



Chief Tax Officer Insights— Issue Spotlight

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Never before has the tax department played such an integral role in the success of the business. Chief tax officers (CTOs) are expected to align tax with business goals, drive strategic value, increase transparency, and improve the efficiency of tax operations. KPMG LLP's (KPMG) CTO Insights is designed to highlight top-of-mind issues for tax executives and ways CTOs are addressing these opportunities and challenges. We are confident that you will find the information in each issue of CTO Insights practical and actionable in demonstrating the value you and your department bring to your organization.

Tax disputes: As volume rises worldwide, corporate tax departments respond

Inundated with tax exams

Around the world, the quantity of tax controversies facing companies is going in one difficult direction: Up.

Heightened global audit activity is a direct symptom of the massive market evolution of the past few years. Recent trends have both increased the complexity of determining corporate tax liabilities and incentivized greater aggression on the part of revenue authorities. A nonexhaustive list of triggers is explored below.

The challenging audit environment is taking a toll on tax functions, raising the burden of compliance and adding stress to company financials. But it isn't going away anytime soon. Across jurisdictions, the relentless rise of tax controversies is only expected to further increase through 2022 and beyond.



Drivers of increased audit activity

Why do corporate tax leaders often feel like their organizations are under constant audit? Several developments have led to increased tax disputes domestically and globally. Key drivers include:

Deep international policy changes

The shifting international tax landscape underpins much of the growth in tax dispute volume. Rules proposed by the Organisation for Economic Co-operation and Development (OECD) are at the heart of the issue. If adopted, new international tax principles—including Pillar 1 on global taxing rights and Pillar 2 on base erosion and profit shifting—are major changes that could have profound impact on the taxation of multinational businesses. They would introduce a new worldview on value generation, raising coordination issues that can lead to disputes. Depending on the final design of Pillar 1's tax certainty rules, taxpayers within the scope of the new Amount A tax regime could find themselves in years-long, intensive multilateral reviews of their operations.

Uncertainty remains about the future of the Pillars, but a failure to adopt them could lead to more disputes, rather than fewer, as unilateral measures such as digital service taxes (DSTs) proliferate. Some jurisdictions have already begun to transition their domestic tax regimes. The problem is that interpretations and implementation of DSTs are decidedly inconsistent, and they raise issues with treaty access and creditability. This lack of global consensus, and ensuing variances in domestic laws, would make controversies basically inevitable for multinational organizations.

Transfer pricing is a related global tax issue that is stirring up disputes at a high rate. Calculating transfer prices and meeting country-by-country reporting requirements has always been costly and challenging, requiring intensive diligence and documentation of intercompany transactions by tax functions. The OECD's Amount B project, which aims to address these issues by streamlining the rules for certain marketing and distribution transactions, remains in its early stages. Nuances in national regulation, increased compliance obligations, and evolving economic pricing methods all factor in, further increasing the likelihood of reporting mistakes and global controversy risk.

Pandemic era economic volatility

Fiscal pressure has long been a key issue for governments across the globe, just as tax policy enforcement has long been a common way for

domestic and international authorities to address budget shortfalls and pay for new programs. However, the COVID-19 lockdown and the subsequent economic impacts of the past two years have made economic challenges more widespread and universal.

Now, significant revenue needs in almost every country are driving increased audit activity across the globe. Companies are also facing more aggressive tax examinations as jurisdictions pull out all stops to collect what they feel they are owed.

Multinationals are not only dealing with new issues being raised. Some jurisdictions are even taking positions on issues many tax leaders thought were already well-established law. This trend is particularly prevalent in revenue-needy countries such as Brazil and Mexico, where authorities have stepped up enforcement of nonincome tax issues, become more aggressive around VAT, and disallowed certain related-party transactions under domestic laws that were previously considered subject to tax treaties. As these tax authorities seek to secure revenue for their own jurisdictions, the threat of unresolved double taxation is growing.

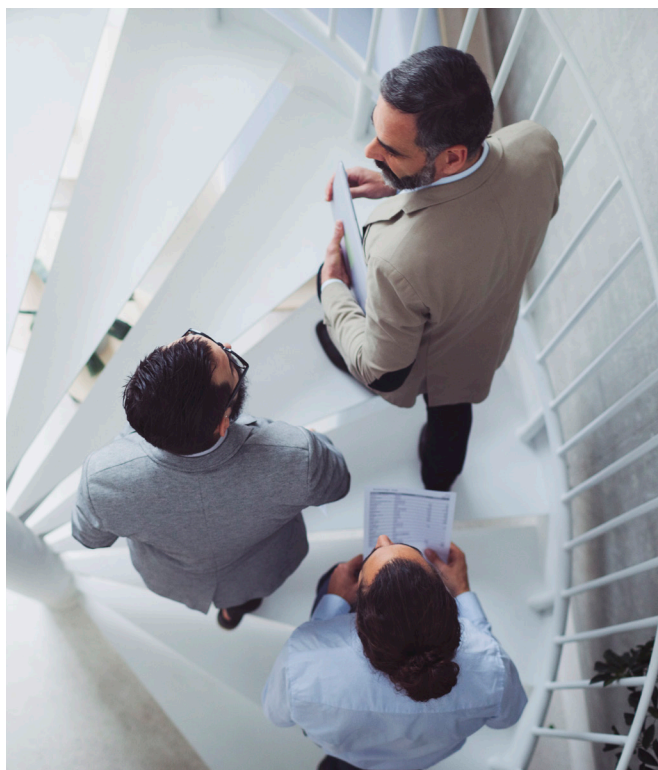


New IRS initiatives

Much like tax authorities worldwide, auditors with the Internal Revenue Service (IRS) in the U.S. are increasingly focused on revenue raising, which drives greater scrutiny on corporate tax compliance, increases focus on enforcement, and leads to more aggressive exam tactics. Moreover, large partnerships have recently come into the IRS's crosshairs as an enforcement priority.

At the same time, IRS auditors are stepping up efforts to check company compliance with highly complex tax challenges, increasing controversy risk. These include major federal tax code changes, such as the 2017 Tax Cuts and Jobs Act (TCJA), and significant global tax issues, such as cross-border transactions and restructurings. Auditors in many states have also been stepping up their focus on transfer pricing and intragroup arrangements in light of evolving state tax issues, such as shifting company footprints and work models post-COVID-19.

Corporate tax departments are feeling the impacts of these trends in heavier tax team workloads. Tax leaders say IRS audits have increased in both number and difficulty, demanding more time and resources from tax functions. Examiners are often getting more granular in the questions they ask and requesting increasingly large amounts of data for their reviews. Given the complexity and newness of some provisions, reviews frequently require follow-up information and discussion.



New approaches to managing disputes

As companies experience additional audit activity, many tax functions are adapting their approaches to managing, mitigating, and resolving disputes, no matter where they arise. This can include creating centralized roles with oversight over global tax controversies and the adoption of technology solutions for tracking and managing a broad swathe of matters.

Many are also taking proactive steps to prevent disputes before they arise.

For example, some international taxpayers publish their tax strategies, even when not required to satisfy statutory obligations in a jurisdiction. Tax leaders say this level of transparency can help show authorities what type of company they are and build goodwill through the exam and resolution process.

Given the particularly high level of disputes involving transfer pricing issues, some multinationals have extended their network of advance pricing agreements with key jurisdictions, eliminating some of their controversy risk. Others have participated in the OECD's International Compliance Assurance Programme (ICAP), a multilateral risk review that allows a company to present its transfer pricing and other issues to several tax administrations in a nonadversarial setting.

When dealing with cross-border audits, another emerging trend is companies taking more issues to competent authority. Lack of common interpretation in areas such as transfer pricing, permanent establishments, and expense allocation is driving more cases to competent authority to clarify treaty provisions between nations and avoid being double taxed. The OECD's published statistics show that a Mutual Agreement Procedure (MAP) is very successful at eliminating double tax. Moreover, some tax leaders say going to competent authority increases chances of a positive resolution, as certain jurisdictions tend to overstate their adjustments.

Double taxation remains a risk, however. For example, auditors in several countries have been known to settle with international taxpayers on a lower adjustment number in exchange for the company agreeing not to go to competent authority, which local auditors believe will "give away the store." Although the settlement may feel like a win, companies are still exposed to potential tax liabilities under domestic laws of the treaty partner. Other countries will make transfer-pricing-based adjustments under domestic deductibility rules, then argue that the issues are ineligible for competent authority consideration.

Dialogue with and education of foreign tax authorities is another focus area for multinational tax functions. Tax professionals in some organizations are spending more time on the ground helping local tax administrators understand their business so they can make more realistic and reasonable assessments. This approach has helped some companies settle audits with amounts that are a small fraction of what was initially proposed.

Questions to consider

- In which jurisdictions is your organization dealing with an uptick in audit activity?
- What issues are gaining the attention of domestic and global tax authorities?
- How is the volume of tax disputes impacting your tax operations, resources, and financials?
- What changes is your tax function making in how it approaches tax controversies?

For further information

Explore the resources below for deeper insights on the topics in this edition of CTO Insights.



Tax Controversy & Dispute Resolution Services

We are here to help clients prevent disputes before they arise, manage controversies that may arise, and resolve challenges by tax authorities in an efficient and effective manner. We combine technology with human capabilities, and leverage data analytics and cloud-based technology, for clients who are inundated by tax audits.



Tax Controversy & Dispute Resolution Quarterly

This publication aggregates hot topics, uncovers dominant trends, and offers value-added insights from our Tax Controversy & Dispute Resolution professionals.

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