Global tax controversy update

Rob Hanson
IRS organizational and budget update
IRS declining audit trend

Number of Returns Examined, Fiscal Years 2012–2017

SOURCE: IRS Data Book Table 9a
Latest on IRS Leadership

New IRS Commissioner - Charles P. Rettig

- Tax attorney specializing in Federal and State tax litigation
- 35+ year career at small (11 attorney) tax controversy practice in Beverly Hills
- Long time member of the IRS Advisory Council and various State Advisory Boards
- Technical vs Management background as compared to recent IRS Commissioners
- David Kautter remains Assistant Secretary of Treasury
Latest on IRS Leadership (continued)

IRS Chief Counsel Nominee - Michael J. Desmond

- Tax attorney specializing in Federal tax litigation
- Currently a solo-practitioner in Santa Barbara, previously a partner at two large D.C. firms
- Served as Treasury’s Office of Tax Policy’s Tax Legislative Counsel, and as a litigator in the Tax Division at the Department of Justice

Significant turnover in IRS Senior Executive ranks due to retirements – 50% retirement eligible
Overall IRS staffing down, from 100,000 in 2010 to roughly 82,000

- Succession planning crisis
- 40% of overall workforce eligible to retire in 2019
- Fewer than 100 employees under the age of 25
- Less than 1,000 under the age of 30 (many are part-time/seasonal employees)
- LB&I agents staffing fallen from 7,000 in 2010 to below 5,400
- Appeals staffing reduced by over 35% since 2011 (No Appeals Officers in 11 States)
- Revenue officer staffing down roughly 33% since 2011
Budget Woes Continue

- FY17 budget ($11.2B) was lowest since 2007, approximately $1B in cuts since 2010
- 20 percent budget reduction (adjusted for inflation) since 2010
- 70 percent of IRS budget is related to personnel costs
- Virtual hiring ‘freeze’ for past 6 years
- Training budget down from $169M in 2010 to $39M in 2017
- FY 2018 budget provides no relief
  - Treasury Department cut by 4.1%
  - IRS cut $239M
  - Additional $200M needed to keep pace with inflationary costs
2019 Budget – Additional Budget Cuts Proposed

President’s FY 2019 budget proposes base funding of $11.1B vs $11.2 in FY 2018

• Earmarks $2.3B for “running key tax filing and compliance IT applications”
• Proposes additional $15B over the next 10 years to “close tax gap”
• $330M of the $15B ask would be allocated to 2019 – primarily for enforcement and technology
• Per budget request - $15B investment would generate $44B in revenue (net $29B)
• Taxpayer service funding would be reduced by 8.7% compared to 2017 budget
• IRS also requesting $397M over next two years to implement new tax law:
  - 73% allocated to technology and hardware
  - 19% taxpayer assistance and outreach
  - Balance allocated to guidance, forms and publications, etc.
Focusing on MNCs avoidance

No sign of abatement

Your company’s behaviour on tax is devious, calculated and, in my view, unethical. I think you do evil.

Margaret Hodge, UK MP - to Google

“I see people who do not pay the legitimate level of tax in Australia as thieves”
Joe Hockey, Australian Treasurer

We need to use the momentum to fight against base erosion and profit shifting to ensure corporates pay their fair share of taxation; EU ready to be at the forefront of this work (Valdis Dombrovskis)

Tax reform doesn’t touch the issues that are harming developing economies. We see harmful tax competition and the race to the bottom.
Davos 2016
Multinational companies (MNCs) are facing transformed administrative practices, rapid legislative and regulatory changes, and increased scrutiny, leading to increased tax risk and retrospective exposure.

**Legislative/regulatory changes:**
- Tax Cuts and Jobs Act
- Interpretation of Base Erosion and Profit Shifting (BEPS) Actions 8-10
- State-aid risk
- Increased transparency
- Multilateral instrument (MLI)
- Proposals to tax digital assets

**Increased scrutiny:**
- New audit approaches to certain operating models
- No territorial limitations on factual inquiries
- Unprecedented levels of taxpayer information exchange

**Increased risk and exposure:**
- Multi-territorial value chain and profitability analysis
- Joint and simultaneous audits
- Increased litigation risk and complexity
- Reputational risk
- Permanent establishment (PE) risk
- Digital tax administration foot-faults
OECD, EU developments
Major shifts in the international tax area

**Convergence**
- EU anti-tax avoidance directive (ATAD) measures in effect as of 2019
- Multisided approach to transfer pricing
- Transformer change in the transparency environment
- Joint and simultaneous audits
- MLI in effect
- BEPS Member States on Harmful Tax Practices and EU Blacklist target preferential regimes and non-transparency
- Mutual Agreement Procedure (MAP) minimum standard and arbitration provisions
- Implementation of EU mandatory disclosure regime

**Unilateralism**
- Different ways of translating base erosion and profit shifting (BEPS) minimum standards into domestic legislation
- Wide variety of digital and intellectual property (IP) tax measures, including measures to tax digital assets: more weight being given to the market over the IP ownership location
- Significant increase in compliance obligations and in exposure to penalties
- Decreasing scope of taxpayer rights and tax treaty protection
- Domestic anti-abuse provisions overriding arm’s length principle
- Geopolitics and trade policy
Europe: Tax transparency package: exchange advance pricing agreements (APAs)/rulings/Country-by-country reporting (CbCR) Proposal for public CbCR  
New directive: mandatory disclosure for intermediaries and taxpayers  
In pipeline: whistle blowers rules

BEPS Action 14: Transparency on Mutual Agreement Procedures

BEPS Action 13: CbCR, Transfer pricing master/local files

BEPS Action 12: Mandatory disclosure

Foreign Account Tax Compliance Act (FATCA) / Common Reporting Standard

Industry sector initiatives

National-level initiatives

Headquarter country revenue authority

The OECD Multilateral Convention delivered:

- Peer reviewed
- Multilateral exchange
- Automatic exchange
- Importance of quality of data and information
- How to achieve consistent interpretation by all stakeholders?
Dispute resolution

► Transfer pricing and permanent establishment issues lead to most controversy (central services, IP)
► MAP peer reviews start to deliver results
► More transparency on country practices (MAP statistics per country as of 2017)
► EU Arbitration Directive will cover years as of 2018
► MLI objective is to improve MAP and arbitration

Top countries:
1. Germany > 1100 cases
2. United States > 900 cases
3. France > 800 cases
4. Belgium > 700 cases
5. Italy > 400 cases
6. Switzerland, UK, Netherlands, Spain (around 300 cases)
Digital tax administration
Digital disruption of compliance
The shift in focus from returns to data

The traditional compliance model
Request data from accounting
Analyze / prepare / fix data
Calculate adjustments
Prepare form
Submit return
Wait for audit
Cycle time = n + 3 years

The digital compliance model
Extract data directly from source systems
Submit data directly to government
e-audit / e-assess / e-match
Respond to assessments / audits
Tax
IT
IT
Govt

Digital disruption
- Unprecedented volume of information and data being submitted directly to the government (B2G reporting)
- Tax not involved until audit
- Cycle time from transaction to audit drastically compressed

ERP* - Enterprise resource planning software

Cycle time = n + 90 days
Impact of digital tax administration

**Governments require digital data submissions to augment tax reporting**

- Countries have invested in advanced data analytic platforms to **increase compliance and reduce fraud**
- Coalitions (e.g., OECD) are expanding the amount of **inter-country data sharing** allowed

**Resulting in**

**Mexico**

- Increase in tax revenue without increase in rate: **38%**
- Average increase in audit assessment value: **76%**


**Worldwide**

- **16** Tax administrations now using advanced analytics (such as predictive models) to reduce VAT fraud and increase compliance


**Brazil**

- Increase over plan for 2017 audit and penalties collected: **42.5%**


**Rapid increase in the adoption of digital tax administration initiatives**

- Countries are seeing **significant return on investment** on analytic investments through increased tax revenue
- **Initiatives** launched (e.g., BEPS) are becoming mature (June 2018 – Action 13 requirement)
What we’re hearing
Four key themes

Monitoring the changing requirements
► How do we stay up-to-date on all of the current digital tax requirements and upcoming changes so that we are ready to comply?
► How do we plan for the IT changes without negatively impacting other projects in the pipeline?

Data quality and integrity
► How do we build a solution that maintains data integrity and quality, which tax does not control?
► How can we pre-audit data prior to submitting?
► How do we gain visibility to what is reported locally?

Support and skill sets
► How do we help the other functions understand the impact that these changes are having?
► What will the tax and IT resources that support tax look like in the future?

Operating model – roles and responsibilities
► Who ultimately has responsibility for digital tax?
► How do we balance local vs. global processes given the different requirements, and systems?
► How do we gain and maintain cross-functional support?
Recommended approach

Digital tax administration life cycle

Review for readiness for digital reporting

- Defend in digital audits
- Manage, analyze and submit data
- Continuous monitoring
- Informed stakeholders
- Remediate identified challenges and risks

Action steps

1) Perform a readiness review
2) Evaluate your source systems for digital tax enablement
3) Monitor developments in digital tax administration
4) Manage your company’s submissions
5) Be prepared for audits
Today’s agenda

Tying it all together – a global approach to managing tax controversy risks
Implement a customized tax risk management model

Establish strategy, risk and organization
► People:
  ► Design tax governance and organization structure
  ► Allocate roles and responsibilities
  ► Plan and document tax strategy
  ► Set tax risk management framework

Design supporting process & controls
► Document current tax process & controls
► Align tax process & controls to strategy, risk and organization plan
► Integrate tax process & controls with business processes

Implement technology to support process and controls
► Map and capture tax relevant data
► Evaluate, design and implement technology-based solution
► Training
Rethinking the tax function

Some companies are re-evaluating where they can add the most value as an in-house team and where they should work with others to get the right mix of cost and quality.
Better control, efficiency and value

Control
1. Improved visibility over global audit activity
2. Improved audit risk management and reporting – Tax Control Framework
3. Improved oversight and controls

Efficiency
1. Better linkage between audit issues and outcomes
2. Faster identification and resolution of systemic issues or emerging audit themes
3. Better managed and aligned resourcing

Value
1. Free-up in-house team members for more strategic value-added activities
2. Access to knowledgeable local country compliance / controversy specialists
3. Better data-driven insights