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Tax issues in digital convergence

Deloitte Touche Tohmatsu report, **The trillion dollar challenge – Principles for profitable convergence**, was released late in 2005, it made the case that digital convergence is:

- resulting in new and diverse products and evolving delivery platforms for businesses;
- creating confusion and uncertainty in the marketplace; and
- creating opportunities for those businesses willing to invest the time and resources necessary to move forward and compete in a global marketplace against competitors they previously did not face.

Convergence also raises a number of critical tax questions. For example, as borders dissolve for business purposes, which government entity has the right to tax? As different products and ideas enter the marketplace, how will a good or service be defined and what types of taxes will be applicable? How a business tackles these and other tax questions can make the difference between profit and loss in this constantly changing environment.

This insert highlights a few of the many tax issues – and tax planning opportunities – that make it vital for the tax department to be involved in decision-making from the beginning of the convergence process.

Direct tax issues

- Convergence will undoubtedly result in significant costs for capital expenditure, research and development (R&D), and opportunities to create intellectual property. The value of these investments could be significantly increased with effective tax planning.
- Organizational convergence may involve mergers, acquisitions, joint ventures, and partnerships with other businesses all of which can be structured to maximize tax efficiency from a transactional, operational, and exit-route perspective.
- Convergence often leads to a shift in the business model and value chains of a business. This may influence the location of where income is earned or risks are borne. Evaluate internal transfer pricing models from a tax perspective to determine the most efficient tax position is achieved.
- Convergence typically involves increased use of the Internet to download products and services. Bringing the Internet into the equation blurs traditional tax residency borders and may result in unintended tax consequences unless there is careful planning in advance.
- Convergence may also result in the dislocation of human capital resources. This may influence where it is best to source human capital, whether it be offshoring or near-shoring, how best to move your human capital resources, and how best to incentivize your human capital resources on an after-tax basis.

Indirect tax issues

- The new products and delivery platforms created through convergence could have complex tax implications in countries that impose a value-added tax (VAT). Investigate potential VAT issues early in the planning stages to avoid possible financial penalties and damage to your company's reputation.
- VAT treatment and compliance obligations may differ depending on whether a business is acting as an agent or a principal in a transaction. Be sure to make this determination at the outset.
- Consider whether your business is supplying goods, services, or a combination of the two, and in which tax jurisdiction they will be supplied. Competitive advantages may be possible by establishing a business in a country with a lower VAT rate.
- Remember that numerous VAT simplification measures are available to businesses. These can ease compliance burdens – and possibly help you avoid having to register in multiple VAT jurisdictions.
- If convergence results in mergers, acquisitions, or joint ventures, it is vital to perform VAT due diligence to obtain reasonable assurance that there are no 'hidden' VAT costs. Also consider the recoverability of VAT on transaction costs.

R&D tax credits

- Convergence creates significant R&D opportunities through the development of new products and ongoing improvements to existing products and services. R&D tax incentives are available in many countries. Be sure to take advantage of these incentives wherever possible to minimize development costs.
- Many countries offer R&D incentives for a surprisingly wide range of activities, such as overcoming issues associated with system uncertainty where there are significant technical challenges. Be sure to determine whether any of your 'nontraditional' R&D activities are eligible for tax credits.

Conclusion

Convergence represents opportunity and challenge for executives, and tax is an important – and often neglected – aspect of the decision-making process. A review and evaluation of tax issues could determine whether a business is a winner, bystander or loser in the convergence evolution.

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