Germany’s turn

During its G20 presidency, Germany thinks there is much work to be done on preventing and resolving tax disputes.

Martin Kreienbaum, Director General of International Taxation at Germany’s Federal Ministry of Finance
“Wisely and slow, they stumble that run fast.”

Friar Laurence,
Romeo and Juliet, William Shakespeare
The elusive search for certainty

Adam Smith in 1776 described his four canons of good taxation: equity, convenience, efficiency – and certainty. Nearly 250 years later, the world continues to struggle with tax certainty.

With trade inextricably linked across borders, there are more sources of uncertainty than ever. When tax uncertainty exists – arising from unstable tax regimes, unpredictable tax administration policies or other sources – companies do not invest, invest less or invest elsewhere. Governments are then left with lower and less predictable revenue streams.

Moving into a post-BEPS (base erosion and profit shifting) world, equilibrium remains out of reach: companies are seeing more robust audit approaches, while tax authorities often consider certain tax planning behaviors of companies to be too aggressive.

As both taxpayers and governments seek certainty, it is in the interest of both to find better ways to resolve disputes, or even better, to avoid them altogether. Solutions should provide taxpayers with a stronger right to effective resolution mechanisms. And they should also be timely: justice delayed is justice denied. When excessively postponed, even good or fair outcomes on the principles are unsatisfying and costly.

Efforts to bring certainty earlier in the process, such as rulings on tax arrangements, advance pricing agreements (APA) and cooperative compliance, are valuable. But there is more work to be done. Recent decisions by the European Commission involving “State aid” in the context of a tax ruling from tax authorities call into question the reliance one can put on government rulings, casting a pall of uncertainty over well-established processes in many EU countries.

There is also more room for improvement with mutual agreement procedures (MAP), a process by which countries can resolve cross-border disputes. Taxpayers can request a MAP but cannot compel jurisdictions to pursue or reach an agreement. Most do not set a time frame and taxpayers have very little participation in or visibility over the process.

More mandatory arbitration between jurisdictions would also help improve certainty. In November 2016, the Organisation for Economic Co-operation and Development (OECD) released a multilateral instrument to implement tax treaty-related BEPS recommendations, including a provision enabling (but not requiring) countries to include mandatory binding arbitration in their tax treaties. More than 100 countries have agreed in principle but only 20 have committed to implement mandatory arbitration in their bilateral tax treaties.

But MAPs and mandatory arbitration alone are not enough. Neither of these processes nor voluntary arbitration have sufficient transparency or taxpayer involvement to prevent double taxation.

The good news is that the G20 and the OECD are now focused on the need to improve tax certainty, and a recent OECD survey asked businesses for detailed input about sources of uncertainty and suggestions for solutions.

The OECD is pushing for more jurisdictions to commit to mandatory binding arbitration. Their agenda also includes promoting the value of cooperative compliance and APAs. Further work on a broader arbitration process would also help.

It is said that businesses crave three “Cs” – consistency, clarity and certainty – and nothing is more true when it comes to taxes. But governments benefit as well. We need a fair and consistent approach to allocating profits to tax jurisdictions around the world. And we need to preserve the cornerstone principle that double taxation should be avoided.

In this important period of global transformation in the taxation systems around the world, let the dialogue for tax certainty continue to be a priority.
“At McKesson, tax presents at each audit committee meeting. Through frequent and effective internal communications, C-suite executives can be confident that if something were a material risk or opportunity, they would already have heard about it.”

Paul Smith  
SVP, Global Taxes, McKesson Corp.

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Tax-related risks should not be underestimated in our interconnected and digitalized world. Potential tax risks lurk everywhere as businesses expand into new markets, tax authorities step up enforcement and governments change laws. A holistic approach covering the prevention, management and resolution of disputes can help protect companies from today’s biggest tax risks.

**Enforcement risk**
Tax authorities today are taking a tougher stance when it comes to enforcement, especially for cross-border transactions. The digitalization of tax collection and increased sharing of information among tax authorities are fueling this shift in approach. Companies that don’t have their data in order could face greater tax controversy going forward.

**Reputational risk**
Everyone is thinking about taxes these days. The news media and nongovernmental organizations closely follow how much a company pays in taxes and where. Those businesses that are perceived to be skirting their “fair share” of tax could end up in the headlines, putting the company on the defensive.

**Legislative risk**
As governments around the world revamp tax systems to reflect the realities of today’s business world, they are introducing new laws and regulations. Companies need to monitor and ensure compliance with global initiatives as well as country-specific actions.

**Operational risk**
Businesses often lack the resources – whether it’s skilled employees, streamlined systems or technological tools – to deal effectively with changes to the tax landscape. The inability to ensure compliance and monitor tax risks could affect a company’s financial planning and lead to disputes with tax authorities.
“What BEPS has done is to rationalize and justify our existing tax policies, reinforcing and refining our rules, rather than significantly altering how we operate.”

Akhilesh Ranjan
Principal Chief Commissioner of Income Tax, India’s Ministry of Finance

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Focus

Seeking certainty

Are tax authorities better at analytics than you?

Tax administrations are ramping up their use of digital methods to collect and analyze taxpayer data. Businesses, in turn, face an urgent need to develop analytics capabilities and become as digitally savvy as the new digital tax authorities.

Global Tax Policy and Controversy Briefing

Today’s environment is marked by a complex mix of tax policy changes and proposals. The latest report provides insight into the EU Common Consolidated Corporate Tax Base proposal, digital tax administration and the G20’s new challenges in 2017.

EY Global Tax Controversy Services Network

Watch this video ey.com/tcvideo to learn how EY can help businesses around the world address tax risk, manage controversy and resolve disputes. For additional information, or to connect with one of EY Global Tax Controversy professionals, visit us at ey.com/tc.
Tax Insights platform

Our website provides exclusive content focused on the latest changes in the tax world, be it new laws, technology or business models, that will affect your company today and far into the future.

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OECD tax leader details next steps beyond BEPS
Tax certainty is at the top of the OECD’s agenda. Read about plans to deliver practical outputs, improve certainty and support economic growth.

Brexit and UK taxation
The tax implications of Brexit are substantial, creating an environment ripe for new tax changes and risks. Find out how to prepare.

BEPS project rewrites the book on transfer pricing
Read why companies must now be certain their tax strategies and transfer pricing policies are well-documented, globally consistent and ready for unprecedented scrutiny.
Making the best of uncertainty

How do we know what we don’t know? It’s a deceptively simple question, and one that tax directors of multinational businesses are grappling with today in the face of constant change.

On a recent trip to Asia, for example, I met with the tax director of a multinational business who was concerned about a recent tax resolution in Europe. The organization’s local employees had informed her at the last minute about a successful settlement (seeking her approval after the resolution had already been negotiated with the tax authorities), and she was now trying to determine the possible repercussions in other European countries and around the globe.

She is right to be concerned. In today’s interconnected tax world, where tax authorities increasingly share information, a tax ruling or resolution in one part of the world – in this case Europe – can be expected to have consequences for a company’s operations elsewhere. Greater transparency is in itself a good thing. But with it comes increased uncertainty for taxpayers.

Playing a new hand
Globalization, international tax reform and digitalization have transformed the tax field in recent years. Taxpayers must develop new strategies in order to cope with today’s reality. It’s a significant challenge when you consider the many different developments occurring simultaneously – each with their own unique challenges.

In the past, even recently, organizations did not plan extensively for controversy. Businesses filed their tax returns and dealt with any questions or concerns from tax authorities a few years later – more often than not in an amicable way.

Governments today, however, are under pressure to gather more tax revenue and are overhauling their approach to tax collection. Tax authorities are now more focused than ever on collecting what they believe is the right amount of tax. In this environment, controversy is no longer a case of if, but when.

Point of view
A significant catalyst for change is the base erosion and profit shifting (BEPS) project by the Organisation for Economic Co-operation and Development (OECD). It is expected that the BEPS reforms will lead to greater transparency and increased certainty in the long term. But as the various initiatives are rolled out across the world, there could be greater tax controversy in the short-to-medium term until any inconsistencies are resolved.

One of the recommendations requires multinational businesses with more than €750 million in revenue to file reports with financial and tax information for every tax jurisdiction in which they do business. Tax authorities can exchange this information through different mechanisms, including bilateral tax conventions.

The goal is to provide tax authorities with comprehensive information about where profit, sales, employees and assets are located and taxes paid. If everyone has access to the same information, it should be easier to determine the correct amount of taxes owed.

However, each country has their own tax laws and may not view a transaction or structure the same way. We are seeing the consequences of such diverging viewpoints in Europe.

A number of multinational businesses have found themselves the target of European Commission State aid investigations in recent years. These probes are focused on whether tax benefits granted to these organizations by sovereign nations were in fact not accepted under European Union rules. The investigations are retroactive – in some cases going back a decade or more – and billions are at stake as a result of conflicting perspectives. The organizations involved must also deal with the reputational risk stemming from such actions.

Double trouble
Digitalization presents another considerable risk for tax departments today. Tax authorities around the world are digitally gathering, storing and analyzing tax data, and sharing this information with each other.
The expanding web of information is incredibly complex. Companies often have different business lines, units and supply chains and operate in multiple jurisdictions. As taxpayers submit increasing amounts of information, it could alter their tax picture depending on how the tax authority analyzes and reviews that data.

In this environment of rising uncertainty, double taxation has become a tangible threat for taxpayers. When cross-border tax disputes arise, the countries involved may all insist they are owed more money. There is little downside to a government trying to collect more tax revenue.

But uncertainty and inconsistency are not good for business. In a September meeting in Shanghai, the G20 countries publicly supported the OECD’s efforts to reinforce certainty throughout the global tax system, acknowledging the “benefits of tax certainty to promote investment and trade.”

Supporting certainty
Tax administrations have developed new ways to better enforce their laws and have been sharing more information, but there is still progress to be made on the resolution of multi-jurisdictional disputes. On this front, there is still much work to be done by local tax authorities, and regional and supranational organizations.

The BEPS reforms do include measures aimed at improving dispute resolution mechanisms. One goal is to increase the effectiveness of the mutual agreement procedure (MAP), a feature of tax treaties that permits so-called competent authorities from governments to resolve disputes, including double taxation. A peer review process will monitor whether countries are adhering to the new MAP guidelines.

Governments’ commitment to the revised MAP process will ultimately determine whether it is a success or not. It will be a long and challenging process, and countries will need to devote a sufficient amount of resources, including people, in order to develop a robust conflict resolution process. Governments must also provide clarity to taxpayers in terms of their legal positions with regard to complex matters, such as transfer pricing, hybrid instruments and debt equity issues.

Taking action
While much of this is out of taxpayers’ hands, businesses can still take measures to reduce uncertainty. Greater information sharing and the introduction of MAP are forcing organizations to take a forward-looking approach when it comes to controversy. The tax director at a multinational company must now think more broadly and proactively about potential risks, and have access to the relevant information sooner.

This brings us back to the tax director in Asia who was concerned about a ruling in Europe. How can companies stay on top of all these risks, especially when none have tax employees in every country in which they operate?

Organizations can start by defining their baseline. What are the company’s risks around the world, and what kind of internal processes and controls are already in place? The next step would be to set up or strengthen the system that monitors global risks. It takes time and may be costly, but so are tax controversies with hundreds of millions at stake.

Of course, businesses would prefer to invest their money in developing new products and services. But tax directors, the C-suite and the board should see these changes as an opportunity. They can set up the tax function of the future, which is strategically aligned with the rest of the business and equipped for a digital future.

By Rob Hanson
EY Global Director – Tax Controversy
Seeking certainty

Are we there yet?
As businesses and tax administrations begin to navigate the post-base erosion and profit shifting (BEPS) environment, taxpayers should brace for greater tax controversy and uncertainty for the foreseeable future.

By Gerri Chanel

In the post-BEPS world, the presumption of innocence does not always extend to multinational companies when it comes to their tax affairs. Tim McDonald, Vice President – Finance & Accounting, Global Taxes, for consumer goods giant Procter & Gamble, says the nature and intensity of audits has dramatically increased in recent years.

“There’s now a presumption that you’re not operating correctly and that you’re violating law even before individual facts are introduced and there’s a presumption that there’s significant revenue to be raised,” says McDonald. Adding to the scrutiny at times, he says, is a view that “if country A is being aggressive, country B doesn’t want to be left behind.”

When the Paris-based Organisation for Economic Co-operation and Development (OECD) launched its base erosion and profit shifting (BEPS) project in 2013, a convergence of trends had already created the harshest controversy environment in years. More frequent robust audits, increasing disclosure and transparency requirements and constantly changing tax legislation, among other developments — were causing unprecedented levels of tax risk and uncertainty.

Today, these dynamics have escalated and new ones have blossomed, tax professionals say. As businesses and governments begin to navigate the new tax environment, the stage looks set for even higher levels of tax controversy and uncertainty for the foreseeable future.

Unfolding story

The OECD’s approach to curtail BEPS was meant to be a phased, unified implementation. Such order has proven elusive. It is still not clear if, when and to what extent individual jurisdictions will adopt the OECD recommendations in their legislation and tax treaties. In addition, the project itself is still evolving.

Ongoing changes and inconsistency and uncertainty over how to treat them are likely to result in sustained, significant levels of controversy.

“We haven’t seen how some countries will use BEPS,” says Heather Maloy, US Tax Controversy Leader, EY National Tax, based in Washington, DC. “And we haven’t seen whether there will be a backlash to it.”

Ambiguity also arises from separate independent initiatives, such as the UK’s diverted profits tax. In response to the UK legislation, Pascal Saint-Amans, Director of the OECD’s Centre for Tax Policy and Administration, commented in 2014 that “it’s a bit bizarre that in the middle of the project, you have a country acting unilaterally because that’s what we’re trying to avoid.”

The UK is not alone. Australia enacted a multinational anti-avoidance law and has proposed a diverted profits tax expected to take effect in mid-2017. Together, they are similar to the UK’s diverted profits tax, but operate more stringently and impose greater sanctions.

And, of course, US President Donald Trump’s tax reform proposals will potentially ripple through the global economy, forcing governments and taxpayers to consider how they will interact with BEPS-related changes (for coverage of Trump’s tax reform proposals, see p.32).

Countries are acting unilaterally for a variety of reasons. They may view the solution to cross-border base erosion differently than the OECD recommendations or may be seeking broader solutions.

“International tax rules to mitigate BEPS in the strictest sense addresses cross-border transactions, but General Anti-Avoidance Rules (GAAR) apply to all taxpayers,” says Balaji Balasubramanian, Singapore-based Senior Tax Manager, Financial Markets – Fixed Income, for Standard Chartered Bank, which operates in more than 70 countries. The Diverted Profits Tax proposed in Australia and...
implemented in the UK, are examples of targeted measures adopted by tax authorities, whereas GAAR enacted in China and soon to be implemented in India applies to a broader range of transactions, according to Balasubramanian.

In cases where BEPS provisions are adopted by jurisdictions that already have GAAR or specific anti-avoidance provisions (tax laws designed to deal with particular transactions), clarification may be needed to address potential conflicts.

Regional actions
Regional initiatives are producing additional complexity and uncertainty. Consider, for example, the European Union’s State aid regulations, which allow the European Commission to overturn any ruling or benefit from an EU member state that gives a business, industry or regional group of companies a selective advantage that could distort trade between member states.

The EU State aid regulation has been in effect for many years and applies to any type of advantage, including tax benefits. Historically, there have been few large-scale State aid tax investigations. But in recent years, an unprecedented number of investigations have been launched with large amounts at stake.

In August 2016, for example, the European Commission rendered its decision following an investigation into alleged State aid issues associated with tax arrangements of a US multinational with the Irish Government. Ireland has now been ordered to recover unpaid taxes by the business for the years 2003 to 2014 of up to €13 billion, plus interest. Both the Irish Government and the company have announced they have appealed the ruling.

Tough times
In an October 2016 EY survey of senior tax executives, 23% said they are currently under audit in more than 15 countries, an increase of 6% from 2015 and 10% from 2014. In line with this, 56% said the number of countries subject to an active audit has increased, up by seven points from 2015.

“We are seeing multinationals encounter more aggressive audits in an increasing number of jurisdictions. In some cases, the number of open years under audit has doubled in the last five years,” says Rob Hanson, EY’s Global Director of Tax Controversy, based in Washington, DC.

Audits have also become more adversarial. In the same EY survey, 72% of respondents said that the enforcement posture and tactics of foreign tax authorities had become more aggressive, up from 66% in 2015.

“Since OECD member states have until 2019 to implement the BEPS provisions, it is a bit too early to see what controversy will arise directly from it, but we are already seeing in many conferences with tax authorities that their mindset has changed and that they feel stronger in their positions,” says Klaus von Brocke, the Munich-based Leader of EY’s EU tax services group.

In addition to a more adversarial stance by authorities, almost half of respondents to the EY survey reported that tax authorities are raising audit issues that reflect BEPS focus areas, a jump of 16% over 2015.

McDonald’s experience supports this trend. “We’ve seen a number of governments cite BEPS as authority in their audit behavior based on their existing laws when in most cases countries need to pass new laws that reflect the OECD guidance.”

“They therefore require treaty ratification, either through the multilateral instrument or through bilateral treaty negotiation,” McDonald says. “That has not stopped governments from claiming authority under BEPS and taking robust new positions.”

Tax administrations that in the past worked alone on tax issues are now increasingly working with justice
departments and courts, according to Jean-Pierre Lieb, Paris-based Leader of the EMEIA Tax Policy and Tax Controversy teams for EY Société d’Avocats.

“Tax administrations are also less reluctant than in the past to use criminal penalties to challenge companies,” Lieb says. “We have seen this happening in Italy, Spain, France, the UK and Germany.”

“Some jurisdictions are using tax police to enforce criminal penalties,” adds Hanson, “which could lead to tax raids and arrests. The result is that senior executives traveling into the local country from headquarters are potentially at risk of being detained and accused of criminal wrongdoing.”

Sharing secrets

While cross-border information sharing is not new, it only began to gain significant traction in 2009 amid OECD pressure to crack down on tax havens and bank secrecy, along with the reorganization of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. And the pace has continued to accelerate.

During the past five years, the number of agreements for information exchange upon request has doubled, from about 3,500 to 7,000.

Automatic exchange of information has also taken root – and is about to expand exponentially. The first multinational automatic information exchange program, the EU Savings Directive, dates to 2003 (it was later replaced by a broader provision), but action accelerated after the 2010 enactment of the Foreign Account Tax Compliance Act (FATCA) by the US. The G20 then sought a global standard for automatic exchange of certain financial information and endorsed a common reporting standard (CRS) developed by the OECD in 2014.

Currently, more than 100 jurisdictions have committed to implement the CRS, under which financial institutions will report specified information to the residence jurisdiction of taxpayers. The first automatic exchanges under the program begins in 2017 and will accelerate in 2018.

This year will be a watershed one for another reason. A number of countries have already adopted the country-by-country reporting (CbCR) requirement recommended by the OECD and some of those filings will begin in 2017. Automatic exchange of the information is also a foregone conclusion: as of late 2016, 50 jurisdictions had signed agreements providing for the automatic exchange of CbC reports and that is expected to be only the beginning.

The new automatic exchange programs will increase the amount of information available to tax administrations regarding the assets and cross-border activities of both individuals and entities.

“Administrators will have a lot more information,” says Maloy. “What are they going to do with all that information?”

One concern is that information may be misinterpreted without the right context. Because CbC data is high-level, it is particularly subject to misinterpretation.

For example, if a company has very different businesses in different countries, comparison across countries might be meaningless. Auditors may not seek the correct context before proposing tax adjustments, especially if they are short-staffed, and some, especially in the current environment, might be more likely to take a hard line about their position.

The HR and analytic capabilities of tax administrations are also diverse and in flux. While there has been a spike in transfer pricing resources within many tax administrations, leading to more tax inquiries and audits, many tax administrations have reduced their staff due to budget restrictions.

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EY — Tax Insights for business leaders №18
“The pressure of doing something about base erosion and profit shifting was not created by the OECD BEPS project, and the alternative scenario would have been countries going off and completely doing their own thing.”

Achim Pross
Head of the International Co-operation and Tax Administration Division at the OECD Centre for Tax Policy and Administration

Key action points

- Develop a consistent philosophy of controversy: under what circumstances will disputes be resolved, litigated or otherwise handled?
- Evaluate resources, processes and systems for global tax risk identification and management, including the ability to stay connected with complex, voluminous and fast-paced change.
- Ensure that the board and audit committee understand and agree with the corporate policies for tax risk and tax controversy and understand the structure and key processes for the organization’s tax controversy, and risk management.

“The level of experience and expertise around data mining and data analysis is also different from one tax administration to another,” says Lieb. “As a result, not all authorities have the same capabilities to adapt to all the new information.”

Here to stay

Even when BEPS legislation is fully implemented, uncertainty will remain since the recommendations reflect a move away from relatively clear rules and well-understood standards to more subjective tests and alternative approaches. A number of the new rules will be more challenging for taxpayers to apply and for tax authorities to administer.

However, Achim Pross, Head of the International Co-operation and Tax Administration division of the OECD’s Centre for Tax Policy and Administration, points out a perspective that is sometimes overlooked during the current upheaval: “The pressure of doing something about base erosion and profit shifting was not created by the OECD BEPS project, and the alternative scenario would have been countries going off and completely doing their own thing,” says Pross. “The structured and coordinated BEPS project, with its stakeholder involvement, committees and technical discussions with everybody around the table has achieved much more certainty than there otherwise would have been.”

Efforts to enhance certainty are now under way. At the EY aHead of Tax event in June 2016, Saint-Amans gave a preview of a host of practical actions on the OECD’s agenda to improve certainty. For example, he said the OECD will try to get as many countries as possible to commit to binding arbitration in mutual agreement procedure (MAP) cases, which will provide taxpayers with more certainty by better ensuring that treaty-related disputes being handled through MAP will be resolved.

Saint-Amans also said he hopes countries will start signing a multilateral instrument to implement tax treaty-related BEPS measures in the first half of 2017 during the German G20 Presidency. (See interview on p. 36 with Martin Kreienbaum, Director General of International Taxation at Germany’s Federal Ministry of Finance). Along with promoting the value of advance pricing agreements (APA), “the OECD Forum on Tax Administration will continue to promote the value of cooperative compliance between revenue bodies and large business taxpayers,” Saint-Amans said.

Amid this environment of transformation, governments understand they must provide some degree of certainty to taxpayers.

In July 2016, the G20 finance ministers signaled a priority to promote economic growth and acknowledged the importance of tax certainty in promoting that growth through investment and trade.

At the meeting of the G20 leaders in September 2016, the roles of taxation and tax certainty were key agenda items. At the summit, the OECD and the International Monetary Fund (IMF) were asked to continue working on pro-growth tax policies and tax certainty.

Pursuant to that mandate, the OECD launched a survey in October inviting businesses and other stakeholders to contribute their views on tax certainty, including what they consider the main sources of that uncertainty and their preferred solutions. The survey results will be included in an OECD report to G20 leaders in advance of their 2017 summit, setting out practical and concrete policy options to enhance certainty.

Ironically, the G20’s focus on boosting economic growth through tax could usher in another era of tax reform – and another wave of uncertainty.

“A convergence of many realities came together to produce the BEPS project,” says McDonald. “Many of those pressures are still with us and they are likely to remain for some time – it’s our new reality.”
As indirect taxes become an increasingly important source of revenue, governments are stepping up enforcement and looking for ways to address the challenges ushered in by the digital era.

Even as governments attempt to better align corporate income tax policies with modern business activities to collect more revenue, they’re also focusing intently on indirect tax collections. The European Commission, for example, estimates that 15.2% of value-added tax (VAT) went uncollected by the European Union’s 28 member states in 2013, a tax gap of €170 billion.

Controversy over indirect taxes, including VAT, goods and services tax (GST), customs and excise duties is far from new. However, it is on the rise as indirect taxes – collected on the governments behalf by those selling goods and services – come to provide a growing share of state revenues. Tax and customs administrations are stepping up compliance and enforcement efforts for indirect tax, including for digital products and services.

The challenges and risk of controversy within the indirect tax space are multifold, including complex legislation and different compliance obligations from country to country, and changing business models. For the C-suite, the increased risks surrounding indirect taxes have moved this area up the corporate agenda.  

Controversy’s next frontier

By Ross Tieman
Seeking certainty

**Not so simple**

There is much at stake for governments and taxpayers alike. Consumption taxes today on average generate 30% of the national tax take for member states of the Organisation for Economic Co-operation and Development (OECD), according to the OECD’s Consumption Tax Trends 2016. That’s as much as personal and corporate income taxes combined, and ahead of social security taxes (26%).

“One of the reasons why there is a strong appeal for governments around indirect taxes is that they are consumption based and therefore a consistent source of revenue, not subject to the same peaks and troughs that can affect other types of taxes,” says Adrian Ball, EY Asia Pacific Indirect Tax Leader.

Consumption taxes have spread quickly around the world. Invented in Germany, and first introduced in France in 1954, VAT is today levied in 167 countries from Albania to Zimbabwe. The US is the only OECD member that doesn’t have a federal sales tax. But 45 of the 50 states, and thousands of local jurisdictions, impose sales taxes, generally collected by retailers and service providers and remitted to the state.

However, the line between taxable and non-taxable items may not always be clear and their treatment may vary from country to country, according to University of Sydney Law Professor Rebecca Millar. Examples include complex multi-party arrangements such as loyalty programs and third-party warranties, she says. Multi-jurisdictional and digital transactions only add to the increasing complexity of consumption taxes.

“The suggestion that VAT is a simple tax fails to take account of the complexity of real-world transactions,” says Millar.

**Golden tax**

Similar real-time system link-ups to tackle fraud have been rolled out in Brazil and China. In the latter country, for example, vendors are obliged to enter transaction details into the Jinshi, or Golden Tax software system in order to issue a VAT invoice.

“China used to have an issue with VAT fraud,” says Ball. “So they implemented the Golden Tax software system.”

In Asia, tariffs and excise duties often remain important components of state revenues, with a focus on audits and enforcement activities. The challenges of an audit can be compounded by some revenue authority schemes that provide incentives for officials to maximize assessments, according to EY’s Ball.

However, soaring use of data and data analytics, both by authorities and businesses, is changing the way that audits and enforcement will happen, says Ball.

“That’s a tidal wave that’s sweeping through the countries of this region,” says Ball. “I think it’s going to be increasingly used by reformists to address issues of collection efficiency and corruption within the collection agencies.”

**Digital drain**

But even as governments focus on resolving longstanding indirect tax issues, the digital economy has raised a slew of new, especially cross-border challenges.

Mike Semes, EY’s Pennsylvania-based National Director State and Local Tax Controversy Services, says a large proportion of future controversies will arise from the digital economy.

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**Key action points**

- Track legal rulings on VAT liabilities and nexus in jurisdictions where you are present and ensure you are conforming to emerging obligations.
- Prepare now to implement new laws and directives on VAT being introduced in the European Union and elsewhere in a drive to tax the digital economy.
- Engage with tax authorities early to highlight areas of uncertainty arising from increasing online transactions and help shape new laws.

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**Consumption taxes**

- **10%** of OECD member countries’ gross domestic product (GDP)

**Taxes on general consumption**

- **Two thirds** of revenue from consumption taxes, while taxes on particular goods and services account for the remainder (2014)

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**Taxes on:**

- Specific goods
- General consumption

**Source:** OECD
“Our clients want to know what the rules are, so that they can play by the rules,” says Semes. “Further, it is extremely difficult for state laws and regulations to keep up with the pace at which business is changing.”

Semes says online retailing poses enormous tax administration tests. For example, when an online retailer doesn’t charge sales tax to a customer from another US state or country, the customer is obliged to remit the tax, but few, if any, customers do. As a result, governments are taking a big hit on tax revenues.

Governments must also work to create a consensus on how to address the services side of indirect taxation, which is increasingly the heart of the cross-border economy, says Professor Itai Grinberg, Professor of Law at Georgetown University in Washington DC.

These issues will become increasingly important going forward as countries rely more on indirect taxes and reduce their reliance on direct taxes, according to Grinberg.

“The question is whether that attention is coordinated in a way that prevents cross-border services from being overtaxed on the indirect side,” Grinberg says. “That is probably one of the next serious questions that will arise, both for indirect taxation and for international tax globally.”

On the hook
Since going after individuals is administratively unfeasible, many US states have now adopted what they call a bright-line nexus call to define the responsibilities of online vendors. This stipulates that even if a company has no physical operations in a particular state, it is liable for collecting and paying sales taxes if the company’s in-state revenues exceed US$500,000.

The bright line threshold exempts small businesses that would otherwise face disproportionate costs from collecting VAT on cross-border transactions.

The European Commission, which supervises tax collection in Europe, has reached similar, albeit stricter, conclusions.

In January 2015, the EU shifted to a destination basis for VAT collection for broadcasting, electronic services and telecommunications within Europe. Now the supplier has to collect VAT at the rate of the state where the customer lives, and remit the tax to the government there via the so-called Mini One Stop Shop (VAT Moss) run by national tax authorities.

This initiative failed to resolve controversy; however, because turnover thresholds at which vendors were required to register for VAT vary from country to country, and EU rules made cross-border online vendors liable for VAT no matter how small their sales.

Small sellers of online services, including designers, authors and musicians, voiced concerns about the administrative and financial burdens.

In December 2016, the Commission adopted its VAT Digital Single Market Package which sees to make it easier for e-commerce businesses to comply with VAT regulations. Given that EU businesses are reckoned to incur VAT compliance costs averaging €8,000 a year in each state where they operate, the change is expected to save firms €2.3 billion a year.

This should counter intensifying controversy and help innovative start-ups challenge the dominance of existing online platforms.

Australia’s revenue lawmakers have wrestled with similar issues. In 2017, Australia will reduce the AUS1,000 limit under which one can personally import items GST-free, a step that should help “level the playing field between Australian retailers and online sellers,” according to Howard Adams, EY Asia Pacific Law Leader. But this is only a first step in reducing VAT controversy, he says.

“No doubt there will be more changes as the tax system tries to keep up with the digital revolution.”

Source: OEC

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage of Total Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income and profits</td>
<td>33%</td>
</tr>
<tr>
<td>Consumption</td>
<td>30%</td>
</tr>
<tr>
<td>Social security</td>
<td>26%</td>
</tr>
<tr>
<td>Property</td>
<td>6%</td>
</tr>
<tr>
<td>Payroll</td>
<td>4%</td>
</tr>
<tr>
<td>Others</td>
<td>1%</td>
</tr>
<tr>
<td>Others</td>
<td>33%</td>
</tr>
</tbody>
</table>

Average tax revenue by category as a percentage of total taxation (2014)
With the likelihood and severity of controversy on the rise, how can businesses avoid and, when needed, resolve tax disputes?
Businesses that find themselves locked in a dispute with tax authorities today face this statistic: the number of unresolved mutual agreement procedure (MAP) cases has grown 163% since 2006, according to the Organisation for Economic Co-operation and Development (OECD).

MAP cases arise in situations where two or more parties are unable to reach an agreement following an audit and subsequent negotiations. The increasing number of MAP cases – in 2015 they rose by 14% – provide an indication of the degree to which tax disputes are rising, according to Paris-based Jeffrey Owens, Senior Tax Policy Adviser at EY.

As tax controversy rises across the world, so does the need for more effective dispute resolution mechanisms, especially across borders. Transfer pricing itself accounts for 80–90% of current tax disputes, says David Canale, Washington, D.C.-based EY Global & Americas Leader, Transfer Pricing Controversy Services. While there are different plans underway to improve these mechanisms, including through the OECD’s base erosion and profit shifting (BEPS) project, it will take time to implement them broadly across the world.

“With the expected surge in controversy, tax authorities are likely to have their hands so full that resources and focus will be under severe strain,” Canale says. “The reality is that even with these efforts to improve dispute resolution, matters are going to get slightly or even potentially much worse before things overall begin to improve.”
Today’s volatile controversy environment is being shaped by stricter enforcement, as governments continue to look for new ways to raise revenues. In addition, the BEPS initiative could lead to more disputes in the years ahead as governments share more information but have different views on a taxpayer’s filing.

“The BEPS rules require a detailed functional analysis requiring specialist knowledge of each company’s business model, plus a series of subjective judgments,” says Sol Picciotto, Emeritus Professor at the UK’s Lancaster University Law School. “Few jurisdictions have the resources to do this for every business; it’s almost a recipe for uncertainty and dispute.”

The local tax dispute of the past will increasingly become global in nature. Morrie Cheng, MetLife’s Hong Kong-based VP for Asia Tax, says that almost all audits today are territorial. In the next few years, however, Cheng expects that there will be more joint audits involving two or more nations and those audits would lead to more MAP cases. “I believe there will likely be more competition between different national tax authorities,” says Cheng.

Indeed, many such audits will not reach a harmonious conclusion, warns Joy Svasti-Salee, a professor and international tax specialist at the Centre for Commercial Law Studies at Queen Mary University of London. When one country takes a position in an audit and makes an upward adjustment to profit there is a direct impact on another county, and potentially a knock-on effect on other countries where the group is doing business, she explains.

The new country-by-country reporting requirements under BEPS, and the increasing amount of data sharing, means that countries are likely to identify profitable group companies and better focus their transfer pricing enquiries.

“This may result in more disputes with more at stake, including more potential double taxation and increased bilateral litigation, which is not a solution to a multilateral problem,” says Svasti-Salee.

**New resolutions**

The tax uncertainty is expected to lead to a surge of cross-border disputes which makes it urgent for a clearer and more effective dispute resolution process.

One recommendation prescribes specific improvements to MAP, seeking to resolve MAP cases within a two-year time frame. In order to do so, G20 nations and others must join in this convention to subscribe to minimum standards related to dispute prevention, access to MAP processes, resolution of MAP cases and implementation/follow-through on MAP conclusions, in addition to peer review.

Owens believes requiring peer review is compelling. Each participating tax administration will be monitored and reviewed by all the others who will be able to issue red, yellow or green cards against various criteria. “For those

**Who gets the tax base**

Not every audit will lead to a successful finding and conclusion. In such cases, the taxpayer has the right to pursue, where available, a mutual agreement procedure (MAP). Also known as a competent authority proceeding, a MAP process involves officials from two or more jurisdictions collaboratively reviewing the facts within a specific multilateral audit. The OECD recommends introducing a range of measures, such as the introduction of minimum standards and peer review, to improve the resolution of MAP cases. This is an important step, since the number of new MAP cases reported each year is on the rise, as is the backlog of unresolved map cases (the latter is up 163% since 2006).

### Inventory of MAP cases (OECD countries)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of new cases</th>
<th>Inventory of MAP cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>—</td>
<td>1036</td>
</tr>
<tr>
<td>2015</td>
<td>2352</td>
<td>6176</td>
</tr>
</tbody>
</table>

### Average time for completion of MAP cases (with other OECD countries)

<table>
<thead>
<tr>
<th>Year</th>
<th>Time in months</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>22.10</td>
</tr>
<tr>
<td>2015</td>
<td>20.47</td>
</tr>
</tbody>
</table>

*Partner economies: Argentina, China, Costa Rica, Lithuania, South Africa*
countries that participate, it should lead them to allocate more resources and work more cooperatively,” Owens says. The main obstacle is that the countries with the skills, expertise and resources such as Germany are signing on to the change, while many developing countries continue to hesitate, according to Owens. Nonetheless, he believes there are incentives for all nations to improve their dispute resolution.

“No one wants a bad business rating, as that can hurt foreign direct investment,” Owens says. India, for example, is already working more closely with the US to settle a backlog of MAP disputes. At a special October 2016 working session in Washington, DC, Indian and US authorities concluded over 100 pending MAP cases – many of them long-standing.

Another BEPS initiative aimed at delivering greater certainty prescribes the development of a “multilateral instrument” that will be used to help harmonize various definitions, treatments and conditions described in global tax treaties. It is an essential step, as the 15 actions within the BEPS project, including the improved dispute resolution process would require lengthy amendments on a treaty-by-treaty basis without this mechanism.

In late November 2016, over 100 jurisdictions concluded negotiations on this instrument, which will now be used to update more than 3,000 treaties worldwide.

“This will help clarify rules and add greater transparency and consistency that should help to reduce the number of issues up-front,” says Canale.

**Mandatory dispute settlement**

In a world characterized by political and economic uncertainty, governments need to avoid adding tax uncertainty which in turn requires that cross border tax disputes are resolved quickly and effectively. This is why businesses and many governments are pushing for mandatory arbitration as a safety net to the traditional MAP process. So far, 20 nations have committed to binding mandatory arbitration, according to Achim Pross, Paris-based Head of the OECD’s International Co-operation and Tax Administration Division. He expects more to join in the near future and sign up to the arbitration provision in the multilateral instrument that the OECD recently released.

Here again, the challenge is widespread implementation. For now, the countries where binding arbitration is most needed are refusing to join, according to Canale. He cites several possible reasons including a loss of sovereignty and unwillingness to give up and a lack of faith in the integrity of the existing institutional framework in which arbitration currently takes place. No matter the jurisdiction, the court system should always be considered the last resort. “Not only are courtroom proceedings potentially even more drawn out than other avenues, they also have a tendency to harm a company’s in-country reputation,” says Beijing-based Joanne Su, EY Asia-Pacific Transfer Pricing Markets Leader. In China, for example, companies rarely choose to go to court, says Su. “If you do this, you will be viewed as uncooperative and will ruin your relationship with the government.”

**The best defense**

Of course, prevention is the best cure, says Canale. A first step for businesses is to make sure their transfer pricing strategies and practices are up-to-date and fully BEPS-compliant. If they are called into an audit, they can present their case quickly and confidently. In fact, the faster a company can answer the questions in an audit, “the better the chance of a timely and reasonable conclusion,” says MetLife’s Cheng.

Cooperative compliance is another tool that taxpayers are using to boost certainty. For example, large businesses in the US can agree to share information up-front, working collaboratively with the Internal Revenue Service to pinpoint and resolve potential tax risks prior to filing. The OECD has published a range of guidelines for such programs, and a growing number of nations and large corporate taxpayers are working with the process.

“This is where we move away from an adversarial posture based on a lack of trust to one where the taxpayer puts their cards on the table: these are the issues; here is where we have uncertainty; let's have a conversation,” says Pross. Greater openness coupled with early certainty “will lead to fewer disputes and should benefit both tax administrations and taxpayers.” Perhaps the most effective means is to submit proposed transfer pricing methodologies to authorities within an application for an advance pricing agreement (APA). “Though these can take a great deal of up-front effort to negotiate, once concluded, they become easier to update/renew and they provide the taxpayer with transfer pricing certainty for the life of the APA,” Canale says.

A more open and transparent approach to MAP cases and APAs would bring further certainty to the international taxation system, according to Picciotto of Lancaster University. For example, APAs could be used across entire industries instead of for a single company, Picciotto says. As an example, he cites the Dominican Republic, which created APAs for the package holiday sector. “Countries should do more to open up their APA and MAP processes so that other taxpayers can see the sorts of agreements being reached and be in a better position to understand how their operations will likely be viewed,” says Picciotto.

**Key action points**

- As tax transitions to an era of transparency, the number and severity of issues/disputes will increase. Update all transfer pricing to confirm global consistency and full BEPS alignment.
- As tax authorities seek a new, BEPS-driven equilibrium, audits will be increasingly aggressive and frequent. The best way to satisfy auditors is to provide comprehensive, well-documented, BEPS-compliant justifications for transfer prices.
- In cases where the risks of adjustments, interest and even penalties is considerable, companies should consider greater up-front transparency with tax authorities.
Controversy-proof your business

By Karen Lynch
With tax controversy on the rise, companies are searching for ways to minimize disagreements with tax authorities. New tax strategies, clear communications and a flexible mindset can help businesses navigate the risks ahead.

"It’s a board decision how conservative or aggressive your tax strategy should be.”

Jacob Malmros
Head of Taxes, Alfa Laval

Out with the old
Tax controversy needs to be addressed as a strategic business priority, given its potential consequences. Tangible impacts can include additional taxes, interest, penalties, legal fees for appeals, share price erosion triggered by financial statement adjustments and the need to reserve cash in case of liability (rather than putting it to profitable use). Less tangible costs can include a drain on senior management focus and business confidence, as well as reputational damage in the eyes of consumers and other stakeholders. Another effect could be a company’s designation to tax authorities’ “high-risk” category, perpetually subject to closer scrutiny and repeat audits.

Across the world, businesses are re-examining their tax strategies. Alfa Laval, a Swedish supplier of industrial equipment, put its tax policy in writing and is considering making it public, according to Jacob Malmros, Head of Taxes. “The most important point in it is to be more conservative, as the best way to manage risk,” he says.

Key risk areas that businesses are reviewing include transfer pricing, especially in the treatment of intangible assets, and the creation of permanent establishments, subject to reporting requirements and tax in one country after the other. The EY 2016 Transfer Pricing Survey found that the fact that transfer pricing is one of the most visible topics today in the global debate surrounding tax avoidance has contributed to the new risk aversion.

In that survey, 7 out of 10 businesses consider establishing a clear strategy as their top priority. However, strategic differences are evident among regions. While participants from all regions...
indicate that tax risk management is their top transfer pricing priority, respondents from the Americas are somewhat more focused on their effective tax rate than their peers in other regions.

At Alfa Laval, as at many organizations, “it’s a board decision how conservative or aggressive your tax strategy should be,” Malmros points out. Board members are keenly aware of the damage tax controversy can do to a company’s performance and reputation. For their part, tax officials increasingly expect board-level engagement in tax matters.

For example, at McKesson Corp., a San Francisco-based pharmaceutical distributor and health care information technology company, Paul Smith regularly brings members of his team to present at meetings of the board’s audit committee, in his role as SVP, Global Taxes. He also looks for opportunities outside of formal board meetings to keep tax matters in front of directors.

Laying the groundwork
In global business, tax control frameworks can be essential tools for mastering today’s risks. Given increased oversight by tax authorities, so are controversy management frameworks.

Tax control frameworks include a clear tax strategy, a comprehensive plan for operationalizing the strategy, assigned responsibilities, documented governance and regular testing and updating in line with business dynamics and changing tax rules. These frameworks often form the basis of cooperative compliance relationships with tax authorities.

As the OECD sees it, “when the tax control framework of a multinational enterprise participating in a cooperative compliance program is determined to be effective, and when the enterprise provides complete disclosures that include relevant information and tax risks ... the extent of reviews and audits of returns submitted can be reduced significantly.”

Controversy management frameworks represent another level of control. “Companies operate in many more countries today, which is driving their need to strategically manage global controversy from beginning to end,” says Frank Ng, a member of EY LLP’s Tax Controversy and Risk Management Services group in Washington, DC.

As they work across jurisdictions, dealing simultaneously with more and less automated and sophisticated tax administrations, businesses need to understand local laws and procedures, including dispute resolution tools, appeals rights and litigation procedures. “Many multinationals at headquarters are looking for a line of sight to tax exposures on a real-time basis,” Ng says, including how many audits are open, at which stage in the process and the potential impact in other jurisdictions.

A particular flashpoint for tax risk is the current digital transformation affecting global businesses and tax administration functions. “Governments are looking to digital technologies as well as transactions within the digital economy as new sources of tax revenue,” says Channing Flynn, EY Global Technology Industry and Digital Tax Leader based in San Francisco and San Jose.

Businesses should understand the four key components of digital tax and develop a strategy to deploy them within their tax organization, he says. These include: digital tax effectiveness, digital tax administration, tax technology and tax big data. An overall Digital Tax Strategy should then answer four questions: What are the tax implications as digital technology changes business strategies, models and supply chains? What can businesses do to meet the demands from governments’ digital tax administrations, continued regulatory changes and increasing transparency requirements? How can digital technology help build a better working tax function? And how can it provide value-added insights and better visibility by leveraging data?

Reaching out
Alfa Laval has good relations with its tax administration at home in Sweden, Malmros says, but has an especially bad relationship in one Asian country in which it operates. For over four years, Swedish authorities have been trying unsuccessfully to agree with this country’s administration on Alfa Laval’s transfer pricing approach. Recently, tax inspectors came on site and demanded all emails from the local chief accountant and financial controller in the country, Malmros says. “It’s a very hostile environment.”

EY survey results point to shifting relations between business and government. At the EY Annual International Tax Conference in October, more than half of tax directors said the number of countries in which they are subject to an active audit has increased. Nearly three-quarters said the enforcement posture and tactics of tax authorities around the world have become more aggressive.

To head off controversy, the EY 2016 Transfer Pricing Survey shows two out of three respondents expect to increase their use of advance pricing agreements (APAs), in which tax authorities and taxpayers concur on transfer pricing for future years. Today, only about a third in the survey are relying on APAs. Governments such as Australia have established early engagement programs to provide rulings to those considering complex transactions. “Businesses looking for tax certainty should engage early and often with tax authorities,” says EY’s Williams. “Here in Australia, the early engagement program will probably reward those companies that appear to be transparent and working with the tax authority on a real-time basis.” Under the program, companies would bring up areas of potential risk, engaging with and securing defined outcomes from the administration before tax filing time, averting controversy. Timing is critical in more ways than one. That’s the lesson that Smith rigorously applies at McKesson. “Tax strategies that seem nonaggressive and ‘middle of the

Key action points

- Maintain a global perspective on tax changes in all jurisdictions.
- Establish clear frameworks for tax control, controversy management, digital tax and communications.
- Work on your relationships with tax authorities.
- Reinforce your tax department with new skills, including advocacy and digital capabilities.
Seeking certainty

“To increase financial statement certainty, we have taken steps to accelerate the review of our tax returns in the US and around the world.”

Paul Smith
SVP, Global Taxes, McKesson Corp.

Tax is increasingly seen as a matter of corporate social responsibility, like environmental stewardship or fair labor practices. Growing numbers of businesses in Europe, for example, now publish their tax policies online.

Tax communications strategies need to be firmly in place. Fundamentals include previewing all press releases for potential tax significance, documenting a policy and procedure for responding to tax inquiries from the press and maintaining a dialogue between the tax and corporate communications functions. Best practices include the proactive identification of a business’s full economic contribution around the globe – not only in terms of income tax, but also property, payroll, sales and employee income taxes on stock-based compensation. The economic substance of business decisions, such as the operational responsibilities and functionality of a foreign intellectual property subsidiary, should be defensible in tax terms.

Internal corporate communications are critical for business confidence as well as tax compliance. “Through frequent and effective internal communications, C-suite executives can be confident that if something were a material risk or opportunity for the company, they would already have heard about it from their tax department,” Smith says.

Keep in mind that change can happen suddenly, and communications should not lag. In December, Smith, sought to get ahead of the curve by flying to Washington, DC, to emphasize his organization’s tax concerns well before the new presidential administration took office. In the current rally for US tax reform, as in so many tax changes around the world, “there will be big winners and losers,” he says.

“Helping to highlight unusual fact patterns or issues to minimize the risk of unintended negative consequences for McKesson is an important priority for me.”

fairway’ when put in place may appear quite differently when viewed by the tax authorities many years later,” he says.

Among the risks this can raise, Smith is particularly attuned to the damage that resulting financial statement adjustments can do to a company’s valuation.

“To minimize this risk and increase financial statement certainty, we have taken steps to accelerate the review of our tax returns in the US and around the world,” he says.

Talking tax
The fact that so much tax information is being gathered by tax authorities – with some calling for its public disclosure – leaves room for misinterpretation and public controversy. “You are virtually proceeding with your tax affairs nowadays on a cards-face-up basis, so if you have some tax uncertainty in your hand, then it will almost inevitably lead to tax controversy,” says Williams.

The baseline for communicating a business’s tax profile involves ongoing dialogue with tax authorities, grounded in accurate data and providing the necessary context. However, even APAs with tax authorities can raise public relations risks, with the media and other groups sometimes referring to them as “secret deals.”

This APA dilemma provides just one example of the need to raise tax on the communications department’s agenda.

Credit: Steffen Thalemann

Paul Smith and his team at McKesson Corp., a San Francisco-based pharmaceutical distributor, understand that communication is essential today when it comes to tax matters, be it with the company’s management, board members or tax authorities.
Filing taxes used to be a relatively straightforward exercise. A taxpayer would compile the relevant data, send it to the tax authority, and answer any subsequent questions. The process is much more complicated today. Taxpayers must comply with new laws as governments around the world implement global tax reforms via the Organisation for Economic Co-operation and Development’s base erosion and profit shifting (BEPS) project. Companies must also file tax data on a regular basis, knowing it will be shared between different jurisdictions. And tax authorities are getting tougher with enforcement, examining tax rulings and positions from the past.

As governments around the world maneuver for more tax revenue, multinational organizations could be faced with a growing tax liability. Companies need to design a strategy to deal with increasingly complex, multi-jurisdictional challenges or face the real possibility of double taxation.

A sticky situation
The modern tax predicament explained through a cake allegory

Five years ago, a business paid taxes in seven jurisdictions outside its home market and brought the income it earned back to Jurisdiction A, receiving a credit for the taxes paid elsewhere.
Seeking certainty

Three possible outcomes:

1. **Same size portions:** A business successfully appeals the audit and retroactive increase in taxes demanded by Jurisdiction D.
   - **Total cake:** US$500 million
   - **Jurisdiction A:** 40%
   - **Jurisdiction D:** 6%
   - **Jurisdiction C:** 6%
   - **Jurisdiction B:** 28%

2. **Shifting servings:** Through an agreement between the two jurisdictions, it is determined that a business will pay US$30 million more in taxes to Jurisdiction D, while Jurisdiction A will issue an additional foreign tax credit and collect less tax revenue.
   - **Total cake:** US$500 million
   - **Jurisdiction A:** 34%
   - **Jurisdiction D:** 12%
   - **Jurisdiction C:** 6%
   - **Jurisdiction B:** 28%

3. **A bigger cake:** After the jurisdictions fail to reach an agreement, a business must pay US$30 million more in taxes to Jurisdiction D for 2012 with no foreign tax credit from Jurisdiction A. Double taxation and a growing tax liability is the outcome. A business may seek a resolution through the mutual agreement procedure (MAP), administrative appeal or litigation.
   - **Total cake:** US$530 million
   - **Jurisdiction D:** 12%
   - **Jurisdiction A:** 38%
   - **Jurisdiction C:** 6%
   - **Jurisdiction B:** 28%
Give & take

With global tax reform, many countries are now competing on corporate tax rates rather than on specific incentives.

In 2013, the UK followed many others in the European Union and introduced a new incentive known as a "patent box" that lowered the tax rate for corporate income generated from patents held in the country. The aim of the patent box, which more than a dozen other countries have also introduced, was to boost investment and ensure the tax regime remained competitive.

Shortly after the UK’s patent box was launched, the Organisation for Co-operation and Economic Development (OECD) unveiled its plan to overhaul the global tax regime. The UK and at least 93 other countries are now implementing those reforms, commonly known as the base erosion and profit shifting (BEPS) project. As a result, the UK – along with those other countries – had to reconcile the specific contours of the patent box with its parallel commitment to this global effort aimed at ensuring tax policies worldwide align more closely with economic activity.

The patent box illustrates the challenges governments around the world face as they compete for foreign investment with their tax policies, while simultaneously playing the role of responsible global citizen.

In a broad sense, governments are transitioning to tax rate competition rather than tax base competition, and businesses are getting caught in the change. The European Commission, for example, continues to try and breathe life into the notion of a Common Consolidated Corporate Tax Base that would apply a common definition to what is in and out of the tax base.
Governments are already competing on corporate tax rates: India, Italy, Luxembourg and the UK (among others) are all planning rate reductions this year, and the US may join them. Of 52 countries surveyed recently by EY, only Peru is planning a corporate tax rate increase in 2017.

Much of the work of both the OECD and the European Commission aims to not only bring about consistency between tax systems, but to also remove those elements of competition that the consensus view finds to be harmful in nature.

“Countries have tried to forensically target the unfair methods of tax competition that lead to a shrinking tax base,” says Matthew Mealey, EY EMEIA International Tax Services Leader. “They are trying to distinguish between harmful tax competition and fair tax competition without impinging on national sovereignty to set tax policy.”

**Big bang**
The short history of this huge reform process starts with the global financial crisis – governments have acted to try and reduce tax “leakage,” tightening both their tax laws and increasing their audit and enforcement scrutiny as revenue dwindled.

But instead of an orderly transition, businesses and governments trying to operate in this new environment are now experiencing uncertainty. Most countries want to stop the various forms of tax base competition they often describe as harmful and unfair, but sticking to their new path sometimes proves challenging, leaving their tax laws in conflict and taxpayers struggling to figure out how to comply. Keeping up with the pace of reform is a major challenge for companies today, says Vaibhav Sanghvi, Tax Director for Asia Pacific and Japan for the US software maker Symantec, who is based in Singapore. “You won’t find a single tax director who says they have all the resources they need.”

Sanghvi says changes to IT systems are often necessary in order to comply with the new regulations and reporting requirements, which is a complex process.

The long-term trend of digitalizing the tax-collection process has helped governments collect revenue because their tax authorities now can maintain databases of information on taxpayers and their transactions, building profiles of them over time rather than relying on information disclosed in individual tax returns. There’s also increased interest in tax from the media, nongovernmental organizations and the general public, and an expectation that the authorities will do something with the reams of data they are collecting.

The G20 first turned to the OECD for a solution in 2012. The BEPS plan can be grouped into three categories: tax laws of countries should be internationally coherent and should not leave any income inappropriately untaxed or double-taxed; tax authorities should obtain insight into the global operations of taxpayers and be able to share relevant tax information with each other; and profit should be taxed where value is created.

Three of the actions relate to the area of transfer pricing and seek to make it harder to shift profits to low-tax jurisdictions, the type of activity that leads to base erosion. The base erosion issue prompted the UK and other countries to change their patent boxes to ensure companies only receive the tax incentive when the research is done inside the country itself. >
Beyond patent boxes, the OECD recommends that tax inspectors challenge the tax effectiveness of the transfer pricing arrangements that businesses declare in their returns, forcing them to justify why profits are booked in specific locations. “The new guidance bases the transfer pricing analysis on the real deal, not the paper deal,” says Rotterdam-based Marlies de Ruiter, EY Global ITS Tax Policy Leader and former Head of the OECD’s Tax Treaty, Transfer Pricing and Financial Transactions Division.

**Push or pull**
Challenges to a smooth transition from a mix of base and rate competition to more focused rate competition are not just coming from countries, but from different levels of government as well. Taxpayers are familiar with the push and pull over tax laws when policy makers and tax administrators have different ideas of how a new tax rule should be implemented.

Highly negotiated incentives – sometimes characterized by very low tax rates for certain types of transactions – are one type of measure that will be under pressure going forward, says Chris Sanger, EY Global Head of Tax Policy, based in London.

The new tax environment is also increasing tension between governments and the international bodies that recommend global or regional standards. The European Commission, for example, has contributed to this uncertainty, raising a new question in the process: should the new BEPS recommendations be used to tax old transactions?

Since 2013, the European Commission’s Directorate-General for Competition has reviewed more than 1,000 tax authority rulings for what they argue may be unfair tax benefits. These State aid cases have yielded four final decisions and another three open formal investigations. But the heavy financial impact – not to mention the reputation risk – outweighs that small volume.

“The European Commission is the epicenter of European Union pressure for tax reform,” says EY’s Mealey.

Opponents say the European Commission doesn’t have jurisdiction because the problem of base competition is a flaw in the globally accepted system of accounting rules and norms.

Border adjustability is “certainly something that’s going to be discussed.”

**US President Donald Trump**
in an interview with the website Axios

Ironically, the State aid cases have reinforced the basic message of the BEPS plan, and compelled member states to comply.

**Rebalancing the scales**
Uncertainty isn’t limited to the countries in the EU. Developing countries have been fighting for years to secure more tax from multinational businesses. Indeed, developing nations are more prone to tax losses than developed ones as a result of profit shifting, according to a 2014 International Monetary Fund (IMF) study entitled *Spillovers in International Corporate Taxation*. It found that overall losses for all countries is about 5% of corporate income tax revenue, but the figure jumps to 13% in non-OECD countries.

The IMF report advises countries to take a cautious approach when entering a bilateral tax treaty and pay close attention to potential risks because “a treaty with one country can become a treaty with the rest of the world.”

“In the modern world of tax planning, companies will route their investments through the country that has the treaty most favorable to them,” says Victoria Perry, the assistant director of the IMF’s Fiscal Affairs Department.

Developing countries are starting to demand revised treaties – or are canceling them altogether. In 2011, Mongolia canceled its treaty with the Netherlands as it sought to collect tax from a mining company. In Kenya, Tax Justice Network Africa has sued to nullify the country’s treaty with Mauritius, arguing it clashes with the constitution. (The treaty is based on the OECD model treaty.)

**Full speed ahead to US tax reform**
After decades of false starts, the prospect for US tax reform in 2017 will be the strongest since 1986 following national elections that elevated Republican President Donald Trump to the White House and put Republicans in control of Congress.

**01 The starting point**
The starting point for the legislative effort in the House of Representatives is expected to be a proposal released by House Republicans last June. The proposal includes a provision for border adjustments, which would exclude US exports from the tax base while including imports. This represents a major departure from the current corporate tax system, transforming the current income-based tax to a destination-based tax on domestic consumption.

The proposal is not without some controversy. Proponents say it complies with World Trade Organization (WTO) rules, but opponents say it might not be compliant and could prompt retaliation from other nations. While proponents emphasize the level playing field that the border adjustability would create for US firms, opponents claim it could increase retail prices and negatively affect importers, which include retailers.

**02 Points in common**
A speedy process assumes the House, Senate and White House come to quick agreement on what the overall reform should look like. President Trump and congressional Republicans have said they favor a drop in the corporate income tax rate from its current level of 35%, which was set in 1993, and an end to most of the expenditures, exclusions, and incentives that amount to base competition.

Statements also suggest some agreement about immediate expensing of capital expenditures, although Trump has proposed limiting the provision to manufacturers on an elective basis.
Anytime I hear border adjustment, certainly something that’s going to be.

The Treasury Department is the policy body in the US, and the Internal Revenue Service in charge of administering the changes. Drafters of the tax law need to be mindful of the complexity of implementation, which will entail transition rules, and IRS and Treasury guidance to implement. “We need to have systems that can ingest information and analyze it,” says Douglas O’Donnell, Commissioner of the US Internal Revenue Service’s Large Business and International Division. “Without ample funds to update infrastructure and make necessary changes, we will be facing more complications in what is always a difficult implementation exercise.”

Another indicator of developing countries’ concerns is messaging by NGOs and the G77, a coalition of developing countries, that there is a need for a stronger alternative to the OECD dialogue on tax. Those forces advocate an upgrade of and additional resources for the tax work of the United Nations.

IMF’s Perry says that rather than handing out tax incentives, governments should work on improving their tax administration and providing businesses with a smooth experience, featuring minimal bureaucratic hassles, rather than lowering the tax rate. “Survey after survey of businesses show that all of that is more important than the tax rate,” Perry says.

And they should require companies to file tax returns even if tax holiday incentives are offered in order to obtain information regarding the business in their country, says Perry.

Conflicts resolution
As countries seek more from their taxpayers, they could end up in conflict with each other over where a multinational organization’s profits arise and taxes should be paid.

Statistics show that the inventory of unsettled cross-border tax disputes – most commonly on the issue of transfer pricing – was already rising before the BEPS changes. The backlog in OECD countries jumped 163% between 2006 and 2015, according to OECD data. (So-called mutual agreement procedure [MAP] cases involving two OECD members are double counted.) The BEPS plan was cognizant of this demand and aims to improve dispute resolution mechanisms.

One of the BEPS reforms is focused on making the MAP – the key process for companies to ask two countries to collaboratively discuss who levies what tax – more timely and efficient. “Sometimes companies send letters to governments to invoke a MAP and don’t even get an answer,” says de Ruiter.

Other dispute resolution tools are becoming more popular, including advanced pricing agreements, in which businesses and governments negotiate what prices should be used for cross-border, intra-group transactions before tax returns are filed rather than argue about them after.

The reform process requires that all countries publish a basic profile of their relevant tax authorities, processes and contact details, which will be posted on the OECD website and assessed for effectiveness. The organization of the information, including instruction on how to access MAP in a country-specific manner, will prove very useful, according to Douglas O’Donnell, Commissioner of the US Internal Revenue Service’s Large Business and International Division. By 2019, controversy statistics will include inventory totals between specific countries, as long as there are at least five cases, according to O’Donnell.

O’Donnell says the MAP process could also be used before controversies develop, or to avoid them in the first place. In that scenario, tax authorities relevant to a particular multinational could collaborate with each other once that company submits its tax return.

“We may be able to do that in a multilateral setting, looking at the country-by-country reports and all of us in the room agreeing on which items do not present sufficient risk,” says O’Donnell.

O’Donnell says it’s critical that competent authorities can agree on approaches to resolve disputes going forward, including the consistent application of the arm’s-length principle for related-party transactions. Otherwise controversy inventories could grow, he says.

All information in this article was current as of the print deadline of Feb. 1, 2017.

Key action points

- It’s more important than ever to monitor fast-changing rules and how they will apply.
- In emerging economies, pay close attention to attitudes about double-taxation treaties.
- As the OECD works to bring more certainty to the global tax infrastructure, consider whether dispute-resolution options are right for your business.
Tax conflicts

Disagreements between taxpayers and governments are nothing new. For much of recorded history, those in power have sought to increase the taxes they collect: in the past, to finance costly wars and enrich themselves; and more recently, to balance budgets. A look at tax conflicts through the years.

1294
The Maltolt

In order to pay for the war with France, the English government levied a tax of 3 marks on each bag of wool. Wool producers and merchants protested again the duty, which negatively impacted the price of wool, and Edward I was forced to retract the so-called maltolt in 1297.

1341
Le Puy salt tax

Salt merchants in Le Puy (France) protested the introduction of a sales tax on salt by Philip VI. The protesters argued that the salt tax violated their rights and the town privileges granted in 1226 and 1307. The tax’s implementation was delayed by Philip VI, but later reaffirmed and remained in place for a long time.

1733
Excise Bill

Great Britain’s Chancellor of the Exchequer, Robert Walpole, submitted an Excise Bill to Parliament that would introduce taxes on tobacco and wine and reduce direct taxes including the land tax. Merchants of the City of London organized strong opposition to the tax, forcing Walpole to withdraw the bill later that year.

1773
Boston Tea Party

In order to protect the British East India Company’s tea monopoly, Great Britain’s Parliament passed the Tea Act in May 1773, which lifted normal export duties and only allowed American merchants who were loyal to Britain to distribute the tea. The legislation was met with fierce opposition from colonists who were fed up with taxation without representation. In December of that year, some 50 protesters boarded three ships filled with British tea and dumped it into the Boston Harbor.
1790

Exemption for fishermen

Fishermen in Fukuyama (Japan), fed up with a shrinking supply of fish, demanded an exemption from taxation and a ban on the use of nets. Their demands were quickly met, but a few of the fishermen were punished a short time later.

1847

Malt tax

British Prime Minister Benjamin Disraeli sought to reduce the duty on malt, which was very unpopular with the agricultural sector. In order to compensate for that reduction, he proposed in his budget to increase the house and income taxes. The budget fell, and the malt tax stayed in place for another three decades.

1919

Soda tax

In 1919, US Congress approved a 10% tax on bottled soda pop and soda fountain sales, describing it as a necessary measure to fund the war effort. The soda tax was not introduced due to health concerns, as is the case today, but rather because it was viewed as a luxury product. It was met with resistance from consumers and business and was repealed in 1922.
Working to foster greater certainty within global transfer pricing, Martin Kreienbaum, Director General (International), Tax Department, Federal Ministry of Finance, Germany, emphasizes up-front cooperation and transparency, such as advance rulings, joint audits and APAs.
Martin Kreienbaum will arguably be one of the most important men in tax in 2017. On 1 January 2017, the Director General of International Taxation at Germany’s Federal Ministry of Finance also became Chair of the Committee on Fiscal Affairs (CFA) at the Organisation for Economic Co-operation and Development (OECD). And with Germany now holding the G20 Presidency (and with the Hamburg G20 Leaders’ Summit fast-approaching), there are few stakeholders who will exert more influence on the direction that world leaders will take on taxation issues.

**INTERVIEW**
by Bill Millar

**Tax Insights:** What outcomes do you hope to achieve under Germany’s Presidency of the G20?

**Martin Kreienbaum:** The G20 has an ambitious tax agenda, and our aim is to make progress on all relevant issues. Obviously, this includes implementation of the BEPS [base erosion and profit shifting] recommendations and further steps on tax transparency, especially with respect to beneficial ownership information. In addition, we want to continue the recent work on tax certainty; the OECD and IMF [International Monetary Fund] are expected to produce a comprehensive report for the G20.

We will also initiate a much-needed discussion on the tax challenges of digitalization, building on the work that has already been conducted during the BEPS project. And in general, we will take the specific needs and interests of African and other developing countries into account, as this is one of the broader policy goals of Germany’s G20 presidency.

**How do tax treaties between countries affect international trade?**

Tax treaties are an indispensable instrument facilitating international trade. They contribute to the creation of a level playing field by preventing serious distortions of competition resulting from double taxation as well as double non-taxation. In addition, they include a mechanism for international dispute resolution (known as the mutual agreement procedure or MAP) that can provide relief for taxpayers where problems result from the unavoidable differences between national legislation and jurisprudence. Last, but not least, the provisions on international assistance in tax matters can indirectly reduce the compliance burden for taxpayers and safeguard the correct application of tax laws.

**With regard to certainty, what is the scale of tax controversy today in Germany, and how does it compare to worldwide trends?**

We are seeing a rise: there were 374 new MAP cases in Germany in 2014 and 363 in 2015. But disputes are to be expected. Today we see companies that are deeply integrated internationally, and are executing more and more complex, cross-border activity than ever before. This presents a real challenge, not only for us, but also for other administrations. Over the last 10–15 years, we have seen a significant increase in MAP-based disputes worldwide. If you look at the OECD figures for 2015, you see there are 2,509 new cases worldwide. Many are counted twice because authorities from two or more countries report the same case. In addition to the new cases, the size of the backlog increases. So existing MAP cases are not being resolved as quickly as new cases are coming in, meaning the worldwide backlog is becoming quite sizable – over 6,000 cases. The fact that so many are asking for access to MAP procedures is a positive development in a way. It shows that companies are placing trust in the agreements and cooperation we have with our treaty partners.

**There are many ways to handle disputes. In your view, what is the ideal approach?**

I think we should focus not only on resolution, but also on prevention of disputes. I believe it all starts with the greater use of joint audits. In cross-border situations, companies can make information available to other administrations so that everyone...
Seeking certainty

can operate on the same factual basis. It starts with improving processes relating to transparency. If following an audit, the parties are too far apart and cannot reconcile, then MAP becomes an indispensable tool. After that, I believe countries need a proper arbitration mechanism to resolve cases — which is available in Germany. Of course, in Germany, this is a very small number of cases, as less than 3% of our MAP procedures closed without an agreement between the involved jurisdictions. So we need all three steps: joint audits, then MAP, followed by arbitration.

How will the OECD’s BEPS project impact these processes?

Action 14 is one of the few BEPS actions that resulted in a binding minimum standard for tax administrations. This demonstrates how vital it was for the OECD to make progress in dispute resolution. BEPS will improve matters by granting access to MAP procedures: more nations will do so. Second, timely resolution: two years on average, which will be a significant improvement in many cases.

How many nations are likely to adopt these measures?

All countries participating in the BEPS project have committed to the minimum standards. And while this presents a challenge for Germany in terms of sufficient staff and resources, it will be much more difficult for many others. In particular, there are developing nations that at this point do not have the needed skills and resources. Here, the OECD and others are providing training, workshops, etc., to aid them in capacity building.

What will be the impact from Action 14’s peer review process?

The review and monitoring process is meant to encourage countries to have the appropriate policies and resources in place. Peer review should be a very effective mechanism, as no country wants to be seen as underperforming standards, which will hurt investment. Initially, the G20 nations will first be monitored, but others will likely participate at a later time. We must start somewhere; the others will follow later.

**“Tax treaties are an indispensable instrument facilitating international trade.”**

**Martin Kreienbaum**
Director General (International), Tax Department, Federal Ministry of Finance, Germany

Do you have any advice for businesses?

Most disputes and MAP cases stem from transfer pricing. Here, the central issue for taxpayers is to provide sound documentation in a timely manner. Without the necessary basis of established facts, the resolution of transfer pricing disputes becomes very difficult. One more consideration: perhaps make more use of APAs [advance pricing agreements] or advance rulings. Gain that certainty early and avoid disputes.

As Chair of the OECD’s Committee on Fiscal Affairs, how do you define success for its Tax Certainty program?

I am convinced that more tax certainty will translate into a better business environment and higher economic growth. Compliance with the minimum standard as agreed in BEPS Action 14 has been continuously advocated by the Committee on Fiscal Affairs and will be crucial in this respect. Moreover, the G20 should strive to agree on additional measures to make life easier for business and tax administrations at the same time. As was mentioned earlier, this will be one of the core elements of our G20 tax agenda.

Are there any parallel or related actions by groups beyond the OECD?

There is an important one from Brussels where the European Commission has proposed to convert the existing arbitration convention into a directive and broaden its scope to comprehensively include business taxation. There is also discussion on ways to expand the use of joint audits for preventing disputes.

Will US business tax reform herald a new period of uncertainty for other governments?

I think that there has already been a wealth of discussion about possible US business tax reform, and well-thought-out proposals have been put on the table. Of course, it is up to the US to decide on the further direction of eventual policy changes. Quite naturally, changes to existing tax rules always contain some element of uncertainty, but I count on the new US government to continue its excellent relationship with other countries about international tax issues.

How will the cross-border tax architecture of 2025 differ from that of today?

We have seen significant improvements of the international tax architecture over the last few years. However, additional steps are necessary to further eliminate harmful double taxation and double non-taxation. I am convinced that internationally concerted action is better suited to deal with these issues than unilateral measures. In this regard, the Inclusive Framework on BEPS – which is open to all interested jurisdictions – will be of high importance as it presents a unique opportunity to intensify the constructive tax dialogue among countries worldwide. So if we continue our close international tax cooperation, I am confident that the cross-border tax architecture of 2025 will be something we all can look forward to.

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Tax authorities and taxpayers have sometimes found themselves in an adversarial position. Recently, there have been mutual efforts to improve cooperation as many jurisdictions seek to change the traditional relationship, where discussions can be protracted and costly before eventually reaching an agreement on taxes due. Uncertainty, driven by greater transparency, global tax reforms, changing enforcement postures of governments and digitalization and information sharing, injects more complexity into this dynamic. Both sides must work toward finding and maintaining an efficient way to allow governments to collect and taxpayers to pay their tax liabilities.
Danish artist Philip Overbuary explores the interaction between ferrofluid (a liquid containing nanoscale magnetic particles) and magnetic fields. Each time it is exposed to magnetic fields, the ferrofluid morphs into different shapes and patterns. Similarly, the relationship between taxpayers and tax administration is under pressure as different forces sculpt a new tax environment.

Source: Science Gallery Dublin
Transparency

While new transparency initiatives could lead to more misunderstandings, taxpayers and governments are better off keeping the lines of communication open. Businesses should examine and understand their tax picture and risks, then reach out for a discussion with tax authorities.
Certainty

New rules make tax an increasingly complex web, making it challenging for taxpayers to identify the risks and be compliant. Detailed guidelines from governments with respect to legislation and regulatory enforcement will help bring much-needed certainty for taxpayers.
First the pain ... then the gain?

Tax controversy will get worse before it gets better. But in time, reforms to the global tax system could bring greater transparency, certainty and consistency.

By Ross Tieman

Pfizer Inc., a multinational pharmaceutical company with operations around the world, has seen an increase in inquiries from tax authorities during the normal audit process in recent years, according to Michael Nelson, Pfizer’s Senior Director, Tax Planning.

Moreover, disputes that used to get resolved during audits are now more likely to be pushed into the upper administrative echelons, or even to court to be settled by judges, he says.

And it’s a global trend. “We’ve seen increased activity globally, including jurisdictions in the regions of North America, Europe/Middle East/Africa, Latin America and Asia Pacific.”

Taxpayers like Pfizer find themselves today in a tax landscape that is quickly evolving. Governments are increasingly sharing information across borders and are becoming stricter in terms of enforcement. In addition, new tax laws developed under the base erosion and profit shifting (BEPS) project by the Organisation for Economic Co-operation and Development (OECD) are being rolled out across the world as governments seek to bring tax legislation into the globalization era.

For the next few years, taxpayers are bracing for more uncertainty, disputes and possibly litigation with tax authorities until reforms to the international tax system deliver greater consistency and certainty.

“We are facing an increasingly complex world,” says Nelson. “I think the pendulum has swung in a direction in which there will be more time and resources devoted to tax controversy, more intensity on the part of tax authorities and a greater use of dispute resolution mechanisms.”

Risky business

There’s little doubt that tax controversy is intensifying both across borders and within countries. According to EY’s annual survey of corporate tax professionals, published in April 2016, enforcement and controversy are the highest tax risks faced by firms, identified by 35% of those surveyed. Operational risk was pushed into second place.

Tax audits are clearly on the increase. Last year, another EY survey of 267 senior tax executives from large public and private companies (the majority were headquartered in the US) found that 23% of respondents were under audit, a 10% increase from 2014. And 72% said the enforcement stance and methods of foreign tax administrations were more aggressive in 2016.

“We’re going to see a tsunami of new disputes in the next two to three years,” one former government official predicted at a recent EY aHead of Tax event.

Stricter interpretations

This reflects more aggressive enforcement of existing rules. The 2008 financial crisis drove governments around the world to recoup shortfalls in their budgets through increased tax collection. Tax has become...
the subject of intense focus and criticism from nongovernmental organizations, the media and politicians.

Increasingly, taxpayers risk being caught in the crosshairs as two countries take different views of what a particular international rule means. Or they may find past tax positions challenged retroactively by governments.

Resolving doubts through discussions with tax authorities is becoming more difficult: tax administrations appear less willing to interpret the law, so more disputes will likely be settled through the mutual agreement procedure (MAP), often a feature of international tax treaties, or even in court.

“Generally speaking, it is more problematic than in the past to get a settlement agreed or to get a ruling from tax authorities,” says Arjo van Eijsden, who heads EY’s tax controversy practice in the Netherlands and Belgium. “Tax authorities are stricter in their interpretations.”

Jean-Pierre Lieb, EY’s Tax Policy and Controversy Leader for Europe, the Middle East, India and Africa, says disputes will also rise because of a greater focus by tax administrations on more technical issues, such as transfer pricing.

“There will be more reluctance than in the past to settle before court,” says Lieb.

A surge in disputes could lead to rising costs, potential double taxation or worse. In some jurisdictions, Lieb says, governments “can use criminal charges against the legal entity, but they will also target those criminal charges against individuals who are in charge of tax structuring.”

Conflicting views

The introduction of a global set of harmonized tax rules will also trigger new uncertainties that only rulings can resolve. The OECD’s BEPS initiative, finalized in 2015, covers everything from transfer pricing, permanent establishments and hybrid mismatch arrangements to treaty benefits and the digital economy.

In theory, the new system should make it easier to calculate corporate tax liabilities and achieve the certainty that companies and governments crave. But in reality, countries may interpret the rules differently during implementation, leading to heightened controversy over issues, such as the location of intellectual property or transfer pricing, according to van Eijsden.

“There are some very good actions within the BEPS action plan,” says van Eijsden. “But it takes time to adjust legislation at the national and international level.”

Missing out

Of course, it is difficult for lawmakers to imagine every situation in which tax is payable. In the past decade or so, for example, digital businesses have gone global with unprecedented speed. But their business models often do not fit easily into the rules of tax systems designed to impose levies on local, physical assets.

The new economy, with its more varied and flexible working models, contributes to the creation of a “hidden economy” and consequent revenue shortfall for tax authorities, according to a report for the UK’s Office for Tax Simplification.

New laws, including the BEPS project, will address these issues in coming years. Until then, digital, cross-border businesses will likely continue to be the target of controversy over which taxes they should be paying, at what rate and to whom the tax is payable.

What’s past is prologue

Past tax deals are also becoming a future risk for companies. The increased data sharing among tax authorities combined with transparency efforts, such as the BEPS’ country-by-country reporting initiative, give tax administrations more information on taxpayers than ever before.

Some are using it to look at past rulings and declarations. The European Commission, for example, has launched several investigations into tax rulings offered by individual countries within the European Union to select companies or sectors, examining whether State aid rules were breached. Billions of euros are at stake.

A new and more challenging world of controversy lies ahead.

I think the pendulum has swung in a direction in which there will be more time and resources devoted to tax controversy, more intensity on the part of tax authorities and a greater use of dispute resolution mechanisms.”

Michael Nelson
Senior Director, Tax Planning, Pfizer Inc.
“We will reach the point where disputes are resolved faster”

Interview with Akhilesh Ranjan, Principal Chief Commissioner of Income Tax, India’s Ministry of Finance

By Elliot Wilson

Tax Insights: How important are the base erosion and profit shifting (BEPS) recommendations by the Organisation for Economic Co-operation and Development (OECD) to you and India?

Akhilesh Ranjan: India has always been a major player when it comes to BEPS, partly because we are an emerging economy whose companies are branching out into the world, and we need to protect our tax base. India is also a huge market where multinationals want to come and do business. We have always endorsed the principle that tax should be paid where value is created. Even now, with India making a concerted push to go global, our tax practices have always worked in line with the rules set out in the BEPS action plan. What BEPS has done is to rationalize and justify our existing tax policies, reinforcing and refining our rules, rather than significantly altering how we operate.

Which BEPS actions are the most relevant to India?

Transfer pricing is extremely important to us. Country-by-country reporting is also of immense significance, as we are always striving to get more information about companies’ cross-border operations in order to improve our risk assessment processes and our understanding of, and ability to react to, transfer pricing issues.

We are making good headway on tackling treaty abuses. Being a full member of the Joint International Tax Shelter Information Centre (JITSIC)* has also been a great help to data gathering. In the past, we would get almost zero information about how multinationals operate outside India. What we needed were rules and norms that enabled us to decide where to focus our efforts and optimize our revenues. The BEPS measures certainly do that, and the membership of JITSIC has proven to be an enormous help.

BEPS Action Plan 7 deals with permanent establishment (PE) and the measures some companies take to avoid PE status. The country’s tax administration remains focused on increasing efficiency, consistency and, ultimately, certainty.

India started the decade with high-profile tax controversies with multinational businesses. Today India is engaged with international tax reforms, digitalization and a new sales tax.

The country’s tax administration remains focused on increasing efficiency, consistency and, ultimately, certainty.

*According to the OECD, JITSIC is an initiative that "brings together 36 of the world’s national tax administrations that have committed to more effective and efficient ways to deal with tax avoidance. It offers a platform to enable its members to actively collaborate within the legal framework of effective bilateral and multilateral conventions and tax information exchange agreements – sharing their experience, resources and expertise to tackle the issues they face in common.”
“I’m not worried about the ghost of retrospective taxation any more. We are focused on ensuring that our tax rules are consistent with global norms.”

Akhilesh Ranjan
Principal Chief Commissioner of Income Tax,
India’s Ministry of Finance
tax treaties, and it’s the issue we would really like to improve on and make more functional. Over the past three years, we’ve had tremendous success in resolving tax disputes with a large number of countries. We will reach the point where disputes are resolved faster and more efficiently.

What are the other challenges you face in trying to levy taxes in a country of 1.25 billion people?

What concerns us primarily is ensuring that tax that should be paid in India, is being paid in India. We are still net importers of capital and technology, and I don’t see that situation changing much in the next 10 or 15 years. But we are looking at enforcing a source-based taxation system. This will ensure that tax is levied on all income accrued in the country, irrespective of the nationality of an individual or a company. On the information front, we believe there has to be a global agreement wherein flows of data relating to multinationals are visible to every interested and relevant government. We are introducing better reporting declaration systems across our taxation departments, focusing on putting systems in place that provide us with comprehensive details about high-value transactions.

Are you investing in new IT systems and human capital in order to track and analyze an ever-expanding volume of corporate data?

Yes – and this is an ongoing process. Our systems and mechanisms are improving, as is our capacity to store and analyze information flows. One of the biggest challenges we face is that of being able to receive, process and analyze real-time information flows sourced from domestic and international companies. And that can only happen by expanding our internal capacity. We are currently formalizing data security policies so that everything is collected and analyzed centrally. We signed the Foreign Account Tax Compliance Act (FATCA) in 2015 with the United States. The OECD and the US Government have since examined our processes and our safeguard systems, and reported that India was compliant with their rules and is heading in the right direction.

The number of states in India, which have traditionally determined their own tax codes. They will soon adopt a standard sales tax after India’s Parliament approved a goods and services tax (GST) bill last year. The tax reform is expected to make it easier to do business in India, boosting the country’s economy.

Sources: CNN; Foreign Affairs

The subject of retrospective taxation is one that multinationals investing in India often raise. How can this concern be addressed?

Too much has been made of the so-called retrospective taxation in India. We firmly believe there never was any new and retrospective taxation, just a retelling of the rules that were already clear and in place. That’s all history now. I’m not worried about the ghost of retrospective taxation any more. We are focused on ensuring that our tax rules are consistent with global norms. And on the policy front, I do not think any major issues can be raised.

What are the biggest challenges facing your department now and in the long term?

We have a very complicated and very long legal procedure in general. When you talk about certainty for taxpayers, this is an issue we take very seriously, as it can take years for corporates accused of tax evasion to have their case heard in court, and even longer for an appeal to be brought to a final decision. Cutting litigation lead times, reducing the amount of litigation that is channeled through the system and increasing certainty for taxpayers are very important targets for us.

What is it like being in charge of such a vast information and data organization? What is the hardest part of the job?

Fortunately, we started moving on the information technology front long ago, and we have systems in place that file taxes and disburse tax refunds. The challenge is to set up new organizational units staffed by experts adept at analyzing new flows of tax data. I’m 100% positive we are up to the task. You see, it’s not such a terrifying job for me.

The recent push to clean up India’s economy by eliminating large-numbered banknotes has caused some problems. Nevertheless, could it have a positive impact on tax collection in the long term?

I believe so. Government efforts to tackle the problem of unaccounted money are well known, and the decision is definitely in the right direction. A huge number of cash transactions that would once have gone unrecorded, will now be tracked, processed and analyzed, and that makes our jobs far simpler. It makes it far easier to track sources of income and verify whether or not they are being fairly reported. If people move away from cash transactions, it’s better for tax administrators. And we are moving toward more digitalization and digital processes through banking channels, which is a great sign. But cash is still the heartbeat of life in India. So this is a long-term process, where the key is to change individual psyches – and that is what the Government is trying to do.

Akhilesh Ranjan

Akhilesh Ranjan is the Principal Chief Commissioner of Income Tax at India's Ministry of Finance. He is also India's representative for the OECD's BEPS project as well as for the implementation of the OECD's global standard on the automatic exchange of information. Previously, Ranjan held the role of India's Competent Authority. He joined the Indian Revenue Service in 1982 after receiving a post-graduate degree in Physics from St. Stephen's College, Delhi University.
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