Chief Tax Officer Insights

Navigating tax controversy: Unlocking value through effective tax functions

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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. *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 controversy remains a top agenda item for CTOs as they navigate today's evolving global business landscape. Around the world, the quantity of tax controversies facing companies is going in one difficult direction: up. Recent trends have both increased the complexity of determining corporate tax liabilities as well as the aggression of revenue authorities. The challenging audit environment is taking a toll on tax functions and CTOs are increasingly focused on how to approach audits, ensuring comprehensive documentation and proactive tax planning.

The complexities of tax controversy

International policy changes

The shifting international tax landscape over the last several years reinforces much of the growth in tax dispute volume, particularly rules proposed by the Organisation for Economic Co-operation and Development (OECD). New international tax principles—including Pillar One on global taxing rights and Pillar Two on base erosion and profit shifting—are major changes that are having a profound impact on the taxation of multinational businesses. The rules introduce a new worldview on value generation, raising coordination issues that can lead to disputes.

Uncertainty remains about the future of the Pillars and global acceptance, 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. 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.

Experiences with the IRS

Much like tax authorities worldwide, auditors with the Internal Revenue Service (IRS) in the US 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 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 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.

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 amount of data for their reviews. Given the complexity, 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, a multilateral process that allows a company to present its transfer pricing and permanent establishment issues to several tax administrations in a risk review setting rather than in an examination.

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 to mitigate the risk of double taxation. The OECD's published statistics show that 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 by 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

A coordinated approach to tax controversy for multinationals

Insights on Tax Controversy & Dispute Resolution

News and insights on how to manage and mitigate controversy.

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