KPMG

The global tax disputes environment

How the tax disputes teams of multinational corporations are managing, responding and evolving

Global Tax Disputes benchmarking survey 2016

KPMG International

kpmg.com/tax

This special report takes an in-depth look at the issues faced by those in charge of managing their company's tax disputes, and the processes, practices and resources they have in place to meet these challenges. The Global Tax Disputes benchmarking report is based on a secondary survey that was included in KPMG International's 2016 Global Tax benchmarking survey which offers an inside view of the structure, governance, priorities and performance measures of tax departments today and delivers insights on how leading tax departments expect to transform in the next 5 years.

For tax executives of international companies — including those charged with tax dispute management — benchmarking against comparable tax departments can be a powerful tool for reflecting on your organizational structures and competencies. It can also help leaders assess how the changes made today can help prepare organizations for the challenges and opportunities they are likely to face tomorrow.

The current survey tells us that companies are seeing a significant rise in tax audits and disputes, and all signs point toward even more intense tax authority activity in the future. The pace at which tax authorities have changed and intensified their approach — both unilaterally and in cooperatively — has been surprising.

Tax executives clearly recognize the importance of tax dispute management to their business, but the survey results suggest that some companies may not be quick enough to invest in strengthening their dispute resolution functions at a pace needed to keep up with the tax authorities. Nevertheless, some companies are leading the way by putting in place comprehensive frameworks for ensuring their tax dispute burdens are well managed both locally and globally.

This report presents an overview of key findings related to tax disputes from this year's survey, together with insights from senior leaders of KPMG's Global Tax Dispute Resolution & Controversy Services global member firm network. We also present key takeaways for tax dispute management leaders to help them prepare for the challenging times ahead.

For a snapshot of the survey's overall findings, please see KPMG International's Global Tax Benchmarking Survey 2016: Summary Report.

Contents

About the survey

— KPMG International's Global Tax Benchmarking Survey 2016 charts the evolution of leading tax departments and identifies operational benchmarks for high-performing tax teams. This special report highlights the survey's findings about the people, processes and technology deployed by tax departments to manage their activities related to tax audits and disputes.

— The findings in this report are based on a survey of 270 people in charge of the tax function and operations of companies in all major industries based in 35 countries worldwide.

— Over two-thirds of respondent organizations are public companies. About the same proportion has up to 5 billion US dollars (USD) in annual revenue or turnover, and one-third has more than USD5 billion in annual revenue or turnover. Over 40 percent of respondent organizations have more than 10,000 employees globally. Almost 60 percent have branches, subsidiaries or other permanent establishments in more than 10 countries.

You can still take part in the 30-minute survey of tax leaders, and, by doing so, gain access to a personalized view of how your department measures up across key areas.

Email tax@kpmg.ca to learn more.

Tax audits and disputes — the changing environment

Overall, KPMG International's Global Tax Benchmarking Survey 2016 confirms that behavior is changing among tax authorities worldwide. Feedback suggests tax executives are finding today's tax administrations increasingly difficult to deal with.

Indeed, tax authority activity has been rising steadily in recent times, as financially strained governments press for higher revenue collection and media and public attitudes harden against perceived corporate tax avoidance.

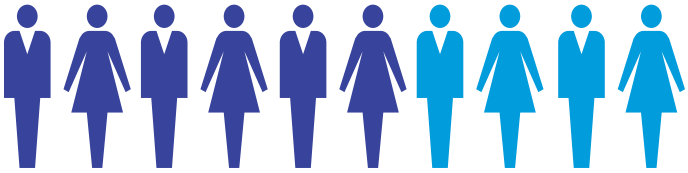
Audit activity is rising across the board, from direct taxes and indirect taxes to employment and domestic compliance issues — and international tax in particular. Now that the Organisation for Economic Co-operation and Development's (OECD) proposals for curbing tax base erosion and profit shifting (BEPS) are complete, countries worldwide are working to put them in place. From broader requirements for tax transparency through more stringent transfer pricing policies to greater scrutiny of business substance, the changing rules open the door to considerably more tax disputes — especially given differences in interpretations and timing as countries translate them into domestic laws.

Interactions with tax authorities

In this environment, it is not surprising that the survey respondents have noted rising tax audit scrutiny over the past 3 years. In particular, the respondents have observed increases in the following activities (in rank order):

1. more frequent requests for information
2. more frequent contact
3. more audit queries
4. more aggressiveness in raising assessments.

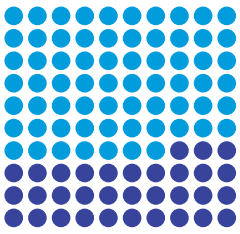
Along with this added activity, almost half of the respondents observe that tax audits are taking longer to conclude.



More than half of the respondents say their disputes are getting harder to resolve.

About half say tax authorities are taking a harder line in negotiations.

Two-thirds attribute the increase in disputes to tax authority aggressiveness and their reluctance to reach settlements.



One-third of the respondents say the tax authorities they deal with have less appetite for settlement, resulting in more litigation the last 3 years.

Note: Total might not add up to 100% due to rounding.
Source: KPMG International 2016.

Just over **one-quarter** of the respondents noted an increase in the tax authorities' application of penalties globally.

Despite increased audit activity, just over one-quarter of the respondents noted an increase in the tax authorities' application of penalties globally. This result varies by region, however, with more penalty applications reported by the respondents in the Americas and Europe. Indeed, penalties are being applied much more frequently in certain countries, such as France and the UK. In the UK, for example, HM Revenue & Customs has moved from rarely charging penalties on large businesses to mandatory consideration of penalties whenever there is an error in a tax return without any change in the underlying legislation.

When audits result in disagreements between companies and tax auditors, more than half of the respondents say the disputes are getting harder to resolve. Two-thirds attribute the increase to tax authority aggressiveness and their reluctance to reach settlements. About half say tax authorities are taking a harder line in negotiations, for example, by refusing to compromise in marginal cases and by expecting taxpayers to concede all disputed taxes.

Further, one-third of the respondents say the tax authorities they deal with have less appetite for settlement, resulting in more litigation in the last 3 years. Just under half of the respondents say the likelihood of litigation is about the same as the last 3 years. In the UK, for example, statistics from HM Revenue & Customs (HMRC) support this trend. The proportion of settlement proposals accepted by HMRC governance panels has been declining year-over-year and is now below 50 percent , leaving taxpayers to decide whether to concede or litigate.

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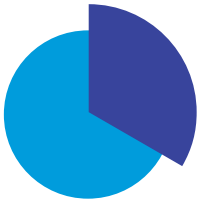
While litigation used to be seen as something to be avoided, as tax authorities have become more aggressive and less willing to settle, litigation has come to be a viable component of many companies' strategies for dispute resolution.

The respondents say the most common new techniques adopted for promoting compliance and resolving disputes in the past 3 years are (in rank order):

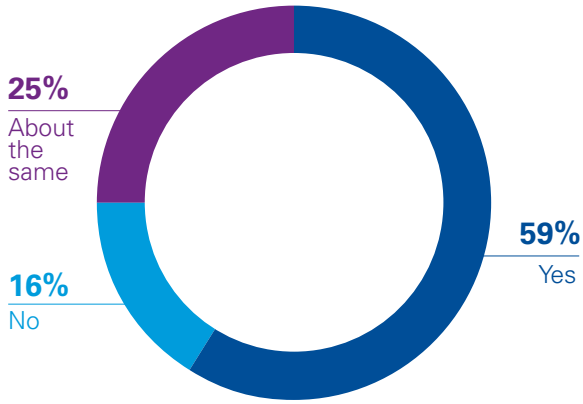
1. cooperative compliance and real-time working of issues
2. advance tax rulings
3. advance pricing arrangements.

However, results suggest that on average less than one-third of the respondents have seen any attempt by tax administrations to bring new resolution techniques to bear. Further, over one-third of the respondents say the question is 'not applicable' to the tax authorities they deal with.



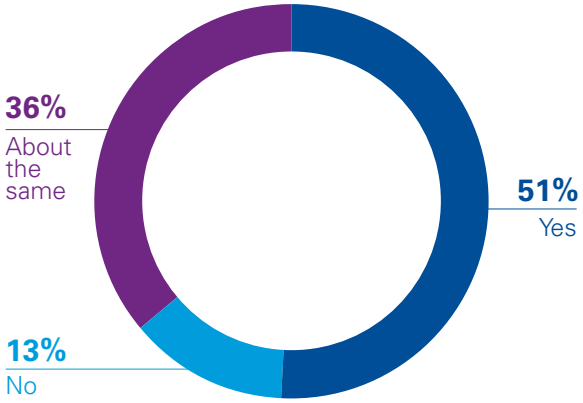
On average **less than one-third** of the respondents have seen any attempt by tax administrations to bring new resolution techniques to bear.

Is the level of difficulty in reaching resolution with the tax authorities you deal with increasing?



Note: Total might not add up to 100% due to rounding.
Source: KPMG International 2016.

In negotiations/settlement proceedings during the last 3 years, are tax authorities taking a harder line, e.g. not 'splitting the difference' in marginal cases or expecting taxpayers to concede substantially all of the tax in dispute?



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Source: KPMG International 2016.

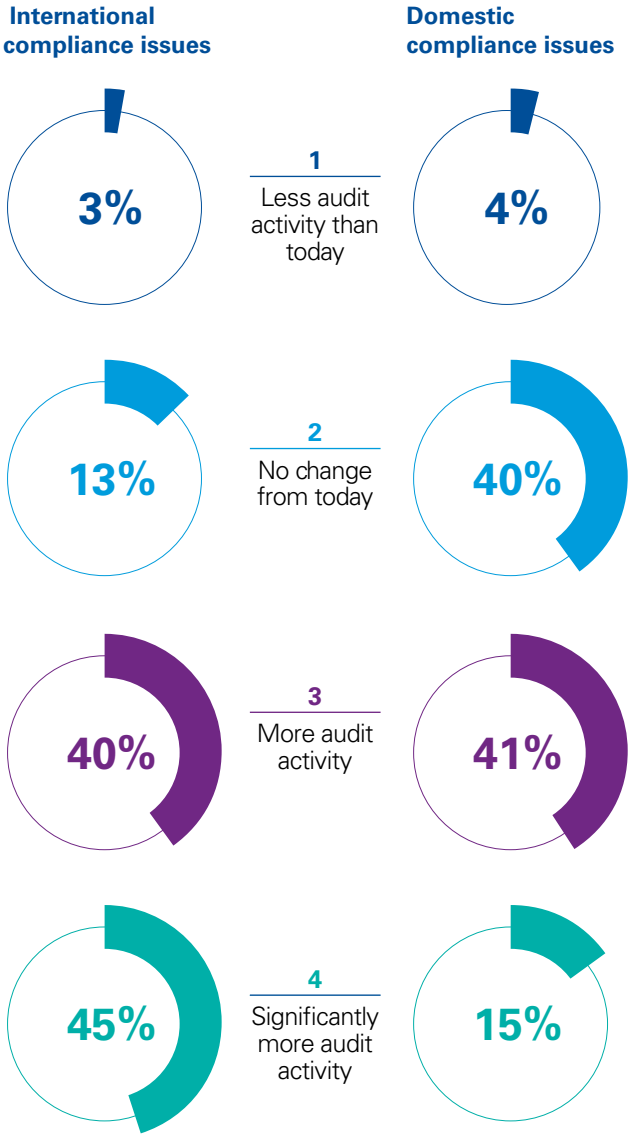
Tax authorities' focus

When asked where tax authorities are sharpening their audit focus, international compliance issues (e.g., transfer pricing, diverted profits) topped the respondents' list, with 85 percent seeing an increase. As the international tax practices of some large corporations have come under fire, governments, the media and the public at large have become much more aware of the impact of BEPS on countries' tax revenues. Tax authorities, who have also been under pressure to increase tax revenues, have stepped up their scrutiny of international transactions as a result.

International tax issues are by no means the tax authorities' only focus. The majority of the respondents also report more audit activity related to direct taxes, indirect taxes and domestic compliance issues (e.g. income, expenses, reliefs).

About 45 percent of the respondents agree that tax authorities are getting better at assessing risk and allocating audit resources to issues, taxpayers and industries identified as high-risk. This statistic should come as no surprise to readers in countries like the UK and Australia, where risk assessment practices are well advanced. However, the result also shows that the use of risk assessment among other tax authorities is more widespread. As discussed later in this report, tax authorities are also investing heavily in technology to help them assess risk and develop audit priorities.

On a scale of 1–4, in which areas do you see/anticipate the tax authorities you deal with undertaking more audit activity?



Note: Total might not add up to 100% due to rounding.
Source: KPMG International 2016.

Collaboration and information sharing

The majority of the respondents say tax authorities are sharing more taxpayer information than they did 3 years ago, and levels of information sharing are set to intensify as new country-by-country tax reporting requirements, the Common Reporting Standard and automatic exchange of information come into effect.

Fewer respondents have noted other forms of increased collaboration among tax authorities, such as using formal powers to obtain information, conducting joint audits, or taking part in multilateral tax administrator groups.

Much of the current collaboration is not visible to taxpayers, so companies may not yet be aware of the extent to which it is occurring. The expansion and rising profile of groups like the OECD Forum on Tax Administration and the Joint International Taskforce on Shared Intelligence and Collaboration demonstrate that tax authorities are expanding their networks and working in concert more and more each year.

Tax dispute management take-aways:
Tax audits and disputes

- Aggressive tax authority activity has been steadily rising and is expected to intensify in coming years.
- Global tax department leaders say tax authorities are:
  - requesting more information from businesses
  - conducting more audits and taking longer to conclude them
  - increasingly reluctant to negotiate a settlement
  - moving more matters forward to litigation.
- All tax issues are coming under more audit scrutiny, with particular attention being paid to international tax issues.
- As tax authorities get better at risk assessment and share more information with other tax authorities, there is an increased potential for more aggressive tax adjustments, with a commensurate increase in the potential for tax controversy.

Tax dispute management today

With tax audits getting more difficult and time-consuming and levels of tax disputes continuing to rise, are today's tax functions prepared to deal with the challenges ahead?

While there is room for improvement within many companies in terms of the organization, resources and attention devoted to tax dispute resolution, a minority of international companies currently appear focused on making the investments in people, processes and technology they need to effectively manage their tax disputes on a global basis.

Reporting lines and day-to-day management

Overall survey results confirm the trend toward global tax departments centralizing management and resources to improve their efficiency and effectiveness and help them contribute more value. The same benefits can accrue to tax dispute management functions. Centralization can help ensure accountabilities are clear, the right mix of dedicated and shared resources are available, and processes and technologies are leveraged to improve consistency, quality and efficiency.

Currently, however, only about 20 percent of respondent companies have a specific group that handles tax audits and disputes exclusively. The majority of these companies have five or fewer members on their dispute management teams and have no plans to expand their teams in the next few years. In two-thirds of companies without dedicated teams, disputes are handled by the tax department, while one in ten companies relies on multidisciplinary teams.

The respondents most commonly say that day-to-day management of tax disputes is the responsibility of a tax manager (or equivalent). About half of the people responsible for tax dispute management report to the finance function, and a third report to global tax management.

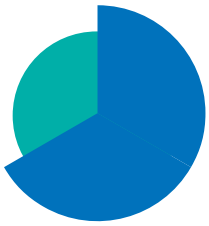
Less than 10 percent have a global head of controversy or equivalent who is responsible for the day-to-day management of tax disputes. While these companies are clearly in the minority, the global head of controversy role delivers significant benefits by providing these executives with the power and mandate to clarify reporting lines, centralize tax dispute monitoring and controls, and provide strategic direction. The role is relatively new in most companies and, given the benefits being derived, more companies are expected to appoint a global head of controversy in the future.

A global head of controversy can also have the profile to ensure senior management is kept well informed of the company's disputes and their reputational and financial implications. Forty-seven percent of the respondents say that the people in charge of their company's tax dispute management have access to their organization's management and audit committees, while one-third has access to the management committee only.

Survey results

Only **20 percent** of respondent companies have a specific group that handles tax audits and disputes exclusively.

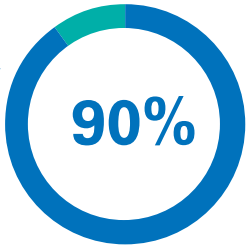
About half of the respondents with established internal processes for handling tax disputes employ people with specific, relevant tax dispute management experience.



In **two-thirds** of companies without dedicated teams, disputes are handled by the tax department.

One in ten companies relies on multidisciplinary teams

Almost **90 percent** of companies with internal dispute management processes include a process for escalating tax disputes that cannot be resolved at the lowest administrative level.



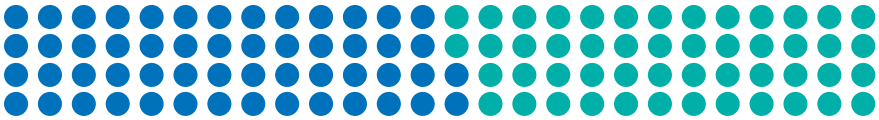
Over **one-third** of the respondents have established an internal process for managing all tax disputes.

Under **10 percent** have a global head of controversy or equivalent who is responsible for the day-to-day management of tax disputes.

Note: Total might not add up to 100% due to rounding.
Source: KPMG International 2016.

About **half** of the people responsible for tax dispute management report to the finance function...

...and **a third** report to global tax management



About **54 percent** of respondent companies have a budget for managing tax disputes.

For **40 percent** of these respondents, the budget for managing tax disputes is more than **10 percent** of the tax function's budget overall.

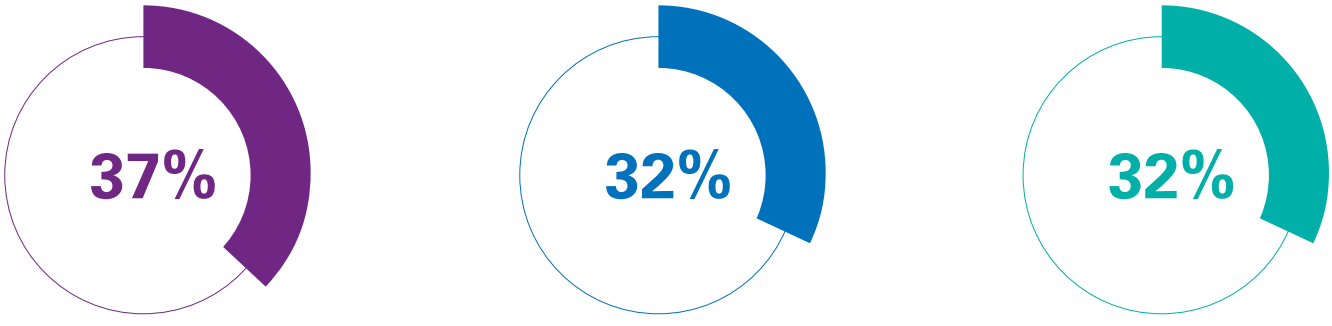
Source: KPMG International 2016.

Resources and processes for managing tax disputes

About 54 percent of respondent companies have a budget for managing tax disputes, and, in about half of these cases, the budget coverage of particular disputes depends on the nature or quantum at risk. For 40 percent of these respondents, the budget for managing tax disputes is more than 10 percent of the tax function's budget overall. Almost four of five respondents believe their current tax dispute management budget is adequate.

Established central processes, including processes for escalation, help companies identify issues and risk early and achieve global consistency in how they manage disputes worldwide. Just under one-third of respondent organizations do not have in place such processes. These organizations are most likely to manage disputes internally within the tax function on a dispute-by-dispute basis. A sizeable minority of them outsource dispute management to external advisors, while a handful rely on in-house counsel (or equivalent).

Does your organization have an established internal process for managing tax disputes?



Note: Total might not add up to 100% due to rounding.
Source: KPMG International 2016.

Nevertheless, it is encouraging to see that over one-third of the respondents have established an internal process for managing all tax disputes, and that a slightly smaller proportion have a process that depends on the nature and quantum of risk involved.

About half of the respondents with established internal processes for handling tax disputes employ people with specific, relevant tax dispute management experience (e.g. legal, previous dispute resolution experience). Twenty-nine percent of companies with internal processes would outsource dispute management tasks.

Almost 90 percent of companies with internal dispute management processes include a process for escalating tax disputes that cannot be resolved at the lowest administrative level. These processes are important for bringing issues to the tax dispute management team's attention as early in the dispute resolution process as possible.

In one in five of these cases, the escalation process only applies to disputes of a certain nature or involving disputed taxes over a certain threshold, which is an advisable practice. Tax dispute management teams do not have the time or resources to involve themselves in every dispute. Establishing a materiality threshold (e.g. USD20 million in disputed taxes) can focus scant dispute management resources on those cases with the most significant financial and reputational implications.

However, smaller cases still need to be monitored, since they can grow into larger disputes or add up to large amounts if the same relatively small issue is replicated across many jurisdictions. An analysis of smaller issues, such as US state income tax issues, can reveal cumulative savings opportunities and serve as a business case for adding more resources. As we will see in the next section, technology can help make sure tax dispute management teams are able to keep watch over all of the company's tax disputes.

Tax dispute management take-aways:
Tax departments today

- In light of swelling levels of tax disputes and the significant reputational and financial losses they can cause, some forward-thinking companies are investing in processes and resources to strengthen their tax dispute resolution functions. For example:
  - 20 percent of the respondents have a specific group that handles tax audits and disputes exclusively
  - two-thirds have an established internal process for managing and escalating tax disputes
  - more than half have a budget dedicated to tax dispute management.
- Under 10 percent have a global head of controversy or equivalent who is responsible for the day-to-day management of tax disputes and who can help the dispute team to clarify accountabilities, centralize tax dispute monitoring and controls, provide strategic direction, and communicate with the board and senior management. Centralizing company-wide responsibility for tax disputes under one leader is expected to become a leading practice in the years to come.

Leveraging technology

As part of their increasingly sophisticated risk assessment and audit practices, tax authorities in many jurisdictions are employing data analytic tools to flag audit issues and risk-assess taxpayers, in part to make up for shrinking tax department budgets. For example:

— In the United States, the IRS is focused on developing ways to use available data to analyze returns and develop issues to raise on audit.

— In the UK, HMRC has become adept at using technology to identify issues involving large numbers of smaller taxpayers. Its 'Connect' system can analyze and find connections among large amounts of data to identify cases for audit.

— China's tax authority, in keeping with the country's 'Big Data' macro-policy mandate, is putting resources and emphasis into developing a computerized tax risk analysis platform for conducting tax risk scans.

Similarly, technology can help resource-strapped teams ensure they are managing their company's disputes with efficiency and effectiveness, both centrally and locally:

— Centrally, tax dispute management technology can help implement a governance framework for disputes by providing visibility and transparency into all ongoing disputes in each country you operate in.

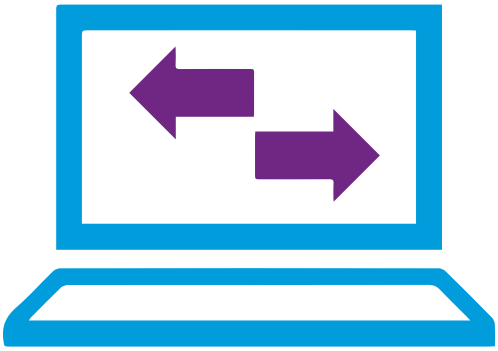
— Locally, technology can offer an easy-to-use and effective means of providing information about in-country disputes, in a consistent and clear format.

Visibility is key to identifying issues early in the process and developing a litigation or controversy strategy. With a worldwide tax audit management system, dispute management teams can follow and compare cases and developments from country to country. Technology can also help to reveal systemic issues within the organization that are giving rise to disputes and ensure the lessons learned are shared across the global organization's transfer pricing and compliance teams.

Currently, only 30 percent of the respondents utilize technology to monitor the number and nature of their organization's tax disputes globally. Excel spreadsheets are the most commonly used technology for this task, while only a quarter of these respondents use a disputes-specific software platform. The low use of dispute management-specific technology could be due to the fact that, as noted earlier, most dispute teams are managed as part of the larger tax department and often lack budget for and control over investments in technology.

Tax dispute management technology can eliminate inefficient, ad hoc processes and give a quick, real-time picture of what's going on with the company's tax controversy matters globally. It is encouraging to see that about 40 percent of the respondents expect their use of technology for managing and monitoring tax disputes to change in the next 2 years.

Only **30 percent** of the respondents utilize technology to monitor the number and nature of their organization's tax disputes globally and only one-quarter of these respondents use a disputes-specific software platform.



40 percent expect their use of technology for managing and monitoring tax disputes to change in the next 2 years.

Source: KPMG International 2016.

Tax dispute management take-aways:
leveraging technology

- Tax authorities in many jurisdictions are employing increasingly sophisticated data analytic tools to flag audit issues and risk-assess taxpayers.
- Technology can also help resource-strapped teams ensure they are managing their company's disputes with efficiency and effectiveness.
- Only 30 percent of the respondents utilize technology to monitor the number and nature of their organization's tax disputes globally, and only one-quarter of these respondents use a disputes-specific software platform.
- Encouragingly, about 40 percent expect their use of technology for managing and monitoring tax disputes to change in the next 2 years.

Tax dispute management of the future

Rising tax authority aggression. Increasing collaboration and sharing of information among tax authorities. More potential for tax disputes. Based on the current survey, many companies have scope to better protect their bottom lines and preserve value by investing in their tax dispute management functions. Across the survey responses, it is clear that a minority of forward-thinking companies are already at work developing robust tax risk management frameworks that are fit for the future.

Based on these results and the experiences of Global Tax Dispute Resolution & Controversy Services professionals of KPMG's global network of member firms, leading tax dispute management functions of tomorrow would have the following key hallmarks:

— **a global, senior executive head of tax controversy** with the power and mandate to clarify reporting lines, centralize tax dispute monitoring and controls, and provide strategic direction

— **dedicated budgets** that are sufficient to cover all of the company's dispute management needs and provide some control over how the funds are deployed and invested

— **dedicated, adequately staffed teams of professionals** with tax dispute management experience relevant to the company and its industry

— **centralized, internal processes** that ensure accountabilities are clear and promote consistency, quality and efficiency in tax dispute management activities, locally and globally

— **clear, company-wide tax dispute management guidelines** to help facilitate the hands-on work of managing tax cases and foster communication between business units and the tax dispute management team

— **escalation processes** for bringing issues to the tax dispute management team's attention as early in the dispute resolution process as possible

— **processes for communicating with company directors and senior executives** about the potential impact of tax disputes on their company's reputations, operations and bottom lines

— **a worldwide tax audit management software platform** that delivers a complete view of all current disputes, as well as potential disputes in the pipeline.

Contact us

For more information about how the member firms of KPMG International can help your business manage and resolve tax disputes efficiently and effectively, please contact our Global Head of Dispute Resolution & Controversy Services below.

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