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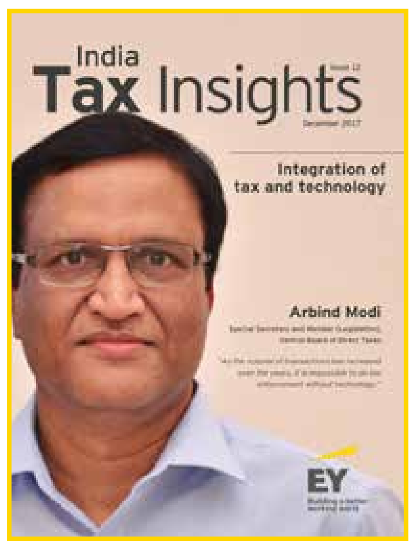
Integration of tax and technology

Arbind Modi

Special Secretary and Member (Legislation), Central Board of Direct Taxes

"As the volume of transactions has increased over the years, it is impossible to do tax enforcement without technology."



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Foreword

Sudhir Kapadia
Sudhir Kapadia
Partner and National Tax Leader,
EY India

We are pleased to present the *12th edition* of our magazine *India Tax Insights*, focusing on the importance of technology in the world of taxation.

A good start on this topic would be by asking why technology is important now more than ever when a profession like tax has survived for so many decades without using it. Here are the trends we see leading to this change. The Government is seeking more tax and operating data and that data is being sought in almost real time. The risk of non-compliance or submitting incorrect data is not something that companies want to face. As a result, collecting, curating and analyzing data of lakhs of transactions and that too from multiple jurisdictions is something that has become an inherent part of the tax function.

While primary responsibility to do this task lies on tax, it actually gets base data from the financial and operating systems of the company. If these systems are not customized to generate the data that tax functions need for their reporting, then imagine the heavy lifting the tax function has to do to filter out and detect the correct data. It is not just a question of risk, but errors can result in a company overpaying taxes or underutilizing credits where they may be rightfully due. Therefore, the crucial step for companies is to set the systems configured correctly. For example, the introduction of GST in India has led to many companies configuring their ERPs to adjust to the new way of submitting data, i.e. electronically.

While finance data may have a direct impact on taxes, a company's operations can also trigger tax risks or opportunities. For example, employees traveling to other countries, the time they spend there and the work they do there have an impact on the company. Today, many technology solutions exist that allow companies to identify the associated risks and compliances before such activities are undertaken. Tax directors can also take advantages of automation around processes. For example, workflow automation solutions can be deployed around the compliance and controversy management functions undertaken by companies. These solutions can help companies scan and store all returns and transfer pricing or other related documents, get reminders for critical tasks and generate dashboards for open and closed cases.

The data lake that is created can be used to undertake analytics to determine the trends, identify outliers and get insights into data, which otherwise seems like a complex task. With focus on reduction of risks and costs in the tax function, robotics and AI can also be considered. The biggest challenge for tax directors today is to appreciate that technology has become a key factor and not all of us may be equipped to take decisions around technology adoption. There are several other choices that people will need to make in the journey – make or buy, custom made or off the shelf, on premise or on cloud, ERP modification or building convertors and so on and so forth. It is time to expand the tax function to include tax technologists in the team who can bridge the gap between the tax requirements and technology world. We at EY see the future of tax to be heavily dependent on technology, the adoption of which will need and also result in the transformation of the tax function.

I would like to thank Mr. Arbind Modi, Special Secretary and Member (Legislation), Central Board of Direct Taxes, for sharing his views on how the Indian Government is leveraging technology for a more efficient and effective tax administration.

I hope you like the articles of industry and EY experts in this edition as we outline the trends of the future. We would be glad to have your feedback and suggestions.

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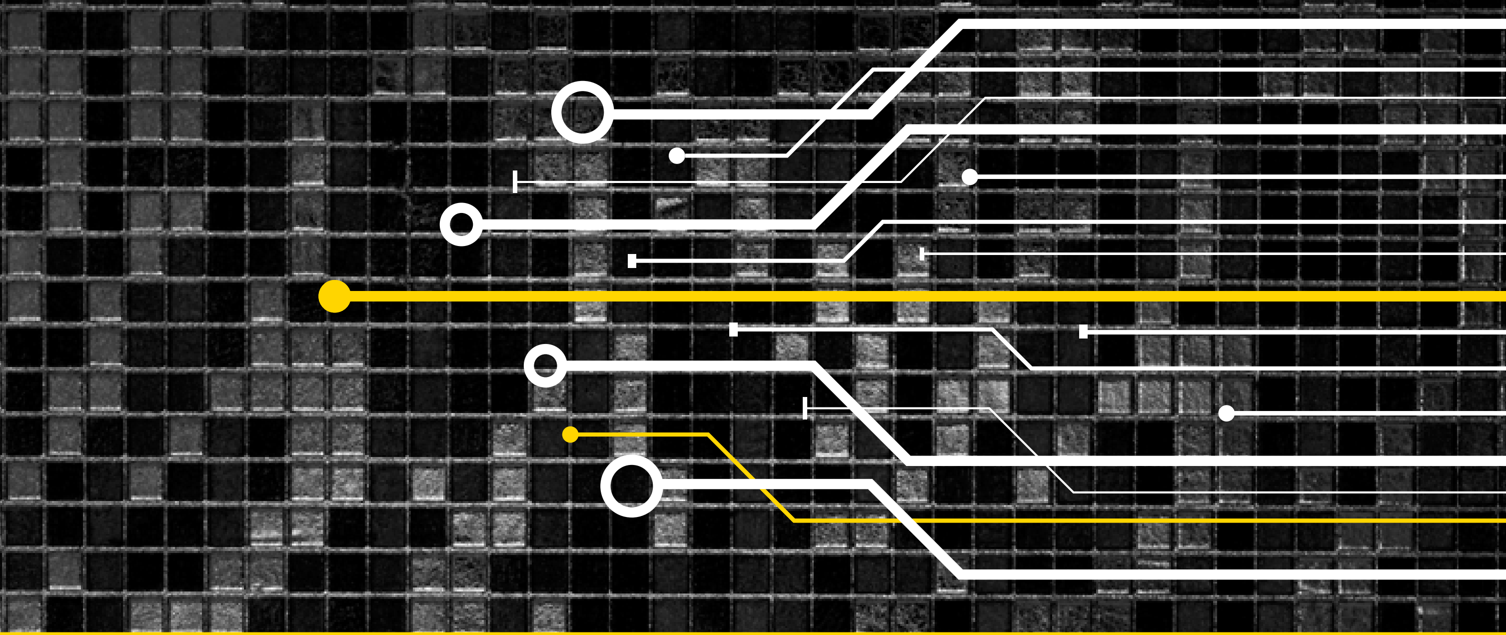

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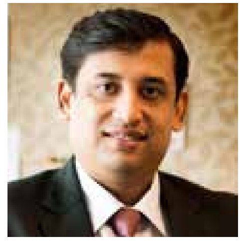
Technology is the new headcount in tax



Rahul Patni

Partner, Tax Technology and Transformation, EY India

Tax authorities going digital – Ahead of the industry

Tax authorities are working hard on the big data available to them through tax returns, annual information report (AIR), statement of financial transactions (SFT), RoC filings, GST returns, cross-border remittances, exchange of information treaties, etc. for undertaking targeted scrutiny of transactions and corporates. A live example of this is notices issued on the mismatch of the value of goods declared in customs and income tax.

Tax authorities are already using advanced data mining and forensic solutions to scan emails and data collected; we expect this to become prevalent in other areas as well. We also expect that in the short to medium term, income tax authorities might start publishing partly/fully completed tax returns of taxpayers for review and sign-off. In fact, steps have already been taken in this direction; for certain returns (ITR-1 and ITR-4S), personal details as well as tax payment details are pre-filled and available to the taxpayer for review.

Are corporates ready for the fast emerging new tax world?

Most fast growing and aspirational companies have identified digital as a board-level agenda item. They are looking for new business opportunities in the digital world; only a tax function that understands digital can effectively contribute to this agenda.

It is well known that due to changing laws and the evolving regulatory landscape, compliance and reporting requirements are increasing at a rapid pace; at the same time, these requirements are also becoming granular and digital. Tax functions need to have a strategy to deal with these changes in a cost-effective manner. A case in point here is India's GST, where the compliance requirements have increased multifold and tax directors are finding it difficult to get additional headcount approval.

In a survey conducted by EY of leading Indian tax directors and CFOs in 2016, more than 90% of the respondents reported that their tax reporting and compliance system is not automated

Srirupa Saxena

Director, Tax Technology and Transformation, EY India

at all or only partly automated. Since then, GST has fast-tracked the topic of technology adoption and in some ways has forced corporates to adopt automation. Leading tax directors are proactively looking at automation opportunities across the board in the tax function.

This is a completely different world for a conventional tax function, which hitherto was responsible for providing tax technical inputs on business issues and ensuring compliances through manual tools (i.e., Excel sheets). Today, the tax function will need to re-skill itself - this is a world where a tax technologist would hold a key place in the tax team and CIOs would co-own delivery/management of tax compliances/risks.

What are the "digital" opportunities in tax?

A range of technology solutions are available to address the varied needs of the tax function:

- That facilitate end-to-end management of the tax function, including data capture, collation, analysis, reporting and visualizations for compliance as well as planning
- For each tax type – corporate tax, transfer pricing and indirect taxes
- That meet local requirements and/ or that of several jurisdictions (countries) for companies with a global footprint

Depending upon the volume, complexity, cost-benefit and other considerations, an organization may automate its processes with a simple solution such as an Excel macro or generic tools that can be used for multiple departments (viz, document/workflow managers) or highly specialized tax applications (tax accounting and consolidation applications, tax determination engines etc.). Also, there are technologies such as robotics process automation (RPA), which mimics human action. Such technologies can be used across the tax life cycle for automating any rule-based, repetitive, high-volume tasks efficiently and accurately.

The tax technology landscape has rapidly evolved and matured over the past few years – the space is now shared by multiple solution providers and products. For most tax functions, the challenge today is determining and crystallizing their requirements, tax technology strategy and resources to execute the strategy rather than the availability of solutions.

With the advent of the cloud, the cost of deployment and maintenance of large applications has come down significantly, cost of sub-optimal compliance is becoming steeper, transparency and information sharing among/with tax authorities are becoming paramount and tax authorities are asking "smart" and "informed" questions.

We expect that these factors, put together, would make a strong business case for the tax function in corporates to develop and execute a digital strategy.

John Chambers (Executive Chairman, Cisco Systems) in a recent interview at MIT on digital disruption technology said, "….. go digital or go home." [1] We believe that as long as the tax function hires and considers technology as the new headcount, we tax professionals as here to stay for a long haul!

1 Website MIT Sloan Executive Education

Arbind**Modi**

Special Secretary and Member (Legislation), Central Board of Direct Taxes

Q.1

Globally, governments are now leveraging technology for a more efficient and effective tax administration and India is no exception. According to you, what are the important initiatives the Ministry of Finance (MoF) has taken in recent times in this direction?

In recent times, the MoF has taken a leap toward digitized tax administration, which has been an ongoing process for almost 25 years. There has been a consensus across different governments about the necessity and the need to modernize the tax administration through massive induction of technology.

If I have to actually trace out the developments in recent times, and I take the last 10–12 years, then the first important event was Dr. Kelkar's report, which reviewed the computerization status of the tax administration, somewhere around 2002, and recommended a very comprehensive program. One of the key things that were recommended was the outsourcing of some of the non-core activities of the tax administration.

The outsourcing was in the nature of a public-private partnership, which was unique in itself if you compare it with the rest of the world. Otherwise, traditionally, with tax functions being sovereign, no part of the activity was ever conceived as or thought of being outsourced. For the first time, we focused on some non-core activities like PAN allotment, database management tax payment information to be received by NSDL and third party information database to be collected through a statutory mechanism but stored and collected by the NSDL. So, outsourcing helped us in accelerating computerization even though we had low in-house capacity.

That was the starting point, when all those recommendations were endorsed by the then-Indian government under Mr. Atal Bihari Vajpayee and Finance Minister Mr. Jaswant Singh. In 2003, we outsourced the allotment of PAN to UTI. The other major initiative in the same year was computerization of manual information collection. AIR was introduced in 2004, which has then become computerized. In 2006, e-filing was introduced. In 2009, the centralized processing center in Bengaluru was set up for processing of tax returns and issue of refunds etc. directly from the Center. Payment of taxes through electronic mode was also introduced somewhere around 2007–08. After 2009, we set up the centralized processing center for processing TDS returns.

Then the big jump we undertook was sometime in 2015, by creating a 360-degree profiling of taxpayers to deal with tax evasion, both for the purpose of widening of taxpayers and deepening of the tax base. During the past 2–3 years we have also taken several initiatives for reaching out to taxpayers – for example, we have launched the Aaykar-Setu, which is a mobile-based app for easy access to several taxpayer services, forms etc.

In the past 2–3 years, there has been a massive push in digitally resolving tax grievances, for example, the CPGRAM of the Prime Minister, where tax-related grievances can be uploaded by citizens. If there are any grievances remaining unattended beyond 30 days, the department is taken to task. e-Nivaran is another online grievance portal.

So, in the past three years, there has been an extensive push to deal with tax evasion and also extend taxpayer services by leveraging technology.

Q.2

Along with the 360-degree profiling of taxpayers, income and transaction reporting and the matching of the data to drive compliance and collection have been the key focus areas. What steps has the Income Tax Department taken for developing a robust data warehouse?

A big push in terms of developing a robust data warehouse was given somewhere in early 2015 when we introduced Project Insight. EY is one of the consultants for that project. The objective is to amalgamate the various information that comes into a single database.

Today, we have a fragmented database with respect to the various sources of information we receive. This fragmented database has actually restricted our ability to do effective data mining and risk management. As a result, what was conceived was to amalgamate these several databases to a single database and create a 360-degree profile of the taxpayer, which will obviously help us to sharpen our risk management and also help us to widen and deepen the tax base.

Q.3

With the GST implementation, how does the game change for data analytics?

There will be several gains in terms of direct tax enforcement because of the introduction of the GST. The first is that we will see real-time data. Under the GST, we will have monthly returns coming in and will therefore have access to the GST data subject to some protocols being established between the two departments. We will thereby be able to have information about sale and purchases on virtually a real-time basis. Even though the returns will be filed a year later, we will have access to that information almost at the end of every month. This will also enable us to do contemporary data mining and take immediate actions in terms of advance tax monitoring, TDS monitoring etc.

The second big gain is that because of the monthly returns, it will block manipulation of turnover expenses at the year-end. This is because when you file monthly returns, you commit your sales figures. Due to input tax credit, to a large extent even your expenses will be frozen. So, year-end manipulation will become restricted. Even if it is not eliminated, it will be substantially reduced.

Another gain for direct taxes will be better compliance due to a self-checking mechanism of input tax credit under the GST. This self-checking mechanism will ensure compliance with the GST, and better compliance with GST means better reporting for income tax purposes because sales, purchases will get recorded and therefore there will be better compliance on the income tax side also.

Lastly, there is a lot of evasion because of bogus transactions with unregistered dealers. Now, the GST data will help us get a sense of the level of transactions with these unregistered dealers. Those who are registered will get input tax credit. To the extent that there is no input tax credit, most of the transactions we can assume to be with unregistered dealers. And all transactions with unregistered dealers carry a very high risk of manipulation. So, our risk management will become that much sharper.

Overall, if you add up all these gains, we should pull forward and see improvement in the compliance in direct taxes too. Whether it is immediate or kicks off in a year remains to be seen.

Q.4

For technology to have a non-intrusive and targeted enforcement, what do you see going forward in this direction?

As the volume of transactions has increased over the years, it is impossible to do tax enforcement without technology. To be effective in terms of enforcement, it is necessary we use technology. Given this backdrop, we have taken steps over the years. The first step was to

completely digitize the collection of information, both from the taxpayer in terms of facilitating e-filing of tax returns and from all other functions. Also, all the forms under the direct tax law have been digitized. That enables us to collect large volumes of information without going through the process of manual data entry and checking. E-filing of information also ensures accuracy of information, so there is no manual checking required.

We have also entirely digitized third-party information reporting. Statement of financial transaction (SFT) and TDS returns are all digitized. So the entire gamut of information collection both from the taxpayer and the third party is now completely digital, including payment.

The next stage after collection is collation. Now the collation part is what we are looking at through Project Insight, where we create a 360-degree profile of the taxpayer. Through these individual profiles, we can evaluate whether a person is a potential taxpayer or not, and if the person is a taxpayer what should be his or her income and what is the kind of income he or she is reporting. I think we will roll out that project in a month or two. So you have collection, you have collation and you have dissemination. Dissemination obviously becomes that much simpler when you create a 360-degree profiling as it will all be linked to a person. Each person carries an identity in terms of PAN and Aadhaar. Since Aadhaar covers more than 80% of the population, all economic transactions will carry some number, either a PAN or Aadhaar, which should allow us to collate and disseminate information to the right officers for analysis.

The fourth part of this whole enforcement is analysis of the data. Here also, the integral component of Project Insight is data analytics, which helps in identifying non-filers, stock-pilers and tax evasion. Finally, we have also introduced e-assessment. Therefore, the information collection, collation and dissemination, analysis, collection of cases for audit on the basis of the analysis, and the audit itself are meant to be performed electronically through e-assessment. This has already been rolled out in many cities and at this point in time, it is almost voluntary and we are looking at ways to accelerate this whole program of e-assessment.

So, end-to-end digitization will take place in terms of data collection, collation and use of data and assessment or audit.

Q.5

With so much of data collection and analytics, one concern the industry has is about data confidentiality and more so when there is so much focus on the exchange of information, where data is also being gathered from treaty countries. What is it that the department is doing to maintain data confidentiality and give the taxpayers assurance on this?

One should know that the law prohibits sharing or disclosing confidential information, except in specified cases for the purposes of tax enforcement. Despite the legal prohibition, it appears that there is some concern. Let me assure you that this concern is ill-founded because of the simple fact that in spite of our collecting large volumes of data, there has been no instance of data leakage so far. I think the concern is more hypothetical than genuine. In fact, even under pressure from activists to disclose data or confidential info, the Government of the day refused to do so and fortunately the courts have also in a way endorsed that position. This implies that the courts are also conscious of the fact that this information needs to be protected.

All the institutions – the legislature (which has framed the law), the judiciary and the executor – are conscious that the tax data and information, whether collected locally or from other countries, needs to be protected. I do not think citizens or any other entity that does business in India or with India or with taxpayers or administrations in India, need to worry about it. We stand behind the legal position that tax administrations will do everything to abide by the law.

Q.6

With regard to Operation Clean Money, what was the role of technology in its effective implementation?

Operation Clean Money, as far as the IT department was concerned, was entirely technology driven, except that where responses were not received (people not explaining the source of their cash deposits), we thought it appropriate to undertake verification, which naturally had to be through physical checks. Otherwise, it was entirely digital - the data was received electronically, the data mining was done, the interface between the depositors and the department was through the portal, the responses were to be filed on the portal, the analysis was done electronically and risk management was also done electronically.

I am not aware of a single incident of leakage or abuse of data. The department deserves all the kudos for handling this large volume of data on a real-time basis, in a very professional manner. This has also given us the confidence that going forward we can handle real-time data and it could not have got bigger.

Q.7

Can technology help in improving the overall tax policy design?

Undoubtedly, more information flowing in through a digitized manner has helped in the designing of the tax policy. We have been able to exhaustively identify those who benefit from the incentives, and also estimate the revenue foregone due to these tax incentives. In fact, we have been publishing these statements regularly now, almost on an annual basis for the past 10 years. We now have more comprehensive information about tax incentives, so we can obviously do better analysis and see how and whether they need to remain in the statue or not. We are able to identify the beneficiaries and also see whether the beneficiaries are those that the law intended to benefit.

Q.8

Any message that you would like to convey on the technology and tax administration? Or any international experience or lessons that we can draw from?

The first is that technology is an integral part of tax administration in India. I do not think anybody can now say that the Indian tax administration is archaic. I believe that India is using more technology than most other countries. Almost all end-to-end processes are digital. Also, now our e-filing is almost 98%+, which is higher than in many of the advanced countries. Most of our tax payment is also electronic now. The second is that I want to reassure all taxpayers, whether in India or outside India, that maintaining confidentiality of taxpayer information is a very important objective for us. And in this regard, all the three branches – the legislature, the executive and the judiciary – are on the same page. The third is that we are absolutely committed to minimizing, if not eliminating, interface with taxpayers. These will be the three guiding principles for tax administration in the future.

Q.9

What are the challenges you see in this entire digitization of the tax function?

The challenge for us now is how we effectively leverage the vast volume of information we are collecting. Also, in the next couple of years, as this data mining work picks up and we are going through a process of learning, some innocent taxpayers may also be put under the compliance burden, partly because of legacy issues and partly because data mining identifies them as suspects. In the immediate or near term, any of these innocent people could feel aggrieved.

So, the challenge is to ensure that the innocent are protected in the process of data mining of the large volume of information. If we can, through data mining, identify only the guilty, then there is no problem. Also, cybersecurity is a constant challenge. I would like to assure that we have taken every possible step to ensure there is no cyber threat to the data.

The digital tax phenomenon:

How will changing taxes on the digital economy impact the broader digital tax agenda?

Channing P. Flynn
EY Global Digital Tax Leader

As August 2017 draws to a close, we reflect on the rise of the digital tax agenda, which is now on nearly every company's tax priority list. Over three years ago, we started developing an EY framework to strategically discuss digital transformation with our clients. This was not just a tax approach but rather a broad agenda that addressed an entire organization's desire to develop and execute a digital transformation, taking it to new and higher places.

All aspects of the digital revolution were on the table, including the use of analytics, digital finance transformation and automation, and even embarking upon completely new lines of business that were digital in nature. We embraced the concept of convergence, which refers to the fact that almost all companies are on a digital path to becoming, effectively, "technology companies" and on that path they are encountering issues similar to what technology companies have encountered.

In short, we have succeeded. Our global approach has enabled EY professionals to help their clients understand and define their overall digital vision in five core areas:

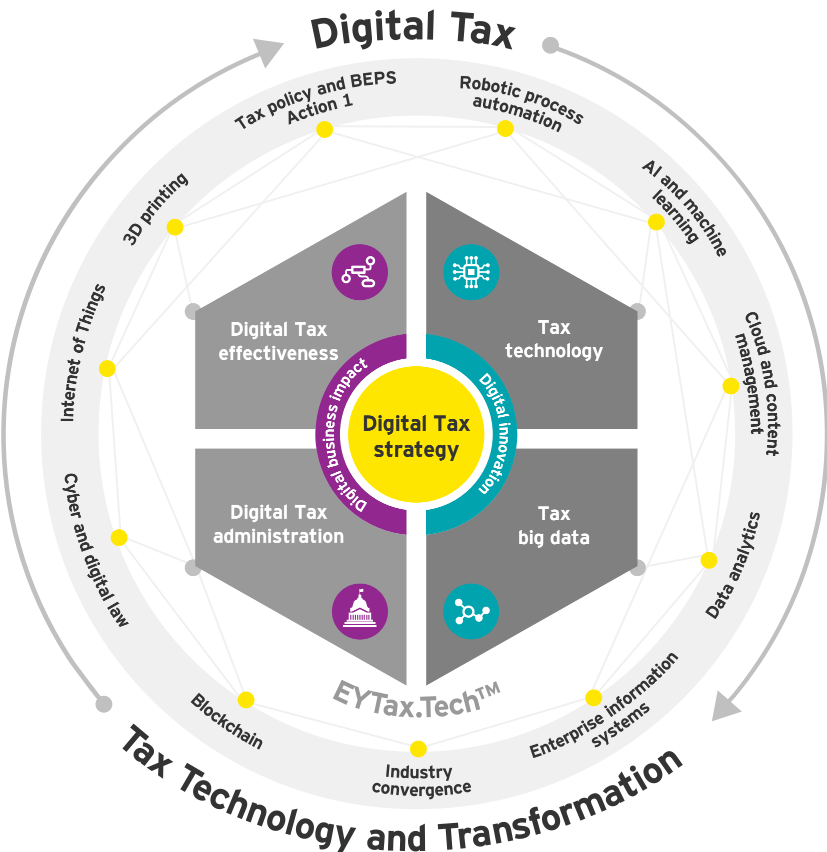
- Develop their digital enterprise strategy
- Adopt a specific innovation, acquisition or incubation approach to achieving that vision
- Create the framework by which their customers would experience this digital vision
- Develop and deploy internal and external supply chains that make digital part of the client's operations
- Establish trust in the overall digital enablement of the vision (e.g., digital legality, cybersecurity and digital tax requirements)

The digital tax quadrants

This overall digital vision has served us well, and to speak more directly to tax professionals, Global Tax developed a succinct Digital Tax Strategy framework (see graphic). It has four quadrants that align to the elements of the firm's overall digital vision, and bring to life the key elements of every taxpayer's digital tax strategy:

Digital Tax Effectiveness:
Among many other items, the alignment of BEPS Action 1, including shifting and emerging global tax policies and law to a company's digital business, whether existing or new

Digital Tax Administration:
The alignment of a taxpayer's compliance, controversy and overall engagement with governments, particularly focused on the increasingly sophisticated digital technologies that tax authorities are using to administer in-country and cross-border taxation



Tax Technology:
The development and deployment of new tools and technologies to the full range of the tax discipline, including intelligent tax automation, robotics process automation, blockchain, artificial intelligence and cloud-based tax systems, and trained strategic professionals (see sidebar) that design and implement such technologies

Tax Big Data:
The trend toward using previously untapped data, often massive amounts, to make more informed and strategic tax decisions within many areas such as strategic planning (e.g., predictive analytics), compliance tasks (statistical data mining) and qualitative risk reduction (data analytics for trends, position support gathering)

These four digital tax areas form the basis for a taxpayer's digital tax strategy because they align and overlap with a company's overall digital vision and strategy. They also enable us to optimize the digital transformation wave for the betterment of the enterprise.

Everything going digital

The advent of the digital economy has created vast interest in the changes it triggers, not only in a company's tax profile but also in its tax function. As a result, we need to be able to speak insightfully about disruptive digital transformation trends and the pressing need for traditional companies to factor in the consequences for their tax and finance functions as they contemplate buying, monetizing and selling digital assets in pursuit of a new strategic vision.

As more and more start-ups and global enterprises seek to deploy or monetize digital assets in their businesses, other companies are developing enhanced digital and technological tools that will enable them to operate

EY Tax Technology and Transformation

Ours is not "business as usual." EY's Tax Technology and Transformation answers the disruptive megatrends that mandate a timely and targeted transformation of the business tax function. We integrate technology, process and data services with the tax operating model strategy taking center stage in the rapidly evolving business environment in which the contemporary tax function operates. EY's Tax Technology and Transformation services are designed to help tax organizations improve their operational effectiveness and redefine the tax function to accommodate the pace of today's speed of business with an appropriately agile organization. We bring together a new breed of tax technologists, immersed in science, mathematics, technology and innovation, along with tax function operational strategists and tax technical advisors, who together thrive in this uniquely digital world.

more efficiently. These trends have created the whirlwind of "everything is going digital" that we are currently experiencing (which, by the way, is not unlike the trend we observed in the 1990s when the word of the decade was "e-commerce").

So, what is the impact of the digital economy on tax policy, and how do our Digital Tax Strategy and our overall digital vision anticipate the changes?

Critical debate around OECD deliberations

As readers of India Tax Insights know, the OECD continues to focus on the digital economy. In Tallinn, Estonia, on September 14 and 15, several members of the European Commission and those participating in the OECD's overall BEPS and Digital Economy Taskforce will meet to advance the debate over taxation of the digital economy. This follows summer 2017 activity in Silicon Valley, California, where the Taskforce met with individual companies, industry groups and others to hear concerns about the fairness of some expressed policy approaches. The group intends to release an April/May 2018 Final Report on the Taxation of the Digital Economy.

It is no secret (nor should it be) that views are quite disparate on the parameters of a new taxation regime for the digital economy – with companies generally on the opposite side of governmental bodies. The digital economy transforms itself so quickly in such unpredictable directions that the thoughtful, methodical rule-making processes typical at tax authorities are stretched to the limit. From an enforcement perspective, just as tax authorities start coming to grips with one set of previously unimagined transactions, a whole new set is being created by digital entrepreneurs. The OECD has a truly monumental challenge before it to balance competing views of the digital tax world:

- The view that governments should ring-fence the digital economy (i.e., the concept that "digital companies" or "digital activities" should be labeled and taxed differently) compared to other elements of the economy.
- The view that lawmakers and tax administrations can react to the digital economy with technologically forward-looking rules that impose a reasonable tax burden on new models of commerce when they are profitable, thereby enabling their beneficial growth.
- The view held by many policy makers that legacy digital companies (mostly within the technology and media sectors) have made tax minimization a guiding principle in structuring their affairs, contrary to this author's view that the vast majority of companies structure their affairs to optimize market opportunities using the latest technological efficiencies, with tax consequences clearly secondary to business planning. This topic elicits strong emotions, and policies that embody this view will not only be punitive toward

- those legacy digital companies but to companies in any industries that integrate digital technologies into their business strategies.
- The unilateral behavior of many jurisdictions that have or will soon adopt their own unique and often protective digital economy tax rules. This trend is driven by the simple fact that individual countries all see the digital economy slightly differently: some see tax avoidance or legal concerns, others see an investment and growth opportunity, and still others see both aspects and are struggling to strike the right balance.

I do not envy the OECD and collaborating national officials for the immense task they have undertaken to proffer policy guidelines and demonstrative taxation concepts. It is far from clear whether they can provide enough agreed-upon policy guidance to stem the tide of individual countries' unilateral legislation and turn it around in the direction of global coordination (as they have successfully done on other BEPS initiatives such as Country-by-Country Reporting within Action Item 13). The stakeholders in the countries seem too diverse in their views of the digital economy, and most governments still appear intent on using tax policy to both attract investment and deter unwanted economic decisions.

Bringing it all together

National governments' decisions about how to tax the digital economy are linked to the four quadrants of the digital tax agenda and to the five elements of the overall digital vision outlined above.

The new rules lawmakers impose to govern how and why digital transactions and flows of data are taxed will, in turn, stimulate the evolution of new concepts regarding tax enforcement, triggering changes to digital tax administration approaches and policies . Moreover, this will drive the creation of new tax technology tools and analytics techniques to understand tax paradigms, risks and opportunities.

As companies across industries "go digital" at an increasing rate, the taxman is on the verge of transforming how they will be taxed, which will probably lead to new supply chain variations that optimize tax efficiency in relevant jurisdictions. This will impact the discipline surrounding the creation and use of tax technology tools, government tax administrative efforts and the very role of the tax department in the overall trajectory of a company's path to the success it hoped for when investing in digital. That is quite an impact, and it will happen very quickly.

Of course, all elements of the existing digital tax framework will continue in the present day to impact legacy companies across a full range of digital tax issues, but this is only the beginning of this trend. I foresee that the overall dominance of all things digital entails the unique convergence of a company's digital vision with emerging digital economy taxation policy issues and how that will create a new and exciting digital tax landscape. A lot is riding on tax professionals as the digital transformation currently sweeping the world disrupts and changes forever the function and role of the tax department in tomorrow's digital organization.

The good news is that there will be plenty of room for diversely talented tax professionals working alongside the robots!

Deepak Doegar

CFO, JCB India

It is critical for all the business transactions to imbibe strong automation for accurate and easy tax compliance, with a strong business process as the backbone.

- Deepak Doegar

In what ways have you embraced technology in your tax function?

In order to understand technology in a tax function, let us take a step back to go the basics of any business, industry or a factory, i.e., the core processes of purchase, manufacturing and sales. These core processes then translate into the transactions of finance, which finally culminates into tax, reporting or accounting and filing. Thus, technology in a tax function will be effective when the core business processes are in control.

At JCB, over the last several years, we have integrated manufacturing with purchase and sales, making sure that good quality data and accurate information are available for tax reporting, be it direct or indirect taxation.

With the GST implementation, there was a complete overhaul of our SAP processes. We took it as an opportunity to revamp several of our processes to not just look at it from the compliance standpoint but also from an internal process and efficiency control standpoint.

In terms of direct taxation, TDS return is a good example of effective use of technology. Technology has helped in collating relevant information to file accurate TDS returns. Still, there is a huge opportunity to effectively embrace technology in direct taxes.

What are the challenges you have faced in identifying, selecting and implementing tax technology solutions for your company?

In my view, a significant challenge is that of finding the right skill set for the implementation of the technology at hand.

Another challenge is to standardize processes. It is a framework for businesses that operate in different states where regulations differ. At JCB, we have plants in Haryana, Rajasthan and Maharashtra, so we have to make sure that standard processes are in place. So, it is imperative to have the right set of consultants with an in-depth understanding of not only our processes but that of the industry too, in order to bring in the best practices for efficiency enhancement.

What advantages have you been able to derive using technology?

GST is the most recent and one of the biggest examples. In the GST regime, we are able to process 3,000 purchase orders every day by deploying only three people. Technology has played a major role in the entire process of three-way matching of invoices and ensuring accurate documentation. We are a construction equipment firm but very similar in nature to the automobile industry. In automobile, the movement of parts and number of components that go out are huge. So, to ensure proper structuring and internal control check, we have identified codes for all the purchased items and linked them with HSN Code, which is a sort of harmonized code used consistently across the globe, and then the HSN Code to the tax rates. With this master linkage, the process efficiency or transactional accuracy gets massively enhanced.

Thus, it is critical for all the business transactions to imbibe strong automation for accurate and easy tax compliance, with a strong business process as the backbone.

What are other areas where you think technology can help?

In tax itself, there is a huge opportunity for effectively embracing technology. For example, there is a lot of documentation with regard to customs. As we export a significant amount of material, we have to seek a refund of these expenses from the Government, which requires a substantial manual work at both ends. It is commendable to see that the Income Tax Department has been on a journey of automation for several years. I think they are

three steps ahead of any company in India. For instance, the Income Tax Department just using the PAN can link all the transactions in a firm. While we as a firm, who have to file various returns at different stages, need to develop and have a full-proof check to ensure consistency and accuracy before filing. We have to evolve to that and I do not think we are there or 99% of the industry is there. While different companies have their own challenges, it will be good to reach that level in a year's time, which will require linking of different masters as well as different systems.

How do you see the future of the tax function in your company given the automation and technology developments happening in tax?

In my opinion, nothing much will change in the next six months as there are still a lot of refinements and other compliances required in the new GST regime, which will continue to be the key focus in the coming months as well. But after that six-month period, the focus should shift from getting transactions through to more effective filing, in order to make sure that we are better integrated with our vendors and customers, as these areas are prone to higher inconsistencies. So, one has to move from mere transactional mode to business strategizing processes with the help of technology developments.

How is India placed vis-a-vis other jurisdictions with regard to tax technology?

In terms of direct taxation, I do not think any of the tax regimes I have exposure is as far as India is. In some of the developed countries, they have a Tax Identification Number (TIN) for corporates and for other areas they use their social security number. Though they are able to link a lot, still I do not think they have reached the required level yet. Perhaps the Indian tax department has, because I think they have designed it very well, by linking Aadhaar to everything. We are at the forefront from a technology standpoint.

In terms of implementation and the execution of processing returns, I do not think it is easier for a company or a corporate or an individual to be able to transact with the Income Tax Department today as it was earlier. But from a technology standpoint, we are definitely probably best in class with respect to direct taxation.

On the GST side, we have to wait and watch to see everything matches up, although we are seeing an extension in the filing of return dates. But if this is streamlined, it will be best in class, because in most other countries of the western world, which are considered more advanced as they had implemented GST many years ago, they match invoice by invoice.
Also, Customs is one area that needs attention in terms of technology usage for effective enhancement of processes.

In terms of investments in technology and thereby change in processes, what is your take on the cost-benefit analysis, being a company successfully running large operations?

The way the tax department has automated, it has acted like a driving force for the corporates to automate, which is a positive sign. From the perspective of a cost-benefit analysis, if one removes the inefficiencies in the processes, it pays off very easily because today tax and regulatory compliance in general is an inefficient process. Therefore, automation, coupled with the Tax Department's ease of getting returns through, contributes to the cost benefits for a firm.

What is your view on JCB in India and how is the Indian operation perceived globally?

JCB India is a leading manufacturer of earthmoving and construction equipment in India and with over 250,000 machines in India, it has contributed to the development of infrastructure in India for over close to four decades. It forms a significant part of the JCB Group and has remained committed to the India growth story. We have remained invested in India, even during the recent downcycles, and will continue to introduce new and innovative world-class products.

Divyesh Lapsiwala
Tax Partner, EY India
D

Automation **in GST**

It is well said that any technology that does not appear magical is insufficiently advanced. In my opinion, this fairly summarizes what the Government of India has been focusing on in the past 5-7 years. Putting in place a national database of a significant size of the population (Aadhaar), digitizing Government and regulatory records (across regulations), and envisioning a seamless connection between all of them are rapidly changing things around us. India "stack" is the new buzz word in blockchain, and interestingly all of it is Government driven.

The Indian Government is heavily invested in using technology with a stated objective of less government and more governance. And the GSTN should evolve into a fine example of this. As is true with any new technology, it is disruptive, it appears to be complex and it is quite different from what we have seen in the past. It is a massive change, and therefore it will require positive adaptation and transformation.

GST has merged about 20 tax regulations into one body of law, aligning the legal principles regarding taxability, when tax should be paid, the quantum of tax and how tax should be paid and reported. It was this configuration that presented an opportunity to automate compliances end-to-end — to not only require returns to be filed online (which was anyway being done in all major regulations that merged into GST for more than five years now) but also provide an invoice-level listing of business transactions. This ushers in transparency and auditability. This becomes the pivot of allowing seamless credit to the buyer and blocking the ability to claim fictitious credits.

With more than five months now since the go-live of GST, most of us have had a first-hand experience of this compliance and reporting framework. GSTN reporting has changed the entire compliance framework, and therefore it is important for us to appreciate some of the quick learnings from it and short- to medium-term goals that we need to set for ourselves to be able to make this compliance a business as usual (BAU) process.

Taxpayer tech needs an upgrade

Experience thus far suggests that the GSTN tech is ahead of the taxpayer tech in general. The level of preparedness and detailing planned and executed by the Government has pushed taxpayers to prioritize technology changes and adapt to them. Of course, it is a continuous process of evolution for GSTN, which requires taxpayer systems to be even more agile.

Quality and consistency of data never mattered so much

When data is sought at the transaction level, it needs to have all the attributes of being complete and adhering to the set standards. This is very different from presenting summary information for a month (which was the case with earlier regulations). Data cleansing, massaging and templating are the key to being able to meet compliance obligations.

Strong processes are needed for data collated and/or massaged offline

The experience of the first few months is clear: It is not possible to get it right in one go! Taxpayers have done workarounds to make the data fit the requirements. This means taxpayers are now maintaining detailed trails of all amends made offline, which will be paramount as year-end reconciliations need to be submitted along with the annual return.

Non-compliance has a direct impact on customers

The framework does not give you a choice! If you do not comply, your customers do not get tax credits. Therefore, it is a self-policing mechanism to ensure everyone is in the database and everyone reports correctly. Any failure leads to cash flow loss for customers, which will mean working capital impact on either party for the tax amount. It could also result in the customers rejecting invoice payments, further adding to cash flow risks.

Technology brings "one-way" of doing things; processes need to be aligned with that way!

For the first time in Indian indirect tax regulations, everyone is trying to align with a single way of doing compliances. Clearly, this is easier said than done! We are expecting disparate technology solutions to speak the same language in terms of output, not just columns and rows of data, but also formatted in the correct data structure. This indeed is adding to the list of manual workarounds being done for the first few filings.

This will be the biggest enabler for mitigating tax evasion

The Government has suggested that it would set up an analytics laboratory as a part of the GSTN framework. It will also formally share data with the direct tax regulators. This is a clear articulation of its objective to prevent tax evasion and easily identify high-risk transactions/taxpayers. Also, analytics will present a lot of patterns, and therefore outliers may be easier to pick. Sharing data with other

regulators will mean that taxpayers will not be able to present different records to two different authorities.

Process awareness and discipline need to be inculcated

Given all this, taxpayers are heavily focused on getting it right! They are working on imbibing discipline in capturing transactions, the process followed for it (including accounting) and the documentation around it. Taxpayers are organizing periodic workshops to emphasize the importance of this new compliance framework and encouraging teams to share experiences and learn from each other. This is entirely new, and therefore core processes (procure to pay, order to cash and record to report) are being closely monitored by taxpayers for consistency and accuracy.

Choose a good compliance partner (including software) to make this BAU

With any technology deployment, choosing the right partner and stabilizing the steps (along with checks and balances) are important. Taxpayers have been seeking professional help from compliance partners who can walk them through this journey and help them settle their compliances as BAU.

The GSTN will evolve and therefore technology changes will be continuous

Technology, particularly new technologies, is a classic example of something that is ever changing and ever evolving. Therefore, the expectation is that the GSTN will be dynamic and require constant monitoring. This will also need taxpayers to have standby teams to be able to deliver transformation in their environments in the shortest possible timeframes.

All in all, this is clearly the biggest change in compliance India has seen. It may also be (by the sheer volume of data we are dealing with) arguably the biggest technological leap the world has ever seen. In a country like India where the penetration of tech is not very high, this will certainly create several challenges, but there has to be a start. It is hoped that the framework will stabilize over the next 6-12 months, after which it should make life simpler for a compliant taxpayer, track evaders and reduce the ongoing cost of compliance. And, of course, if the tax base and compliance rates increase, the GSTN may become the fulcrum of moderate to low tax regimes in the future.

Digital tax
The way ahead

With tax and technology at the crossroads, it has become increasingly important to consider the views of both technologists and tax experts as part of building the tax function strategy. With this in mind, we brought together two experts from two seemingly very different domains to share their views on a range of questions. Jitesh Bansal is a Tax Partner with EY India comes with a range of tax experience, with a current focus on tax function outsourcing. Rajan Sachdeva is leading the Technology and Managed Services agenda for EY's Africa, India and Middle East regions and is responsible for leading the integration of digital strategy across all EY service lines and for helping clients develop a digital strategy.

What is tax technology?

Jitesh: The answer is simple: It is technology that helps solve tax problems (ranging from tax insights and planning to tax compliance, litigation, data management, etc.).

Technology in tax is still taking the first steps. Where do you see all of this headed?

Jitesh: GST has given tax functions the first taste of technology and transformed indirect tax functions. While every change comes with some resistance to implementation (and so has GST's technology enablement), I believe this resistance will soon change into a habit and technology-driven compliance will soon become a way of work. Today, there is a lot of people dependency in the way tax functions operate, and tax teams are fine with it. Once tax teams get used to the convenience and independence that technology brings with it, working without technology will become hard to imagine. For example, it was not so long ago that tax payments used to be tracked by the Government and companies manually. But we have already become so used to the Government's computerized tracking and reconciling of tax payments (through the Form 26AS mechanism) that we can hardly imagine doing it otherwise.

With your experience in digital and leading technology transformation across industries, what are the key learnings you believe can be applied to tax?

Rajan: Digital and technology today are playing the role of a catalyst and disruptor across multiple industries. We have helped clients leverage digital and technology to disrupt themselves and also change the paradigms in the industry. Today, key enablers such as automation, analytics and artificial intelligence (AI) are helping clients simplify and strengthen internal and market-facing processes.

Automation and AI are being leveraged to bring enhanced reliability and productivity in managing repeatable and rule-based tasks. Analytics helps bring insights to simplify and help achieve outcomes. As the application of these technologies matures, they would drive further automation and intelligence in the tax functions as well. The benefits of these technologies go beyond productivity improvement to the realm of intelligent tax management.

Jitesh Bansal

Rajan Sachdeva

Do you really believe tax teams are well positioned to start using technology for their operations?

Jitesh: Yes, definitely. The finance functions of companies today are already largely tech-enabled. Tax functions are therefore already well positioned to use all the digital information available for tax needs.

Why has it not happened yet?

Jitesh: The most scintillating use case for technology is solving complex problems that cannot be solved easily today, and the tax law, being complex, fits in well.

But complex tax problems are tough to solve using technology given that they are often quite unstructured (for example, even reconciling financial statements to tax filings using technology is sometimes very hard!).

Further, some of the underlying data used by tax functions (such as tax orders, signed documents and communications with tax department) are not yet fully digital. This has made it tougher for tax teams to fully adopt technology from end to end

Having said this, with the Government's increased use of technology to administer tax compliance using technology, companies will need to catch up to stay ahead of the curve. Tax technology tools will also naturally evolve to be able to meet market demands.

What are the problem areas for tax that technology can potentially facilitate?

Jitesh: Almost everything, eventually. The first in the wave is using technology to perform, oversee and store tax compliances with minimal human intervention. This requires almost only structured data and is therefore a low hanging fruit (this is already happening with GST compliance, litigation tracking tools, tax data repositories, etc. as we speak).

The next wave that is quickly emerging is the use of technology for tax analytics and planning (effective tax rate efficiency, predicting tax cash flows, etc.). With the number of variables and changing dynamics, we sometimes have a false sense that the human mind is better placed to process all of this and come up with a logical answer. But I truly believe we can only think of a few things at a time and a computer, on the other hand, can digitally process a lot more variables. The thinking ability, dashboard visualization capabilities, etc. of technology will provide insights that the human mind can easily consume and use for strategic decision making. This marriage of technology and human abilities should be a very exciting combination.

What are your thoughts?

Rajan: There are multiple technology enablers that would help define a new paradigm in the tax function. While the technology space is continuously evolving, enablers such as robotics process automation (RPA), machine learning (ML) and analytics have matured to find commercial applications.

RPA would help reduce manual interventions in end-to-end tax process, while ML would help match tax incidences with activities captured in the system of record (ERP). The convergence of these technologies and analytics can help in building a CFO tax dashboard that provides an end-to-end view for managing the tax incidence of a firm.

What should companies be doing to gear up for a tech-enabled tax function?

Rajan: It is critical for companies to seamlessly manage the convergence of the IT, digital and tax functions. The key challenge for firms is to organize these varied competencies within the organization to drive a cohesive agenda along with business-as-usual activities.

We typically recommend a gradual immersion to evaluate the potential of digital across the organization. We take our clients through a Digital 24 Journey involving 2 hours of digital awareness, 2 days of workshop for digital immersion, 2 months for developing the digital strategy followed by 1-2 years of digital transformation and change management after the business case is understood and internalized by the company.

What is the buzz around tax outsourcing?

Jitesh: Tax functions are faced with a number of challenges (constant legislative change, people-dependent processes, increasing asks to partner with business, etc.). Addressing these challenges takes investment in the right skillsets, processes and technology. Tax is not the core competency/focus area for companies and therefore they are not keen to make these investments and take the risks associated with them. They would rather pass this on to professionals whose job it is to make these investments in people, process and technology.

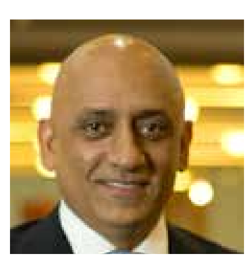
Do you see tax going the way IT functions did 10 years back – largely outsourced?

Rajan: Cloud technology has matured from Infrastructure as a Service (IaaS) to Software as a Service (SaaS) to Platform as a Service (PaaS). This has enabled end-to-end platforms and their corresponding applications to be available on the cloud with pay-per-use commercial models. Other functions such as IT, supply chain, HR, finance and procurement have espoused these technologies to drive business value. For the tax function, while this journey seems inevitable, the speed of transformation depends on the company's willingness to move toward managed services and the maturity of platform tools available on the cloud.

What is your vision of the tax function of the future?

Jitesh: This is a difficult one. Every time I have had an unrealistic vision of the future, the future has surprised me with an even more unrealistic version – in my experience, the future has been stranger than fiction. I believe we will reach a stage where tax will be a by-product of every transaction and will be paid and reported automatically in real time. There will be no need to separately administer tax. Tax will be administered as part of an overall mechanism that oversees all transactions. With this, it will be impossible to separate the tax professional and the technologist. Exciting times ahead!

Standard technology solutions for the tax function



Ajay Kumar
Tax Partner, EY India

Not long ago, organizations in their digital journey looked at low-hanging fruit or what was very core to the business. Things have changed so much now that almost every company wants to call itself a digital company.

A challenge facing tax functions today is that it is no longer a step-by-step approach to going digital. On the other hand, Governments are looking to interact with companies digitally, with full transparency on their tax, finance and operations data. Tax heads who have been trained on law suddenly find themselves in the deluge of having to manage and confirm the accuracy of tax data being submitted with the authorities and also audited by them using advanced data analytics applications. Globally, despite the dynamic nature of the underlying law and business models, the tax function finds limited opportunities for automation. The dilemma of tax heads is understandable. However, there are some automation opportunities that tax functions can adopt irrespective of the country they operate in.

1

Replace emails with workflow and collaboration solutions

Unlike in other functions, information exchanged by tax professionals may need to be maintained for long periods of time, either under the requirement of law or for genuine business purposes — e.g., tax authorities may ask for proof that services were indeed provided by the headquarters to warrant a management charge, and usually it is emails that are produced before the tax authorities. However, as and when people leave the company, their mails may be archived or destroyed, possibly enhancing the risk of dis-allowances on account of management charge. There are numerous instances of tax professionals really struggling to get cogent data. A properly designed workflow and team collaboration application can increase the efficiency of the tax team manifold and make it easier to store and retrieve tax data any time.

2

Implement robotics for repetitive processes

Tax professionals end up spending a lot of time on manual processes that have little or no subjectivity involved. Where such processes have to be undertaken regularly and are time consuming, companies can look at implementing robotics solutions to execute the tasks quickly and efficiently. The challenge here is not implementing robotics but identifying which processes need such a solution.

3

Develop integrators for converting finance data into tax data

The tax function fundamentally feeds on data from the finance and accounting function, and the tax treatment of such data may be different from the treatment adopted under local country GAAP. Therefore, there is a need to convert finance data into tax data. To do that, an application can be developed with the underlying tax logic for an accounting data point to be converted into tax data point. It needs to be done for each country separately. An alternate approach could be to have a simple system that can store the differences between the accounting and the tax data for use in year-on-year tax reporting and compliance and reconciliation.

4

Develop an entity-management system and global compliance calendar and guidance for completion

One of the cardinal responsibilities of the tax function is to ensure that the team is aware of the steps involved in reporting to authorities across the world. An entity management system that has global tax and regulatory compliances built in with requisite access controls for internal team members and also third-party consultants with alerts, reminders and escalations can go a long way in addressing a basic yet unaddressed problem of most tax professionals. A major plus would be its integration with the task tracker and workflow applications mentioned earlier.

5

Undertake data analytics before data is submitted to authorities

The quality of data submitted to the tax authorities is fundamentally a function of how much subjectivity is left with the accounting person while entering accounting entries in the ERP or generating invoice data. Even if all the tax logic is built

into ERP, there is still the chance of errors due to the human element involved in data entry. This may not always necessarily create a risk but can cause real damage in terms of a missed planning opportunity. A system can be developed whereby all finance data with the backup can be read and tested with the tax data model to detect outliers and see trends to spot areas that may require further investigation. The system can also help with analysis of related-party transactions, ETR analysis, book-to-tax differences and sales-to-tax payouts and more.

6

Develop a ticket system for responding to business teams

One of the major stakeholders of the tax function is the business unit. The amount of pressure put on the tax function and the quick turnaround time that is expected to address business queries make it very intriguing. The tax function can build a ticket system allowing business persons to raise a ticket with backup and get it addressed by the tax team, thereby increasing the effectiveness and utilization of the tax team. This may also help develop FAQs, which can be very handy for business process owners.

7

Develop a robust data-reconciliation engine

This is a must-have for all companies as tax authorities are collecting data from different sources and will push companies to reconcile the differences – for example, reconciliation of sales in GST returns with sales reported for income tax and reconciliation of payments made in foreign currency with what is submitted in transfer pricing documentation etc. Excel has lot of features but it has its limitations. A robust data-reconciliation engine would significantly reduce the time of the tax teams and also increase the accuracy and reliability of the data being submitted to the authorities.

8

Notice and controversy management platform

The tax function needs to ensure that responses notices received from authorities across the world are submitted timely and any risks that have surfaced as a result of such investigation are being handled properly. It is usually left to the trusted tax teams across the world and the updates are shared on emails or PowerPoints. A robust tax notice and tax controversy management application with workflows and maker-checker attribute built in is essential for any company operating in different jurisdictions.

Who will succeed in this journey?

Given that there are not many companies who have adopted technology in the tax function, the published best practices are limited. However, based on our experience of developing tools at EY, we believe that to succeed:

- The solution should be flexible enough to accommodate various scenarios impacting tax – for example, change in laws, change in teams, change in reporting requirements and change in compliance obligations – with minimum intervention of the technology people.
- The design of the solution should be conceived in such a way that non-technology people can make changes in the solution and adapt it to their requirements.
- The solution should cater to multi-country requirements for tax.
- It should be simple to use.
- It should actually replace the work being done manually.
- It should have a mobile component for ease of reference and use.

At the end, it is not about how sophisticated or how latest the technology is. The challenge here is developing systems using the right technologies in such a way that they do not get outdated soon, are easy to use, reduce the time and cover the tax risks comprehensively. It is also important for any such technology invasion in the tax function to have the backing of the top management and adequate budgets to make them happen.

Global News

01

OECD releases draft 2017 update to the Model Tax Convention and Commentary[1]

On 11 July 2017, the Organization for Economic Co-operation and Development (OECD) released the draft contents of the next update to OECD Model Tax Convention (the 2017 update). Significant parts of the 2017 update were previously approved as part of the Base Erosion and Profit Shifting (BEPS) Package. The forthcoming 2017 Model Tax Convention will therefore introduce the treaty-based recommendations contained in the BEPS final reports on Action 2 (Neutralizing the Effects of Hybrid Mismatch Arrangements)[2], Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)[3], Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) and Action 14 (Making Dispute Resolution Procedures More Effective)[5].

It also includes four areas that were not previously released. Interested parties are invited to submit comments on the following changes to the 2017 update:

- Changes to the Commentary on Article 4 related to the issue of whether a house rented to an unrelated person can be considered to be a "permanent home available to" the landlord for purposes of the tiebreaker rule
- Changes and additions to the Commentary on Article 4 (Resident) that are intended to clarify the meaning of "habitual abode" in the tiebreaker rule
- Changes to Commentary on Article 5 (Permanent Establishment (PE)) relating to disposal test, among others; further, addition of a new paragraph that indicates that registration for the purposes of a value-added tax or goods and services tax is, by itself, irrelevant for the purposes of the application and interpretation of the PE definition
- Deletion of the parenthetical reference (other than a partnership) in Article 10, which is intended to ensure that the reduced rate of source taxation on dividends is applicable to a fiscally transparent entity (FTE), where new Article 1(2) considers a dividend paid to FTE as income of a resident to the extent it is taxed in the hands of the entity or in the hands of the members of that entity

OECD Model Tax Treaty and Commentary is considered as an important source/aid for interpretation of tax treaties by taxpayers, the administrative authorities and the Courts. It is important for companies to continue to monitor the developments in this area in the OECD and in the countries in which they operate, and to consider actively engaging with policymakers in this international tax debate.

1 Refer EY Global Alert titled "OECD releases draft 2017 update to the OECD Model Tax Convention" Dated 14 July 2017.

2 Refer EY Global Tax Alert titled "OECD releases final report on Hybrid Mismatch Arrangements under Action 2" dated 11 October 2015.

3 Refer EY Global Tax Alert titled "OECD releases final report under BEPS Action 6 on preventing treaty abuse" dated 20 October 2015.

4 Refer EY Global Tax Alert titled "OECD releases final report on preventing the artificial avoidance of permanent establishment status under Action 7" dated 19 October 2015.

5 Refer EY Global Tax Alert titled "OECD releases final report on improving the effectiveness of dispute resolution mechanisms under Action 14" dated 8 October 2015.

02

OECD, UN, IMF and World Bank toolkit for addressing difficulties in accessing comparable data for transfer pricing analysis[6]

On 22 June 2017, the "Platform for Collaboration on Tax" (the Platform) – a joint effort of the OECD, United Nations (UN), International Monetary Fund (IMF) and World Bank Group (WBG) – released a toolkit (the Toolkit) designed to help developing countries address the lack of "comparables" for transfer pricing (TP) analyses.

The Toolkit's aim is to help ensure greater practical implementation of TP regimes that apply the arm's length principle, in accordance with the realities faced by many developing countries.

The Toolkit includes four sections: (i) part I provides an introduction on addressing the difficulties in performing comparability analyses, (ii) part II describes issues arising when conducting a comparability analysis, (iii) part III includes approaches to apply internationally accepted principles in the absence of comparables and (iv) part IV provides a summary, conclusions and recommendations for further work, and includes several case studies. The Toolkit also contains multiple appendices that contain practical guidance and examples that might be relevant when performing a comparability analysis.

The Toolkit explains that difficulties in accessing information on comparables are a common concern of developing countries. It goes beyond a narrow examination of how to deal with a lack of local comparable data and focuses on practical measures that developing countries can implement in the short to medium term – noting that while there may be potential alternatives to the "arm's length principle" that do not rely on comparables (e.g., formulary apportionment), they are unlikely to be implemented in the foreseeable future. However, often times the data that is available will still allow a reasonably reliable analysis to be performed and a satisfactory approximation of an arm's length outcome to be determined. The Toolkit also provides common approaches to be used in the absence of comparables. With respect to the policy options, the Toolkit provides considerations on the use of carefully constructed safe harbors aligned with the arm's length principle. In summary, the Toolkit concludes that there are three key areas that developing countries might consider particularly effective:

- Use of safe harbors
- Use of data relevant to comparability analyses contained in information submitted tax administrations;
- Use of a framework for the selection and application of the most appropriate method, reiterating the importance of the actual delineation of the transaction

The Toolkit describes approaches that both tax administrations and taxpayers can use when dealing with the lack of comparables. Multinational businesses active in developing countries may want to consider the guidance provided in the Toolkit when developing and applying their transfer pricing policies for such countries.

6 Refer EY Global Alert titled "OECD, UN, IMF and World Bank toolkit for addressing difficulties in accessing comparable data for transfer pricing analysis" dated 6 July 2017.

03

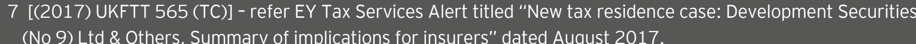
UK Tribunal rules on location of board meeting itself not sufficient to determine tax residence[3]

In the case of Development Securities Ltd. & ors. vs. HMRC[7], the UK First Tier Tribunal (FTT) held that Jersey companies set up to hold UK real estate were resident in the UK for tax purposes.

In this case, three Jersey companies were used as part of a tax structure designed to increase the group's available capital losses. The Jersey companies were ultimately owned by Development Securities PLC (a UK Company). The arrangement of Jersey companies with UK group companies was to crystallize latent capital losses without losing the benefit of indexation allowance. To be successful, the arrangement required the Jersey-incorporated companies to be tax resident in Jersey for a specific period.

The FTT found that although the relevant board meetings were held outside the UK, the directors were in effect doing no more than following instructions given by their UK parent. The transaction was clearly not in the interests of the companies and indeed could only take place with parental approval for it to be lawful. It further denied the claim of the taxpayer, based on some previous rulings, that a company will "almost always" be resident where the board of directors meet. In particular, in this arrangement the only decisions that the Jersey board had to take were "uncommercial" – namely, to buy assets at a price greater than market value. As a result, the court found that the companies were centrally managed and controlled, and tax resident, in the UK, negating the tax benefits of the structuring.

The decision makes it clear that the location of board meetings will not in itself determine tax residence if central management and control are not effected through those meetings. A company's central management and control is where strategic decisions are taken and in most cases, a company's strategy will be underpinned by a general commercial objective to maximize value and realize profits. If such an overriding commercial objective is wholly absent, it will be easier to decide that a company's central management and control are exercised at a higher level, namely, where the decision to use the offshore company for wider group purposes is taken.



7 [(2017) UKFTT 565 (TC)] - refer EY Tax Services Alert titled "New tax residence case: Development Securities (No 9) Ltd & Others, Summary of implications for insurers" dated August 2017.

04

Danish tax board rules sub-contracting of service constitutes a PE[8]

An Austrian company (ACo) completed the construction of a new building in Denmark for a Danish company (DCo), after which ACo proposed to enter into a contract for servicing the building. The services comprised of assistance with daily operations well as cleaning and maintenance of the building façade, and the services were expected to last for a period of 10 years. DCo would make offices and storage facility to be used exclusively for the purpose of the service contract.

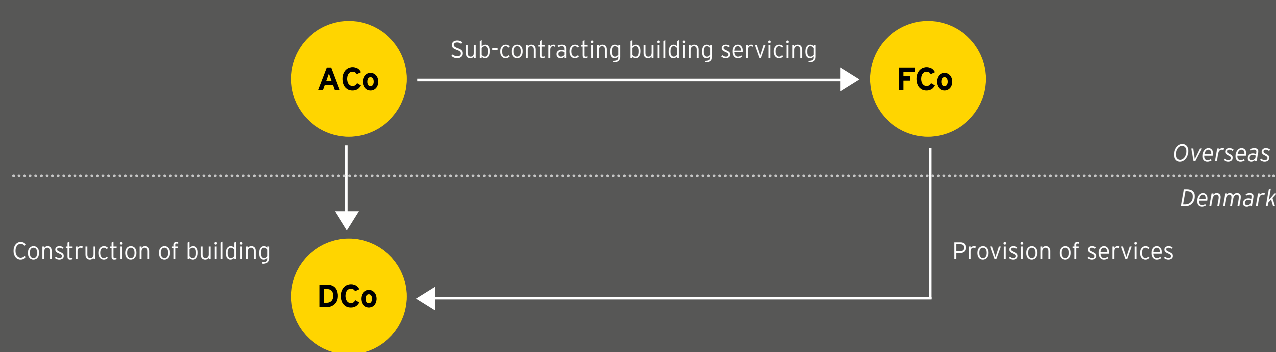
For fulfilling its obligation under the service contract, ACo engaged a foreign non-related subcontractor (FCo). ACo did not carry out any of these activities in Denmark. It did not have an office at its disposal in Denmark and did not have any employees working in Denmark for the purpose of the service contract.

The rights and obligations towards DCo were not transferred to the subcontractor and remained with ACo.

The Danish Tax Board (the Board) referred to the recommendations prepared by the OECD Committee on Fiscal Affairs on the interpretation and application of Article 5, which indicates that a foreign company that performs business in another country through a subcontractor can create a PE if the other requirements for creating a PE according to the OECD MC Art. 5 are met. It was held that ACo created a fixed PE in Denmark on the premises of DCo for the following reasons:

- As per the contractual terms, ACo would have offices and storage facilities at its disposal in Denmark regardless of the fact that the services would be outsourced to a subcontractor.
- ACo would remain liable for the execution of the work, and the rights and obligations toward DCo were not transferred to the subcontractor.
- The subcontractor would be carrying out the Austrian company's business in Denmark through the fixed place of business, as the activities performed by the subcontractor in Denmark would be part of the Austrian company's overall business.

This decision is of importance to multinational enterprises to consider the possibility of the emergence of PE by outsourcing their core business activities to sub-contractors.



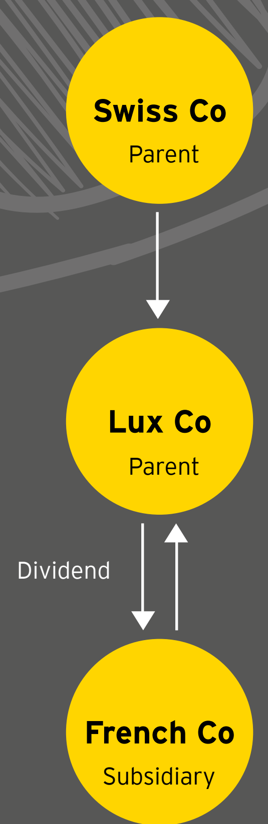
8 Refer EY Global Tax Alert titled "Danish Tax Authority rules subcontracting of services by foreign company to non-related foreign entity creates a permanent establishment in Denmark" dated 28 August 2017.

05

CJEU rules French anti-tax treaty shopping rule infringes Parent-Subsidiary Directive and freedom of establishment[9]

On 7 September 2017, the Court of Justice of the European Union (CJEU) issued its decision in the French case C-6/16. This case concerned the application of a (former) French anti-tax treaty shopping provision.

In 2005 and 2006, a French company (French Co) paid a dividend to its Luxembourg-based parent company (Lux Co). The shares of Lux Co are indirectly owned by a company resident in Switzerland. As per the applicable French tax law, the dividend paid by a French subsidiary to a parent company established in another EU member state is fully exempt from French dividend withholding tax under certain conditions. However, this exemption does not apply if the recipient of the French dividend is a legal entity directly or indirectly controlled by one or more entities established in non-EU countries. In that case, the recipient will only qualify for the exemption if it can prove that benefitting from the exemption is not the main purpose or one of the main purposes of the structure (the counter evidence rule).



In the present case, the French dividend is received by Lux Co, which is indirectly controlled by a parent company based in Switzerland (Swiss Co). According to the French tax authorities, Lux Co was unable to demonstrate that the structure did not have as its main purpose or one of the main purposes to benefit from the exemption. The French court asked whether this rejection was in accordance with EU law and referred the case to the CJEU.

The CJEU ruled that the previous French regime infringed both the Parent-Subsidiary Directive and the freedom of establishment. This is based on the fact that the French legislation only takes into account the taxpayer's motive for the structure. Unjustifiably, it does not make an individual examination of the whole operation at issue to determine whether the structure is in conflict with the purpose of the Parent-Subsidiary Directive or the freedom of establishment. In other words, the French anti-abuse rule does not contain an "economic activity" (or "substance") test, as required under EU law.

9 Refer EY alert titled "CJEU rules French anti-tax treaty shopping rule infringes Parent-Subsidiary Directive and freedom of establishment" dated 8 September 2017.

Transfer pricing:

using technology to avoid pitfalls

C

Paresh Parekh

Tax Partner, EY India

There are 10 types of people in the world: those who understand binary and those who do not.

Binary digits, which started off as computer processor instructions for making human life simpler, literally control human life in modern times. We are surrounded by smartphones, smartwatches, tablets, laptops, software on such devices, machines in manufacturing – all controlled through such binary digit computer processor instructions.

With the world becoming "smarter", multinational enterprises (MNEs) are increasing investments to match the pace of the "digital revolution". Also, taking a cue from such technological advancements, tax administrations across the globe are aggressively advancing their digital capabilities, using sophisticated data analytics to achieve more revenue, greater efficiency and improved compliances.

Transfer pricing, being a dynamic area, has always been at the forefront of the changes impacting the taxation domain. With the implementation of the Base Erosion and Profit Shifting (BEPS) project of the Organization for Economic Commerce & Development (OECD), the focus of tax administrations across the globe has shifted from the analysis of jurisdictional entities to the MNE as a whole.

Tax administrations are looking for transparent disclosures by MNEs of all the critical details inter-alia including inter-company transactions within the group. Under the BEPS regime, MNEs are required to gather and provide substantially more information on their global operations to the tax administrations than ever before. Such a requirement necessitates a transfer pricing policy being laid for the transactions. Simultaneously, MNEs have to ensure that such transfer pricing policy is followed in letter and spirit. Appropriate control measures need to be in place to highlight any deviations from the transfer pricing policy and suggest corrective measures.

With the traditional definitions of a "permanent establishment" undergoing a change, MNEs need to review their operations and monitor their activities to be compliant with the new law. With global changes creating additional compliance and monitoring burden on MNEs, automation can help them with real-time global tax management, data access, analytics and government data feeds. Simultaneously, automation can assist tax administrations with effective use of the data collected from the taxpayers.

Big data

It is rightly said that if you torture the data long enough, it will confess to anything. Tax professionals are not always sophisticated technology users. Therefore, automation for them should not only serve the purpose of effective data collection and analytics but also be user-friendly.

MNEs can leverage automation for the following:

Data collection

MNEs, through the Country-by-Country Report (CbCR), have to collate various data points pertaining to the country of tax residence, related-party revenue, unrelated party revenue, earnings before tax, cash tax paid, headcount etc. In case MNEs decide to collate such data manually, their results may be susceptible to human error. To ensure accuracy, MNEs could explore the possibility of using appropriate software that connects with their enterprise resource planning and extracts the required data points.

MNEs can achieve the following through automation of their tax and accounting process:

- Extraction of relevant tax data from source systems, data integration and retrieval of data for end users
- Reduced time in managing data and increased efficiency of data-driven tax processes
- Integration of different data sources and third-party tax software
- Standardization and automation of data collection processes from multiple sources
- Ability to accommodate tax software that requires data format changes
- Improved data quality through maximized automation of data

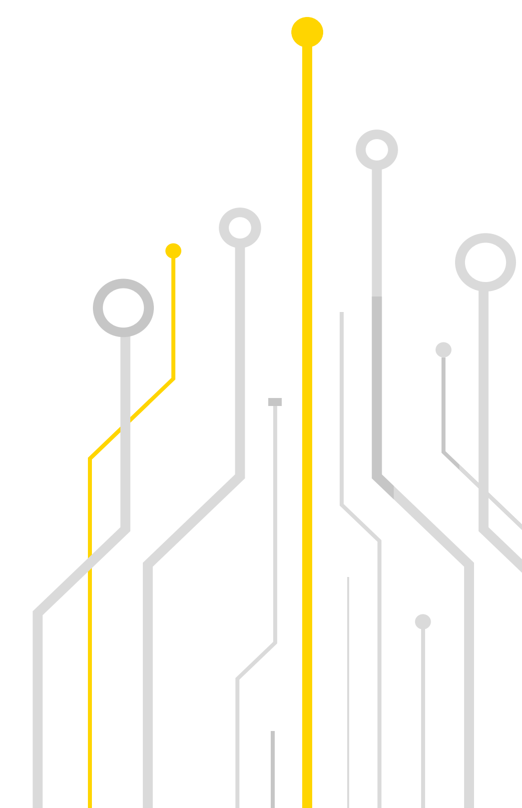
Data analysis

Along with data collation, MNEs can also automate the task of highlighting any deviations in the trends of the data points by defining relevant rules for data analysis.

Such analysis can help MNEs undertake a risk assessment of the data before furnishing it to the revenue authorities. Data analytics tools can also be leveraged by the revenue authorities for selection of cases for scrutiny based on the risk assessment.

The inclination of Indian revenue authorities toward digitization is quite evident from their use of data analytics on data gathered from banks following demonetization to form patterns and identify suspicious deposits by citizens.

Further, with respect to the CbCR details, data analytics can help both MNEs as well as tax administrations identify patterns and variances. MNEs can track the intensity of the various activities and consequently identify the role of each entity at different levels of the value chain. Such role can be related either to the development, enhancement, maintenance, protection and exploitation (DEMPE) activity for an intangible or to agency-related activities.



Digital tax administration

Tax administrations are striving to prove their digital supremacy by taking measures to achieve e-filing, e-accounting, e-matching, e-auditing and e-assessing.

E-file

Use of standardized electronic form for filing tax returns required or optional; other income data (e.g.,payroll, financial) filed electronically and matched annually

E-accounting

Submit accounting or other source data to support filings(e.g., invoices, trial balances) in a defined electronic format to a defined timetable; frequent additions and changes at this level

E-match

Submit additional accounting and source data; government accesses additional data (bank statements), begins to match data across tax types and potentially across taxpayers and jurisdictions in real time

E-audit

L2 data analyzed by government entities and cross-checked to filings in real-time to map the geographic economic ecosystems; taxpayers receiving electronic audit assessments with limited time to respond

E-assess

Government entities using submitted data to assess tax without the need for tax forms; taxpayers allowed a limited time to audit government- calculated tax

Digitization will assist tax administrations to improvise the set of taxpayers scrutinized as well as the aspects to be examined.

Disruptive innovation can hurt if you are not the one disrupting. Accordingly, the benefits for MNEs lie in implementing this mantra in essence and starting to digitize their taxation function. A head start might prevent any technological slip-ups when digital tax administration becomes a full-fledged reality.

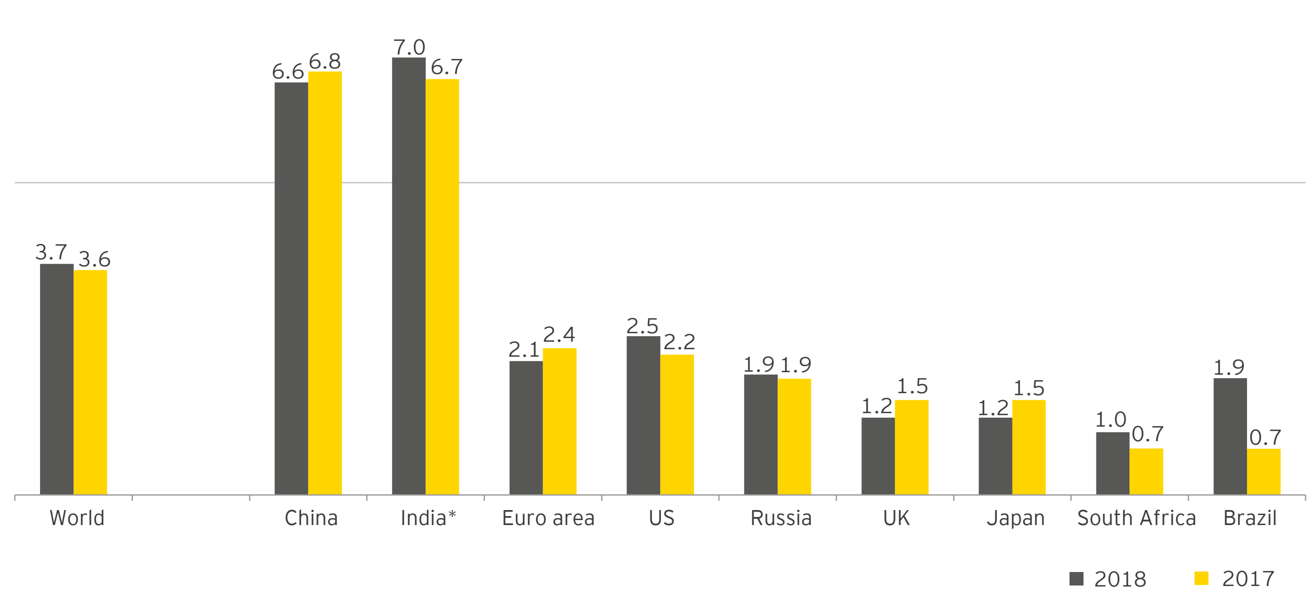
EconoMeter

macro-fiscal trends

Demonetization and transitional challenges of GST implementation led to a downward revision in India's projected GDP growth in FY18

- The OECD lowered India's FY18 GDP growth forecast to 6.7% due to demonetization and transitional challenges of GST. However, at a projected growth rate of 7% in FY19, India is expected to regain its position as the global growth leader.
- The RBI, in its fifth bi-monthly monetary policy review, has also estimated India's GVA growth at 6.7% in FY18.
- The OECD projects global growth to improve from 3% in 2016 to 3.6% in 2017 and 3.7% in 2018.

Chart 1: Real GDP growth projections (%, annual)



Source: Organisation of Economic Co-operation and Development (OECD) Economic Outlook, November 2017
*forecast pertains to fiscal year

Reversing its falling trend, real GDP and real GVA growth improved to 6.3% and 6.1% respectively in 2QFY18

- On the production side, growth in real GVA increased to 6.1% in 2QFY18 from 5.6% in the previous quarter.
- The turnaround in GVA growth was due to strong growth of 7.0% in manufacturing while growth in construction sector also marginally increased to 2.6% during 2QFY18.
- There was a broad-based slowdown in services sector growth.
- Growth in public administration and defense services fell to 6.0% in 2QFY18 from 9.5% in the previous quarter.

Table 1: Sectoral real GVA growth (%)

Sector	3Q FY16	4Q FY16	1Q FY17	2Q FY17	3Q FY17	4Q FY17	1Q FY18	2Q FY18
Agr.	-2.1	1.5	2.5	4.1	6.9	5.2	2.3	1.7
Ming.	11.7	10.5	-0.9	-1.3	1.9	6.4	-0.7	5.5
Mfg.	13.2	12.7	10.7	7.7	8.2	5.3	1.2	7.0
Elec.	4.0	7.6	10.3	5.1	7.4	6.1	7.0	7.6
Cons.	6.0	6.0	3.1	4.3	3.4	-3.7	2.0	2.6
Trans.	10.1	12.8	8.9	7.7	8.3	6.5	11.1	9.9
Fin.	10.5	9.0	9.4	7.0	3.3	2.2	6.4	5.7
Publ.	7.5	6.7	8.6	9.5	10.3	17.0	9.5	6.0
GVA	7.3	8.7	7.6	6.8	6.7	5.6	5.6	6.1

Source (Basic Data): MOSPI

GVA: Gross value added

Revival in investment and falling imports drives growth in 2QFY18

- Investment in fixed assets (excluding valuables), which remained subdued for four quarters in a row, grew at a faster pace of 4.7% in 2QFY18 as compared to 1.6% in 1QFY18.
- While export growth has remained constant in 2QFY18, import growth fell, leading to a lower negative contribution of net exports to GDP growth.
- Growth in government consumption expenditure (GCE) fell to 4.1% in 2QFY18, after recording double-digit growth for five consecutive quarters.

Table 2: Real GDP growth (%)

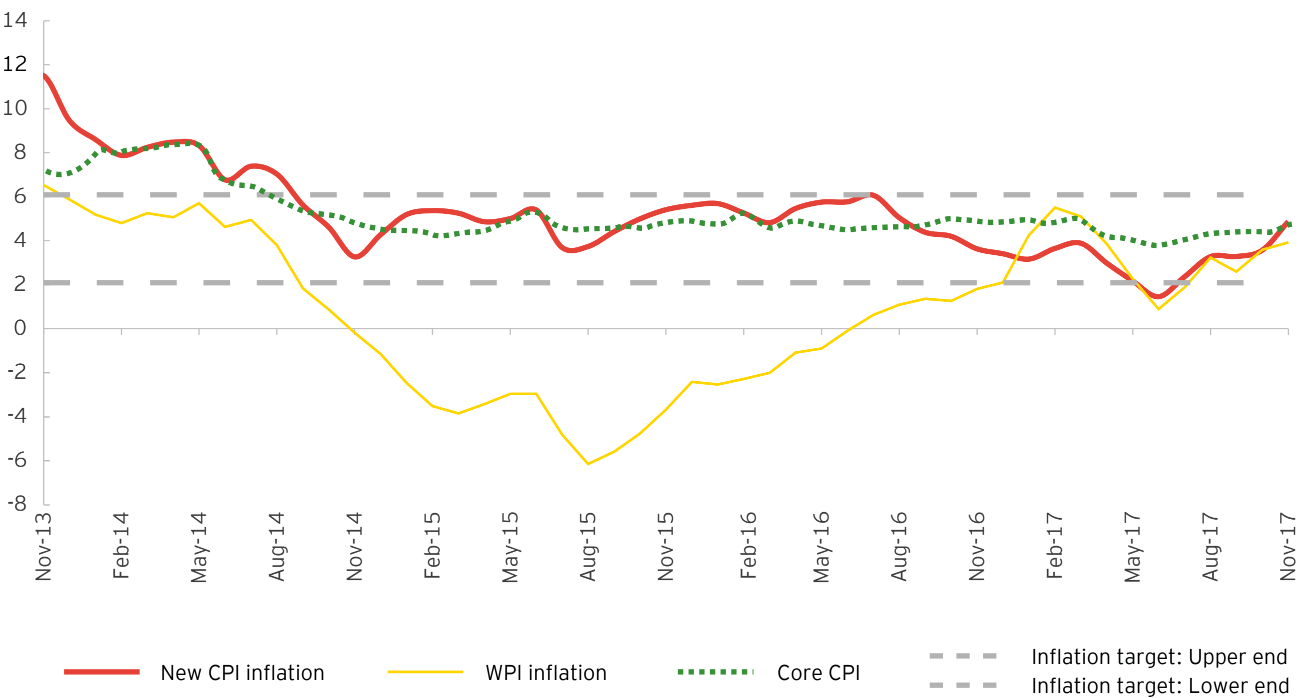
AD component	3Q FY16	4Q FY16	1Q FY17	2Q FY17	3Q FY17	4Q FY17	1Q FY18	2Q FY18
PFCE	5.9	11.8	8.4	7.9	11.1	7.3	6.7	6.5
GCE	5.1	2.4	16.6	16.5	21.0	31.9	17.2	4.1
GFCF	7.0	3.9	7.4	3.0	1.7	-2.1	1.6	4.7
EXP	-8.7	-1.6	2.0	1.5	4.0	10.3	1.2	1.2
IMP	-10.0	-3.7	-0.5	-3.8	2.1	11.9	13.4	7.5
GDP	7.4	9.0	7.9	7.5	7.0	6.1	5.7	6.3
Net exports contribution to growth (% points)	0.5	0.5	0.5	1.2	0.4	-0.3	-2.6	-1.3

Source: CSO, MOSPI, Government of India
AD: Aggregate demand; PFCE: Private final consumption expenditure; GCE: Government final consumption expenditure; GFCF: Gross fixed capital formation; EXP: Exports; IMP: Imports; GDPMP: GDP at market prices

The Reserve Bank of India (RBI) retained the repo rate at 6% in its December 2017 monetary policy review due to heightened risks to CPI inflation and increased inflation expectations

- CPI inflation reached a 15-month high of 4.9% in November from 3.6% in October 2017 primarily due to rising vegetable prices, while core CPI inflation increased to an eight-month high of 4.8%.
- The RBI expects CPI inflation to range between 4.3%-4.7% during 3Q and 4Q of FY18, 10 basis points higher than the projections reported in the October 2017 policy statement due to the impact of HRA by central government which may peak in December 2017, staggered impact of HRA increases by state governments and sustained increase in global crude prices.

Chart 2: Inflation (y-o-y; %)

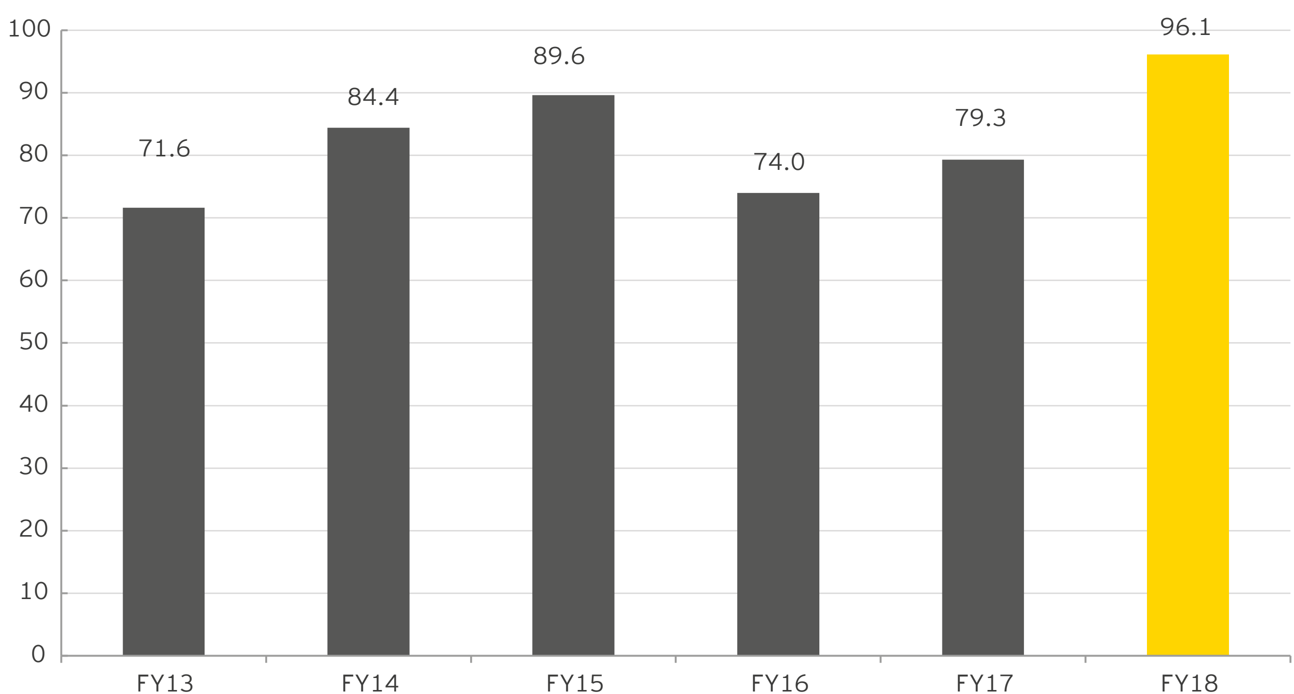


Source: MOSPI
Note: CPI stands for Consumer Price Index

The Center's fiscal deficit crossed 96% of the annual budgeted target up to October 2017

- The Center's fiscal deficit during April–October stood at 96.1% of the FY18 annual budgeted target.
- Such a high level of fiscal deficit would constrain the ability of the government to fiscally support growth.

Chart 3: Fiscal deficit during April–October FY18 as a % of annual budgeted target

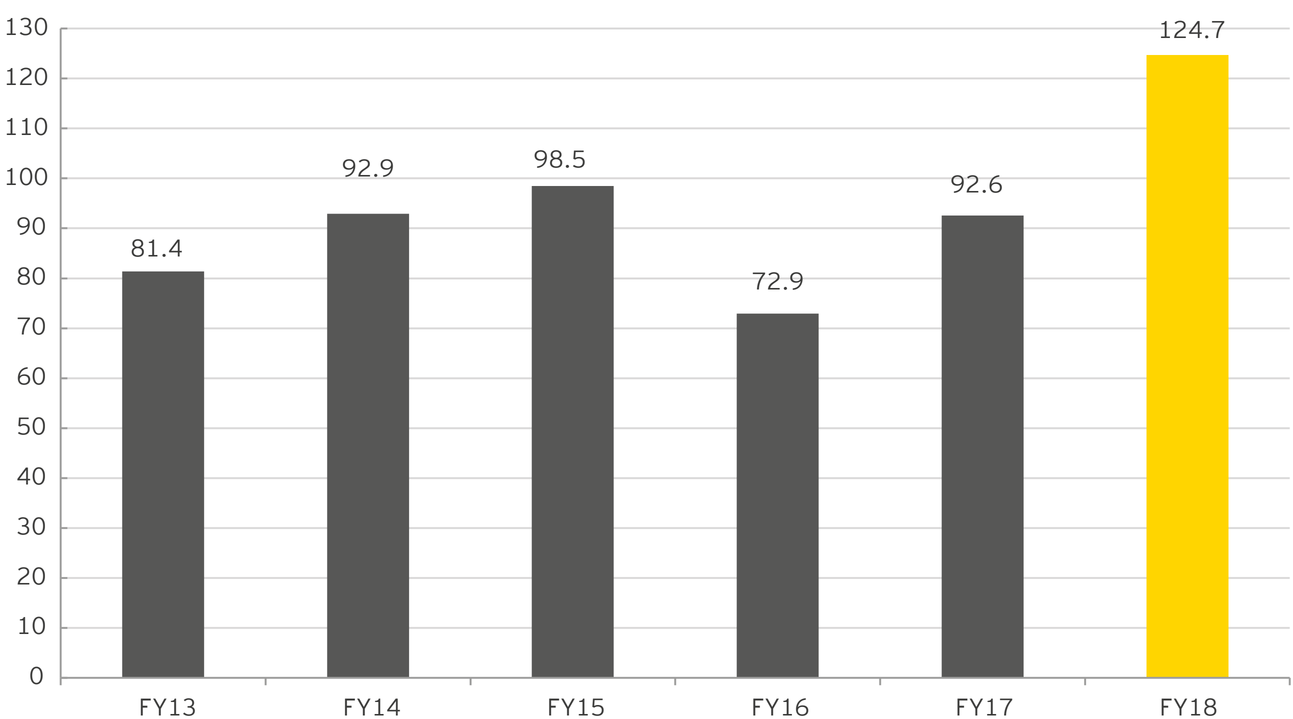


Source: Monthly Accounts, Controller General of Accounts, Government of India

The Center's revenue deficit stood at 125% of the annual budgeted target up to October 2017

- The Center's revenue deficit during April-October FY18 stood at 124.7% of the annual budgeted target.
- Revenue deficit as a percentage of the annual budgeted target had already crossed 100% by June 2017.

Chart 4: Revenue deficit during April—October FY18 as a % of annual budgeted target



Source: Monthly Accounts, Controller General of Accounts, Government of India

Growth in tax revenues during April–October FY18: Marginally higher than last year

- During April–October FY18, gross taxes grew by 18.9%.
- During April–October FY18, direct taxes grew by 13.8% as compared to 10.7% in the corresponding period of FY17.
- After the introduction of GST, growth in indirect taxes during April–October FY18 was slightly lower at 21.1% as compared to 25.4% during April–October FY17.
- Non-tax revenues witnessed a contraction of (-) 43.4% during April–October FY18.

Table 3: Gross tax and non-tax revenue (growth rates, %)

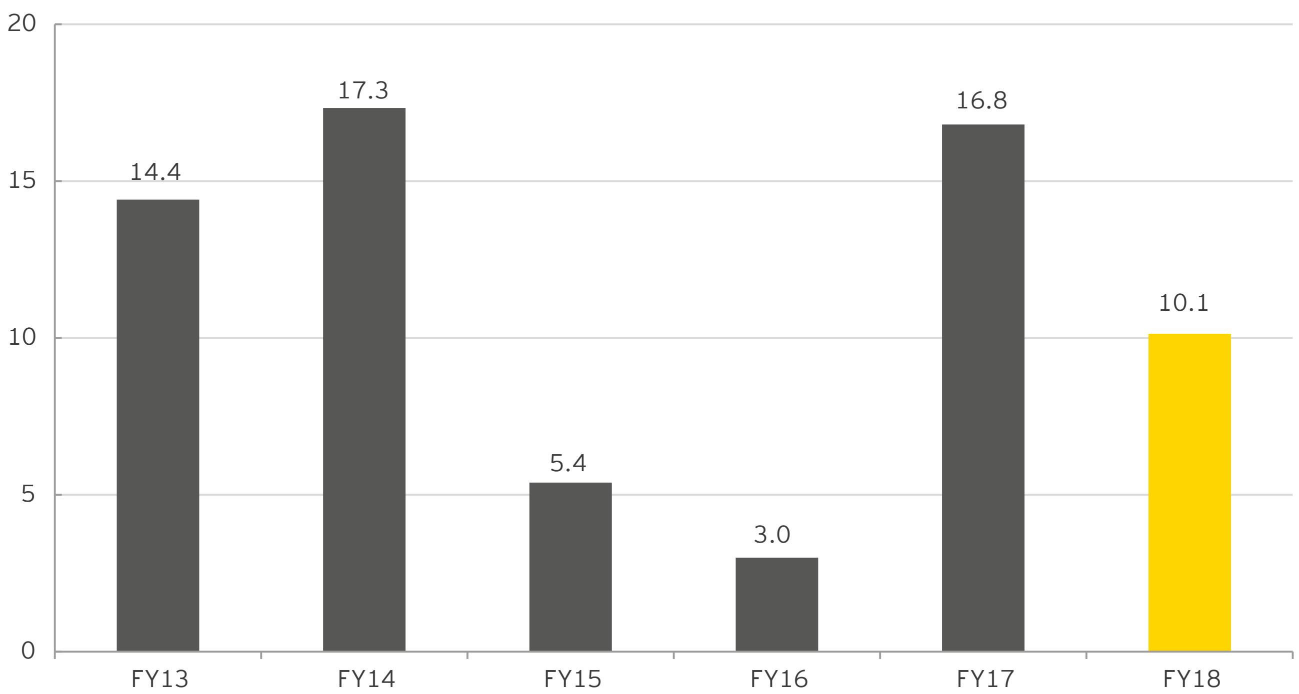
	q-o-q						Apr–Oct FY17	Apr Oct FY18
Tax/ Non-tax revenue	1Q FY17	2Q FY17	3Q FY17	4Q FY17	1Q FY18	2Q FY18		
Gross tax revenue	30.6	8.7	21.0	17.1	15.2	23.0	18.0	18.9
Direct taxes*	26.9	-0.1	14.3	15.6	16.6	11.7	10.7	13.8
Indirect taxes**	34.5	19.4	24.2	15.1	13.4	30.3	25.4	21.1
Non-tax revenue	-40.6	-8.5	67.9	32.6	-6.5	-38.2	3.7	-43.4

Source (Basic Data): Monthly Accounts, Controller General of Accounts, Government of India
*Personal income tax and corporation tax
**Union excise duties, service tax, customs duty, and CGST, UTGST, IGST and GST compensation cess from July 2017 onward

Center's revenue expenditure grew by 10.1% up to October 2017

- The total expenditures of the Central Government grew by 12.3% during April–October FY18 compared to 12.6% over the same period in FY17.
- Growth in revenue expenditure was 10.1% during April–October FY18 as compared to 16.8% in the corresponding period of the previous fiscal year.

Chart 5: Growth in revenue expenditure during April–October FY18 (%, y-o-y)

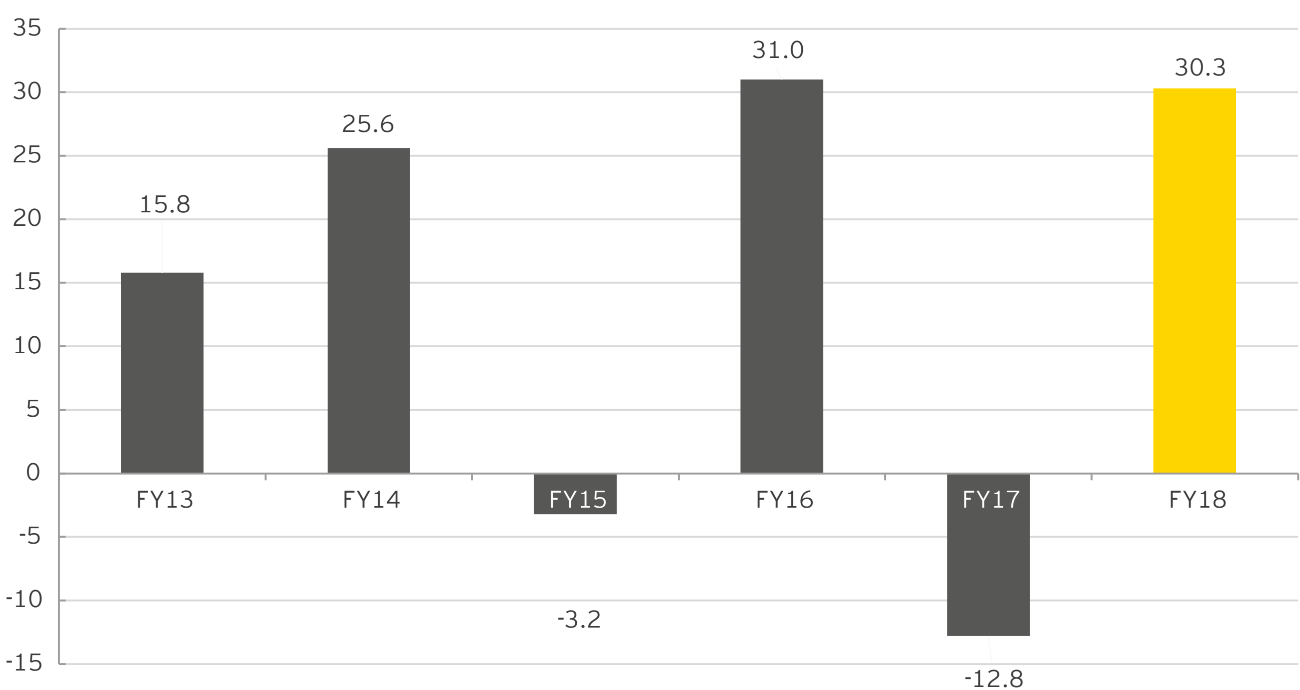


Source: Monthly Accounts, Controller General of Accounts, Government of India

Growth in the Center's capital expenditure increased to 30% largely due to strong base effect.

- Center's capital expenditure grew by 30.3% during April–October FY18 reflecting the negative monthly capital expenditure in October, which in turn, was due to large negative amount for loans disbursed indicative of repayments received by the Center.
- Previously, growth in capital expenditure during April-September 2017 had dipped to 8.5% from 20.1% achieved up till August 2017.

Chart 6: Growth in capital expenditure during April–October FY18 (%, y-o-y)



Source: Monthly Accounts, Controller General of Accounts, Government of India

“In the past three years, there has been an extensive push to deal with tax evasion and also extend taxpayer services by leveraging technology.”

- Arbind Modi

“It is critical for companies to seamlessly manage the convergence of the IT, digital and tax functions”

- Rajan Sachdeva

“It is technology that helps solve tax problems”

- Jitesh Bansal

“The Indian Government is heavily invested in using technology with a stated objective of less government and more governance. And the GSTN should evolve into a fine example of this”

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“Disruptive innovation can hurt if you are not the one disrupting”

- Paresh Parekh

“Governments are looking to interact with companies digitally, with full transparency on their tax, finance and operations data”

- Ajay Kumar

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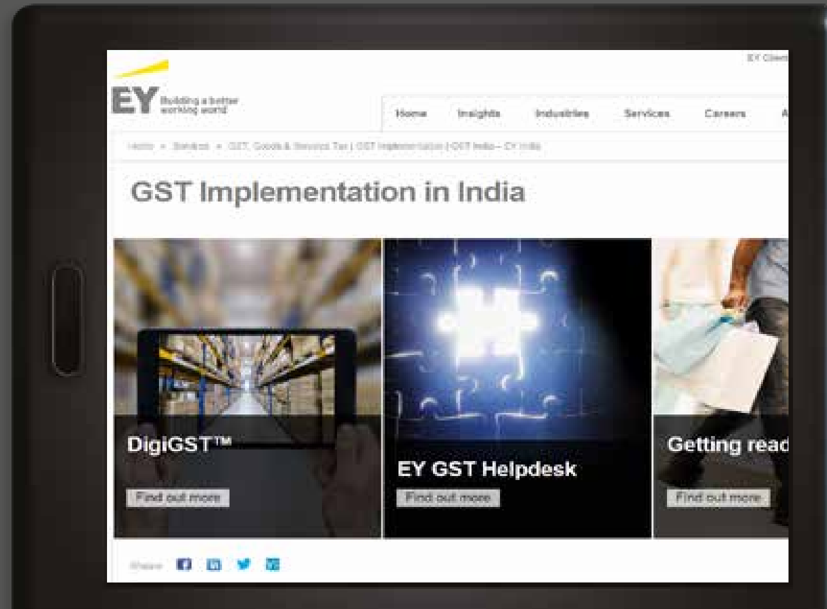

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