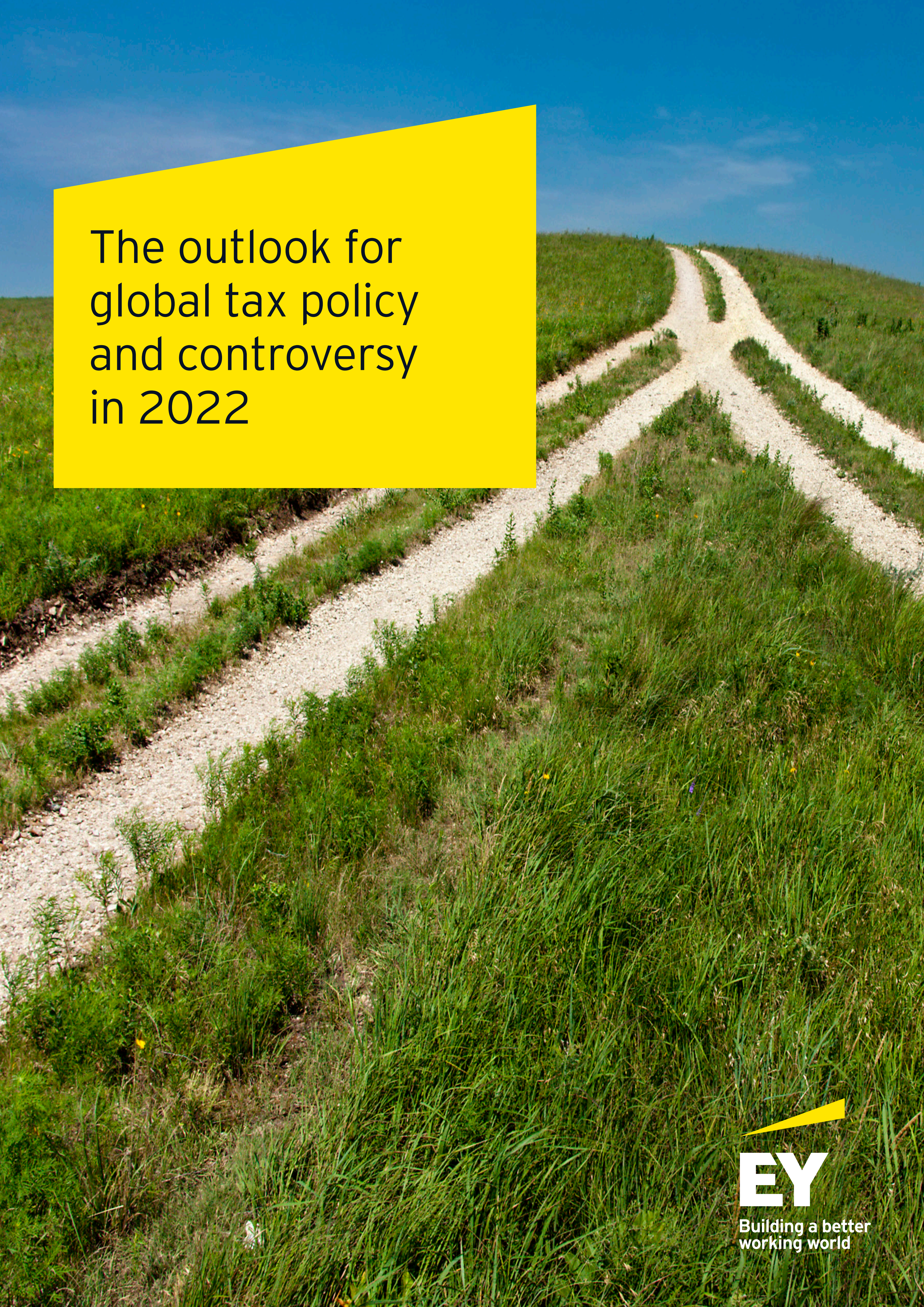
The outlook for global tax policy and controversy in 2022



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Can unprecedented tax uncertainty lead to unprecedented tax collaboration?

"As 2022 begins, the only universal tax certainty is that a wave of change is on the horizon," says Kate Barton, EY Global Vice Chair of Tax. "And arguably, more than ever, multilateral tax considerations are at the epicenter of individual jurisdictions' fiscal policy." The fiscal challenges facing governments are shared; the globalization and digitalization of the economy, climate change and the ongoing repercussions of the COVID-19 pandemic remain top of mind around the globe. Increasingly, the responses to these challenges are not only shared but require close cooperation with others to succeed. "Certainly, tax is a matter of sovereignty, but global cooperation and coordination can support the tax policy choices of each jurisdiction to the benefit of all," continues Barton. "Indeed, this increasing global interdependence may very well lead to a new era of multilateralism," says Barbara Angus, EY Global Tax Policy Leader, "as governments explore new ways to work together on a variety of common tax objectives."

The historic Organisation for Economic Co-operation and Development (OECD)/Group of Twenty (G20) Inclusive Framework agreement on the BEPS 2.0[1] initiative in October 2021 is an illustration of the multilateral cooperation possible but also a test of that cooperation. With political agreement reached on key parameters, can those parameters be translated into detailed operating rules that individual jurisdictions will implement consistently and that will function as intended? The same can be asked about climate-related activity: throughout 2021, jurisdictions made or reaffirmed climate pledges, but will they be able to make the changes necessary to meet those goals?

The commonalities and interconnections are not limited to these major initiatives. All governments need revenue to fund their operations and provide services to their people, and tax increases do not occur in a vacuum. Jurisdictions run the risk of deterring investment or stifling their economies if they merely out tax their neighbors, so a government's approach to revenue raising through higher taxes requires careful consideration of circumstances outside their borders. Moreover, the current focus on enforcement to bring in revenue is nearly universal, after a period of COVID-19 pandemic-related reprieves and pauses around the globe. Governments also are increasingly digitizing their tax administrations and sharing tax information with each other, and there is a growing move toward requiring public disclosure of tax information.

How governments are responding to these and other challenges is addressed in this article, with observations by EY Tax professionals in 68 jurisdictions gathered in the annual *EY Tax Policy and Controversy Outlook* survey at the end of 2021. This article identifies and examines the trends and areas of divergence found in the contributors' projections for 2022, at the global, regional and individual jurisdiction levels. Detailed reports for all 68 jurisdictions are available for those interested in more information.

[1] Formally, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) project on addressing the tax challenges of the digitalization of the economy

Commitments to a greener world

Collaboration on sustainability reached new heights in 2021, with jurisdictions around the world reaffirming or committing to new climate goals at U.S. President Biden's Leaders' Summit on Climate and later at the United Nations Climate Change Conference (COP26) in Glasgow, Scotland. Reaching those goals, which are mostly designed to meet the 2015 Paris Agreement to limit global warming to 1.5 degrees Celsius, will require extensive action, and tax policy will play a major role.

Carbon taxes are a key tool available to governments as they try to influence behavior. Generally, these taxes are levied on the carbon content of goods and services, making businesses (and ultimately consumers) pay for the otherwise hidden cost of pollution. Currently, 80% of G20 jurisdictions have already implemented, are scheduled to implement or are considering a carbon pricing initiative.[2] Moreover, the reach of carbon regulation can be extended beyond domestic activity: the EU Carbon Border Adjustment Mechanism (CBAM), proposed to take effect 1 January 2023, would put a price on the carbon content of sector-specific exports into the European Union (EU), potentially reshaping global trade flows. The CBAM would be in a reporting phase as of 2023; collection of the adjustment is due to start in 2026, although that date may be accelerated.

Carbon pricing measures encourage businesses to take active steps to decarbonize their supply chains, especially when combined with environmental, social and governance (ESG) reporting. "Businesses and individuals want to see progress on climate. Increased ESG reporting, an expanded set of incentives and more uniformity in the carbon credit market give them the incentive and the tools to do so," says Cathy Koch, EY Global Sustainability Tax Leader; EY Americas and Global Tax Policy Network Leader.

An array of other climate-related taxes are also being used or considered by governments. Plastics taxes have been enacted across Europe with varying implementation dates, scopes and compliance mechanisms, and more are under consideration in 2022 at the national and local levels. Traditional fuel, energy and waste taxes remain an option for raising revenue that typically has been met with minimal public outcry. The *EY Future Consumer Index Survey*[3] found that consumers are more supportive of raising taxes to affect behavior in relation to climate change than any other type of tax increase polled, including 29% of respondents expressing support for a climate-related tax increase that affects people like themselves.

New or increased taxes are not the only lever governments are using to encourage green behavior; green incentives are also on the rise. For example, in the United States, the Biden administration's Build Back Better package includes proposals of more than US$300 billion for green tax credits and incentives over 10 years, representing a significant portion of the US$500 billion earmarked for energy, climate and resiliency measures. Generally speaking, close to 30% of *Outlook* contributors expect enhanced incentives for business investment in their jurisdictions in 2022, many of which may have green components. Additionally, about 20% of contributors expect enhanced research and development (R&D) incentives in their jurisdictions in 2022, which could also have green aspects. Increasing incentives has been a trend for several years, but the outcome of the ongoing BEPS 2.0 project will have significant implications for tax incentives, potentially sending policymakers looking for alternative ways to influence investment behavior.

[2] EY Climate Cash and Tax Barometer 2021
[3] www.ey.com/en_gl/future-consumer-index

Implementation of BEPS 2.0 policies

With high-level political agreement reached in October 2021 by 137 of the 141 member jurisdictions of the OECD/G20 Inclusive Framework, the two-pillar BEPS 2.0 project is now at an inflection point. Even as work in the Inclusive Framework to flesh out the substantive details of both pillars continues, jurisdictions are already beginning to take initial steps toward implementation of the new rules that are still under development. The pace of work is being driven by strong political momentum, which is reflected in the agreed timeline that contemplates implementation in 2022 with the new rules to begin to take effect in 2023. As these major reforms unfold, it will be important for multinational companies to closely monitor both the output of the technical work in the Inclusive Framework and the implementation activity in all the jurisdictions that are relevant to their business footprint. There will be opportunities in 2022 for businesses to engage with policymakers both through the global process and at the individual jurisdiction level, where practical information on the commercial and operational aspects of the mechanisms under consideration could help inform the final design decisions.

The high-profile negotiations over new global minimum tax rules at an agreed rate of 15% under Pillar Two captured headlines throughout 2021, culminating with the OECD's release of agreed model rules covering core mechanics of the global minimum tax on 20 December followed just two days later by the European Commission's release of a draft EU Directive on Pillar Two based on those rules. There will be more to come in 2022 on the substance of the global minimum tax rules as well as on the critically important areas of compliance and administration. But it is already clear that these new rules will have far-reaching implications for multinational businesses. The global minimum tax is intended to be broadly applicable, with multinational groups that have annual revenue of €750 million or more falling within the scope of the new rules and jurisdictions having the option to apply the rules to locally headquartered companies without regard to this revenue threshold. And the implications will extend beyond in-scope businesses to the extent that jurisdictions choose to make overall changes in their tax systems, including potential increases in their corporate tax rates and expansions of their corporate tax bases, in response to Pillar Two developments around the world. Indeed, widespread implementation of Pillar Two would significantly impact the tax policy choices available to jurisdictions for encouraging business investment, with the potential to profoundly alter tax policymaking in the future.

The development of new nexus and profit allocation rules under Pillar One also is proceeding. The work here involves changes to the core building blocks of the international tax architecture, with the intent of increasing the share of taxing rights over global business income that is assigned to market jurisdictions. The OECD has begun releasing a series of discussion drafts on the major components of the new rules, providing stakeholders with an opportunity to offer feedback as the rules are further developed. This is on an accelerated schedule as the aim is to reach agreement on a multilateral convention together with model rules for domestic legislation in 2022, with Pillar One to take effect in 2023 when implemented by a critical mass of jurisdictions. In terms of scope, Pillar One is significantly narrower than Pillar Two, with the most fundamental of the changes to be applicable to multinational groups that have annual revenue of more than €20 billion and profitability above 10% (with plans to expand the scope by lowering the revenue threshold to €10 billion after an initial seven-year period). However, the implications extend beyond the scope of the new nexus and profit allocation rules because the political agreement on Pillar One includes the withdrawal of digital services taxes on all companies when the new rules take effect. Moreover, the formula-based concepts reflected in the Pillar One rules have the potential to affect tax administrations' policy interpretations and administrative approaches more generally. Significantly, the Pillar One construct depends on close cooperation among tax administrations at an operational level that would need to extend beyond agreement on the rules to the ongoing application of such rules in individual cases.

Ongoing activity related to Pillars One and Two will dominate the tax agendas of governments around the world in 2022. "The development of these major reforms through consensus of the 141-jurisdiction Inclusive Framework reflects a level of global coordination on tax policy that has not been seen before," says Angus. "However, implementation will require action in each jurisdiction, where there can be expected to be variation — potentially considerable — in the rules that are ultimately adopted."

Preparing for these developments also will be high on the tax agendas of multinational businesses in 2022. "Companies are already focusing on what types of disputes may arise with the adoption of both pillars, and Advance Pricing Agreement applications are already up quite significantly," says Luis Coronado, EY Global Tax Controversy Leader. Where disputes cannot be prevented, dispute resolution will be critically important. "The BEPS 2.0 dispute resolution approach is likely to be quite complex in nature," continues Coronado, "and the early days of its operation are unlikely to be smooth; however the government panels for Pillar One are a much welcomed feature."

Evolution of the tax mix

Jurisdictions must consider these global factors as they evaluate their current approaches to taxation. "Tax competition will not be eliminated by BEPS 2.0 or other multilateral agreements, it will just move in new directions as jurisdictions find their balance in this shifting environment," says Marlies de Ruiter, EY Global International Tax and Transaction Services Policy Leader. During much of 2020 and 2021, governments focused on supporting their people, businesses and economies, further straining their fiscal balances. This exacerbated the need for increased revenue that already existed in many jurisdictions. We see momentum building for tax change with close to 30% of *Outlook* contributors expecting significant local tax reform in their jurisdictions in 2022, up from under 20% in the 2021 *Outlook*.

Outlook contributors report that corporate tax rate changes have been proposed and are under debate in several jurisdictions. At the time this article was written, such rate changes have been put in place effective for 2022 in Colombia (plus 4 percentage points), France (minus 2.5 percentage points or 1.5 percentage points, depending on the tax bracket), Malaysia (temporary increase of 9 percentage points for 2022), the Netherlands (plus 8/10ths of a percentage point) and Turkey (temporary increase of 3 percentage points for 2022, phasing down from a temporary increase of 5 percentage points for 2021). Changes to the corporate tax base continue to be more fluid, with about 20% of *Outlook* contributors expecting overall expansions of their jurisdictions' tax base and just over 10% expecting reductions. Transfer pricing, withholding tax and the treatment of losses, in that order, are the most common areas where contributors expect their jurisdictions to make changes that could increase tax costs for businesses.

The story is similar for value-added taxes (VAT), with 15% of *Outlook* contributors expecting their jurisdictions to make rate changes (eight increases and two decreases) and about 20% of contributors expecting base changes (eight increases, four decreases). "With the largest revenue generator in many jurisdictions being VAT, small changes to the scope or rules with respect to VAT can have a large impact," says Richard Stern, EY Tax Administration and Reform Services. "Additionally, while headline VAT rates typically capture the most attention, changing secondary and zero rates are frontline tools for governments, particularly during times of crisis." It remains to be seen what effect the December 2021 EU Council agreement on VAT rates will have. That agreement, with a stated intent of giving EU member states more flexibility to apply reduced and zero rates while supporting European Green Deal commitments, still requires adoption by the European Parliament.

Changes to the personal income tax are also on the table in some jurisdictions, with greater expectation of base changes than rate changes. Almost a quarter of *Outlook* contributors report proposed changes to the personal income tax base in their jurisdictions for 2022, and another 15% view such changes as possible in 2022. The expected effects of such potential changes, while not dramatic, are mixed: close to half of contributors who expect proposed or possible changes forecast broadening of the personal tax base in their jurisdictions and about a quarter expect contractions. With respect to personal tax rates, roughly 20% of contributors report proposed or possible changes in their jurisdictions in 2022, with close to a third of them expecting increases and close to a quarter expecting decreases.

One area that could see further activity in 2022 is the treatment of cryptocurrencies, as tax authority interest in cryptocurrency expands along with the increase in use. Jurisdictions currently have very different approaches to cryptocurrency, from a ban on its use in mainland China, to monitoring programs in Taiwan, to tax reporting requirements in the US and specific taxes in Hungary. The extent to which jurisdictions move toward coordination in this area will be something to watch in the coming years.

Intensified focus on tax enforcement

In 2022, tax authorities will be more empowered, connected and capable than ever. This is the result of converging factors that include automatic exchange of information, enhanced data gathering powers, multilateral collaboration and the availability of digital tools.

Many governments — the US and UK among them — continue to make substantial investments in their revenue authorities. At the same time, the cost of two years of COVID-19-related stimulus and support will put pressure on corporate income taxes. "Tax authorities are contemplating new horizons and looking to increase the use of technology, such as by automating the risk appraisal and enforcement functions, with a view to delivering a positive revenue impact," says Chris Sanger, EY Global Government and Risk Tax Leader.

These factors contribute to increased focus on tax enforcement. More than 60% of *Outlook* contributors expect rising levels of tax enforcement in their jurisdictions in 2022. This broadly aligns with what businesses tell us, with more than half of respondents to the 2021 *EY Tax Risk and Controversy Survey*[4] similarly expecting increases in tax enforcement. Moreover, close to 60% of contributors expect a higher number of tax audits in their jurisdictions in 2022, which aligns with the results of the 2021 *EY International Tax and Transfer Pricing Survey*, where 65% of business respondents report a similar expectation regarding tax audits.

Transfer pricing-related issues have long been at the heart of many tax disputes, and that is expected to continue in 2022. More than half of *Outlook* contributors rank transfer pricing as the leading tax audit concern in their jurisdictions for 2022, surpassing the second-placed issue — deductions — by a factor of over three to one. Increases in transfer pricing enforcement are expected among three-quarters of contributors.

Two areas that are likely to attract particular attention from tax auditors in 2022 are reported losses and qualification for COVID-19-related tax benefits. More than half of *Outlook* contributors expect their national tax authorities to audit stimulus or support benefits received by businesses during the pandemic. In addition, close to 70% of contributors expect their jurisdictions to make more use of joint or simultaneous tax audits, reflecting the growing multilateralism in tax administration. In three-quarters of jurisdictions, contributors expect taxpayers to experience new or differing interpretations of tax laws by their tax administrations, including in the area of transfer pricing. "Increasing levels of cross-border controversy, particularly in relation to transfer pricing and differing interpretations of tax treaties, will continue to drive demand for access to effective mutual agreement procedures," says Joel Cooper, EY Global ITTS Controversy Leader.

Transparency is another area where more activity is expected in 2022 with significant implications for business taxpayers. Approximately 70% of *Outlook* contributors expect new transparency and disclosure requirements to be adopted in their jurisdictions. Moreover, several jurisdictions are putting in place new requirements for companies to demonstrate the effectiveness of their tax governance. Here, the approach to assuring business tax compliance — and the relationship between taxpayer and tax authority on which it is based — is moving away from the model of filing returns to be audited several years later. Instead, these tax authorities are looking for a company to demonstrate that it manages taxes in a robust and effective manner in order to establish a trust-based relationship. With strong governance and a more transparent relationship with the tax authority, the company may be offered various administrative benefits, such as expedited tax rulings or tax refunds or access to a dedicated relationship manager.

With jurisdictions around the world intensifying their enforcement focus, tax departments may find themselves juggling multiple demands for their attention, putting those that are not fully prepared at higher risk of disputes, penalties and reputational damage. "Responding to such a fast-changing enforcement environment requires a plan, and a well-defined, common proactive approach to tax risk and controversy management is essential," says Coronado.

Regional tax actions and trends

Global trends are magnified when examined on a regional basis.

[4] www.ey.com/taxrisksurvey

Expectations of change in the Americas

Increased tax controversy is expected in the Americas, with more than 70% of *Outlook* contributors expecting the number of tax audits to rise in 2022. Over three-quarters of contributors in jurisdictions in the Americas expect heightened tax enforcement more generally. Earlier investments in digital capabilities give many tax administrations in the Americas the ability to take more vigorous enforcement actions now, with jurisdictions such as Mexico – a regional leader in this regard – developing new tax compliance models that may be of interest to other jurisdictions as well.

Tax reform expectations are relatively high in the Americas, with significant proposals recently agreed or under consideration in Chile, Colombia, Costa Rica, Dominican Republic, Mexico and the US. "Companies should not wait until proposals become law to develop their response plans," says Marna Ricker, EY Americas Vice Chair of Tax. "Companies will be more successful at adapting to change if they closely monitor developments, model potential impacts and take the opportunity to provide input into the legislative process."

It is notable, however, that despite significant legislative activity, no *Outlook* contributors in the Americas expect enhanced R&D incentives in 2022, and only in Mexico and the US are proposals for enhancements of other business incentives on the table, which is significantly below the level of the expectation for increased business incentives in jurisdictions elsewhere around the world.

Focus on innovation in Asia-Pacific

Continued expansion of incentives is expected in Asia-Pacific as jurisdictions look to be innovative in the ways they attract and retain business activity. More than half of *Outlook* contributors in the region expect enhanced R&D incentives to be adopted in their jurisdictions in 2022, while almost 40% expect other business incentives to be enhanced. "Jurisdictions in Asia-Pacific are, however, starting to look toward a post-BEPS 2.0 world," notes Matt Andrew, EY Asia-Pacific Tax Policy Leader. "The question is, what tools can these governments use to encourage investment with Pillar Two global minimum tax rules implemented?"

Tax administration developments also are a significant focus in the region. Singapore's entry into the International Compliance Assurance Programme (ICAP) is attracting attention, and Australia's Combined Assurance Program (spanning both direct and indirect taxes) is an early example of trust-based programs that are growing in the region. Malaysia is known to be considering a similar approach, and in Japan, approximately 100 tax audits a year will contain tests of a company's tax governance. "Regardless of these new relationship-based approaches by some tax authorities, tax controversy is expected to rise," says Martin Caplice, EY Asia-Pacific Tax Controversy Leader. "I believe 2022 will be a watershed year for tax administration and enforcement in the region." *Outlook* contributors in all Asia-Pacific jurisdictions except Indonesia and Vietnam – where enforcement is already at elevated levels – similarly view enforcement activity as likely to increase in 2022.

"Asia-Pacific jurisdictions are actively participating in the global BEPS 2.0 discussions and bring a wide range of perspectives to the table," comments Eng Ping Yeo, EY Asia-Pacific Tax Leader. "The outcomes of those global discussions are expected to be reflected in tax change – in some cases substantial change – across Asia-Pacific in the months and years to come."

Continued collaboration in EMEIA

"Brexit aside, Europe has long been a frontrunner in multilateral coordination and is poised to continue moving forward on an ambitious agenda," says Maikel Evers, EY EU Tax Policy Hub. "In particular, sustainability initiatives driven by the European Commission are enjoying strong support from member states." BEPS 2.0 is another major focus of the European Commission, just as the recommendations coming out of the first BEPS project have been. EU Directives, starting with the draft Pillar Two global minimum tax directive, are intended to be the basis for mandating implementation of the new rules by the member states and may lead to more consistent adoption within the EU than in the world at large.

The EU will also continue to push forward in other areas, including public country-by-country reporting (CbCR) where a long-debated directive entered into force on 21 December 2021, with member states required to transpose it into national law by 22 June 2023. "Public CbCR is a major step in the public tax transparency movement, taking it from largely voluntary to mandatory for businesses operating in the EU," says Bridget Walsh, EY EMEIA Area Tax Managing Partner. "Companies in scope should closely monitor both national consultations and draft legislative language across the 27 jurisdictions and consider how technology can help as they prepare for the new disclosures that will be required while also managing applicable reporting requirements under new global minimum tax rules." Similar to the scoping for Pillar Two, both EU and non-EU-based multinational corporations operating in the EU with consolidated revenue of more than €750 million will be impacted by the CbCR directive. In addition, a new EU focus on low-substance or shell entities, inspired by the so-called "Pandora Papers," is advancing with the release of the draft directive called UNSHELL also in December 2021.

Indirect tax is another area of significant activity in the EU. There is coordinated action to address the VAT gap, the difference between the tax owed and collected, including e-invoicing and adaptation of rules for digital commerce. "Governments are looking at how to adapt indirect tax for a greener world, using special rates and exceptions to incentivize certain actions as a key tool," says Jean-Pierre Lieb, EY EMEIA Tax Policy and Controversy Leader. "We are now seeing indirect tax at the very heart of the work done by governments and the EU Commission."

Looking forward

"Regardless of where you do business, staying flexible is vital to success in this rapidly evolving tax environment," says Barton. "Today, planning for the future necessarily means planning for uncertainty as the pace of tax change continues to accelerate." Angus concluded, "Tax legislative and administrative changes will proliferate in 2022. Companies need to monitor ongoing developments in the global tax environment, assess how changes impact current transactions and future investments, and be ready to adapt."

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