How do you adapt to the changing tax risk landscape?

Our 2021 EY Tax Risk and Controversy Survey identifies three ways Tax leaders can manage increasing tax risk and controversy.
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Build your future today
Many businesses — of all sizes, but especially the very largest — have not adjusted fully to ongoing, dramatic changes in tax authority scrutiny of their affairs, according to respondents to the 2021 EY Tax Risk and Controversy Survey. And change may be far from over: 53% of tax leaders expect greater enforcement in the next three years, especially as governments begin to address budgetary pressures arising from responding to the COVID-19 pandemic.

This report is part of our Tax Leaders Imperative Series, which provides critical answers and actions to help you reframe the future of your organization. For more insights for tax leaders, visit ey.com/taxleaders
Recognize the part tax plays in long-term value creation for the business and the risk tax disputes present to both the bottom line and company reputation

Align people, processes and technology to help the business not only manage but predict and pre-empt inquiries, disputes and litigation

Understand that taking a proactive, forward-looking approach may require fundamental change: creating the tax controversy department of the future through the implementation of three solution areas:

- **Tax risk assessment:** predicting and addressing tax disputes before they occur by sustaining the comprehensive assessment of all tax risks facing the enterprise.
- **Tax risk management:** establishing a framework to prioritize and mitigate the impact of tax risks that do arise, noting any potential knock-on effects.
- **Tax audit, dispute and litigation management:** mitigating financial and reputational risk to the enterprise by using a range of tools to secure quick and effective resolution of disputes.

Time is of the essence. The pace and volume of tax change is relentless, and digitalization is disrupting the decades-old tax compliance life cycle. The way in which tax auditors collect information, risk-rate businesses and then select and audit them has and is shifting, with human interpretation being supplemented by data analytics, machine learning and artificial intelligence.

Survey respondents also say that they now see a far more diverse tax risk environment. This spans a spectrum – everything from the scrutiny of routine, commercially sound activities to major, billion-dollar settlements in court. But it also includes a middle ground of sorts – the opportunity for more open, transparent and collaborative relationships with revenue authorities.

Looking forward, a second crescendo of tax enforcement change is building. Concerns about the efficacy of untested dispute resolution processes related to potential new ways to tax cross-border activity may add to future tax risks. At the same time, unprecedented pressure on governments to decrease budget deficits arising from their responses to the COVID-19 pandemic is already creating new hazards in many jurisdictions.

All things considered, there is an urgent need for tax leaders to respond, and this report details exactly how they can take the initiative – by building their tax controversy department of the future.
Taxing new demands

Tax authorities have become exponentially more sophisticated in the six years since cross-border tax rules began to be significantly overhauled. Survey respondents say authorities are collecting and analyzing fresh data from new transparency and disclosure submissions, sharing that information with each other via automatic information exchange protocols, thus extending their view across the entire footprint of the business.

And tax authorities everywhere, from the most mature to those in emerging markets, are digitalizing, transforming their ability to understand complex value chains and using data analytics to examine companies from every angle. In some cases, tax authorities know more about a company’s tax or customs activities than the company itself.

This increased scrutiny comes at a time when businesses are seeking to satisfy all stakeholders, both by answering their calls for disclosure and continuing to deliver long-term societal value. Tax is now a central part of that strategy, with many businesses maintaining a clear policy around external publication of tax strategy, policies and other data. In some countries it’s a legal requirement, while in others, businesses are making a proactive and prudent decision to do so.

“By developing a clear narrative about their tax profile, companies have the opportunity to give stakeholders the full picture of the contributions they make to public revenues and social services through the taxes they pay,” says Kate Barton, EY Global Vice Chair - Tax. “Being proactive on this will help the company advance its broader focus on creating long-term value for shareholders, customers, employees, and the communities it serves.”

The stakes for tax leaders are high. From the perspective of the wider business, those who fail to prepare may face new financial exposure from higher tax assessments, double taxation and penalties (often punitive), interest and surcharges resulting from challenges to new and existing ways of operating.

Reputational risks associated with tax controversies can also spill into the public domain, creating a deeper impact on business, particularly for those with well-known brands or focused on building long-term value. In fact, 35% of respondents expect higher levels of reputational risk for business in the next three years.

At the operational level, tax leaders of affected businesses will have to divert attention away from core tax function purpose, instead responding to inquiries and managing disputes. Perhaps of even more concern is that around four-in-ten respondents in both Asia-Pacific and Central and South America say they are concerned about possible tax-related criminal charges being imposed – something that is already occurring in a growing number of countries.
The value of tax technology

Tax technology can be an effective tool in supporting global tax risk and controversy management.

All tax leaders should have access to dashboards listing and visualizing all active inquiries, disputes and litigation. Without them, the prioritization of disputes – critical to both effective tax risk assessment and tax risk management – cannot be provided. Reaching such a state requires finding and then implementing tools that have broad functionality and flexibility, allowing incoming inquiries to be logged, responses largely automated, case facts stored, and possible future disputes identified via the analysis of all available data.

Such systems are no longer out of reach. Leading practices in this area include building them or leveraging tools provided by their professional services providers, such as the EY Tax Audit and Controversy Management (TACM) solution that integrates people, process and technology.

Businesses at the top end of the tax risk and controversy management maturity model are also finding tax data collected for compliance and reporting purposes is valuable for predicting future disputes. It can contribute to a more informed understanding of financial health, making it an important part of the sustainable business practices underpinning long-term value.
Building the tax controversy department of the future

Using a global framework can address and help mitigate risk more effectively.
The sheer pace and volume of tax change means there is only a limited window of opportunity for leaders to fully prepare the tax department and wider business for the plethora of converging trends. But respondents indicate they are largely unsure of how to pre-empt challenges. Disputes arising three years from now will be so different from those of today that it makes them difficult to predict. “It’s absolutely crucial to refresh your tax risk and controversy management strategy, putting in place new strategies now,” says Luis Coronado, EY Global Tax Controversy and Transfer Pricing Leader. “That’s how you get ready to provide answers in the coming years, when revenue authorities will request substantial amounts of detailed evidence about a specific structure or transaction you put in place today.”

It’s absolutely crucial to refresh your tax risk and controversy strategy, putting in place new strategies now.

Luis Coronado, EY Global Tax Controversy and Transfer Pricing Leader

So, how do tax leaders put themselves in a better position to spot risks before they become disputes? By investing in better tax technology, businesses can proactively plan for and respond to the risk of tax controversy. This includes creating or improving tax controls and taking full advantage of available dispute prevention and resolution programs.

But the businesses that really thrive in the period ahead will be those that are properly and progressively assessing the spectrum of leading practices their peers adopt and, in turn, implementing them quickly, globally and with strong resolution across all phases of tax controversy work. In short, they’ll build their tax controversy department of the future, now.
A well-defined, commonly agreed, global tax risk and controversy management approach will incorporate as many leading practices as possible across the spectrum of tax risk assessment, management and dispute resolution activities.

"A well-defined, commonly agreed, global tax risk and controversy management approach will incorporate as many leading practices as possible across the spectrum of tax risk assessment, management and dispute resolution activities," says Jean-Pierre Lieb, EY EMEIA Tax Policy and Controversy Leader.

That approach should be underpinned by consistent, globally agreed processes and supported by robust tax technology that not only tracks and manages ongoing disputes but also predicts where and on which issues future tax audits or litigation may occur. And with 74% of survey respondents saying the digitalization of tax administration processes has increased overall tax risk for their department, businesses and their tax leaders will need to work hard — and invest soundly — to keep up.

Transformation to a future state tax risk and controversy management strategy will require deliberate investment and committed action by companies, especially those that may not already be building such an approach. The build-out doesn’t need to happen overnight, and leading practices can be implemented individually or in phases. But failing to understand the critical consequences — or taking no action at all — may have a deep, detrimental impact on any organization.

Developing and documenting a global framework can help ensure consistency in implementing and then sustaining a tax risk and controversy management approach. It can also help drive more value, both financial and results-focused, from a company’s external advisers, defined in the survey as tax providers, law firms and other third-party service providers.

In many cases, a broader, and potentially complementary, framework may already be in place, such as a Tax Control Framework (TCF). Such a framework is maintained by 50% of survey respondents and can provide a solid place from which to start the transformation of tax risk and controversy management. However, implementing and sustaining a TCF can be challenging. Among those with one in place, 27% didn’t achieve their desired results, while 56% said their TCF was too resource-intensive to sustain.
Those who stuck with their TCF reported solid benefits: 75% say they have substantial or full visibility of all tax disputes globally, 10 percentage points higher than those without one. TCF adherents say they are also almost twice as likely to proactively execute processes designed to reduce tax risk before a return is filed — such as running pre-filing data analytics — than those without one. Finally, respondents with a TCF also say they feel their C-suite is more than twice as likely to be fully aware of risks — such as BEPS 2.0 and its implications. And with investment in the tax department always needed, that may be helpful.

Expanding any current strategy (including those centered on a TCF) to include more leading practices in the area of tax risk and controversy management will assist and better enable tax leaders transitioning to the tax controversy department of the future. Those who take the most proactive, forward-looking approach will understand they need to change, and will find ways to do so.

What is a Tax Control Framework?

A centrally governed TCF sets out the activities, tools, processes and organizational arrangements that can help increase the likelihood tax risks are identified, assessed and understood, and that appropriate responses are activated to mitigate the impact of such risks. They typically apply to all taxes, not just those on income, with different processes for direct and indirect tax management. Ideally, tax risk management processes should also be embedded in the wider risk assessment and management processes of the group. Only that will help ensure that tax risks are treated at par with any other risk the business is facing.

Businesses already building the tax controversy department of the future should be focusing on three key solution areas:

1. **Tax risk assessment**
2. **Tax risk management**
3. **Tax audit, dispute and litigation management**
Assessing tax risk

How to identify what key tax risks the company may face, and where.
An effective global tax risk and controversy management approach begins by undertaking a comprehensive assessment of all tax risks facing the enterprise. Doing so enables tax leaders to prioritize active disputes to be closed, and in which order, during the later tax risk management phase of work.

The primary objective of tax risk assessment is to do everything possible to stop tax controversy before it occurs. It is delivered via top-down governance, systems and processes that enhance monitoring, compliance and dispute prevention efforts. Naturally, this will be an ongoing and evolving process. A one-off snapshot of status is only useful until things change, which is often and quickly.

Alongside commenting on how they assess tax risk on an ongoing basis, survey respondents identified what tax risks they see today. Their responses fall into three broad categories:

1. Ongoing concerns that have been identified in past surveys, with transfer pricing again the leading tax risk identified.
3. Issues associated with the OECD’s Base Erosion and Profit Shifting (BEPS) projects.

Transfer pricing has been identified as the biggest source of tax risk in all previous EY Tax Risk and Controversy surveys, and again in this one. “That’s not a surprise, given the supply chain upheaval resulting from global trade disputes and the far-reaching changes in the global legal framework which arose from the BEPS rewrite of the OECD transfer pricing guidelines” says Ronald van den Brekel, EY Global TP Market and Innovation Leader. “On top of these changes, tax leaders will also need to address potential future scrutiny of the transfer pricing aspects of profit volatility and changing benchmarks against independent parties – things that have definitely been skewed by the COVID-19 pandemic.”

How the COVID-19 pandemic is driving new tax risks

Since the start of the pandemic, tax authorities have been important deployers of support and stimulus. Support manifested not only through employment support programs, cash payments and loans, but also the provision of administrative relief. This included delaying tax filing deadlines, deferring the payment of certain taxes and, importantly in the area of tax risk management, suspending tax audit and litigation activity. It is expected that by the end of 2021, most revenue authorities plan to be policing tax at full strength. But respondents report concerns across several pandemic-related tax issues, and audit scrutiny of such issues is already occurring in several jurisdictions.

For example, the tax risks resulting from mobile workers have already been experienced by 45% of respondents. This reflects travel and immigration changes and subsequent permanent establishment and employee tax/social security risks. At the same time, enhanced scrutiny of COVID-19-related tax issues such as losses and refunds has already been experienced by 39% of respondents, rising to 48% in Asia-Pacific and 52% in Central and South America. All such issues (and more) are likely to drive new tax audit activity in 2021 and beyond.

Increased enforcement

53% say they expect higher levels of tax enforcement in the coming three years.
BEPS (both the 2015 Action Plan and the OECD’s ongoing project on the tax challenges of the digital economy) also feature prominently as areas of tax risk. Thirty-one percent of respondents foresee increased tax risk from BEPS 2.0 in the coming three years.

“That’s a figure lower than one might have expected,” says Barbara Angus, EY Global Tax Policy Leader. “It may reflect the fact that many taxpayers don’t expect any measures to be implemented within the three-year period the survey question covers, or perhaps respondents did not focus on how the proposed measures could have such broad effect, well beyond the ‘digital’ in the project name. Or it could well be that tax leaders are experiencing a bit of ‘BEPS fatigue.’”

Notably, more than three-quarters of respondents report that national level legislative reform has increased their tax risk exposure – but only 47% say they actively track new tax policy developments on an international scale.

“That’s a disconnect,” says Marlies de Ruiter, EY Global International Tax and Transaction Services Policy Leader. “And it’s surprising, given that international tax policy developments are and will be driving national level legislative reform and, potentially, future controversies. A comprehensive approach to knowing what is coming is essential. The first step for businesses should be to set up a process to make sure that tax changes in their key markets are being actively monitored.”

Looking forward, higher levels of unilateral tax measures are also expected in the coming three years by 44% of respondents, who highlight topics such as withholding taxes, evolving transfer pricing interpretations that differ from OECD guidance, and a tax measure hitherto absent from our surveys: Digital Services Taxes (DSTs) – themselves now starting to be the subject of new tax audits in several countries.

Geographically, Europe is viewed by respondents as posing the highest tax risk to businesses in the coming three years, although the Americas and Asia-Pacific were close behind. Likewise, survey results indicate Europe is also the region where the highest number of survey respondents plan to invest differentially to improve tax controversy outcomes during the same period.
Tax risks from inside the company

Not all tax risks come from outside the business. Improved communication inside the company can be a useful way for tax leaders to help ensure their department stays current with business strategy, new investments and any decision-making affecting the taxes the company must pay. Such communication can be “horizontal” with other business units, commercial and supporting departments or “vertical” with the C-suite, board and audit committee. The good news is most respondents say their C-suite’s oversight and interest in tax risk has grown in the past three years.

While it may be time-consuming (and a potential candidate for service-provider assistance), developing a program of mock tax audits to scrutinize particular transactions, structures or positions can be one of the best ways for tax leaders to stress test controls and defenses. Yet just 28% of respondents do so today, and only 37% routinely test their own tax filings using data analytics. That figure will probably rise as more tax leaders hire professionals with new skills in data analytics, machine learning and artificial intelligence— all part of the broader transformation of how tax is managed. But much can be done today to improve early warning signs.

The importance of tax technology in assessing risks cannot be understated. Sophisticated tools now provide globally accessible platforms that allow tax and finance personnel anywhere to log any tax authority touchpoint — everything from inquiries and data requests to audits, mutual agreement procedure (MAP) status and litigation updates. A comprehensive system can track every type of contact, help enable the prioritization of disputes to be closed and provide efficiency and effectiveness in responding to tax authorities.

Tax risk assessment

28%
say they conduct mock tax audits
Managing tax risks

How to mitigate tax risks and controversies by managing them in an effective, consistent manner.
Leading practices in this area suggest using a variety of tools to help respond to increasingly forensic, multisided (i.e., looking at taxpayer data from more than one country) and whole-of-group tax audits. Such audit approaches are leading more and more businesses to proactively build and sustain tax administration-ready, substance and business activities-based comprehensive files of tax documentation that support key transactions, structures or tax positions.

Such files – which 53% of respondents report maintaining – typically comprise background documents, opinions, functional interview notes, meeting and call minutes, and emails – all things that tax auditors will increasingly demand more of in the future.

When a new inquiry or data request is received from a tax authority, it is critical that the tax department has a process to clearly and quickly classify it, assess the level of risk it may present and apply pre-agreed procedures that address the different types and levels of revenue authority inquiry. Forty-seven percent of respondents follow such an approach today. Again, technology can support this activity.

Effective tax risk management is the second phase of building the tax controversy department of the future. It establishes a framework approach to prioritize and mitigate the impact of tax disputes, noting any potential spill-over effects across different tax years or geographies. Leading approaches in this area will be consistent but flexible, globally implemented, supported by senior executives and agreed to by all participants.

Tax risk management often involves engaging with external providers and tax authorities, highlighting the importance of strong communication and relationships in these areas. Technology again plays a critical role, providing the platform on which to store and analyze tax positions.

The importance of documentation

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Shadow analysis

37% of respondents run their own data analytics based on those they think are used by tax authorities.

Technology can also allow tax leaders to take advantage of standardized responses to routine inquiries. These responses can be stored within the technology platform, available to finalize and use as soon as an inquiry is received.
Dispute prevention tools

The taxpayer-tax authority relationship need not be adversarial. Instead, it can be based on trust, transparency and communication — though well more than 200 respondents report they believe the negative attitudes exhibited by some revenue authorities toward multinational corporations (MNCs) are the leading barrier to effective management of disputes.

Such attitudes aside, most tax authorities offer programs that can help reduce the likelihood of tax disputes occurring before a tax return or other filing (such as a transfer pricing report) is lodged. Among others, these include tax rulings (the most effective dispute prevention tool, according to respondents), advance pricing agreements (APAs) and accelerated Competent Authority negotiations.

Cooperative compliance programs usually occur in real time. In a relatively recent development, the OECD’s new International Compliance Assurance Programme (ICAP) centers on review by a multilateral group of revenue authorities of an enterprises’ country-by-country reports. This can result in a reduced scrutiny approach for a time (usually two years) if a company is deemed to be low risk — and assuming that the company’s material facts do not change during that two-year period.

Active participation in such programs can deliver many benefits, including fewer unexpected disputes, the mitigation of penalties, interest and surcharges, and the possibility, when successful outcomes are achieved, to reduce the tax provision.

From the perspective of the tax leader, such methods can free up tax personnel to focus on key activities, and support a virtuous circle by establishing better, more transparent relationships with key tax authorities. But they may not be the right fit for every company, and advice should be taken on the pros, cons and overall investment of time and resources that may be needed if they are to deliver expected outcomes.

Survey results indicate relatively low utilization of such programs, with only 40% of respondents saying they execute a clearly defined, proactive cooperative compliance strategy. Fewer — 35% — report executing a clearly defined, proactive, well-resourced strategy to secure APAs. Looking across expectations for the coming three years, the ranking is similar — though bilateral and multilateral APAs are aspirational targets for respondents, reflecting the move toward more multilateralism in tax. These figures will need to increase if companies are to successfully manage the potential tax risks emanating from a new set of changes to cross-border tax rules.
Managing tax audits, disputes and litigation

A holistic approach combined with the right tools can secure effective dispute resolutions.
Tax audit management focuses on securing quick and effective resolution of disputes and covers tax audits, exam management, appeals, mediation, arbitration, the use of processes such as MAP, and, as the final option for many businesses, litigation.

Effective tax dispute management includes ensuring that the multiple steps of a tax audit, dispute or litigation case is handled in a consistent manner. This in turn helps to ensure that the interests of the business are protected in the most cost- and resource-efficient ways. The result is that teams have more time to focus on other, value-adding activities.

Such an approach can be beneficial across the spectrum of different dispute types and might contain an extensive range of individual process steps covering topics including audit preparation, information provision, position formulation, dispute negotiation, dispute settlement and post-dispute tasks to complete. Leading practice on this issue also includes assigning who will be responsible for, accountable for, consulted on and informed about each individual step taken. And while every tax dispute is unique, 57% of respondents report using a set of largely consistent process steps today.

Tax technology also plays an important role in tax audit management. The right tools enable tax departments to log each individual step of the tax audit or litigation management process into a central platform, empowering tax department leaders to gain global visibility over both status and total financial exposure. Likewise, leading practice suggests that any settlement data should be stored, providing better indications of the potential cost of any future dispute on the same topic.

Addressing each new dispute should commence with clear thinking about the overall approach the company wishes to take.

Dispute resolution tools

Dispute resolution tools and programs – a rapidly growing area – play a key role in tax dispute management.

“Understanding the time tax litigation takes up and the impact unresolved double taxation can have on major investments, the OECD and countries continue to invest significant time and effort to improve MAP,” says Joel Cooper, Transfer Pricing Controversy Leader of the EY Global Tax Desk Network. Cooper adds that while MAP challenges do remain, especially where complex, integrated value chains are present, “there is a definite sense of hope among the global tax community that MAP will continue to improve over time.” But only 35% of respondents report actively using MAP wherever possible, rising to 39% among the largest companies.

There will always be barriers to effective dispute resolution, with such obstacles more likely to come from outside the company, say respondents. The leading barriers reported are the overall complexity of cross-border tax law (24%), the negative attitudes of some revenue authorities toward MNCs (19%) and a lack of willingness to compromise by some jurisdictions (16%). Few respondents report internal barriers, indicating that work clearly needs to continue to build more trust between taxpayers and revenue authorities.

Entering litigation is typically – but not always – a final step in the tax audit management process. Litigation can sometimes be viewed as a necessity in some jurisdictions, and the ability to litigate should always be considered within any tax risk and controversy management strategy. In fact, 40% of respondents say they follow a clear protocol on when to engage a litigation-focused strategy on each individual dispute.

Finally, when settling a dispute in one jurisdiction, a company would do well to consider, and mitigate, any multiyear and multijurisdictional spillovers. By doing so, the likelihood of new disputes being triggered elsewhere is lessened. But 59% of respondents do not follow such practices.

Legal

40% say they have a clear protocol on when to litigate tax disputes
Business taxpayers will continue to be under intense scrutiny from both governments and the public. Action should be taken.
Survey respondents report that they are twice as likely to handle active disputes centrally as opposed to regionally (34% versus 17%). Centralization is even more prevalent among the survey’s largest businesses, where 51% manage the most important disputes at headquarters level. This may reflect the need to ensure that while regional tax departments (which may have fewer deep technical specialists or litigators) have a key role to play in identifying and reporting new disputes, cases with the most complex circumstances, biggest financial risks or the need to pursue litigation are properly resourced and managed.

Centralization can also mean consolidating the number of external service providers used, thus increasing efficiency, control and visibility. Most respondents (47%) reported using between one and four professional providers to manage all disputes globally, while just 14% use 11 or more.

Improved communications and relationships with other parts of the business and external stakeholders (such as competent authorities) will also support transformation. Internally, this should include the C-suite, business strategy or commercial units, working to ensure that key information is taken into tax compliance, tax planning and tax controversy risk assessment processes.

Two-thirds of survey respondents (66%) say tax risk and controversy has become more important to their company in the past three years. If the 53% of all respondents who foresee increased tax enforcement levels in the coming three years are right, that number could increase. Businesses in the Media and Entertainment (57%), Oil & Gas (59%), Telecommunications and Life Sciences sectors (both 68%) all have even higher expectations that tax enforcement levels will increase.

Some characteristics of the future enforcement landscape look to be crystallizing already. Firstly, tax authorities may actually know more about a company’s global tax affairs than the taxpayer themselves. Secondly, businesses will be expected to provide far deeper evidence – sometimes to forensic levels – to support their filings and positions. And thirdly, there will be more multilateralism in tax, both in terms of enforcement itself but also in available dispute resolution opportunities.

The composition of tax risks can and will change over time. But regardless of whether the future brings a greater focus on financial transactions (already noted by 43% of respondents), the denial of certain deductions or the disallowance of payments to certain jurisdictions, those businesses that take a global, strategic approach to tax risk and controversy management will be better prepared than those who don’t.

Five steps to take now to help mitigate tax risk and controversy

1. Understand how tax contributes to the long-term value of your business and how disputes and controversy can jeopardize that value.

2. Monitor and have an action plan for ongoing tax policy and administrative developments - past, present and future.

3. Build your tax controversy department of the future - either around a Tax Control Framework or as a new series of leading practices.

4. Invest in the necessary digital and technology tools that allow you to prepare defense files, analyze your data and manage all tax authority interaction.

5. Proactively assess and utilize all suitable dispute prevent and resolution programs.
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