



Special report: Why more tax controversy is in the offing

By *Ralph Cunningham* July 19, 2023



Access to more company information, increasingly aggressive tax authorities, and global reform negotiations nearing their end are just some of the factors behind a heightened risk of controversy, say the tax directors and practitioners who spoke to Ralph Cunningham.

Taxpayers and their advisers believe more disputes with revenue agencies around the world are inevitable because of new disclosure, reporting and exchange of information regimes, not to mention the BEPS 2.0 global tax reform project, whose details have yet to be finalised and whose impact is still u

Improved technical expertise and better technology are also putting tax authorities on a surer footing when they decide to pursue companies for the tax they believe is due or an amount they will settle for.

All of this points to more conflict in the years to come, according to the tax directors and advisers *International Tax Review* spoke to for this special report about tax controversy trends.

Tax departments are not just dealing with the issues that tend to crop up regularly, such as where R&D expenses have been incurred or whether a team or individual's move to a particular jurisdiction for an extended (though temporary) period of time has created a permanent establishment. New concerns such as ESG reporting have created extra demand for their time. With this comes the potential for disagreements and disputes with tax authorities.

A finding from **KPMG's 2023 Chief Tax Officer Outlook Study** reflects the view about the potential, if not likelihood, of more conflict with tax authorities. The research, which was carried out in autumn 2022 with more than 300 tax directors and their advisers at the firm, found that 65% of them believed that "worldwide tax enforcement activity, audit and controversy are likely to increase significantly in the near future".

And more than half of the EY tax professionals in 70 jurisdictions who participated in the firm's annual **Tax Policy and Controversy Outlook** survey at the end of 2022 and beginning of 2023 said they foresaw higher levels of tax enforcement and a higher number of tax audits in their jurisdictions during the year.

"In particular, increased enforcement around transfer pricing will continue in 2023; almost half of respondents say increased transfer pricing enforcement is already occurring, while a further fifth say it is likely to occur," according to the survey.

"While the programmes themselves may no longer be available, auditing of COVID-19 support and stimulus measures by their tax authorities is expected in 2023 by almost 60% of respondents," it added.

Dialling down

Some interviewees for this report mentioned that while, on one hand, companies are becoming less aggressive about their tax strategies, on the other, tax authorities – perhaps emboldened by extra tools and powers – are getting more so.

"The battleground is now in the context of commercial planning or group structures, so issues to do with substance, beneficial ownership or deductibility, for example, whereas in the past it was about schemes, says Helen Buchanan, head of Freshfields' global tax disputes practice, who is based in London.

Jens Schönfeld, partner at Flick Gocke Schaumburg in Bonn, adds: “What you see is that especially big listed companies are focusing on being compliant, instead of structuring.

They do structure but not in an aggressive way. Even in the US it's no longer in vogue to structure aggressively.”

Geo differences

Just as the nature of disputes may have changed, the relationship between taxpayers and tax authorities in Europe is not the same as it used to be either, Schönfeld believes.

“You can't even rely on what the tax authorities are saying,” he says. “In the past, there was a good relationship, typically, between tax auditors and taxpayers, but now it's more of an aggressive relationship, because they do this nitty-gritty stuff and do not focus on the big points.

“I think that's really hard for foreign investors. It's not even about getting legal certainty. It's more about administrative certainty,” he adds.

“Even in Bavaria, the tax authorities were quite open and business friendly in the past,” Schönfeld continues. “They still are because there are a lot of multinationals there, especially in Munich, like Google, Amazon and Apple. But, though I wouldn't say aggressive, it has become harder to deal with the tax authorities.”

Keith Brockman, Tampa-based vice president of tax for MasterBrand, the largest manufacturer of residential cabinets in North America, says dealing with the US tax authorities is getting harder, too.

“It's not that much different to Europe. I think they are sharing more information or trying to corroborate information from various jurisdictions,” he explains.

He notes, however, that the US takes perhaps a different approach to exchange of information than some other jurisdictions: “It will only provide certain information within certain parameters.”

The US tax authorities can also be unwilling to discuss issues that they may have recently successfully litigated, according to Brockman.

“Once a big case happens, like on R&D credits, they will just make that sort of a blanket rule across the board, saying ‘here's how we're going to enforce those requirements’, and the local team loses their ability to have any latitude on that issue because it's been moved up to a higher level.”

TP trends

In transfer pricing (TP) controversy specifically, three issues are driving trends, according to Raffaele Petruzzi, of Petruzzi Advisory in Vienna.

“One is about making sure that multinationals are paying enough of the so-called fair amount of taxes in your country.

“The second aspect is the international environment and the work coming from international organisations such as the OECD, the UN and the European Commission on transfer pricing and non-transfer pricing aspects that nevertheless have an impact on transfer pricing topics – for example, pillars one and two,” he says.

Third, he adds, is the evolution of national legislation and regulation in smaller countries as well as bigger ones like the [UK](#) and [Canada](#).

Petruzzi chooses another word to describe how tax administrations are managing their relationships with companies.

“The approach is becoming more sophisticated rather than aggressive” he says. “I would call it sophisticated because, before BEPS 1.0 a lot of tax administrations did not have either the tools or the knowledge to question what taxpayers were doing, and so, of course, the audits were probably not very sophisticated.

“Now, because of the higher amount of knowledge that was spread and developed as a result of BEPS, tax administrations are probably questioning more.”

Shiny new tools

Joint tax and TP audits, risk assessment tools such as exchange of information – both the OECD and EU have updated or introduced new reporting rules or standards for crypto-assets in 2023, for example – and country-by-country reporting are adding to the arsenal of tax administrations in deciding where they should direct their resources, but new technology is also playing its part.

More than 70% of the tax administrations surveyed for the [OECD's Tax Administration 2022](#) comparative guide said that they “are already using cutting-edge techniques – such as artificial intelligence and machine learning – to exploit data in ways that can uncover previously hidden assets or identify new risks”. The research came out last year, and only goes up to 2020, but this use has undoubtedly got greater as these methods of data manipulation have become more mainstream.

Right direction

While tax controversy looks set to rise in the future, one well-used dispute resolution technique is still popular, even if there are frustrations over timing and results.

Tax authorities closed about 13% more MAP cases in 2021 than they did in 2020, according to the latest [OECD statistics](#). They still take a long time to resolve, and fewer new cases were opened than in the previous year. TP cases that were resolved in 2021 took about 35 months to reach a conclusion, compared to 32 months in 2020. It was about 21 months for other cases, whereas it was 18.5 in 2020.

Wider trends

Elsewhere, Brockman of MasterBrand sees tools such as exchange of information as a good thing if they are used transparently – that is, with the knowledge of taxpayers.

“A lot of times the company may not know that the tax authorities are reaching out to other jurisdictions for information, so I think if it's more collaborative, it would be better,” he says. “They could be getting some information and making generalisations. You may have a limited risk distributor in one jurisdiction and a different set-up somewhere else, so you're going to have different results.

“Is it right to compare the same profit levels, for example? That's where it gets a little harder to compare information. Is it really apples to apples? If it were more collaborative by including the taxpayer so they could provide comments once the tax authorities receive that information, I think that would be even more helpful to explain any differences,” he says.

Buchanan of Freshfields believes one issue is likely to feature highly as a potential source of controversy between taxpayers and tax authorities in her practice in the near future. It is one that ties back to the point about how the focus has changed to tax planning within commercial transactions as the use of schemes has died away.

“Main purpose,” she says without hesitation, referring to the anti-abuse rule, also known as principal purpose, which is now part of many bilateral tax treaties because of the OECD's Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting and the organisation's model tax treaty.

“Transfer pricing is always there,” she adds. “That's just a constant, but there are so many TAARs [targeted anti-avoidance rules] and GAARs [general anti-avoidance rules] around now.”

For Brockman, penalties and disclosures are going to continue, with increasing controversy. “I think that is pretty much certain,” he adds.

Future disagreement

The so-called two-pillar solution to the taxation of companies in the digitalised economy – BEPS 2.0 – is likely to generate its share of disputes in the future, but it is difficult to predict with any certainty

where the issues might arise, particularly when it comes to pillar two, which seeks to implement the **global anti-base erosion (GloBE) rules**, including a minimum effective tax rate of 15%.

More than 50 jurisdictions or regions are at various stages of pillar two implementation – some, such as the EU, Japan and South Korea, have fully or partially enacted their interpretation of the rules, more have published proposals in the area and others have set up working groups to study the best way to implement the GloBE rules, with more set to follow.

The differing interpretations of the interlocking rules and who they should apply to, and when, illustrate the potential for controversy.

“There’s so much complexity and so much scope for disputes,” says Buchanan.

It has yet to be seen what disputes may arise, adds Brockman. “No one can forecast accurately.”

*This feature is part three of a three-party special report on **tax controversy**. You can read the second part [here](#), and the first part [here](#).*

TAGS**NEWS****FEATURE****GLOBAL****DIRECT TAX****INDIRECT TAX****TAX DISPUTES****TRANSFER PRICING**

Ralph Cunningham

RALPH CUNNINGHAM WORKED AT ITR BETWEEN 2004 AND 2018 AND IS NOW A FREELANCE JOURNALIST

