Tax is transforming, the time to prepare is now
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Governments are implementing sweeping global tax reforms, new transparency and governance requirements and a wide variety of new taxes as they strive to raise revenue while supporting growth in an uncertain economic time. Compliance with these new tax measures and disclosure obligations will require a significant effort from businesses. "The global tax landscape is changing across both policy and administration dimensions, and companies need to look beyond the immediate and prepare for what is ahead," says Marna Ricker, EY Global Vice Chair of Tax. "As businesses prepare their data for new reporting, they also need to focus on what it means. They need to be ready to tell their tax story."

After several years of deliberation and negotiation, jurisdictions are poised to begin translating agreement on global tax reforms into domestic law, most notably the global minimum tax developed under Pillar Two of the BEPS 2.0[1] project. "These global reforms do not exist in a vacuum but rather have significant interplay, and global negotiations over the design are still ongoing even as jurisdictions are starting their legislative processes," says Barbara Angus, EY Global Tax Policy Leader. Any lack of alignment in the new rules across jurisdictions will increase complexity and create challenges for taxpayers and tax administrations alike. "The multilateral dimensions of Pillar Two are likely to bring controversy in future years, so companies will need to be ready," says Luis Coronado, EY Global Tax Controversy Leader.

How jurisdictions will implement Pillar Two, new transparency requirements and a plethora of sustainability and other tax measures will all unfold in concert, creating far-reaching effects. These and other challenges are addressed in this article, reflecting observations by EY Tax professionals in 70 jurisdictions gathered in the annual EY Tax Policy and Controversy *Outlook* survey at the end of 2022 and beginning of 2023. This article examines the trends and areas of divergence found in the contributors' projections for 2023 at the global, regional and national levels. Detailed reports for all 70 jurisdictions are available for those interested in more information.

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

BEPS 2.0 agreement advancing to domestic legislation

The realities of BEPS 2.0 Pillar Two will take shape in 2023, with a multitude of jurisdictions currently considering, proposing or discussing domestic legislation to implement the agreement among 138 member jurisdictions of the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework. In December 2022, the EU unanimously adopted the Minimum Tax Directive, which all EU Member States must now transpose into domestic Pillar Two legislation by the end of 2023. Also in December, South Korea enacted legislation that aligns with Pillar Two. The UK and Japan have released draft legislation, Switzerland is advancing constitutional measures to allow for domestic implementation that must be approved through a public vote, and numerous other jurisdictions also are taking steps toward implementation.

"With domestic activity increasing exponentially, it is critical that global companies monitor developments in jurisdictions that are relevant to their footprint and begin preparing now for change," says Angus. The Inclusive Framework's model global anti-base erosion (GloBE) rules, together with related commentary and agreed administrative guidance, are intended to be used by jurisdictions as the basis for their domestic legislation. The Pillar Two design introduces minimum effective taxation of 15% for multinational entities (MNEs) with annual revenues of at least €750 million. Where the effective tax rate on the income of an MNE group in a given jurisdiction is below 15%, as computed under the agreed rules, the right to impose a "top-up tax" will be allocated to jurisdictions to which the MNE group has a connection, with priority given first to the low-tax jurisdiction itself, then to the headquarters jurisdiction (or a jurisdiction that is home to an intermediate parent of the low-taxed entity), and finally to any other jurisdiction in which the MNE group has operations. These rules generally will start to apply for tax years beginning in 2024. "Pillar Two's system of interlocking rules means that even if a company's headquarters jurisdiction does not implement global minimum tax rules, implementation by other jurisdictions will have implications for its operations both at home and abroad," adds Angus.

"The complexity of the Pillar Two rules and the short timeframe before they take effect are creating significant compliance challenges. The rules for applying the top-up tax require significant data collection and calculation," says Rocio Reyero Folgado, EY EMEIA Tax Leader. In late December 2022, the Inclusive Framework released a transitional safe harbor that allows an MNE to avoid undertaking the full detailed GloBE rule calculations for those jurisdictions in which the safe harbor is met. The safe harbor relies on an MNE's Country-by-Country Report (CbCR), which must be derived from specified Qualified Financial Statements to be eligible for the safe harbor. Companies are required to use this transitional safe harbor for a jurisdiction in the first year it is available or the opportunity to use it is gone forever. "It is important that companies start considering applying the safe harbor now and confirm that their CbCR meets the requirements to qualify," says Reyero Folgado.

Pillar Two contemplates the filing of a standardized GloBE information return that is still under development by the Inclusive Framework. The return could include 200 or more data points for each jurisdiction, including information that may not be maintained in the financial reporting systems used by the tax department. The accuracy and availability of data will be key, and MNEs should review their systems and processes in light of these new requirements to identify what changes could be made to facilitate compliance and reporting going forward.

The other component of BEPS 2.0 is Pillar One, which involves new nexus and profit allocation rules aimed at assigning a greater share of the taxing rights over global business income to market jurisdictions as well as a new system of fixed returns for baseline marketing and distribution activities. While this complex technical work is continuing in the Inclusive Framework, Pillar One is on a different trajectory than Pillar Two. "Negotiations seem to be challenging, as illustrated by the Pillar One consultation documents being released as Secretariat papers – not by the Inclusive Framework. In this regard, adoption by a critical mass of jurisdictions does not appear imminent. If Pillar One is not adopted, it is likely that jurisdictions will continue implementing their own digital services taxes, resulting in varied compliance requirements," says Matt Andrew, EY Asia-Pacific Tax Policy Leader. While the outcome of the Pillar One work is not yet clear, these discussions are expected to fuel global tax changes – in one form or another – in the coming years.

A push for transparency

The information requirements of Pillar Two are part of a larger wave of new and evolving transparency demands on companies, from governments and other stakeholders. The implementation of new regimes for reporting by digital platforms and with respect to crypto assets, along with the expansion of the Common Reporting Standard, mean that much of the economy will be within scope of Automatic Exchange of Information among tax authorities. These regimes, combined with full implementation of the Mandatory Disclosure Regime in the EU, will provide tax authorities with a substantial amount of new information. Argentina has also created a new mandatory disclosure regime for international transactions. Additionally, many Latin American jurisdictions are creating beneficial owner registries or related reporting requirements.

The highest profile transparency development may well be the EU Public CbCR Directive. This Directive requires public disclosure by large companies of income taxes paid and other tax-related information, beginning no later than for the first financial year starting on or after 22 June 2024 (and potentially earlier). This will apply to both EU-based MNEs and non-EU based MNEs doing business in the EU.

Looking outside Europe, Australia will subject large MNEs, including those headquartered outside Australia, to public reporting of country-by-country tax and operating data for fiscal years starting in July 2023. Companies should be on the watch to see whether other jurisdictions follow suit. Chris Sanger, EY Global Government Tax Leader and UK Tax Policy leader, notes that "the UK has already passed legislation to require public country-by-country reporting, but it is currently lying dormant, awaiting activation by the government. To date, the government has resisted, as it didn't want to be a first mover, but with the EU and Australia moving ahead, the UK may well follow soon."

New sustainability and climate reporting requirements are also emerging around the world. Various reports on environmental sustainability metrics, such as greenhouse gas emissions, climate pledges and progress on goals is or will soon be reportable in the EU, the UK, Japan, India and South Korea. A vote on the US Securities and Exchange Commission proposal for mandatory climate reporting is expected in early 2023.

Beyond government requirements, there is also growing demand from customers, employees and investors for companies to disclose more information relating to environmental, social and governance (ESG) factors. "There may not be a mandate yet, but it is effectively mandatory," says Cathy Koch, EY Global Sustainability Tax Leader and EY Americas and Global Tax Policy Network Leader, "to share how your company is addressing the growing need for more sustainable operations."

Sustainability at the intersection of transparency and tax

"Tax has a huge role to play in a company's green transformation, both fulfilling requirements and in seizing opportunities to make that transformation easier," states Koch. "Governments around the world are making climate pledges and developing policies to support those pledges." Incentives and grants, regulation and taxes are all policy levers being used by governments. These measures can create financial opportunities and challenges, and they also can create additional record keeping and disclosure requirements. Businesses need to know their environmental impacts, understand their societal and statutory obligations and avail themselves of financing and funding options.

Fueling the green transition

"Companies have an opportunity to create long-term value by addressing sustainability, starting with investigating and planning around government incentives," says Kevin Flynn, EY Americas Vice Chair of Tax. "The US Inflation Reduction Act of 2022 includes an unprecedented level of funding with $369 billion in climate and energy-related provisions to incentivize renewable energy, encourage adoption of electric vehicle technologies and improve the energy efficiency of buildings and communities," he continued. In February, the European Commission announced the Green Deal Industrial Plan, a package that will contain incentives for Europe's net-zero industry and to support the fast transition to climate neutrality. Canada has also proposed investment tax credits for clean technologies and clean hydrogen production.

However, the implementation of Pillar Two global minimum tax rules could substantially alter the effectiveness of tax incentives and, thus, governments' decisions to offer them. In jurisdictions with low headline tax rates, an incentive could push a company's Pillar Two effective tax rate below 15%, thus subjecting the company to potential top-up tax that would negate the benefit of the incentive. This may lead to governments reassessing their historical approach to incentives in light of Pillar Two. The EU also will need to address this potential complexity as it designs the Green Deal Industrial Plan.

Emerging energy taxes and environmental taxes

Governments are also encouraging more sustainable behavior through new taxes. The EU has reached a provisional agreement to implement an EU Carbon Border Adjustment Mechanism (CBAM) from 1 October 2023, for example. Designed to prevent carbon leakage due to relocation of emission-intensive production to third countries, the CBAM is essentially a levy applied on imports. The UK is also expected to launch a consultation on its own carbon border adjustment.

Windfall taxes are another option that will affect the traditional energy sector. Such taxes on energy profits are being discussed and implemented by many governments. The EU adopted a temporary "solidarity contribution," which is effectively a windfall tax on energy company profits, that will be levied by EU Member States at a rate of at least 33% on the surplus profits of energy companies in 2022 and 2023. India, Malaysia and the UK have also enacted windfall taxes on the energy sector and other jurisdictions are looking at similar measures.

Colombia, Italy and Spain passed plastic packaging taxes that became effective 1 January 2023. New Zealand also introduced a range of new quasi-taxes to combat climate change, which will apply from 1 January 2025 on specified sectors.

However, some jurisdictions, including Japan and Cyprus, are delaying planned implementation of expanded green taxes due to concerns about their impact on the already volatile economy.

Additional revenue through base broadening and new taxes

Raising revenue without harming the economy requires careful balancing by governments. Corporate income tax rates remain fairly stable overall, with a few exceptions. South Korea and Türkiye are reducing rates by three percentage points and South Africa by one, while the UK is increasing its corporate income tax rate by six percentage points. Some jurisdictions are looking for additional revenue by broadening their tax bases. About 15% of *Outlook* respondents expect expansion of the corporate income tax base in their jurisdictions with potential changes to withholding taxes, anti-hybrid rules and transfer pricing rules being most common. Several respondents also expect expansion of the value-added tax (VAT) base in their jurisdictions.

Jurisdictions are also expanding their overall tax bases through new taxes, in addition to the green taxes noted earlier. Canada and Colombia both instituted taxes on some luxury items, such as planes and yachts. Canada increased its corporate income tax rate on banks and insurance companies by 1.5 percentage points. Türkiye similarly raised its corporate income tax rate for the financial sector to five percentage points above the standard rate. Argentina enacted a one-time "windfall income tax prepayment" for companies that saw extraordinary income from the increase in international prices, creditable against future taxes.

New tax controversy challenges against the backdrop of enduring pressures

Outlook contributors paint a picture that shows tax enforcement becoming more intense in 2023 — perhaps not surprising given that the COVID-19 pandemic caused many revenue authorities to slow down or even temporarily shutter their audit and litigation programs. 2023 sees the first full year of full resumption of such activities.

"There are many enduring tax enforcement pressures that taxpayers will need to address — a higher volume of tax audits, conducted with higher intensity, more (and more detailed) information requests from revenue authorities and continuing expansion of both tax transparency regimes and new tax governance requirements," says Coronado. Over half of *Outlook* respondents anticipate their national-level revenue authorities sending a higher number of information requests to business taxpayers in 2023. "As a result of these pressures, the need for companies to take a more proactive global tax controversy management approach will continue, if not increase, in 2023," says Jean-Pierre Lieb, EY EMEIA Tax Policy and Controversy Leader.

Responses to the *Outlook* survey indicate that tax controversy in 2023 will likely be driven by three broad themes, in addition to the rise in transparency discussed earlier.

A more challenging overall tax enforcement environment

More than half of *Outlook* respondents foresee higher levels of tax enforcement and a higher number of tax audits in their jurisdictions in 2023. In particular, increased enforcement around transfer pricing will continue in 2023; almost half of respondents say increased transfer pricing enforcement is already occurring, while a further fifth say it is likely to occur. While the programs themselves may no longer be available, auditing of COVID-19 support and stimulus measures by their tax authorities is expected in 2023 by almost 60% of respondents.

2023 will be the time to prepare the tax function for Pillar Two

With the entry into force of global minimum tax rules in many jurisdictions set to occur in 2024, companies will need to adapt systems and processes to meet new reporting requirements, with dispute prevention and audit readiness in mind. Monitoring differences in the local implementation of the new rules will help flag areas where controversy could arise.

A shifting relationship between taxpayer and tax authority

2023 is likely to see several jurisdictions adopt new programs — some mandatory, some voluntary — that test not only the calculations within a company's tax return, but also the tax governance framework under which those numbers were calculated. These can include a review of the company's overall tax policy, its tax control framework and the level of involvement of the company board and C-suite in the tax governance approach being taken.

Companies should be fully aware of how revenue authorities will use these new programs to risk assess and risk rate taxpayers. Those that may struggle to demonstrate the efficacy of their tax governance will likely find that compliance interventions increase, taking up valuable tax function time and resources. Conversely, those with robust tax governance can expect reduced compliance interventions and, in some programs, additional specified benefits.

Regional tax actions and trends

Tax reform ongoing in the Americas

In the Americas, nearly half of *Outlook* respondents expect comprehensive or significant tax reform in their jurisdictions in 2023. In Brazil this is driven largely by efforts to align with key OECD guidelines, as Brazil is committed to successful conclusion of the ongoing discussion regarding OECD membership. In 2022, Brazil introduced new transfer pricing rules that adopt the arm's-length principle and generally follow standards established by the OECD, enforcement of which is likely to be a focus going forward. More action and further reforms in Brazil are expected in 2023, including a possible corporate rate reduction. A renewed focus on climate and environmental policies, which may include tax provisions, is also expected.

Chile is discussing comprehensive tax reform that includes a corporate income tax rate reduction and broad corporate tax changes, as well as an increase in personal income taxes and a wealth tax. *Outlook* contributors also expect comprehensive reform in Costa Rica and Ecuador in 2023, as well as significant reform in the Dominican Republic. Note that Colombia did comprehensive reform in 2022, including a 15% minimum tax rate, though not necessarily aligned with Pillar Two.

The tax enforcement environment for taxpayers in the Americas will be varied and complex. More than three-quarters of *Outlook* respondents in the region foresee higher levels of tax enforcement in 2023 in their jurisdictions. *Outlook* respondents point to treaty benefits, potential misuse of treaties and residency and permanent establishment rules as areas of particular interest to tax authorities in Latin America.

Adoption, enforcement and tax governance are paramount in Asia-Pacific

"South Korea drew global attention by enacting new global minimum tax rules to align with Pillar Two in December 2022, but they will not be alone for long as the region seems to be quickly pushing ahead with implementation," says Andrew. Legislation to implement the GloBE rules in Japan has been released with action on it expected in March, and Australia, Malaysia and New Zealand have all had public consultations on Pillar Two. The Singapore budget statement in February included plans for implementation of Pillar Two rules in 2025 as well as adaptation of its incentives regimes within the GloBE parameters. "Asia Pacific has always been viewed as a leader on incentives policy" says Eng Ping Yeo, EY Asia-Pacific Tax Leader. "Governments across the region are working hard to redefine the incentives measures as a result of Pillar Two, and taxpayers should consider not only the potential risks around existing incentives, but also the new opportunities that are arising."

In Asia-Pacific, two-thirds of *Outlook* respondents foresee higher levels of tax enforcement and more tax audits in their jurisdictions in 2023. Activity related to enactment of new or expanded criminal tax laws is also expected in 2023 — with new measures possible in Indonesia, the Philippines and Singapore.

"The current push for good governance in tax has been embraced by many revenue authorities in Asia-Pacific," says Martin Caplice, EY Asia-Pacific Tax Controversy Leader. "Indeed, Australia's Top 1,000 Combined Assurance Review program is regarded as a leading initiative and may inform other revenue authority programs in the region." New Zealand follows a slightly simpler approach than Australia, requiring the 50 largest companies operating there to fill out a 10-point questionnaire each year. In addition to ongoing tax governance regimes in China and Japan, other jurisdictions are introducing voluntary programs, including Singapore and Malaysia.

More collaboration in Europe, the Middle East, India and Africa (EMEIA)

"Member States in the EU will have a full tax agenda in 2023, including follow-up work on the Pillar Two Directive, formal adoption of CBAM and several transparency initiatives. The EU also has very ambitious plans for additional initiatives in 2023, including on how to make the EU more competitive," says Marlies de Ruiter, EY Global International Tax and Transaction Services Policy Leader. More work is anticipated on the EU Green Deal, the Business in Europe: Framework for Income Taxation (BEFIT) initiative, a proposed directive to prevent the misuse of shell entities for tax purposes (known as UNSHELL or ATAD III) and withholding tax procedures. "There is so much overlapping activity, companies must try and monitor the entire landscape, not just one or two provisions as they are all connected," says Maikel Evers, EY EU Tax Policy Hub Leader.

Substantial tax policy developments are also occurring in the Middle East and North Africa region, including the implementation of VAT in some Gulf Cooperation Council countries. The United Arab Emirates has introduced corporate income tax that includes transfer pricing rules broadly aligned with OECD principles, including the arm's-length standard. Bahrain is also discussing possible introduction of a corporate income tax system that would apply more broadly than the oil and gas sector.

In EMEIA, almost half of *Outlook* respondents foresee higher levels of tax enforcement in their jurisdictions in 2023, and no respondents expect a decrease in enforcement activity. Transfer pricing remains a leading issue for revenue authority scrutiny, with particular focus on IP onshoring transactions, high-value services, treatment of risk, operating margins for distributors, and financial transactions. The level of transfer pricing documentation required by revenue authorities in the region is expanding, and almost half of EMEIA respondents say that revenue authorities are already sending taxpayers requests for information that are more numerous and detailed than in the past.

There are also new and evolving criminal tax laws across the region. These include new revenue authority processes such as those of the French tax administration, where a criminal investigation may now be automatic if a taxpayer is facing high tax penalties. The UK is actively using its Corporate Criminal Offence regime, and Germany is considering a new criminal tax law.

Conclusion

As jurisdictions implement sweeping multilateral tax reforms while also advancing their own tax priorities, it is critical for companies to monitor and respond to activity in all jurisdictions in which they operate. "Adapting to change will take time, and as details emerge about exactly how each jurisdiction is implementing new rules, modeling will be crucial. Companies will want to make necessary preparations and changes early, rather than waiting until the effective date arrives," says Angus.

The need for companies to produce reliable, consistent and comparable information is growing with the myriad of reports, forms and disclosures that will soon be required. "The increasing focus on transparency is transformational, but numbers alone do not present the full portrait of a company. Businesses need to be prepared to add context to these numbers so that stakeholders can understand what they really mean. It is critically important for companies to be proactive in telling their tax story," concludes Ricker.

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