

2017-18 Tax Risk and
Controversy Survey Series

From the source

The view from tax
authorities

This report is the fifth in a series discussing the EY global 2017-18 Tax Risk and Controversy Survey. This final installment shares the thinking of perhaps the most important source of this light – the tax authorities themselves. To receive other reports in the series, please visit ey.com/taxriskseries or connect with your local EY Tax contact.

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The increasingly sophisticated capabilities of tax authorities mean “executives need to have a strategic view and global approach to controversy management.”

– Frank Ng
EY Tax Controversy and Risk
Management Services Executive Director

From the source

The view from tax authorities

Taxpayers and tax authorities alike agree that their world is suddenly rife with uncertainty, and the risks associated with that uncertainty are on the rise.

Tax reform in the US in particular is causing businesses around the world to re-evaluate structures and supply chains, and foreign governments to assess the impact on their tax base. This effort comes even as both work to understand and implement recommendations to prevent base erosion and profit shifting (BEPS) made by the Organisation for Economic Co-operation and Development (OECD).

And both taxpayers and tax administrators agree that potential for tax controversy is on the rise, and avenues to settle these disputes are not optimal. This much is clear from separate surveys of taxpayers and tax authorities conducted by EY in 2017. But they don't agree on everything – taxpayers and tax administrators have different concerns and objectives, and don't prioritize the same risks. And administrators from different countries diverge in their concerns as well.

Until the current transition period gives way to a more predictable system for tax administration, multinationals seem destined to struggle to avoid conflict that results in incidences of double taxation or more. The drivers of controversy will become more apparent with time. Among these drivers: more transparency, particularly around transfer pricing, more aggressive audits, the taxation of intellectual property and the efficacy of multilateral alternative dispute resolution programs, such as advance pricing agreements and cooperative compliance programs – some of which have limited appeal even as bilateral programs, according to the survey of taxpayers.

The riskier environment is also prompting leading businesses to refocus their approach to global tax controversy management, even as they struggle to secure and deploy the resources necessary to comply with a rapidly changing digital tax environment. Many tax authorities are developing more sophisticated capabilities to collect and analyze large volumes

of data and have made great strides in recent years to share information on a more routine basis. This means more real-time auditing, more demands for information from taxpayers and less time for taxpayers to respond to these demands. Many taxpayers, by contrast, are struggling to keep up and obtain the resources they need to fully engage with government requirements.

The increasingly sophisticated capabilities of tax authorities mean “executives need to have a strategic view and global approach to controversy management,” says Washington, D.C.-based Frank Ng, an executive director in EY's Tax Controversy and Risk Management Services.

The first four installments in this survey series (collected at www.ey.com/taxriskseries) relayed taxpayers' perspectives on the risk and controversy environment. In the first report, *Tax steps into the light*, we provided overall highlights of the survey and examined why transfer pricing is perceived to be the top risk of multinational companies. The second report, *Out of the dark: navigating BEPS*, explained taxpayers' responses and reactions to the BEPS recommendations and implementation. The third was called *Dimming the glare: trends in tax controversy* and detailed businesses' responses to the fast-changing environment, particularly the shifting focus from lowering effective tax rates to adopting a risk-focused approach of avoiding problems and managing controversies. The fourth report, entitled *Finding your glow: how businesses can optimize their tax function* explored how businesses are helping their people, processes and technology adapt to the challenges they face.

The reports used light as a metaphor for the increased attention on tax in recent years. The beams aimed at tax come from different sources – media, politicians and civic and government organizations around the world. This fifth and final installment, *From the source: the view from tax authorities* shares the thinking of perhaps the most important source on this subject – the tax authorities themselves. Having surveyed businesses for years on these questions, we are now able to provide an in-depth look from the perspective of tax authorities themselves.

Taxpayers and tax authorities are focused on different risks

Taxpayers in our EY global 2017-18 Tax Risk and Controversy Survey told us they perceive transfer pricing as their top source of risk, followed by indirect taxes. Tax authorities inverted those priorities: Tax authorities ranked indirect taxes their highest compliance risk, followed by transfer pricing broadly defined to include goods and services, intangibles and financial services. Taxation of the digital economy was a close third.

It stands to reason that tax authorities are so concerned about indirect taxes – they represent a growing share of tax revenue in many countries and currently are equal to about 13.6% of GDP in the European Union. And businesses shouldn't lose sight of that even as they focus on adapting to tax reforms on the income tax side.

"The disconnect here between tax authorities and taxpayers has the potential to lead to more controversy, because there will be an inherent mismatch of resources and priorities," says Gijsbert Bulk, EY Global Director of Indirect Tax. "If taxpayers don't understand what authorities are most worried about, they might encounter controversy where they aren't expecting it."

But even among tax authorities, there were split perceptions about sources of risk, and the divergence correlated strongly with the size of a country's economy, with Group of 20 (G20) countries perceiving things differently than those with smaller economies. Both groups ranked indirect taxes as their top compliance concern, but the proportion was more pronounced in non-G20 countries. By contrast, transfer pricing was also a bigger concern for G20 countries, with the digital economy ranking third.

Furthermore, taxation of the digital economy ranked second among non-G20 countries identifying their highest compliance risk. And no non-G20 countries identified transfer pricing of goods and services or financial services as a top risk; few said transfer pricing of intangibles was their highest compliance risk.

Tax risk associated with the digital economy continues to be a main focus in the EU, which released a report on March 1 outlining a collective approach to correcting what it said is a "mismatch between where taxation of the profit takes place and where value is created for certain digital activities."

"It makes sense that indirect taxes and transfer pricing continue to be dominant risk priorities; however, the fastest-growing area of concern is clearly around the taxation of digital activities," says Singapore-based Siew Moon Sim, EY Asia-Pacific Tax Policy and Controversy Leader.



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– **Gijsbert Bulk**
EY Global Director of Indirect Tax



"It makes sense that indirect taxes and transfer pricing continue to be dominant risk priorities; however, the fastest-growing area of concern is clearly around the taxation of digital activities."

– **Siew Moon Sim**
EY Asia-Pacific Tax Policy and Controversy Leader

Which of the following represent the highest compliance risks in your jurisdiction?
Please list five (5) in order of highest tax risk first.

Top 5 G20 countries

n=21

- 1 Indirect taxes – including VAT, GST and customs
- 2 Transfer pricing*
- 3 Tax issues related to operation in the digital economy
- 4 Global workforce-related issues, including employment tax risk and social security risk
- 5 Tax credits/incentives/ special tax regimes (IP boxes)

Top 5 Non-G20 countries

n=9

- 1 Indirect taxes – including VAT, GST and customs
- 2 Tax issues related to operation in the digital economy
- 3 Transfer pricing**
- 4 Global workforce-related issues, including employment tax risk and social security risk
- 5 Tax credits/incentives/ special tax regimes (IP boxes)

**Combines results of respondents' ranking of risk associated with transfer pricing of goods and services, financial transactions and intangibles.*

***No non-G20 countries identified transfer pricing of goods and services to be their highest source of risk. However, 33% did identify transfer pricing of intangibles to be their highest source of risk.*

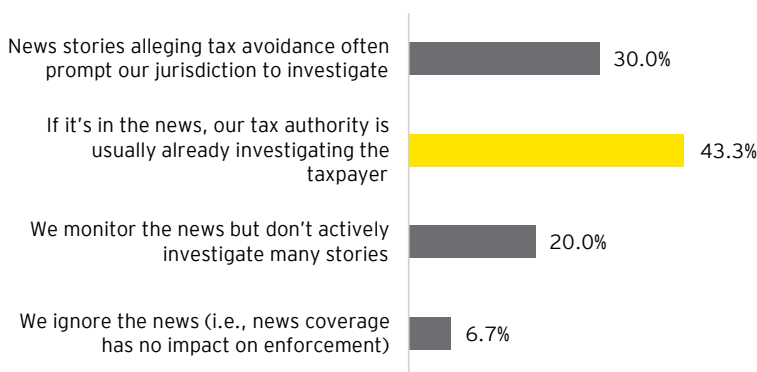
Media coverage of tax matters less to authorities

The survey results show that tax authorities are reacting less strongly to media coverage of business tax in recent years than taxpayers might expect.

EY surveys of taxpayers in recent years showed rising concern about journalists covering their tax payments. Fewer than half of those surveyed in 2011 said they were “somewhat or significantly concerned” about media coverage of business taxes, a figure that increased to nearly 80% in 2014, when such coverage was dominating newspaper headlines. The proportion receded to 60% in 2017.¹

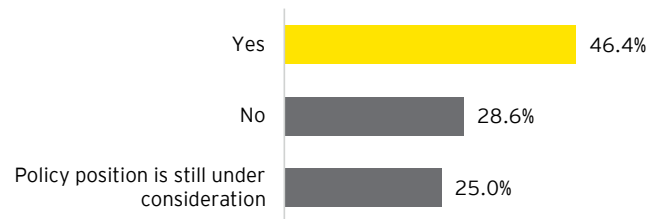
Still, our survey of tax authorities indicates they are less triggered by media coverage than taxpayers appear to believe. Just 30% of authorities said that news stories lead to tax investigations, and 26.7% said they either ignore relevant media reports or don't consider them a reason to investigate a particular taxpayer. That leaves a remainder of 43.3%, who said that if a taxpayer is in the news, it's most likely because they are already under investigation by tax authorities. The overall figures suggest that media does not trigger scrutiny, as taxpayers fear, but that the reverse is true – enforcement activity more often leads to media attention.

To what extent does media coverage (e.g., stories on the “fair share” of taxes paid by companies or their low effective tax rates) affect the way you enforce your jurisdiction's tax laws?



This doesn't mean taxpayers should stop worrying about the press entirely. The survey showed that 46.4% of authorities say their government supports more public disclosure of tax information, and 25% responded that the concept is under consideration. Just 28.6% of respondents told us their governments are not interested in more transparency over tax information. By contrast, 60% of large companies (those with revenues of more than US\$3 billion) said in the taxpayer edition of the survey that they were somewhat or very concerned that governments will soon compel additional public disclosures about how much they pay in taxes in places where they operate.

Does your government support initiatives that would require the public disclosure of taxes paid by businesses?



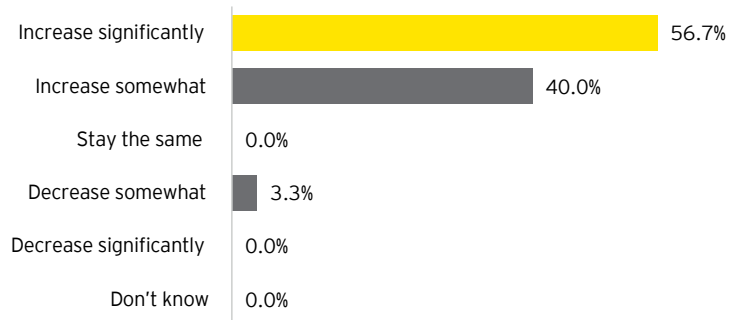
¹From *Tax steps into the light*.



“Businesses need to take these country-by-country reports seriously and give careful consideration to what they disclose and what overall story that information tells.”

– Rob Hanson
EY Global Tax Controversy Leader

In the next two years, do you think disclosure, reporting and transparency requirements globally will:



These projections about public disclosure are timely because of the proliferation of countries requiring country-by-country reporting, a new disclosure in which businesses are required to provide extensive new information about their business activities in all jurisdictions and how that aligns with their tax payments. Increasingly, those reports will be shared between governments under information exchange agreements, heightening the likelihood of public disclosure, either formally or illicitly. With 8% of taxpayers surveyed saying they had been subject to a “name and shame” campaign, there is reason to be concerned about the impact tax controversy could have on an organization’s reputation.

“Businesses need to take these country-by-country reports seriously and give careful consideration to what they disclose and what overall story that information tells,” says Rob Hanson, EY Global Tax Controversy Leader. “And the possibility of public disclosure is just another layer on top of existing concerns that these reports have the potential to spark controversy with one or more governments.”

Dispute resolution programs less popular, but that may change as tax certainty grows



“At best, we could say these programs can be effective in certain circumstances, but they’re not a panacea.”

– Jean-Pierre Lieb

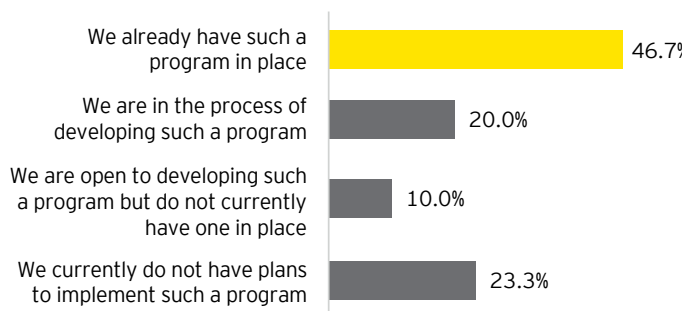
EY EMEIA Tax Policy and Controversy Leader

With controversy on the rise, the need for alternative dispute resolution mechanisms is growing – if those programs can be viewed as mutually beneficial. In their survey responses, taxpayers indicated they were lukewarm about existing programs envisioned as a trade where taxpayers offer more transparency about their business in exchange for more certainty over tax issues.

Taxpayers told us that advance pricing agreements (APAs) take too long to obtain. Pre-filing agreements and cooperative compliance programs are even less popular. The only tools used by at least a quarter of respondents were advance rulings, obtained by 26% of those taxpayers surveyed. However, most companies are still willing to try these options in the future – survey respondents who have used them in the past two years amount to a smaller group than respondents who said they plan to do so in the next two years.

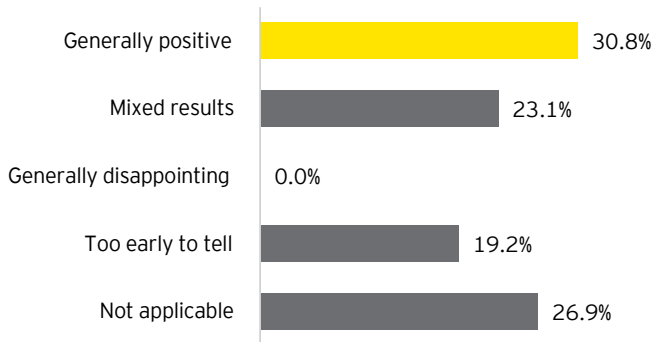
The tax authorities are, at best, indifferent. Most are committed to offering these options, as only 23.3% of respondents said they had no plans to offer cooperative compliance agreements such as the “Horizontal Monitoring” program established by the Netherlands. The program mandates that companies share their tax processes with tax authorities to avoid tax risks. The result leads to more certainty. Twenty percent of authorities surveyed said they were developing something similar to the Dutch program, and 46.7% said they had one already available. A further 10% say they may be open to developing one.

What is your government’s position on the use of cooperative compliance agreements (such as the Dutch “Horizontal Monitoring” program)?



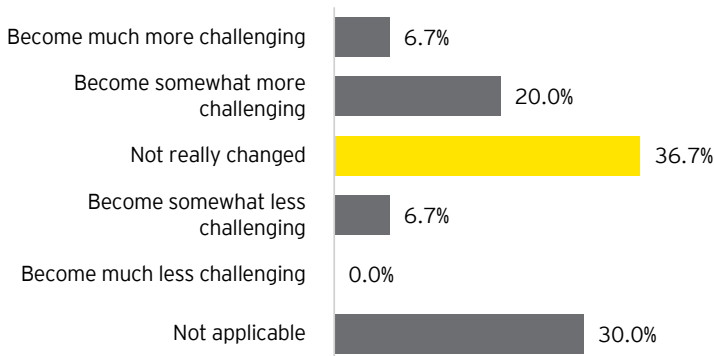
But the tax authorities answering the survey also said they don’t believe these programs will, in most cases, deliver outcomes for both sides that would be considered clearly positive or obviously negative. No respondents said the results were generally disappointing, but just 30.8% felt cooperative compliance programs yielded generally positive results. Another 23.1% said outcomes were mixed. For 19.2%, it’s still too early to tell.

What is your government's position on the use of cooperative compliance agreements (such as the Dutch "Horizontal Monitoring" program)?



Tax authorities' reactions to APAs are similar. We asked how, in the past two years, experiences with taxpayers had changed after APAs were concluded. Just 6.7% of respondents said these made taxpayer/tax authority relationships less challenging. A total of 26.7% said the relationship become more or much more challenging, and another 36.7% reported no impact.

In the past two years, how has your experience with taxpayers changed with respect to concluding an advance pricing agreement (APA)?



"At best, we could say these programs can be effective in certain circumstances, but they're not a panacea," says Jean-Pierre Lieb, EY EMEA Tax Policy and Controversy Leader. "It is possible enthusiasm for these programs may increase in coming years as taxpayers better understand new rules and regulations resulting from the implementation of BEPS."

"If we mutually want a world where there are fewer inadvertent disputes between authorities and taxpayers, the onus is on the tax authorities to give more concrete guidance to the market."

– Jeremy Hirschhorn
Deputy Commissioner for Public Groups
at the Australian Taxation Office

Will governments move to improve these programs, or offer new ones? Both options seem unlikely if legislatures need to sign off, says Jeremy Hirschhorn, Deputy Commissioner for Public Groups at the Australian Taxation Office. “When it comes to the detail of implementation, and dispute resolution practices are part of that, we test the ability of parliaments to truly understand the nuances of those topics,” he says. That’s if they can be convinced to pay attention. Legislators are usually more interested in the policy elements, such as tax rates, than they are in how implementation functions. That puts the pressure on tax authorities to find a way to make things work. “If we mutually want a world where there are fewer inadvertent disputes between authorities and taxpayers, the onus is on the tax authorities to give more concrete guidance to the market.”

The latest attempt to do so is a pilot program from the OECD called the International Compliance Assurance Program (ICAP). The program comprises eight countries that are offering a voluntary option to use the country-by-country reports generated through the BEPS process to facilitate cooperation between multinationals and tax administrations. Launched in January 2018, it is billed as an opportunity for a company to explain its report to one tax administration, which will then work with other relevant tax administrations to ensure all are clear on the company’s actions related to cross-border risks, such as transfer pricing risk or permanent establishment risk. Any questions for the taxpayer can be mutually agreed on by the tax authorities, and the process ideally ends with assurance letters issued to the company from the tax authorities in key areas. Participating countries include Australia, Canada, Italy, Japan, the Netherlands, Spain, the United Kingdom and the United States.



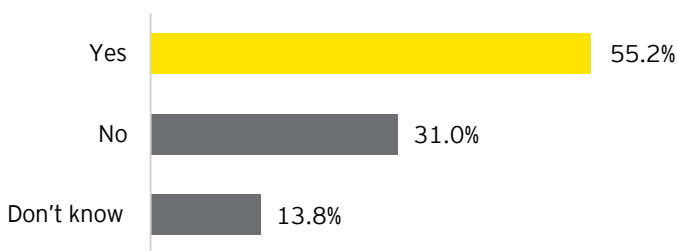
“Now that they will all be looking at the same data, and seeing what a company is doing worldwide, we predict a further increase in simultaneous multi-country controversies.”

– Mat Mealey
EY EMEIA International Tax Services Leader

Intangibles seen as source of risk

The tax collectors surveyed generally agree with taxpayers that intangibles are becoming an increasing source of risk. Taxpayers ranked transfer pricing of intangibles as the second-highest source of risk in the next two years, with 47% of taxpayer respondents expecting to have disputes. Tax authorities' responses corroborated that private sector prediction, as 55% of them confirmed an increased focus on how intangibles are taxed. Thirty-one percent of respondents said they had not intensified scrutiny over intangibles; 13.8% said they didn't know.

In the past two years, have you increased your focus on issues related to the tax treatment of intangibles?



This is an area with uncertainty coming from several sources, particularly as countries implement the BEPS recommendations. The country-by-country reporting mandate is one pressure point, says Mat Mealey, EY EMEA International Tax Services Leader. "Now that they will all be looking at the same data and seeing what a company is doing worldwide, we predict a further increase in simultaneous multi-country controversies," he says. "Multi-country, multi-issue controversies are becoming much more common, and they don't always respond well to traditional single-country approaches to management and resolution," he says.

US tax reform is another variable in the equation. With America moving to a territorial-type system and mandating the repatriation of overseas cash of US multinationals, there are likely to be reactions from other countries, especially as multinational company supply chains and structures adapt to new rules.

"The new international tax provisions in the US law make a number of meaningful changes to tax rules concerning intangibles," says Michael Mundaca, Co-Director of the Ernst & Young LLP National Tax Practice. "As a result, business models will need to be adapted to the new environment as companies analyze the overall impact on business operations."



"Business models will need to be adapted to the new environment as companies analyze the overall impact on business operations."

– Michael Mundaca
Ernst & Young LLP National
Tax Practice Co-Director

Calls to action

1 | Bring your tax technology up-to-date

With governments keen to address indirect tax and digital tax administration on the rise, it will be important to have information technology systems up-to-date and able to respond to requests from tax authorities in real time or near real time. It will also be important to know where your potential controversies fall on tax authorities' priority lists. They will be less likely to allocate their scarce resources to unique problems, instead looking to challenge arrangements that could apply to many companies.

2 | Adopt a global approach to managing tax controversy

The transparency trend, and the potential for news stories to create reputational risk, suggests that tax controversies should no longer be left to local offices that best know their country's tax authorities. These have the potential to be global problems, and a controversy with one country could quickly become a controversy with multiple countries. For that reason, a global approach is necessary.

3 | Take a strategic approach to dispute resolution programs as BEPS certainty grows

Neither taxpayers nor tax authorities are strong believers in the dispute resolution tools available to them, and that calls into question the basic trade-off for companies – certainty on tax questions in exchange for sharing more details about your business. All of these programs can be very effective tools, under the right circumstances, which means that companies will have to evaluate cooperative compliance programs, APAs and other alternatives on a case-by-case basis for fit and purpose.

4 | Monitor – and adapt quickly to – policy shifts and law changes around the world

The 2017 US tax reform was the biggest change in the world's largest economy in 30 years. And companies that do business in the US are actively analyzing the impact on their operations. In addition to BEPS implementation around the world and the changes that will bring, many countries may react to the US law with tax reforms of their own. The current cycle of tax reform globally could fundamentally shift tax rules as we know them today, setting the stage for more uncertainty and controversy.

Conclusion

This survey of tax authorities brings to a close our 2017-2018 Tax Risk and Controversy Survey Series. Over the last year, we used results from a survey of 901 tax and finance executives in 69 jurisdictions across more than 17 industries to chronicle how businesses are reacting to a rise in tax controversy worldwide. This final report relays the views of tax authorities on many of the same issues.

The series has made clear that we have entered a new era of tax controversy, as governments and taxpayers alike adapt to enhanced transparency measures and new reporting requirements, many brought about by global efforts to curtail perceived base erosion and profit shifting.

The series has outlined dozens of specific actions businesses should take to successfully manage multi-dimensional, multi-country tax controversy. But as governments continue to implement their own versions of recommended actions and tax authorities begin to receive and share unprecedented amounts of information, one thing is abundantly clear: businesses should develop a cohesive global approach to tax risk and controversy management. Because companies cannot opt out of this increasingly interconnected tax environment, the time to act is now.

To read all the reports in this series, please visit ey.com/taxriskseries.

Survey methodology

The survey was conducted between June 2017 and December 2017. It was distributed via email and conducted using an online tool in English. Routine reminders were sent out to respondents who had not completed the survey. Once an adequate number of responses had been recorded, the survey was closed. The respondents included 29 administrators and policymakers and one elected official from a total of 21 countries. Figures contained in the report may not add to 100% due to rounding, the non-reporting of "don't know" responses and some surveys in which questions went unanswered. Questions with fewer than five respondents are not reported in the interest of data confidentiality.

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