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The Future of International Tax Planning For Multinationals

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Martin Arzethauser of Kuehne+Nagel Management AG, and Daniel Lehmann and Anke Stumm of Bär & Karrer discuss the issues and challenges facing multinational enterprises in tax planning in light of recent moves to reform the international tax system.

With the introduction of the Organisation for Economic Cooperation and Development (OECD) and G-20 Base Erosion and Profit Shifting (BEPS) Action Plan as well as BEPS 2.0 Two-Pillar Approach, the question arises for multinational enterprises—is there still room for tax planning?

This article examines the question of the continued need and existence of tax planning as a legitimate and economically recognized instrument of corporate strategy.

Does Tax Planning Still Exist?

In the 1990s, tax planning was considered a necessary entrepreneurial tool for multinational enterprises—partially justified with high income tax rates paired with the possibility that, in the case of cross-border transactions, the accumulation of tax jurisdictions could either drastically reduce the taxable profit, or even cause it to disappear entirely. Therefore, tax planning essentially focused on so-called quantitative tax planning.

Since the introduction of the BEPS Action Plan and BEPS 2.0, such efforts to minimize the tax burden have been systematically combated at the international level through the conclusion of international conventions (OECD, G-20) with the main objective of preventing aggressive tax planning.

In other words, the aim of the OECD member countries is to define a fair tax burden for companies and a “fair share” distribution of the total taxation revenue among member countries. In addition, Pillar Two sets out the intention to achieve a certain degree of global tax harmonization in the form of minimum taxation.

As a result, tax planning has not been abolished, but it has become more challenging than before for multinational enterprises.

Effects of International Tax Developments

1. **Characteristics of tax planning**

Until recently, tax planning mainly aimed at optimizing the effective tax rate (ETR), i.e., the quantitative element of tax planning. However, the ETR exclusively concerns taxes on profits. Taxes reported above the tax line in the annual financial report were often not covered by tax planning strategies.

Tax planning activities must include, on the one hand, tax planning across the organizational structure, such as decisions regarding the legal structure (subsidiary, branch, holding companies, etc.), the choice of jurisdiction, and the contractual relationships between group companies mainly focusing on profit and withholding taxes. On the other hand, tax planning must factor in the organization of business processes, including taxes such as sales taxes, value-added tax, customs duties, stamp duties, withholding taxes on services.

1. **Legitimacy of tax planning**

The enterprise has a duty towards its stakeholders to manage its resources economically. Considering that tax payments result in “cash out” effects, which are then no longer available for other investments, strategic tax planning represents a legitimate and indispensable entrepreneurial task. The avoidance of double taxation is also supported by the network of tax treaties as well as the international efforts of the BEPS project by the OECD.

1. **Qualitative element of tax planning**

The newly introduced or projected restrictions on tax planning do not make planning per se impossible, or even replace it. On the contrary, tax planning, which used to be purely quantitative, has now been extended to include a qualitative element.

Tax payments are now additionally assessed by enterprises in terms of sustainability and socio-political aspects. So it is no longer a matter of (solely) minimizing the tax burden by playing off hybrid mismatches in domestic tax legislation; more importantly, tax planning now aims at optimizing the tax burden under the principle that profit taxation should take place where the value-driving functions are performed.

In other words, the qualitative element of tax planning makes use of tax incentives if they are aligned with entrepreneurial value creation and business objectives.

1. **Data processing**

Regarding risk detection, mitigation and avoidance, tax planning is imperative in the context of the ongoing efforts of tax administrations to digitalize and automate work processes. Functions previously handled by internal tax departments are now performed by the tax authorities. For example, in the area of indirect taxes, internal data is transmitted directly to the tax authorities and evaluated by automated means. This comes very close to a "real-time" audit.

To provide standardized data to the tax authorities, internal processes must be defined and structured according to a detailed tax control framework.

Tax authorities exchange information, the complexity of tax assessments increases, and lengthy reconciliation procedures are required. This triggers a corresponding demand for the creation of resources in relevant tax administrations and calls for appropriate dispute resolution mechanisms. The adaptation is likely to take some time, and therefore entails a certain risk of double taxation and double non-taxation, which may require resolution through the appeals courts.

Future of Tax Planning

As a consequence of these developments, qualitative tax planning will become much more important. On the one hand, it is important to ensure that the group internal narrative regarding the business model is designed coherently across countries. On the other hand, to be able to meet the new external requirements, a more automated tax controlling approach along the value chain is indispensable when it comes to understanding processes of individual business units in detail.

The internal tax control system is designed to ensure that business areas discuss planned changes with the group's internal tax department in advance, to ensure that these changes are only initiated if no tax compliance regulations have been overlooked in the process.

Furthermore, with the extension of the tax nexus, it will become more difficult to avoid creating a permanent establishment with tax planning instruments. An important aspect of the "fragmentation" of the tax liability of a multinational enterprise is the significant increase in taxpayer compliance costs.

Summary and Outlook

International tax planning should and will continue to exist. The international measures are not intended to eliminate international tax competition, but to limit it to a fair and reasonable level. Tax planning remains a legitimate business tool, as long as it is exercised within certain internationally recognized limits.

To avoid significant disputes with local tax authorities, increasingly comprehensive tax compliance will be required, the personnel and financial effort of which can be partially offset by digitalization. For this purpose, many companies have also introduced a code of tax conduct for tax planning and compliance purposes, which is now considered part of sound corporate governance.

Therefore, qualitative tax planning will be of greater importance in the future. The effective tax burden of a multinational enterprise will be considered in relation to the principles of sustainability and corporate social responsibility, which will become increasingly important.

As a result, it is no longer a matter of minimizing the tax burden by playing off inconsistent local tax rules (hybrid mismatch in local tax laws), but rather of legitimately optimizing the tax burden (structural, operational, cross-border planning) as well as recognizing that the taxation of profits should take place where the value-driving functions are actually performed.

Qualitative tax planning is therefore not contrary to quantitative tax planning; rather, it introduces an additional emphasis which is likely to become increasingly important today and in the future.

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