patchwork systems in place in countries like Australia and Malaysia and across many of the Member States of the European Union (“EU”), with broad categories of zero rating, exemptions and/or reduced rates, is testament to the political compromises often needed to get a tax enacted.

Interestingly, the OECD recently concluded that reduced rates and other concessions were not an efficient way to protect lower income individuals and address the so-called regressivity of indirect taxes, which is the oft-cited reason given by policy makers for providing such concessions in the first place. A recent OECD study shows that many of these reduced rates actually benefit higher income households more than lower income households. This is particularly the case for reduced VAT rates on restaurant meals, hotel rooms and cultural goods, such as books, theater and cinema tickets. This suggests that a better way to achieve equity and social objectives would be to remove these reduced rates and provide more targeted relief measures, such as income-tested benefits and tax credits.

Another “concessionary” area which will be watched closely is financial services. Historically, financial services were exempted from indirect taxes on the basis that it was considered too difficult to measure the value added on a transaction-by-transaction basis. However, the goalposts gradually shifted when countries such as South Africa recognized the ease
with which VAT could be applied to financial services remunerated on an explicit fee or commission basis. General insurance policies also became subject to VAT/GST in countries such as New Zealand, South Africa, Singapore and Australia; and even in Europe, the exemption from VAT has been substituted by Insurance Premium Taxes.

Now, countries such as China are experimenting with the idea of taxing all, or nearly all, financial services under a VAT; with governmental regulation over their financial services sector being progressively relaxed, it provides a good testing ground for other countries to observe. If the Chinese experiment is successful, expect the debate about reforming financial services to be reignited in Europe and elsewhere. With the entry of market disruptors such as high-tech companies and traditional retailers into financial services, the rise of fee based products, and more sophisticated pricing models used by financial institutions, many of the traditional arguments used to rebut the application of VAT or GST to financial services now appear weakened. The mantra of some governments seems to be that applying indirect taxes to financial services may not produce perfectly pure policy outcomes, but sometimes "near enough is good enough". A related trend is the shift from multiple rate VAT and GST systems to single rate systems. Countries such as China, with its multiple rates of 3%, 6%, 11%, 13% and 17%, should inevitably consolidate into a single rate: a similar change may occur in India where the GST is expected to be initially introduced with multiple rates for different goods and services, but should ultimately be rationalized after a settling-in period. Both countries are undertaking significant indirect tax reforms which will impact on around 35% of the world’s population.

At the other end of the population scale, New Zealand is the country generally regarded as having the most comprehensive indirect tax base, and by and large, it works. It is the model for countries seeking to implement “modern VAT/GST” systems. It would not be surprising to see other countries following the New Zealand lead in 2020 and beyond.

II. Second Trend—Global Framework for Cross-border Services and Intangibles

The second trend, though perhaps likely to exceed a 2020 target, is the shift towards a global framework for applying VAT or GST to cross-border flows of services and intangibles. That global framework is expected to result in a high level of consistency between countries in the VAT/GST treatment of international trade flows, based on the "destination principle". This is the principle that VAT or GST should be levied in the place where goods and services are consumed, not the place from which they originate. The destination principle provides a very powerful response, in an indirect tax context, to the base erosion and profit shifting ("BEPS") debate which is ongoing in a corporate tax context.

As Professor Rebecca Millar recently noted, there is a real contrast in the challenge for policy makers in taxing cross-border transactions under corporate taxes as compared with indirect taxes:

Yet the conclusion that “something needs to be done” simply does not have the same significance for VAT as it does for income tax. This is not because VAT on global digital transactions is easy to collect: it is not. Nor is it because VAT raises different collection problems than income tax: for the most part, it does not. What is different about VAT is the almost universal agreement on the substantive jurisdictional principle that should be used to determine the tax base. Some countries might pay lip service to the destination principle, particularly countries with limited tax collection capacity and a high reliance on VAT to meet their revenue needs. Other countries—or their tax administrations and/or courts—might disagree about what the destination principle requires in particular circumstances. Nonetheless, there is little or no significant disagreement on the fundamental principle. Nor is there any significant disagreement about the most important aspect of the neutrality principle, which entails the notion that there should generally be no tax burden on business-to-business (B2B) transactions under a VAT. Thus, whatever it is that needs to be done, it is unlikely to involve a fundamental re-think of the jurisdictional basis upon which decisions are made about which country has the right to tax consumption. [Footnotes omitted]

While a single set of rules to be applied globally may be an unrealizable dream, agreement on framework principles is not. As the OECD has recently recommended, supplies of services and intangibles in a business-to-consumer (“B2C”) context should be taxed based on the place of performance where they are consumed “on the spot”, such as services physically performed on a person, accommodation, restaurant and catering services, entertainment and sporting events, exhibitions and trade fairs. B2C supplies should be taxed based on the “usual residence” of the customer for other supplies of services and intangibles, such as consultancy, accounting and legal services, financial and insurance services, long-term rental of movable property, telecommunications and broadcasting services, and online supplies of content, storage and gaming. And business-to-business (“B2B”) rules, where the emphasis is on achieving neutrality, should focus not only on where the business customer will use its purchases that final consumers will acquire, but also on facilitating the flow-through of the tax burden to the final consumer.

The logical consequence of this approach is the need for simplified registration and compliance regimes to enable suppliers without a physical presence in that jurisdiction to properly account for VAT/GST. Governments will be incentivized to do so, given that they otherwise run the risk of having to rely on more difficult and costly enforcement and collection mechanisms.

Already we have seen movement towards the implementation of these principles with the adoption from January 1, 2015 of the EU’s “Mini One Stop Shop”, which not only invokes the destination principle for B2C transactions, but also seeks to simplify the compliance burden for business across EU Member States. Similar measures have also recently been implemented in countries such as Norway, South
Africa, Korea and Japan, with others such as Australia and New Zealand shortly to follow. It would not be surprising to see whole trading blocs, such as the Association of Southeast Asian Nations economic community, banding together to administer collection systems on a more simplified basis. This is key: unless governments can come together to simplify or overcome the need for separate country registrations, tax filings, and compliance, they will in many cases be resigning themselves to an “80/20” level of tax collection.8

III. Big Data

This decade has seen a seismic awakening in the business world to the power of data and analytics. Historically the domain of the IT expert, data and analytics is now harnessed to drive business growth; to enter new markets; to drive change across operations, supply chain and finance; to understand and anticipate customer needs; and to implement new business models.

In this series of articles,7 KPMG experts noted the transformative powers of Big Data and analytics in an indirect tax context, and how this phenomenon is reshaping the way businesses, and tax authorities, operate. In the first article we showed how tax authorities are increasingly understanding the importance and availability of data from business. In the second article we examined the impact of Big Data on the formulation and application of indirect tax policy and administration. The third and fourth articles focused on the impact of Big Data in a trade and indirect tax compliance context respectively. The fifth article then outlined how data and analytics could be applied to better understand and manage transactional taxes. Here we examine the impact of Big Data on indirect taxes in 2020 and beyond.

At a recent KPMG Global Indirect Tax Services event held in Hampshire, United Kingdom, participants from many of the largest multinational companies around the world debated eight key statements around the future impact of Big Data on indirect taxes. These statements, while deliberately provocative, paint a picture of the potential of Big Data post-2020. The eight propositions are:

1. **No more periodic returns—tax will be settled in real-time.** Already we have seen innovation in countries such as Brazil, which recently implemented a public system of digital accounting used to approve, store and certify commercial and tax bookkeeping documents, to enable tax authorities to make a complete assessment of their tax accounting information. Similarly, in China, its Golden Tax System provides a data download of transaction level information to the tax authorities on a monthly basis. While not yet “real-time”, that solution is not far away. The experiences in these developing countries beg the question—if Brazil and China can do it, then why not more fully developed economies? Interestingly, in a recent article published by Bloomberg BNA, two academics put forward a thought-provoking proposal as to how indirect taxes could be transformed into something more akin to a retail sales tax through real time tax collection.8

2. **Big data will close the VAT/GST gap.** While there is an abundance of anecdotal evidence supporting increased requests for data by tax authorities from business, thus far much of that data has not been harnessed. This will change. Data analytics enables tax authorities to develop sophisticated risk profiles and conduct trend analysis, flag potential audit issues, and screen out higher risk cases for deeper investigation—cutting off avenues for fraud before they even occur. By analogy, just as we expect immigration officials to use data to pre-screen passengers before arriving at their destination, so too will tax authorities. “Random” audits will become a contradiction in terms.

3. **The tax transparency debate will shift to indirect taxes.** Several recent high profile media cases have highlighted a disconnect between community expectations around the contribution that multinational companies should make to tax collection in the countries in which they operate, and their actual contributions. This has led to mandated disclosure obligations in a number of countries, as well as to many companies voluntarily reporting their tax payments. The role of indirect taxes in that debate has been somewhat muted to date, raising issues such as: (1) whether indirect taxes should be reported as part of a company’s total tax obligations; and (2) does a multinational company bear some responsibility if it is legitimately able to provide goods or services into a country without VAT or GST? Arguably the consumer is the winner, but equally it may be contended that the supplier has secured a competitive advantage over locally-based businesses.

4. **Data quality and analysis will be the new audit battleground.** The new audit battleground will be around the testing of business systems and processes, to better understand controls around manual interventions, and to see how those systems respond to changes as a result of new products or services, or new rates and indirect tax rules. The debate in tax audits will be around whether one data set is better than another—in other words, whether tax authorities’ data which shows a certain correlation or trend is more accurate or robust than that of the company being audited. Tax authorities in Singapore have been amongst the leaders in this area, recognizing the mutual benefit for both companies and governments in the former investing in controls over indirect taxes as a means of securing enhanced compliance, with the latter co-funding the costs of implementing it.

5. **You won’t control all your own data anymore.** Banks and credit card processors are already playing an increasing role as “de facto” tax collectors, with their data routinely being requested for analysis and to validate transaction level data. Interestingly, that same transaction level data which is so critical in an indirect tax context will increasingly...
be leveraged by tax authorities in a corporate or personal income tax context.

6. Your data will become very interesting to others. Increased information exchanges between governments will facilitate multi-country tax authority audits. Additionally, indirect tax systems will increasingly rely on the VAT/GST registration status of parties, or their address details, and that information will likely become publicly available.

7. Indirect tax rules will be written with data analytics in mind. For example, place of supply rules will cease to be based on vague or uncertain concepts such as “residency” for tax purposes, but instead will use proxies such as the consumer’s IP address or credit card information. Interestingly, this could shift the capacity for VAT/GST avoidance into the hands of tech-savvy consumers, able to shop around for the lowest VAT/GST rate using geo-blockers. Nonresident or tourist refund schemes could, at least in theory, be abolished in favour of point of sale discounts, although it may be more convenient for governments to continue with inefficient practices to mitigate the financial impact.

8. You [the tax manager] will be redundant by 2020! This was a tongue-in-cheek suggestion designed to highlight the changing roles and responsibilities of tax managers as a result of the Big Data phenomenon. In the future tax managers will be more focused on issues such as how systems respond to changes in products, services and technology; testing the integrity of systems; and analyzing trends and exception reporting. Big Data demand is expected to reach 4.4 million jobs globally, with two-thirds of these positions remaining unfilled.9 The point is simple—businesses need to retrain, recruit or upskill their tax staff to respond to the Big Data challenge.

IV. What Does It All Mean?

The truly fascinating issue to consider is how these megatrends will interact. If we have a shift towards a more comprehensive VAT/GST base together with the adoption of a global framework for applying VAT or GST to cross-border flows of services and intangibles, what happens when this is overlaid with the Big Data phenomenon? In the future tax managers will be more focused on issues such as how systems respond to changes in products, services and technology; testing the integrity of systems; and analyzing trends and exception reporting. Big Data demand is expected to reach 4.4 million jobs globally, with two-thirds of these positions remaining unfilled.9 The point is simple—businesses need to retrain, recruit or upskill their tax staff to respond to the Big Data challenge.

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NOTES
3 See, for example, Singapore and Malaysia, both of which have a “fixed input tax credit recovery” system for
financial institutions to overcome the compliance problems of partial exemption methodologies.


6 This is the idea that 80% of the revenue can be collected from 20% of taxpayers, being companies such as Amazon, Apple, Google, Alibaba, etc. The other 20% of revenue would likely go largely uncollected given limited enforcement options where the supplier does not have a taxable presence in that country.

