Advancing in a global tax environment in flux

Navigating the controversy tsunami
Advancing in a global tax environment in flux

The multi-part webcast series “Advancing in a global tax environment in flux” highlights the challenges of managing tax risk in the current, continuously evolving international tax landscape.

During the webcasts, our panellists provide a holistic perspective, including practical insights for business, on the consequences of widespread BEPS implementation, the fundamental geo-political developments, such as Brexit and US tax reform, and rapid changes in the way tax authorities administer tax and co-operate with each other.

Webcast session 1: Tax messaging in the new corporate tax transparency era – 21 September 2017

Webcast session 2: Navigating the controversy tsunami – 19 October 2017

Webcast session 3: Are you crossing the threshold? Changing permanent establishment and other nexus rules – 9 November 2017

Advancing in a global tax environment in flux, Part 4: Looking back and ahead: are you ready for 2018? – 7 December 2017

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This roundtable discussion extends EY’s ongoing webcast series highlighting the challenges of managing tax risk in a continuously evolving international tax landscape.

During this roundtable discussion, EY Tax professionals examine the reasons for the ongoing surge in cross-border controversy, the likely approach of tax administrations, how to identify the trigger points in your organization, the remediation strategies – both reactive and proactive - open to companies and a practical review of the controversy process.
Roundtable panellists

Alex Postma  
**Global Leader – International Tax Services**  
Alex Postma is the EY Global International Tax Services Leader and is responsible for the worldwide coordination of international tax services to clients. Alex worked in the United States for 12 years, first as the Dutch desk leader and later as the overall desk leader for Ernst & Young LLP, where he led many global tax strategy sessions with various organizations. He also worked for nearly 12 years with EY in the Netherlands, focusing primarily on Financial Service organizations, before moving to London in 2008 to serve as the EY EMEIA ITS leader. Alex also leads the EY worldwide network of Think Tanks that researches the trends and developments in the international business and tax areas, seeking to anticipate the possible needs of organizations.

Matthew Mealey  
**EMEIA Leader – International Tax Services**  
Mat Mealey is a Partner of the International Tax Services practice in the EMEIA region of Ernst & Young LLP. Mat specialises in strategies to manage corporate income tax cost and risk globally. Mat has over 20 years’ experience advising clients on international tax matters. His clients include both inbound and outbound companies across all industries and predominantly in the FTSE 100/Fortune 500. Mat is a leading authority on double taxation. Mat has a policy role on international tax matters at EY and has regular meetings in this role with Government ministers, HMT and HMRC. As part of this role he has worked closely with UK Government on the UK tax reform, the OECD BEPS initiative and the consequences of this business.

Mike McDonald  
**EY**  
Michael McDonald is the Executive Director in the National Tax Department – International Tax Services, Transfer Pricing of Ernst & Young, LLP. In this role, McDonald advises clients on BEPS-related matters and other transfer pricing issues, such as cost sharing, country-by-country reporting and controversy resolution. Before joining EY, Michael McDonald was a financial economist in the Business and International Tax Division of Treasury’s Office of Tax Analysis. As a specialist in transfer pricing, he has worked on a number of significant transfer-pricing projects, including the final, temporary and proposed cost sharing regulations (2005, 2009, 2011), the services regulations (2003, 2006, 2009), and the 2007 Report to Congress on Earnings Stripping, Transfer Pricing and U.S. Income tax Treaties. Michael received a Ph.D. in economics from Boston College, and a B.S. in Economics from St. Bonaventure University.
Roundtable panellists

Katherine Pinzon
EY
Katherine Pinzon is Transfer Pricing Partner at Ernst & Young LLP, based in Sao Paolo, Brazil. She is currently the Brazilian Transfer Pricing Leader since 2015 with vast experience in Latin America and the Unites States. Katherine was the Florida (USA) market Transfer Pricing Leader from 2012 to 2014. She was also the South America’s Transfer Pricing Leader for EY from 2009 to 2012, and still plays a leading role in major transfer pricing projects (planning, documentation, and controversy) involving major clients in the region. Katherine has more than 18 years of experience as a transfer pricing advisor. She provides transfer pricing services to clients with significant or expanding operations overseas, specifically US multinationals investing in Latin America and, lately with more emphasis, Brazil. Katherine has advised clients regarding all transfer pricing aspects of multinationals, including cross-border transactions, supply-chain planning, and business-transformation activities, among others. Also, she has lead major transfer pricing policy and documentation projects with Brazilian multinational corporations, with focus on the realignment between OECD rules and the Brazilian Transfer Pricing regulations. Katherine received a Juris Doctor in Law from the Central University of Venezuela and a Master of Laws and International Tax Certificate from Harvard Law School.

Luis Coronado
ASEAN Leader – International Tax Services
Luis Coronado is a Partner and ASEAN International Tax Leader of Ernst & Young Solutions LLP, based in Singapore. Luis has worked in Asia since 2005 as part of his more than 20 years advisory experience in international tax and transfer pricing issues. Before relocating to Asia, Luis spent several years serving domestic and multinational companies in Latin America, namely Mexico, Brazil, Argentina, Colombia, Peru, and Venezuela. He has advised companies on the negotiation of bilateral advance pricing agreements and competent authority resolutions with Australia, Korea, Indonesia, Germany, Israel, Luxembourg, Singapore, Thailand, Canada, China, Japan, Malaysia, United Kingdom, Mexico and the US. He has also served many German multinational companies and is fluent in German, having lived in Düsseldorf as a student. He has also worked in Tijuana, Mexico City, Amsterdam, Washington D.C. and Shanghai. Luis has a Bachelor’s degree in International Trade and Customs (Honors) from the Universidad Iberoamericana and a Masters in Business Administration from the University of Southern California. He is a member of the International Fiscal Association and a member of Bloomberg BNA Transfer Pricing Advisory Board.
The increased subjectivity of the rules under many of the BEPS actions will only increase the likelihood of double taxation and therefore disputes between tax authorities, with the taxpayer stuck in the middle.

Alex Postma: The international tax environment is experiencing some revolutionary changes, and the question in front of us today is what impact this has on the amount of controversy companies will have to deal with. After a brief survey of the reasons for the rising surge in cross-border controversy and the likely approach of tax administrations in conducting their audits, our round table will then move on to consider how to identify the trigger points in your organization. We will subsequently discuss the controversy process and the remediation strategies — both reactive and proactive — open to companies. We will wrap up with looking at some of the unexpected consequences that may easily be overlooked.

Mike, can you give us a brief update on the global trends affecting the tax landscape and your view on the impact this is having on tax controversy, perhaps focusing most strongly with your own specialization in transfer pricing?

The use of a new multilateral instrument, or MLI, to quickly incorporate important BEPS minimum standards into treaty networks — and in particular the mandatory adoption of a principal purpose test, or PPT, by countries under BEPS Action 6

Enhanced information sharing among tax authorities — not only in terms of formal processes like country-by-country reporting, but more informally, with groupings such as the Joint International Taskforce on Shared Intelligence and Collaboration now sharing far more information among themselves on new business models and structures.

Together, these developments have significantly tightened the rules and enhanced the tools available to revenue authorities to question, assess and adjust taxpayers’ positions. In addition, the increased subjectivity of the rules under many of the BEPS actions will only increase the likelihood of double taxation and therefore disputes between tax authorities, with the taxpayer stuck in the middle. While the combination of the action items may not be a “perfect storm” for taxpayers, it will undoubtedly be hard slogging, especially in the near term.

Postma: So Mike, spring tide rather than tsunami in your view? Could you provide a little more detail on a few of the key BEPS-specific drivers like 8 to 10 and 13, and perhaps a couple of words on the MLI?

Mike McDonald: I think it’s hard to argue against the fact that the BEPS action items have significantly transformed the international tax landscape. I think the combination of and interaction between a number of trends, in particular, will drive the dispute landscape in the coming years. These, in no specific order, are:

- The modification and clarification of transfer pricing rules under Actions 8 to 10
- The combined country-by-country reporting and transfer-pricing reporting requirements under Action 13
- Similar transparency and disclosure requirements under Action 12, which as our last webcast on transparency showed are now being translated into national level programs around the world

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McDonald: Sure, let’s start with transfer pricing. Under BEPS Actions 8 to 10 and 13, the BEPS project has made significant modifications to the OECD Transfer Pricing Guidelines, in particular with respect to risk and intangibles. Importantly, these modifications apply immediately and potentially retrospectively, as the modifications are viewed as a clarification to existing principles under Article 9.

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With respect to risk, the OECD guidance provides a process-based approach for analyzing the taxpayer’s allocation of risk, and determines that such an allocation may be recast by a tax authority if the entity assuming risk is not able to “control” such risk and does not have the financial capacity to assume the risk. This can have a profound effect on taxpayers, as the allocation of risk is fundamental to determining the intercompany transactions themselves. In addition, the guidance on risk is somewhat subjective and susceptible to differing interpretations. The combination of guidance that is both fundamental and subjective is a recipe for significant disputes.

With respect to intangibles, the guidance, while recognizing legal ownership, clarifies that such ownership does not necessarily generate a right to all (or any) of the return associated with the intangible. The group companies performing important functions (especially so-called “DEMPE” functions—development, enhancement, maintenance, protection or exploitation), controlling economically significant risks and contributing assets must be appropriately remunerated. In addition, special guidance on “hard-to-value” intangibles may allow a tax authority, in certain situations, to use actual outcomes to re-price prior intangibles transactions.

Much of this information will be shared with all of the tax jurisdictions in which the MNC operates, as will information on unilateral APAs and tax rulings. And of course, Action 13 is a minimum standard, so all jurisdictions in the BEPS Inclusive Framework (currently 102) have committed to implement it. Then with respect to the MLI (Actions 2, 6 and 7), the multilateral instrument to modify bilateral tax treaties (MLI) provides the means to swiftly modify treaties to help implement some of the BEPS minimum standards and institute other BEPS measures. The BEPS minimum standards are: review of preferential tax regimes, establishing a transparency framework for tax rulings, the implementation of CbC reporting and making dispute resolution more effective.

Treaty measures included in the MLI include those related to hybrid mismatch arrangements (Action 2), treaty abuse (Action 6), permanent establishments (Action 7) and mutual agreement procedures (MAP) (Action 14). These treaty measures enhance the ability of countries to deny deductions and/or force income inclusions; to expand source country taxing rights; and introduce potentially subjective treaty-shopping provisions. On the other hand, the minimum standard on MAP is intended to facilitate countries providing access to MAP and using best-practice approaches in order to eliminate or mitigate double taxation. Among the alternatives available through the MLI is mandatory binding arbitration, to which 25 jurisdictions have so far signed up.

Taken together, the BEPS-related measures are likely to raise the number of queries from tax authorities that will want to understand and connect the various new sources of information. Subsequently, it will increase audit assessments and MAP disputes, for two reasons. First, we will see a greater assertion of taxing rights associated with each country’s interpretation of the BEPS guidance; and second, there will likely be more disagreements among countries associated with the inevitable differing interpretations of the BEPS guidance.

But it is not the only area of change. There are a number of initiatives outside of, but related to, the BEPS work that have important ramifications for multinationals. A number of countries have introduced what can generally be grouped together as “diverted profits tax” measures, which impose levies on company profits that are routed via what they see as “contrived arrangements” to tax havens. Another of the most far-reaching initiatives is the European Union’s Anti-Tax Avoidance Directive (ATAD), which seeks to implement a minimum standard of anti-tax avoidance rules across, and connected to, the EU. The ATAD measures are intended to go into effect in 2019 and 2020, with the latter date focusing on hybrid mismatches with non-EU countries.
So, in answer to your spring tide question, Alex, we are definitely looking to significant disruptions to international tax norms—and ensuing controversy. In fact, it’s not just us forecasting upheaval—Pascal Saint-Amans of the OECD has himself recently made remarks, such as: “Tax audits probably have increased. We don’t have global data, but I firmly believe that there has been an increase” and “The BEPS project has brought some new provisions, which some could consider as too subjective. It’s not completely untrue.” So all in all, I think there is both a current storm, but perhaps more importantly, the risk of a “tsunami” of disputes in the future.

Tax administration practices

Postma: Mike—thank you for that setting that background. Let’s now turn our attention to how the tax authorities in various jurisdictions are preparing for the above developments and the enhanced flow of information. In particular, what is a typical audit process likely to look like going forward? And will we see regional or country differences? Mat, perhaps you would like to start.

Mat Mealey: Staying with Mike’s “storm” analogy, the oncoming flood of information, particularly under Action 13, will need to be absorbed by tax administrations and will raise a multitude of questions. A recent survey within EY already showed a current significant increase in questions in 90% of the countries interviewed.

2018 will be the first time that tax authorities around the world will receive global information on large MNE groups with operations in their country. The Action 13 data will break down a group’s worldwide revenue, profits, tax and other attributes by tax jurisdiction. In addition it will provide information on legal and financial structures, and on supply chain and IP. In that regard, the information represents a significant opportunity for tax authorities to understand the operation of a group’s business in a way that has not been possible before. And we are seeing tax authorities getting organized around this.

For instance, a couple of weeks ago, the OECD issued a new report titled the Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment, setting out how tax authorities may use Action 13 information to supplement their existing tax risk assessment protocols. Chapter four of the handbook will be of particular interest to taxpayers, as it considers not only the ways in which CbC reports can be incorporated into a tax authority’s risk assessment framework, but it also describes many of the main potential tax risk indicators that tax authorities will likely run across the data they receive.

Tax administration practices

Risk assessment – Country-by-country reporting (CbCR)

- OECD report, CbCR handbook on effective tax risk assessment (published 29 September 2017)
- Sets out guidance on:
  - How each tax authority receiving Action 13 data may consider using this information within their tax risk assessment programs
  - The types of risk assessment tests they may wish to consider utilizing
  - The challenges of effective use of CbC reports for tax risk management
  - How to use CbC report alongside data from other sources
- Includes 19 “risk indicators”

- There have been changes in a group’s structure, including the location of assets.
- Intellectual property (IP) is separated from related activities within a group.
- A group has marketing entities located in jurisdictions outside its key manufacturing locations.
- A group has procurement entities located in jurisdictions outside its key manufacturing locations.
- A group has sales and distribution activities in jurisdictions where the group pays a lower rate or level of tax.
- A group includes entities with no tax residence.
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It should be expected that national tax administrations will, at a minimum, utilize the risk indicator tests as outlined in the report, and the report therefore includes useful data for those companies wishing to develop pre-submission testing to ensure their compliance risk assurance approaches are aligned with those likely to be adopted by national tax authorities.

The report goes on to set out a series of 19 specific risk indicators that can assist a tax administration detecting recurring transactions and one-off transactions that should potentially be subject to further scrutiny. For each risk indicator, a summary overview is provided and an annex sets out what potential results could mean, and also explores other potential circumstances that could explain the results. It should be expected that national tax administrations will, at a minimum, utilize the risk indicator tests as outlined in the report, and the report therefore includes useful data for those companies wishing to develop pre-submission testing to ensure their compliance risk assurance approaches are aligned with those likely to be adopted by national tax authorities. Additionally, the country risk assessment protocols provided for seven key countries provide useful insights for MNEs currently operating within such jurisdictions.

Postma: Mat, looking at the indicators in the CbCR handbook, there are some expected ratios, such as effective tax rate, profit margins, profit per employee, the separation of IP in a separate entity and amount of related party revenues. Also, as expected, there is a focus on mobile activities based in low-tax jurisdictions and on the location—or recent change of location—of valuable assets, such as IP. However, I was a bit surprised to see the procurement activity indicator and very surprised by the deviation from the market trends indicator. And there appears to be a focus on so-called “jurisdictions of interest,” which seems a euphemism for alleged tax havens without regard to the levels of substance in those jurisdictions of interest, which I would have thought to be essential in light of Action 5, where it is very clear that a low tax rate by itself is acceptable.

Mealey: Definitely, there is a clear focus on stateless and low-tax income, and this is not only apparent from best-practice guidelines around BEPS measures that the OECD and the Forum on Tax Administration are developing. Part of that is because, in most cases with stateless or zero taxed income, there is no applicable tax treaty and no MAP so countries can win a dollar of tax without any consequential bilateral discussion or negotiation.

It may be illuminating to examine how the practice guidelines translate across to the actual on-the-ground experience of taxpayers going through audit enquiries. There is evidence to suggest that the BEPS initiative and the enhanced exchange of information between tax authorities has encouraged some tax authorities to adopt more assertive enquiry techniques.

At a high level, we are seeing consistent global trends in tax administration; these include much greater demands for information, much less trust in information provided by taxpayers without further audit and validation, and much greater sense of entitlement from tax administrations for non-territorial information and broader business background to assess business purpose. These administrative changes are being applied to transactions implemented five or more years ago, which may be under audit now. As such, the effective impact of more assertive administration is retrospective.
Also we are seeing a move away from a sovereign approach to an increased interest in what is happening in the other jurisdictions where the MNC is active. This is manifesting, for instance, as a reduced reliance on one-sided transfer-pricing analyses and a corresponding demand for multi-sided analyses. Of course a multi-sided analysis was always necessary under the OECD guidelines, but many countries accepted a one-sided approach as a simpler and more efficient proxy.

Postma: Mat, can you explain what you mean by a multi-sided TP analysis? And what impact, if any, the possible US tax reform may have on this?

Mealey: Put simply, in the past many tax authorities reviewed the functional profile only in their own country in order to assess an appropriate arm’s-length return on those activities. A large number of unilateral APAs and controversy settlements were agreed using this approach. Increasingly, however, tax authorities are insisting on full disclosure of the position of all parties to a transaction or series of transactions. This is in order to obtain a better understanding of all aspects of a group’s operations, the better to evaluate the role and contribution of the entities in their own jurisdiction.

As a result, groups are being required to prepare two-sided or multi-sided transfer-pricing analyses to support their pricing policies. It also is part of the reason why fewer jurisdictions are now prepared to negotiate unilateral APAs and why we are seeing more bilateral or multilateral APAs. And I think it also confirmed that tax authorities increasingly are looking at multi-jurisdictional joint or simultaneous audits. One of the most worrying trends is the increasing incidence of penalties, where transfer-pricing positions were based on one-sided analyses even though countries were entirely complicit in using one-sided analyses as a more efficient shortcut in the estimation of arm’s-length prices.

And to your point on the US tax reform, I could see some US-based MNCs re-shoring IP to the US under a version of the potential reform, and that could indeed reduce current pressure points, such as stateless income and focus on entities with limited substance and limited control over risk and business processes, as Mike mentioned earlier.

Postma: Luis, what are we seeing in the Asia-Pacific region?

Luis Coronado: Prior to BEPS we already had glimpses of the future positions of countries, such as India and China, in their respective country chapters as included in the UN’s TP manual in which they emphasized local contributions, such as location savings, creation of local intangibles and local-market premium in order to increase the income in their respective countries.

This has now become an even stronger focus for Asian tax authorities. Clearly BEPS Actions 8 to 10 put more onus on demonstrating where economic value is being created and provides a framework for argumentation and defense. Countries, such as Indonesia, have also adopted in their local audits an approach based on local contributions, and China has added “promotion” to the Actions 8 to 10 DEMPE rules that Mike already mentioned. Interestingly, the joint and simultaneous audits mentioned by Mat for the moment seem a distant possibility for Asia-Pacific, but on the other hand, I wouldn’t be surprised if they are studied by the Asian tax authorities at this point. Joint and simultaneous audits can help level the playing field between experienced and incumbent tax authorities in areas of international tax and transfer pricing specifically. For example, just this week Cambodia announced its adoption of a transfer-pricing regime and a tax treaty with Singapore. Perhaps such audits will help in building some trust in approaches taken rather than working on a stand-alone basis and rushing to catch up and resolve under MAP or even mandatory binding arbitration.
All tax authorities within the Latin American region, excluding Brazil, have been focusing on requesting massive amounts of documentation about parties in other jurisdictions already.

Postma: And Katherine, are the Brazilian authorities applying similar tactics? How about across the rest of Latin/South America?

Katherine Pinzon: For the Latin American region, BEPS is indeed used by tax authorities as bringing support to and raising the bar on already quite assertive positions within audits.

All tax authorities within the Latin American region, excluding Brazil, have been focusing on requesting massive amounts of documentation about parties in other jurisdictions already, even including final third-party customer information. The data provided in Action 13 is reviewed studiously by them and will only increase the further appetite for information. For many of these authorities, it was also not clear how to determine the value creation in a supply chain. So BEPS Actions 8 through 10 gives these tax authorities more technical guidance on what to ask and how to support their arguments in their audit processes and assessments in the aspects that were below their radar before BEPS.

For Brazil, it is not clear how the Receita Federal will approach the additional information it is receiving, since there is no direct connection with the local transfer-pricing rules. The Receita Federal representatives have nevertheless been very participative on all BEPS discussion, and it seems that Brazil’s position on this matter will continue to be active. I believe that Brazil will have very interesting developments in this area in future years. So let’s wait and see how the uncertainty evolves.

Postma: Thanks, Katherine. Mike, are we finding that the IRS has amended its audit procedures in light of BEPS?

McDonald: Like other jurisdictions, the United States will benefit from the additional information that it will receive as part of the BEPS transparency initiative, such as the information in Action 13. This will help in their directive to conduct robust factual analyses at the examination level, so that cases are properly understood, developed and ultimately resolved. However, this additional information is not likely to be as incrementally helpful as it might be for other jurisdictions — the IRS collects an awful lot of information as it is (5471, 5472, TP documentation, etc.). With respect to the impact of the BEPS guidance itself on IRS audit practices, the US will likely continue to apply its transfer-pricing regulations (the section 482 regulations) to cases in audit that it expects to proceed to IRS appeals and/or litigation, since the 482 regulations are the applicable authority in US Courts.

Of course, the OECD Guidelines are relevant for MAP cases, but even here the US doesn’t see a lot daylight between the two — the US views the OECD Guidelines as generally aligned with section 482, which may be indicative that the IRS is likely to view the modifications to the OECD Guidelines as not reflecting a sea change. (Historically, the US has tended to respect contractual allocations of risk and concentrates more on the pricing of the arrangements in order to address BEPS concerns.)
We are seeing various governments on all continents — such as Russia, Australia and Brazil — investing heavily in data analytics capabilities, not just on the data they are getting from taxpayers or other tax authorities but also applying resources to other streams of data, such as social media.

Having said that, it seems clear that there may be more disputes in MAP settings with other jurisdictions, given the potential interpretative differences of the BEPS guidance. This also ties in to Mat’s points of the use of multi-sided analyses. There will in practice be greater critical scrutiny of one-sided methods under the “most appropriate method” standard, such as the TNMM/CPM method, which traditionally has been the most common method used by the IRS.

Mealey: I’d like to add one point here on tax administration developments, which is the increased technological investment and capabilities of tax authorities around the world. We are seeing various governments on all continents — such as Russia, Australia and Brazil — investing heavily in data analytics capabilities, not just on the data they are getting from taxpayers or other tax authorities but also applying resources to other streams of data, such as social media.

A survey that we did last week among 30-plus countries showed that at least 75% of the jurisdictions are investing in additional data technology for audits. We’ve seen examples of tax authorities doing reviews of corporate websites, social and public media output and so on. We’ve also seen tax authorities interrogate the social media postings and profiles of employees to get a deeper understanding of the jurisdictional functionality of a company.

Postma: I agree with you. In fact, in a few cases we have seen that the combination of enhanced exchange of information between tax authorities and their data analytics capabilities has outpaced a company’s own internal, somewhat siloed data provision, leading to awkward discussions.

Identifying the trigger points

So, having examined the new audit environment and how tax authorities have been empowered to take a more coordinated, multi-country approach, we should look at what this means in practice for multinational companies. In particular, let’s consider some of the common trigger points and discuss what companies need to do to become aware of potential risks within their organization. Katherine, can I ask you to start this discussion please? What are the most relevant triggers in Latin America?

Pinzon: I would say in Latin America tax authorities have a lot of focus on the transfer pricing of tangible goods and intragroup services, especially limited risk distribution entities, with the classical example being a limited distributor with limited market and price risk. For example, we have countries like Argentina, Ecuador and Bolivia questioning the substance of triangulation transactions, where the foreign principal entity buys its final product from a related party contract manufacturer located in the Latin American region and subsequently sells it to a related limited distributor located in the Latin American region. Some of these audits have seen adjustments on transfer price between the principal and the limited risk distributor and in some cases, even a denial of the existence of such principal entity within that supply chain.

Colombia, Chile and Peru have focused their transfer-pricing audits on commodity transactions and the reasonableness of procurement and trader residual profit charge. Moreover, countries like Mexico, Venezuela and Colombia are denying the deductibility of intercompany services charges mostly due to the lack of documentation support and inability to prove the benefit test from the taxpayer. It is very common to hear from clients that they are paying a charge for a service that is only described in an invoice. Another aspect that receives keen attention from the tax authorities is the duplication of functions between the service provider and the recipient of the service. Within Actions 8 to 10, these situations will trigger assessments that may end up with a denial of the deduction of the charge and penalties.
And controversy triggers are not limited necessarily to transactions in Latin America. Action 13 will provide Latin American tax authorities with a global view of the activities of their multinationals, potentially raising controlled foreign company (or CFC) exposures on intercompany transactions that were not subject to alternative transfer-pricing analysis, methodology or valuation locally.

Postma: Mat, how about Europe? What are some of the main trigger points?

Mealey: At the top of my list would be the transfer-pricing changes under Actions 8 to 10 that Mike referred to earlier, which have definitely had an impact across many countries in terms of how they are approaching transfer-pricing cases. I mentioned already the focus of Europe on stateless income and income in low-substance entities, not just in transfer pricing by the tax authorities but also as a key feature in state aid cases by the European Commission.

A second area I would pick out is permanent establishment risk. In France this is increasingly audited by the tax raid. In Italy there is now an amnesty from criminal sanctions where taxpayers accept Pes. The UK —along with Australia and New Zealand —have chosen a different approach, based around using diverted profits taxes (DPT), and we now have significant experience on audit enquiries around this area. In summary, we are finding that the common features are that DPT enquiries are time-constrained, focus mainly on a functional/factual profile and are typically integrated, covering transfer pricing and PE risk, as well as potential diversion of profits. Typical information requests can include a multi-sided value chain enquiry, a review of key contracts, the review of source materials (including emails and other relevant documentation), functional interviews with key personnel and also third-party information enquiries.

As a result, DPT enquiries are complex, involving the provision of a high volume of information, with much of it extraterritorial in nature. The importance of timely engagement with the tax authorities and the provision of relevant and appropriate information cannot be underestimated—they are critical elements in the strategy for avoiding the issuance of a preliminary notice.

Postma: Luis, what is your analysis here?

Coronado: Aligned with Katherine’s comments on Latin America, there is a prevalence particularly in Southeast Asia for high scrutiny on services charges and governments limiting or denying deductions, with arguments around duplication or lack of benefit/value to the payer. Another point is that, despite OECD’s recent analysis and renewed commentary on beneficial ownership, we’re still seeing challenges on beneficial ownership in the Asia-Pacific region, and this will only increase with the inclusion of the PPT in the new MLI. This will be particularly relevant for interest and royalty streams. In addition, certain countries in Asia might have remittance issues due to foreign-exchange restrictions, as well as giving up on withholding applied to non-arm’s-length amounts on non-tangible good transactions.
Then, in line with Mat’s observations, I would say that Asia is waking up to PE scrutiny. As you already indicated, Mat, in Australia sophisticated anti-avoidance regimes, including a diverted profits tax and Multinational Anti-Avoidance Law (MAAL), have been introduced. Japan has seen Action 7-type interpretations ahead of actual MLI adoption. These are two of the big examples, but other jurisdictions are also starting to be interested in more rigorous review of potential PE situations.

Postma: Thanks, Luis. Mike, our other three panel members have mentioned Actions 8 to 10 several times, and a main component of these actions and perhaps one of the key components of BEPS overall is IP. What would you say are the main trigger points around IP?

McDonald: As I stated earlier, the BEPS project made significant modifications to the OECD Transfer Pricing Guidelines, in particular with respect to risk and intangibles.

While this guidance is officially considered to be a clarification to the prior guidance (and hence potentially applicable retrospectively), in practice the application of the new guidance is resulting in more challenges to traditional transfer-pricing transactions and even to underlying structures. This is most readily apparent with respect to the new guidance on risk and intangibles.

A key aspect, in fact one of the fundamental aspects, of intercompany transactions and structures is the allocation of risk. To take one example, under the arm’s-length principle, it is acceptable to separate the assumption of risk from the performance of activities that affect that risk. For example, one entity might commit to funding and taking the risks with respect to the success or failure of a speculative R&D endeavor, while another entity engages in the actual R&D activity without taking on the risk, through, for example, a contractual services arrangement.

Such arrangements must have substance, and the entity assuming risk should have the ability to take on “control” of this risk, and the remuneration to the R&D activity must reflect the full value of this contribution—which might in fact reflect a majority of the anticipated profits. These basic principles have been part of the OECD transfer-pricing guidelines for decades and are similarly reflected in the domestic law of most OECD members.

The new TP guidance provides a much closer look at the relationship between risk—and in particular the concept of control over risk—and the activities related to risk. The prior OECD guidelines devoted only a couple of paragraphs to risk. The revised, post-BEPS guidelines dedicate over 50 paragraphs to the topic.

In practice, this has led to greater scrutiny between the decisions to take on and contractually assume risks and the performance of on-the-ground risk-mitigating activities, such as the performance of R&D.

This scrutiny is most pronounced with respect to intellectual property, where the on-the-ground activities relate often to quite important DEMPE functions. In effect, there is greater scrutiny of the technical capability of an entity to be able to contractually assume risk.

Unfortunately, the guidance on risk can be subjectively interpreted, and it seems clear that different countries are interpreting the guidance differently. Some are more likely to accept a taxpayer’s allocation of risk and concentrate on the pricing of those transactions, while other authorities are more likely to recast or recharacterize a taxpayer’s transaction. Such basic disagreements reflect a second trigger point.

Now, in transactions between two substantive, functionally rich entities, such enhanced scrutiny will often not result in increased challenges by tax authorities. For example, the key distinction between controlling risks and performing risk-mitigating activities is often moot when both entities have the ability to do both. However, where there is an imposition of an intermediary between substantive entities —such as an entity with lower functionality that legally acquires or funds and owns IP—then the ability of such entities to meet the technical “control” requirements is more readily challenged. Taxpayer structures involving such an intermediary really reflect the first key trigger point.

Unfortunately, the guidance on risk can be subjectively interpreted, and it seems clear that different countries are interpreting the guidance differently. Some are more likely to accept a taxpayer’s allocation of risk and concentrate on the pricing of those transactions, while other authorities are more likely to recast or recharacterize a taxpayer’s transaction. Such basic disagreements reflect a second trigger point.
The stakes are also quite a bit higher than before. Challenging and recasting allocations of risk results in more than simply making transfer-pricing adjustments (i.e., pricing or profit adjustments). They may effectively result in disregarding the nature of the transactions themselves, or the multinational’s tax structure. This begs the obvious question as to what the counterfactual alternative structure is supposed to be. Since there are many ways in which unrelated parties can structure transactions, there are similarly many different "alternative" transactions or structures that a tax authority could speculate, to reflect the “accurate delineation of the transaction.”

And since there are at least two — and often several — different tax authorities involved in these disputes, there are potentially as many different “alternative” transactions or structures as there are stakeholders, with little objective evidence to either confirm or restrain such speculation. This reflects another key trigger point — the potential chaos and controversy around recasting the taxpayer’s structure.

There is a related aspect to the increased controversy environment that will result in systematic administrative instability — call it the fourth trigger point — and, accordingly, enhanced controversy. This is the effect of time. One of the important points raised in the new OECD guidance (which might be too easily overlooked) is that contractual allocations of risk often reflect the only evidence of commitments to bear risks prior to those risks materializing. In those circumstances, taxpayer contractual arrangements reflect a clear “placing of bets” with respect to risk, which imply, if substantive, a consistency in behavior regardless of how risks play out.

Audits, on the other hand, typically occur after risks have played out —the intangible turns out to be a blockbuster or, alternatively, the research endeavor fails and the commitment of funding that supports such research is simply lost. The positions of the tax authorities will naturally reflect how risk actually plays out — what we might call outcome bias. A tax authority will in practice only challenge a taxpayer arrangement if risks play out a certain way. Similarly, one or more tax authorities might be in a position to challenge the taxpayer’s arrangement no matter how risks play out. Controversy will be further augmented by interpretive hindsight.

Postma: Mike, thank you very much for that insightful analysis. Can I summarize that key trigger points for potential scrutiny are situations where the risk and the control over that risk are in separate hands; and therefore a divergence between the profit potential and the functionality of an entity might be considered suspect? And that these trigger points might be exacerbated by the size of the transaction and the number of tax authorities that could have an interest in the transaction?

McDonald: I think that captures it nicely. There is one additional trigger that we haven’t talked about yet, and that is remuneration on financial instruments. Although we see a slowly increasing attention by tax authorities around the world, I would assume there will be a significant step-up in attention upon the implementation of the tax avoidance directives in the EU and potentially as a result of the US tax reform proposals on financing into the US. Moreover, the expectation is that — sometime in 2018 — we are going to see the OECD transfer-pricing guidelines on financial transactions, which in my view could mark a significant change in audit behavior by tax authorities around the world.

Controversy process and remediation options

Postma: Now that we have identified a number of common trigger points, it is critical that companies understand how the controversy process is likely to unfold and the range of remediation options open to them. This understanding will be key to developing and managing an effective controversy response strategy. Whichever route is chosen, it is critical that the response is globally consistent. From last month’s webcast on transparency it is clear that tax authorities around the world will be much better informed as a result of increased information flow from corporates to the tax authorities but also as a result of increased communication between tax authorities.

Deviations from globally established tax policies or practices will give rise to questions from local tax offices and will need to be explained. Settlements in one country may be picked up quickly by other countries around the world. And what may have seemed like an acceptable cost for one jurisdiction may not be that appealing if other countries start wanting the same deal. So with that in mind, Mike, if I could stay with you, what are some of the controversy processes that we encounter in practice?
Taxpayers typically have recourse to national administrative procedures and the courts to deal with any resulting double taxation. However, cases of double taxation are often better resolved at the international level between the competent authorities of the jurisdictions involved.

### Controversy process and remediation options

**Controversy management process**

- Early key decisions
  - Reactive or proactive?
  - Unilateral or bilateral/multilateral?
  - Audit defence or APA?
- Identifying the optimal path
- Impact of BEPS/EU mcosource
- Relief of double taxation/MAP and manual on effective MAP procedures

McDonald: The controversy process involves a number of key decisions for taxpayers that need to be made as early as possible, sometimes simultaneously.

- Reactive or proactive? Unilateral or bilateral/multilateral? Exam/audit/defense or advance pricing agreement? The optimal path depends on a number of factors, such as:
  - Tax structure: what are the optics? High risk or low risk?
    High-risk business models feature a low effective tax rate, non-alignment of functions and risks, and profits in “stateless” entities.
  - Information available to tax authorities. What will the relevant tax jurisdictions see?
  - Capabilities and capacity of tax authorities
  - Taking into account the above, the perceived audit risk
  - The degree of coordination between tax authorities
  - Potential interpretive differences between relevant tax authorities. For example, do they have a common understanding of the transfer-pricing rules?

There are a range of possible approaches along the reactive/proactive and unilateral/bilateral spectrum. At one end of the spectrum, a domestic/unilateral approach would involve filing tax returns in each jurisdiction and tactically reacting to proposed adjustments by the revenue authorities. Taxpayers challenging the proposed adjustment may attempt to settle the issue through a formal appeals processes or through litigation. Targeted issues may be dealt with unilaterally through special rulings.

Taking a slightly more proactive approach, a taxpayer may identify systematic or recurring issues in a particular jurisdiction or jurisdictions, and decide that undertaking one or more unilateral APAs will ensure certainty in each jurisdiction, possibly through the use of inconsistent approaches (e.g., agreement on different markups for identical distribution activities in different jurisdictions).

Taking a more comprehensive and proactive approach, a taxpayer may attempt to simultaneously resolve ongoing disputes in multiple jurisdictions and achieve greater certainty through the application of bilateral (between two tax authorities) or multilateral (three or more tax authorities) APAs.

Regardless of the taxpayer’s strategy for managing controversy, controversy itself often leads to double taxation (with the notable exception of successful bilateral or multilateral APAs). Taxpayers typically have recourse to national administrative procedures and the courts to deal with any resulting double taxation. However, cases of double taxation are often better resolved at the international level between the competent authorities of the jurisdictions involved.

Typically, a tax treaty will contain a provision stating that if “taxation not in accordance with the convention” arises, a taxpayer can request the governments involved to enter into mutual agreement procedure (MAP), and “endeavor” to eliminate double taxation. In principle, pursuing MAP should not jeopardize the judicial process, but in practice this may not be the case in some jurisdictions, so careful weighing of the alternatives is important. While many countries have robust MAP programs (e.g., the US, the UK, EU countries and Canada), several countries are still developing their tax administration infrastructure or, in practice, discourage access to MAP.

And, although many countries are currently in the process of adding resources to their APA and MAP capacity, is it probably fair to say that, while MAP provides important double-tax relief in theory, it often falls short in practice? There is a need for improvement in the MAP process, as is reflected in the work undertaken as part of Action 14 of the BEPS initiative (“making dispute resolution more effective”), which will be discussed later.
Prior to BEPS, a taxpayer would assess the factors above and pursue an “optimal path” that balanced its need for certainty and singular taxation with the cost and burden of achieving the desired outcome. For some taxpayers, it might have been entirely reasonable to pursue a purely unilateral/domestic approach, because of ancillary factors (e.g., availability of net operating losses or foreign tax credits), a good track record using these approaches, and cost savings. Such one-off solutions might be particularly attractive when tax systems operated in silos, such that tax jurisdictions would not know the settlements reached by the taxpayer in other jurisdictions. The post-BEPS/post-ATAD environment clearly changed the calculus of managing controversy.

For example:

- The BEPS/EU measures and their different interpretations among jurisdictions will certainly lead to more controversies and substantially higher stakes.
- Enhanced transparency through such measures as the country-by-country and master-file and local-file reporting (including information on all unilateral APAs and tax rulings), and the enhanced automatic exchange of information requirements, such as the EU exchange of rulings that is now in place, eliminates silos. Tax inspectors more routinely share information with each other, often through a liberal interpretation of the “foreseeably relevant” standard, and with no obligation to notify the subject taxpayers. In addition, previously confidential tax-return information risks public release (such as the proposal to publicly disclose country-by-country reporting in the EU).
- Enhanced coordination between revenue authorities, such as joint audits
- More aggressive auditing strategies raise the stakes and the need for resolution: for example, tax authority raids, criminal sanctions and threats to apply alternative measures (e.g., DPT)

Nevertheless, the outcome of MAP procedures is still much less predictable than the outcome of a bilateral or multilateral APA, and therefore more likely to result in a deviation from global tax and transfer-pricing policies. If there is potential for other tax authorities to take this deviation as a given, the global consequences should be considered. Bilateral and multilateral APAs therefore continue to be option of choice.

Postma: Mike, thank you for that excellent analysis of how a company might navigate the controversy process and the options available under what we might call a “file and defend” approach. I’m interested in your comments about the strategies around MAP and APA. Presumably, in determining an approach to a MAP or APA negotiation, the order in which you approach the appropriate tax authorities might be important. Could you comment on that please?

McDonald: You’ve hit on an important point there. It would be sensible to assess, up-front, the experience of the various competent authorities in negotiating multi-country positions, so that the jurisdictions with the most experience, as well as those most critical to a successful negotiation, are approached first. It also makes sense to consider this point when contemplating any changes to a group’s business model or legal relationships in terms of what impact that might have on the resulting MAP/APA network.

Postma: Luis —turning to you —what are your observations about the controversy environment in Asia-Pacific?

Coronado: MAP process in Asia-Pacific generally works and is similar to other locations. The major observation by most taxpayers is the length of time it takes to conclude them.

The need to take a proactive and bi- or multilateral approach, therefore, is significantly greater. Fortunately, access to MAP has been improved as well. The BEPS project introduced a minimum standard on MAP, including many of the best practices identified in the OECD’s Manual on Effective Mutual Agreement Procedures (MEMAP), to which almost 100 jurisdictions have committed.

The multilateral instrument facilitates implementation of these measures into existing bilateral tax treaties, and further includes a mandatory binding arbitration measure to ensure complete relief from double taxation to which over 25 countries have committed. The EU has sought to accelerate and embed these best practices across all EU Member States with the new directive on dispute resolution.
Up to this point, we have concentrated on how companies can manage the controversy process on audit, and in particular the range of strategies—both reactive and proactive—open to companies to defend or resolve matters under contention. In other situations, companies may be encouraged to undertake a more fundamental review of their structure and operations, particularly if there are elements of their operating model that might be inconsistent with a post-BEPS environment.

It is quite positive that a number of the countries that are not OECD member countries have signed up as associate members of the BEPS Inclusive Framework in light of the BEPS project, hence we should be seeing very soon cases that are initiated with the 24-month resolution expectation, and in certain instances a push toward mandatory binding arbitration. APAs generally work in most of the countries that have them in place (with minor exceptions), and more and more taxpayers are considering them as an option to negotiate complicated cases up-front, in a more amicable environment than the “traditional” controversy route. The joint and simultaneous audits we mentioned before could actually turn out to be a new and novel route to prevent and deal with discerning points among tax authorities in a current state approach, as opposed to the traditional one-sided analysis and catch-up. Perhaps it could also contribute to leveling the playing field between the more experienced tax administration and the new entrants to the international tax arena.

Pinzon: I think we do need to mention that what Alex calls the “file and defend” strategy does rely on robust files. Companies choosing this path should carefully review their policies and documentation in light of all the new guidelines and commentaries and not wait to complete their documentation until it is time to defend. Going through mock audits is often a good strategy to determine whether files are indeed up-to-date.

For instance, regarding intragroup services, it will be relevant to understand in detail the importance of a benefit test once a service charge is applied within related parties. You need to document how the receiver of the service improves its business operation due to this service. The cost allocation methods need to bear the various versions of TP guidance in mind. There will be difficulties in demonstrating a benefit of the service if the cost is not assigned objectively to the specific receiver.

Coronado: I agree, and it could make sense, for instance, to proactively establish policies and practices that compare allocated charges against the revenue of the local entity. If the proposed charge exceeds a threshold amount, it should be examined more closely. This review may help with local audits by demonstrating consideration of the impact on local finances. Of course, it has benefits as well for the revenue of the local/paying entity.

Pinzon: Exactly, and we haven’t talked that much about TP on goods, but in Latin America it will be very important to accurately document the actual goods transactions, not only referring to a TP report describing functions, risks and assets involved in the intercompany transaction or related entities, but embedding this into formal distribution agreements that indicate the conditions of the transaction between the parties, including pricing terms, marketing expenses allocation and responsibilities, currency risk and product risk, among others, and to map this information and documentation with objective and quantifiable information.

I would also like to make a brief comment about MAP/APA processes in Latin America. APAs have been included in the transfer-pricing regulations in the major economies in the region. As you may know, there are APA procedures in Mexico, Colombia, Chile and Peru. But only Mexico has developed a more prolific program. I believe it will get stronger and more attractive to clients as a result of the BEPS project. The other three countries have little to no experience with APA procedures—but they will receive more pressure from other tax authorities in the future to get these processes moving forward.

Regarding Brazil, MAP was recently included into tax legislation. The Brazilian tax authority has expressed its willingness and openness to start MAPs. We, at EY Brazil, have been closely discussing with the Receita Federal how we can help to get this process implemented as soon as possible, and I think this MAP is good news when we talk about BEPS impacts on Brazil. MAP is bringing a light at the end of the tunnel regarding the lack of consistency between the arm’s-length principle and the Brazilian transfer-pricing methodology.

Postma: Up to this point, we have concentrated on how companies can manage the controversy process on audit, and in particular the range of strategies—both reactive and proactive—open to companies to defend or resolve matters under contention. In other situations, companies may be encouraged to undertake a more fundamental review of their structure and operations, particularly if there are elements of their operating model that might be inconsistent with a post-BEPS environment. Mat—you have had some experience with groups who have responded by changing their structure. Would you like to expand on the options, please?

Mealey: Before I directly answer that question, I would like to mention a development with policy objectives similar to a multilateral APA, and that is the new OECD International Compliance Assurance Program, or ICAP.
This is a voluntary program that will use CbC reports and other information to facilitate open and cooperative multilateral engagements between MNE groups and tax administrations, with a view to providing early tax certainty and assurance. In our last webcast we discussed the pilot program that is due to be launched, which will involve up to seven jurisdictions.

In the simplest terms, a group of countries will work with the taxpayer to review its CbC reports, and, if all is well, the company will receive assurance that they will not get further compliance interventions for a period of time—at least, not driven by their CbCR reports, assuming such reports do not change materially. Any issues that do require attention will be handled outside of the ICAP program via processes like APAs or, when necessary, a tax audit. I think that while any kind of multilateral approach to providing more tax certainty is an admirable objective, we should also be careful not to overestimate the potential of ICAP. Let me explain:

First and foremost, ICAP only looks at a fairly narrow scope of a taxpayer’s total tax picture—the CbC reports; it focuses on transfer pricing and doesn’t look at the taxpayer’s whole return or tax strategy.

Secondly, only a tiny percentage of taxpayers are likely to be able to access it.

Third, and perhaps more challenging still, is that the program—at least as it currently stands—is only open to low-risk taxpayers. As such, there is a sense that the program is struggling to attract volunteers. It makes more sense to me for ICAP to target higher-risk taxpayers seeking to move lower down the risk spectrum post-BEPS. We will have to see how the program evolves as it moves from pilot to more general release.

Moving on to your question Alex, as we have seen earlier, the changes introduced by the BEPS initiative, together with EU and national measures, such as the DPT, have been so fundamental and wide-ranging that every multinational group should undertake a review of their group structure and operating model to make sure that, going forward, their structure is “future-proofed.” Again, however, there is a wide spectrum of potential options for restructuring. At one end, relatively minor modifications may be enough to iron out—for example, correcting inconsistencies in transfer-pricing arrangements between countries undertaking similar functions or restructuring holding companies affected by the principal purpose test that is now being introduced through the MLI. Although not necessarily minor, we are for instance seeing numerous European-headquartered companies now converting from commissionaires to distributors.

At the other end of the spectrum, very fundamental changes may be required to reorganize business models, where the ownership of IP or current profit allocation is not aligned with the location of DEMPE activities, or where there are other features that would raise interest from tax authorities under BEPS-type reasoning or, for that matter, in the EU from a European Commission’s state-aid perspective.

With these type of business models, the risk inherent in existing structures increases with time and inactivity. Apart from deciding what type of remedial restructuring may need to be implemented, there is also a risk that the transition from one business model to another will in itself generate controversy if tax authorities are minded to argue the case retrospectively.

This may lead, potentially, to long, slow, expensive and destructive disputes in multiple markets, with uncertain outcomes. So this is an area fraught with difficulty for companies seeking an element of certainty—both about their past and future business models. In addition, there are increasing rumors that certain key countries have created an informal grouping (the so-called E6) to exchange information between themselves on new and emerging structures, negotiation and settlement experience. Therefore, an important component of the restructuring exercise will be how to present it to tax authorities and how to come to an agreement on the tax consequences of the transition, with one further element being whether this should be done on a country-by-country basis or on a multi-territory basis.
I thought it would be helpful also to outline a couple of case studies to illustrate the types of issues and remediation strategies we are encountering, particularly in the UK, where these types of discussions are key to negotiating DPT cases.

One focus area is the impact of intermediary countries. Consider a complex group with five functionally rich countries trading with 100 countries worldwide, and also with each other. All trade is via a master-contracting intermediary with limited functions, rather than direct. Pre-BEPS, most controversy was independent and country-specific, and most resolution was unilateral.

The intermediary provided commercial simplification and no tax disadvantage. Post-BEPS, with more emphasis on bilateral APAs and MAP to prevent or resolve disputes, the existence of the intermediary country might complicate, slow down or even prevent bilateral processes from being effective. As such, it may make sense to restructure to remove intermediaries and more closely align the functional footprint of the group with its legal contracting model. That can represent a substantial commercial change.

A different example is profit centers, where the technical analysis supporting profit attribution was a legal/contractual allocation of risk, and where most of the existing transfer-pricing design is based on one-sided single territory analyses. Here, it is urgent and critical to build a multi-sided defense file that supports the return in the profit center by reference to something more than legal/contractual allocation of risk.

Absent that minimum step, in many cases taxpayers may find they are exposed to extended statute of limitations and penalties in the event of a source-country audit. On a prospective basis, that defense might be reinforced with a business-model restructuring, such as on-shoring IP, but the retrospective position is what causes the most difficult controversy and requires the most urgent additional support.

Coronado: I can attest that we have similar situations in Asia whereby, for example, Singapore is sometimes being caught in the middle.

Unexpected consequences

Postma: In the last couple of minutes, as we bring our round table to a close, I would like the panel to briefly cover some of the less-anticipated consequences that can arise in the new environment we find ourselves in.

We already mentioned the potential for lowered permanent establishment thresholds to trap the unwary business traveler and subject have his or her remuneration caught in the tax net of the country of travel under article 15.2.c of the OECD Model Treaty. HR departments and corporate tax teams need to carefully review where potential PE’s arise and whether the remuneration of the traveler could be deemed to be borne by that PE. Katherine, any unexpected consequence on your mind?

Pinzon: Tax authorities are more connected and share more information among themselves that will allow them to get a complete picture of the tax (direct and indirect) framework of a transaction. As we have mentioned before, there are certain intercompany transactions on tangible goods that have impacts on VAT and customs. The recognition of a royalty payment of an imported good will need to be considered in the custom value of the good, for example. This customs-value adjustment will affect the duties base and VAT. Another example will be in a case of a transfer-pricing assessment on imported goods for reselling in the local market.

If the tax authorities consider a higher margin for the audited distributor, and make an assessment on that regard, customs value needs to be adjusted as well, and in many cases a penalty may be applied due to the incorrect customs value declared at the border. In other words, any type of transfer-pricing adjustment needs to be very carefully considered from an indirect tax point of view.
Such an uncertain landscape also affects the value of companies and make otherwise economically sound acquisition decisions less viable. The potentially open-ended tax positions may be a significant stumbling block, in essence.

Postma: Mike, any thoughts from your side?

McDonald: I have already mentioned tax raids and criminal sanctions in this webcast, which I have to imagine are quite unexpected if they happen to you as a result of tax controversy.

But in addition to these type of direct and confrontational elements, past and/or potential future controversies may lead to skittishness in terms of a multinational company’s direct investment decisions or acquisition behavior. For example, it may be unsettling to companies who have reached agreement with tax authorities in EU Member States to have these agreements up-ended by a supra-national authority with which there are no treaty relationships. Such an uncertain landscape also affects the value of companies and make otherwise economically sound acquisition decisions less viable. The potentially open-ended tax positions may be a significant stumbling block, in essence.

Finally, the interaction of increased tax uncertainty with other aspects of international tax policy — such as the potentially significant lowering of the US corporate tax rate — could result in greater on-shoring of valuable intellectual property, to the detriment of offshore jurisdictions and supra-national authorities.

Postma: Thank you, Mike. Mat, any further unexpected consequences?

Mealey: I’m not sure if it is unexpected, but definitely the financial-statement impact of controversy or potential controversy and ensuing penalties need to be taken seriously. This is the insidious aspect of a dynamic interpretation of BEPS Actions 8 through 10, combined with transformed administrative approaches. We see retrospective tax liabilities even where there is no change of law and no change of facts. Fully up-to-date approaches to financial statements provisions allow better communication with analysts and investors as well as anticipating brand and wider public relations concerns.

The provision position also has an enormous impact on the internal perception of historic controversy and the options that can be used to address that controversy when it arises. Transfer pricing is not a scientific discipline. The changing paradigm with which tax authorities look at matters must be continuously reviewed. A very simple example is that TP-related adjustments did not typically lead to penalties in the UK and other countries where the analysis was supported by a benchmarking report, for example. But tax authorities are now starting to say that one-sided approaches to a functional analysis might be “careless,” leading to potential penalties regardless of the quality of benchmarking.

Postma: Katherine?

Pinzon: I think that many tax authorities are getting prepared for this change by further investing in common tools, such as studying and understanding the BEPS reports and creating and deploying practices like the tests mentioned in the CbCR handbook. And, as we see in Brazil, as well as in Russia and Australia — upgrading their information technology and simply ramping-up resources. Companies need to think about their internal controversy management organization and approach, make sure that they have centralized transparency over their processes and — as I mentioned before — be ready with robust documentation.

Key takeaways

Postma: As we close, I would like to thank today’s excellent round table of Katherine, Mike, Luis and Mat. And I would like to give them an opportunity for a final thought or perhaps a key message for our audience. Mike, can I start with you.

McDonald: The information avalanche that is heading in the way of tax authorities around the world — in combination with much closer ties between tax authorities as a result of information exchange agreements, joint audits and the BEPS project process itself — will likely result in a significant increase in incoming enquiries. Corporate taxpayers need to be aware of this, because whether these questions turn into controversy with the tax authorities from many of the BEPS framework jurisdictions will depend on their ability to effectively deal with such enquiries.

Postma: Katherine?

Pinzon: I think that many tax authorities are getting prepared for...
Postma: Mat?

Mealey: There has clearly been a shift from local controversy where disagreement with tax authorities could be dealt with through local settlements or through the local judicial system to multi-country controversy. Much as the transition from single-country transfer pricing to multi-sided transfer pricing, we have moved from single-country controversy resolutions being the ideal approach to now likely being a liability as a result of the coordination and tax information sharing between tax authorities. I would advise companies—as a matter of practical policy—to consider the financial impact of each local settlement, because in effect, it will be a settlement with the rest of world on that issue.

Postma: Finally, Luis?

Coronado: I think what all my fellow panel members are saying—and perhaps this has even been the red line through our entire discussion today—is that a global consistency will be key. Whether corporations have prepared or filed detailed or high-level Action 13 documentation, their supply chains and finance organizations are likely going to be studied and remapped not by a single tax authority, but by interested groups of tax authorities that will share and discuss this information in near real time. In my view, a globally balanced and consistent approach will be key in managing controversy over the next few years.
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