Tax policy and administration: Global perspectives
June 2012: Multinational enterprises are experiencing rapid change with respect to tax audits and controversies worldwide. A closer examination of the broader trends crossing borders may better equip your company to deal with this.

Managing tax controversy challenges on the horizon

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Contents
Snapshot of the current global landscape p6
Forward looking insights by country p10
Australia p10
Brazil p12
Canada p14
China p16
India p18
United Kingdom p20
United States p24
Pivotal challenges on the horizon p28
Proactive actions p36
The shifting global tax audit and controversy landscape: What are the challenges on the horizon?

Dynamic environments can create uncertainty and challenge. Multinational enterprises are experiencing rapid change with respect to tax audits and controversies worldwide. Fundamental aspects of audits and controversies are evolving such as how revenue authorities are obtaining information, how they choose who will be audited, their choice of audit techniques, and how controversies are being resolved. Historical frameworks are being modified by more modern approaches.

But what does the future hold? No one can predict it with certainty. However, a closer examination of the broader trends crossing borders may better equip your company to proactively plan, anticipate challenges, as well as capitalise on opportunities.

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The bigger picture

The volume of tax audits is rising worldwide creating an uncertain environment
The search for revenue is on

Governments are seeking monies to meet their needs and growing deficits – a dominant factor shaping the global tax audit and controversy environment today. Revenue authorities around the globe are engaging in intense tax audits and pressure has been exerted on the tax enforcement and collection processes. As a result, tax authorities around the world have become more aggressive in the corporate tax arena, leading to significant assessments in virtually all areas of direct income tax as well as indirect tax. The volume of tax audits is rising worldwide in almost all major developed and emerging countries, creating an uncertain environment. The situation has become even more challenging because international tax audits can be disruptive and sophisticated while corresponding enforcement actions can typically be harsh and expensive.

Another prevailing factor, not surprisingly, is globalisation. Corporate executives across industries increasingly view this as an important cornerstone for pursuing growth over the next decade. Unfortunately, this strategy mandates that enterprises manage many unique tax systems around the world. Each country employs varying approaches and tax rates resulting in different financial impacts among competitors depending upon where they are established to do business and where they operate. Companies are also under pressure to restructure their operations from a global perspective to be more competitive. These factors, along with increased audit and controversy risk worldwide, cause stakeholders to face huge uncertainty in the area of cross-border tax disputes.
Snapshot of the current global landscape
What trends broadly characterise the dynamic audit and controversy environment that global taxpayers are experiencing right now? The following factors provide a foundation for considering how the landscape will be shifting in the coming years.

**Exchange of information**

Tax authorities are using a multitude of channels to engage in reciprocal information sharing with other countries for tax enforcement and collection purposes. The last decade has seen significant movement in this area. A large number of countries have signed income tax treaties that include exchange of information provisions. Many bilateral Tax Information Exchange Agreements (TIEAs), between members of the Organisation for Economic Co-operation and Development (OECD) and non-OECD members (e.g., the Cayman Islands, Bermuda, and Liechtenstein), have been entered into with the aim of promoting international cooperation on tax matters. Many other multilateral channels have been forged to facilitate this information flow such as the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes and the Convention on Mutual Assistance, the latter of which has recently been signed by India. The OECD Aggressive Tax Planning Directory which enables the sharing of information between OECD members, as well as the Joint International Tax Shelter Information Centre (JITSIC) are further examples of tax administrations engaging with other jurisdictions to share and cooperate with the goal of limiting what they perceive as abusive tax avoidance transactions.

**Adoption of divergent positions**

One of the most significant factors affecting global enterprises today is that tax auditors are more frequently adopting positions that are inconsistent with historic international tax norms, and in some cases, are results oriented. Many other positions represent extraordinary extensions of international tax jurisdiction. Emerging countries such as India, China, and Brazil have made such arguments in order to expand revenue collection. A now well-known example is the Vodafone case in India which was recently decided in favour of the taxpayer. The unprecedented position argued by the Indian tax authorities has been viewed as out-of-step with traditional international tax principles, highlighting the unpredictable nature of India’s tax policy. The Chinese government has also had a practice of imposing Chinese capital gains tax on the indirect sale of shares in a Chinese company, similar to the Vodafone situation. This is a position that government officials in many countries have labelled as irregular, i.e., not in line with generally accepted tax principles.
What could be worse? Well, applying such an extraordinary position retroactively can add even greater difficulty for taxpayers. Unfortunately, the application of retrospective legislation – broadly viewed as unfair and against traditional tax principles – is occurring more frequently in the global arena. Governments may be of the view that the legislation “clarifies” an already existing position and thus may not view the change as retrospective. This is not a hypothetical discussion – in the case of the Vodafone decision, the Indian government has recently enacted retrospective amendments to effectively reverse the recent Supreme Court decision favouring the taxpayer and apply the amendments from Assessment Year commencing 1 April 1962 forward. The impact is restricted by the seven year limit on re-opening computations and further limited by a recent administrative instruction to cases which have not been assessed before 1 April 2012 or which have been subjected to a reassessment notice before that date. This has been a surprising occurrence for taxpayers and, is sure to have a major affect on tax audits and disputes in India and beyond.

**Focus on transfer pricing matters**

The increasing focus by tax authorities on transfer pricing principles to protect their revenue base has been a major trend occurring over many years. Transfer pricing audits and controversies have become the largest and most contentious tax disputes in the world and will remain so in the foreseeable future. This may not be a surprising result considering that there has been a rapid rise in multinational trade, including the opening of several significant emerging global economies. Tax authorities around the world have implemented new documentation requirements and have enacted stricter penalties for not complying. Certain countries are also modernising their existing transfer pricing guidelines to bring them closer to the OECD guidelines. For example, Russia has enacted new landmark transfer pricing legislation that became effective 1 January 2012, Brazil has recently introduced changes to its transfer pricing rules and Chile is proposing to introduce detailed transfer pricing provisions. Transfer pricing scrutiny has also generally increased because multinational companies, in an effort to remain competitive on the global stage, have implemented strategies leading to a greater level of international attention. In addition, recent OECD guidance regarding transfer pricing – the OECD’s first substantial update regarding the topic in over 10 years – is further evidence of this heightened focus.

**Pressure on dispute resolution alternatives**

Historic dispute resolution methods are being increasingly burdened. The use of Competent Authority (CA) procedures under the mutual agreement procedure (MAP) treaty provisions serves as the primary method of resolving tax disputes between different jurisdictions. The inventory of MAP cases, however, is at record highs, placing a serious strain on the system. The general length of time to resolve a transfer pricing dispute using the CA process can be three or five years, or even longer. Although other strategies remain for taxpayers to utilise, they vary by country. Administrative appeals, advance pricing agreements (APAs), and mediation remain key alternatives for taxpayers to select, although the future of certain mediation pilot programmes remains uncertain. Litigation under a country’s court system or in administrative tribunals remains an available but uncertain path for taxpayers and governments alike. Various other controversy procedures may or may not be available in the jurisdiction, such as dispute panels or amnesty programmes.

**Joint audits**

Many international tax authorities are also using a variety of emerging audit techniques. Certain jurisdictions are now pursuing joint audits where an individual or business is subject to a single coordinated audit by two or more jurisdictions. Joint audits stand in contrast to a typical situation where the same transaction is subject to separate audit by two or more countries (a simultaneous audit). Instead, joint audits consider that each participating country be jointly responsible for organising and managing the audit ending in a final combined report on the taxpayer. The joint audit concept arose from the OECD Forum on Tax Administration. Although joint audits have signalled a landmark shift among tax authorities towards coordinated action, not all tax authorities have expressly embraced them as a foundational approach. For example, although the United States pushes their efficiencies, it appears that the UK tax authorities do not wish to make such an official statement at this time.
**New resolution approaches**

New dispute resolution approaches and programmes are emerging around the globe. These include, for example, arbitration alternatives in certain countries and dispute panels in India. One of the newest dispute resolution approaches is the inclusion of mandatory binding arbitration clauses in income tax treaties. The number of countries incorporating these clauses continues to increase. Examples include the United States-Belgium treaty, the Germany-Canada treaty, and the Japan-Netherlands treaty. These provisions are part of the MAP treaty provisions but are used when the CAs cannot reach an agreement through negotiation. (CA provisions generally require the member countries to use their best efforts but do not require the parties to reach an agreement.) These new clauses typically utilise what is called 'baseball arbitration' where each side puts forth their case and the panel selects one or the other position, which is binding upon both governments. Although inclusion of these provisions in tax treaties is a relatively new occurrence, their success remains to be seen: Ultimately, the success of these provisions may be judged by how infrequently they are used while still motivating resolution of disputes in a timely manner.
Australia

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Increasing focus on general anti-avoidance rules (GAAR)
Australia’s GAAR, enacted over 30 years ago, eliminates tax benefits arising from schemes where the dominant purpose for entering into the scheme is to obtain a tax benefit. The GAAR (so-called Part IVA of the income tax law) requires an assessment of the tax benefit obtained by a taxpayer and an analysis of the reasonable alternative scenarios that could have been undertaken to achieve the taxpayer’s commercial objectives (so-called counterfactuals). The Australian Tax Office (ATO) will consider the application of the GAAR where there is an indication of contrivance in an arrangement. The ATO looks for ‘warning signs’ that the arrangement is ‘tax driven’ including where the arrangement contains a step or series of steps that appear to serve no real purpose other than to gain a tax advantage or where the tax result of the arrangement appears at odds with its commercial or economic result. This may also include instances where the parties to the arrangement are operating on non-commercial terms or in a non arms-length manner.
In spite of its long history, the government wishes to update and expand the application of the GAAR. In addition to public statements by the Commissioner of Taxation, the Assistant Treasurer recently announced that the government would introduce amendments to ensure that a taxpayer would not be able to deny the existence of a tax benefit by arguing that it would have done nothing if otherwise faced with a large tax cost. The measures are applicable to schemes entered into or carried out after 1 March 2012. The sentiment to change the GAAR may stem from the fact that the Commissioner has lost the last 10 out of 14 cases against taxpayers and, on 10 February 2012 lost another high profile case. These losses have arisen, for example, in circumstances where taxpayers have submitted key evidence demonstrating the commerciality of an arrangement or the unreasonableness of the Commissioner’s counterfactuals. The tax community continues to be nervous that the proposed reforms may go beyond the government’s announcement so that the government can address other causes for the Commissioner’s losses.

**Continued audit profiling of large taxpayers**

The ATO continues to pursue more modern approaches with respect to tax audits such as their Risk Differentiation Framework (RDF). Large taxpayers, those companies with turnovers in excess of A$250 million, are profiled so as to assign relevant risk ratings relative to the level of the perceived tax risk for each taxpayer. These risk ratings subsequently determine the type and level of intensity of the ATO’s inquiries into that taxpayer and whether the taxpayer will be the subject of continuous reviews, continuous monitoring, periodic reviews or period monitoring.

The RDF contains four risk categories including higher risk taxpayers, key taxpayers, medium risk taxpayers and lower risk taxpayers. The factors which determine the risk rating assigned to a taxpayer include past compliance behaviour, business performance relative to tax outcomes, significant transactions, intelligence from foreign revenue authorities and JITSIC, intelligence from Australian government agencies, and the risks associated with the introduction of new law.

By way of example, larger entities are more likely to be assigned a ‘quadrant one’ risk rating (higher consequence, higher likelihood of non-compliance) or a ‘quadrant two’ risk rating (higher consequence, lower likelihood of non-compliance). Smaller entities may be considered higher consequence if they are deemed to be a market leader, for example, the first to the market with innovative financial products or structures.

**Greater use of formal powers to gather evidence**

Taxpayers in Australia will continue to experience an increase in the use of the Commissioner’s formal powers to gather evidence at the audit stage. Taxpayers are now commonly receiving requests for access to documents or information under certain statutes. This trend is expected to continue and will likely impact the outcome of tax audits given that evidence is among the most important considerations for both the ATO and taxpayers as it is the basis for a taxpayer’s liability. Management of the evidence process by both parties is typically the single greatest determinant of the outcome of tax audits. The taxpayer generally has to meet prescribed record-keeping obligations to enable the revenue authority to readily audit its tax position. In the event of litigation to challenge the ATO’s assessment of tax liability by way of objection and appeal, the taxpayer bears the burden of proof. This onus is not directed to whether or not an assessment or amended assessment is correct; rather, the taxpayer bears the onus to lead positive evidence to establish that the assessment or amended assessment is excessive.

With an increased focus on early evidence gathering, the ATO has also sought to issue more detailed and lengthy information requests prior to the audit stage and in the client review phase of the ATO audit lifecycle. This has required taxpayers to respond by increasing their level of preparedness in gathering evidence and preparing tax technical papers to support tax positions. This required level of preparedness is expected to ensue for years to come as the ATO continues to utilise its existing toolkit for collecting information.

**Aggressively seeking information exchange**

The Commissioner is also increasing its use of the available information exchange procedures to gather evidence in the conduct of cross-border audits. As a member of JITSIC, the ATO has recently coordinated with its JITSIC partners to investigate complex cross-border financing arrangements. Information is exchanged on a bilateral basis in accordance with the relevant article of the tax treaty between the two JITSIC countries. Information may be exchanged via written exchanges or may involve case conferences involving the relevant country examination teams with the discussion moderated by the appropriate JITSIC CAs. The information collected through JITSIC and other channels has led to successful collection efforts and thus the ATO is expected to expand its pursuit of other available information exchange channels.

**Retrospective legislation**

Consistent with a global theme mentioned earlier, considerable controversy has been generated by government legislative proposals that may have a retrospective and potentially adverse effect for taxpayers. This development over the last year or so marks a major change from historic legislative practice in Australia. The most significant example is in the area of transfer pricing but retrospective legislation is also under consideration in other areas such as the tax consolidation rules. The government argues that the law changes are not truly retrospective in the case of transfer pricing as they merely clarify and confirm the original intent of the law. The government also justifies the changes by arguing that they are protecting revenue. This logic has not persuaded the Australian tax community as it appears that adverse court decisions were catalysts for these changes.
Focus on increased enforcement
A number of initiatives have been adopted to increase enforcement of existing tax laws, which have significantly increased collection levels. The federal tax authorities continue to have a strategic focus on revising and simplifying audit processes through procedures and legislation. This has led to increasing sophistication with respect to tax audits. The government has attempted to focus on the needs and profile of taxpayers as well as the agility of administrative tax processes to speed up tax collection. The tax authorities have also focused on their integration and cooperation with other tax authorities at the state and local level and have also pursued increased interaction with taxpayers through tax education and the encouragement of voluntary compliance.
One of the most recent enforcement initiatives is the introduction of SPED – Public Digital Bookkeeping System. Companies operating in Brazil must comply with this new system which requires most companies to send all their bookkeeping by means of digital information electronically to the tax authorities. The required digital data provides the government with a large mass of information to cross check and initiate enforcement procedures at the company level. The availability of information for tax inspection has also grown exponentially by the federal states through their use of all SPED information which is shared with state and local tax authorities. Although still in its infancy, the SPED system is likely to serve as a cornerstone for obtaining even greater enforcement and collection going forward.

**The tax authority’s demand for substance**

Brazil’s tax authorities are more intensely demanding ‘substance’ with respect to a taxpayer’s operations. Federal Administrative Courts have also indicated that economic substance and business purpose are determining factors for the validity of tax planning in Brazil. The substance requirements involve intangible concepts such as business purpose and economic foundation, which increasingly rely on subjective proof. These standards require taxpayers to consistently scrutinize their operations and tax positions – an on-going requirement that is likely to become essential in the coming years.

**Tax settlement as a means of dispute resolution**

Although the Brazilian national tax code envisions settlement as a means of tax dispute resolution, a law is still required to define all of the standards for such provision to become enforceable. A bill regarding these standards has been under debate for a long time by the Congress and it is not possible to foresee if or when this law will be approved. Should it be approved, it certainly would help to create a more transparent, simple, and efficient tax dispute resolution process. This bill would also reduce future demands on the Brazilian judiciary, which may incrementally improve the overall timelines and efficiency of tax dispute processes.

**Enhanced transfer pricing focus and guidance**

The Brazilian government introduced significant changes to its existing transfer pricing regulations – a move evidencing the government’s continued focus on this area for revenue collection. Important changes were proposed regarding the resale minus method, including the imposition of specifically designed mark-ups for certain industries and a standard percentage applicable for all of the industries sectors not otherwise identified. The rules also proposed that interest on related party loans, even if duly registered with the Brazilian Central Bank, should be subject to the transfer pricing rules based on a rate to be defined by the tax authorities. Congress was not wholly in favour of all the changes this time around but the proposals evidence an effort to reduce the litigation in this area as they address several contentious issues.

**Further disputes expected relating to social contributions**

Controversy continues to plague Brazil’s social contribution system referred to as PIS and COFINS. The laws that regulate this system state that the company may deduct, in the sale of its products, credits arising from the acquisition of goods and services used as input. An issue arises because the word ‘input’ does not have an official definition. A normative ruling by the Federal Revenue Services of Brazil (RFB) has a different interpretation than a recent majority decision by the Superior Chamber of the Administrative Board of Tax Appeals (CARF). In spite of the fact that RFB interprets the term ‘input’ in a restricted way, taxpayers often claim the more favorable benefit. As a result, there is an increased issuance of tax notices by the RFB. Due to the lack of a consistent position on the subject, the RFB will persist on issuing tax notices until there is a legal concept of the term or firm court decisions. Future disputes regarding this dilemma are expected.

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Tax policy and administration Managing controversy challenges on the horizon
Moving towards a risk-based audit approach

The Canada Revenue Agency (CRA) is striving to enhance the efficiency of audits while reducing costs by moving towards a new risk-based approach with respect to large case taxpayers. Under this approach, a taxpayer’s risk profile is assigned a grade of low, medium, or high risk. The grade is based on CRA’s evaluation of a number of factors including the company’s compliance history, aggressive tax positions and audit history, as well as its tax governance structure. The CRA’s risk evaluation will be a core element to the CRA’s audit process as it determines the scope and amount of time to be spent on an audit.
The CRA is in the process of reviewing and assigning a preliminary risk profile rating for about 1100 taxpayers. The new approach calls for an annual risk determination of each taxpayer by the Large File Case Manager with input from audit specialists involved on the particular file. The CRA did not reach out initially for input from taxpayers in making their preliminary risk assessment. However, the CRA is now beginning to engage taxpayers directly about their profile. They have identified 50 companies from across the country and have commenced meetings with senior management (CEOs, CFOs, board members, and now tax directors) to share some of their findings and observations noted during their initial risk assessment. The CRA is looking to gain a better understanding of how the company manages its tax risk and is asking a number of questions in this regard, including:

- whether the company has a process in place to identify and assess tax risks
- the extent senior management and the board are involved in tax matters
- which tax intermediaries are used and to what extent they are involved in tax risk management
- what monitoring occurs with respect to non-compliance of tax obligations
- the role of the risk management committee
- whether systems and processes are in place to ensure collection of complete and accurate data.

The CRA is phasing in this new approach over the next five years. It is anticipated that during this period, all large case taxpayers will have been contacted. The CRA is also urging taxpayers to embrace this new approach by adopting good corporate governance policies and to be more open and transparent when sharing information with them. While taxpayers are certainly looking for ways to ensure tax audits are carried out efficiently and that disputes are resolved in a timely manner, many taxpayers are concerned whether the CRA has the trained resources to implement the new approach consistently across the country. As such, taxpayers should monitor the CRA’s progress over the coming years and take active steps to understand their risk profile.

**Pursuing enhanced taxpayer transparency**

Simultaneous with the CRA’s roll out of its new risk-based audit approach, other developments are occurring that are directed at improving the efficiency and effectiveness of the CRA’s audits. Most of these involve new or enhanced reporting by taxpayers, in particular, of transactions and structures associated with aggressive tax planning. For example, draft legislation has been introduced to implement a new information reporting regime for federal income tax purposes in respect of certain tax avoidance transactions. This proposal follows a similar requirement introduced by the Province of Quebec for provincial tax purposes. Moreover, the CRA’s administrative policy is changing to expand the requirements for taxpayers having to file partnership information returns. And finally, the CRA has issued a revised policy to access taxpayer and third-party documents reflecting the CRA’s heightened interest in supporting documents that assist in the determination of tax obligations and entitlements. As a practical result, the CRA can request working papers and other documents from tax professionals and tax preparers and thus taxpayers should expect more frequent requests in the future.

**Limiting access to APAs**

Transfer pricing reassessments by the CRA are becoming more significant and are generally very time consuming for the courts to address as exemplified by recent high profile decisions. The APA programme is a proactive service offered by the CRA to assist taxpayers in resolving potential transfer pricing disputes that may arise in future tax years. Considering that transfer pricing issues can be very complex, factually-based tax disputes, the APA programme has been very popular among taxpayers in helping to manage their tax risks and potentially avoid very lengthy transfer pricing audits, which can result in major tax reassessments. However, the CRA for a number of reasons (e.g., lack of resources) appears to be taking actions to limit access to this programme by rejecting APA applications due to the complexity of the transfer pricing issues. This could be key to the programme if this persists for a long period of time because taxpayers use the programme to address such complexity. The reduction of APAs will likely equate to increased cross-border controversies in the future.

**Reassessments after the regular time period**

Recent court cases have revisited the circumstances in which the CRA is entitled to reassess a taxpayer after the normal reassessment period in certain circumstances. The practical consequence is that tax returns may remain susceptible to challenge by the CRA beyond the normal reassessment period if there is a weak or uncertain filing position, an ambiguous or unclear disclosure of the true nature or amount of an expense, or a transaction with a non-resident that is not an arm’s length person. In addition to the specific court decisions, the sheer number of these types of cases raises concern that the CRA may be broadening its assessment practices and policies with respect to statute-barred years as part of an increased focus on aggressive tax planning. This evolving trend could also yield an increasing number of controversies and disputes if the statute of limitations is ineffective in providing protection for taxpayers.
China

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Greater transparency and information flow
Chinese revenue authorities are increasingly casting a wider net to obtain accurate and comprehensive taxpayer information for purposes of conducting tax audits and assessments. This trend is expected to become more pervasive over the next few years given that the traditional reliance on taxpayers to self-disclose pertinent information has generally proven to be inadequate from the revenue authority’s perspective. In addition to the implementation of the new Corporate Income Tax Law, Chinese tax authorities have issued various administrative circulars in recent years requiring taxpayers and withholding agents to report prescribed activities, corporate structures, business and other information to the relevant tax bureaus. For example, the authorities are now requesting contemporaneous transfer pricing documentation as well as certain information from Non-China Tax Resident Enterprises (Non-TREs) regarding indirect transfers of certain equity interests and those applying for tax treaty benefits. Information from Chinese-capital controlled foreign companies is also being sought.
The Chinese authorities will continue to pursue enhanced information exchange relationships to meet this goal. China’s State Administration of Taxation (SAT) has been pursuing more TIEAs with other countries and incorporating the modernised version of exchange of information clauses under Sino-foreign double tax agreements. Authorities are also pursuing information exchange on a local basis. The tax policy-making arm at the central government level has ramped up efforts to encourage all local level tax bureaus to proactively share taxpayer information between each other. In response, the tax bureaus have been building up platforms and channels to implement this sharing. For example, the SAT and the State Administration for Industry & Commerce issued a joint notice in December 2011 reinforcing their joint cooperation and sharing of information regarding equity transfers by individuals and companies.

**Enhancing trust and cooperation**

The Chinese tax authorities have more recently recognised the need to provide better services to taxpayers as well as increase interactions that foster trust and cooperation. The authorities are pursuing this approach to achieve effective resource utilisation and tax collection, lower-risk tax administration, and greater taxpayer dispute mitigation. They are also now recognising the need to change the role of tax collectors as simply handling basic tax administration and to make certain ‘cultural changes’ with respect to the process. With this goal in mind, the SAT has established a Tax Service Department for taxpayers and withholding agents to utilise. This department strives to ease reporting burdens while also attempting to resolve taxpayer disputes early in the process.

Local level tax officials are also being educated to ‘keep the service concept in mind’ during their interactions with taxpayers. This education will likely carry on given that the SAT encourages tax officials to continue to improve their services for taxpayers in the Outline of the Taxation Work Plan under SAT’s Five Year Plan (2011 to 2015). The SAT is also encouraging and promoting the use of APAs as a service to taxpayers to help achieve pricing and tax certainty and avoid unnecessary tax disputes. Although all of these changes signify a more modern and positive approach by China’s tax administration function, many challenges lie ahead. A big issue will be their implementation with respect to large and multinational businesses in addition to smaller scale taxpayers.

**A strategic focus for tax audits and administration**

The Chinese SAT is shifting from a collection-administration approach to a risk-assessment approach with respect to tax audits and administration with the aim of increasing both time and resource efficiencies. The authorities are now focused on certain areas such as transactions and corporate structures involving low or no tax countries. In addition to concentrating on specific transactions, the Chinese tax authorities are also concentrating on key industries and groups. Specifically, they are focused on Large Business Enterprises (LBEs) as these taxpayers are a key source of tax revenue in China. The SAT is using this ‘administration-service’ approach towards LBEs which they believe will increase LBE tax compliance levels, thereby reducing the frequency and value of any resulting tax disputes. Another strategic change in practice has been to undertake a tax evaluation scheme prior to executing formal tax audit procedures. This has simultaneously reduced the number of tax audits and improved the efficiency of tax audits.

The SAT is also engaging in a strategic approach with respect to APAs. Although widely encouraged and promoted by the SAT, they only plan to focus on ‘important’ cases by prioritising APAs involving high risk, large amounts, or complex functions.

The SAT has also expressed interest in studying, though not a top priority, other types of processes and services in the international tax arena within China’s 12th Five Year Plan period (2011 to 2015). These include, among others:

- joint audits of cross border transactions
- tax collection assistance for other jurisdictions
- a formal advance tax ruling regime for non-transfer pricing issues.

Despite the SAT’s move towards adopting more modern tax administration approaches, they have not indicated any interest in international arbitration for treaty disputes nor building a specialized tax court system with fully qualified tax judges.

**Greater clarity on tax policies and positions**

In recent years, the Chinese tax authorities have formulated policies and have adopted certain practices which have been perceived to be misaligned with international practices creating controversies and disputes. Various issues have aroused the close attention of multinational companies such as invoking anti-avoidance rules to tax capital gains arising from indirect equity transfers, embedding the anti-avoidance concept into the beneficial ownership test, and imposing stringent conditions for tax deferral treatment on corporate restructuring. The SAT has been discussing the creation of supplementary policies involving these issues to be more practical and investor-friendly. The authorities are also considering more alignment with international practices where this would not be detrimental to China’s tax base and principles. Although the SAT is considering giving some relief to such policies and easing the compliance burden of taxpayers, the anti-avoidance motive is likely to be retained in the new supplementary rules. In addition, the Chinese tax authorities have begun to have more open communication with the CAs in other jurisdictions regarding the rationales behind these policies and procedures – a trend that is expected to continue.
Retrospective legislation to impact disputes

The Supreme Court of India recently pronounced its judgment in the Vodafone tax case. The controversy in this case focused on the taxability in India of the offshore transfer of shares of a Cayman Islands Company by the Hutchison Group to the Vodafone Group. The Indian Revenue Authorities contended that in view of the substantial underlying assets in India of the Hutchinson group, the transfer was not of the share of the Cayman Islands Company but instead was in substance a transfer of the underlying Indian assets. Accordingly, the Revenue contended that the capital gain arising from the transfer was taxable in India and consequently withholding tax provisions would apply. The Supreme Court decided in favour of Vodafone to hold that the transaction was not taxable in India and hence there was no need to withhold. One of the reasons for the decision of the Court was that the Act does not have specific provisions to tax such transactions.

In reaction to this loss, the Indian government has enacted a provision under which gains on the transfer of shares of a foreign company would be liable to tax in India if the shares derive, directly or indirectly, their values substantially from assets located in India. This enactment regarding indirect transfers would apply retroactively from Assessment Year commencing 1 April 1962. The impact of such a change would be limited by the ability of the tax authorities to re-open assessments only for a specific period, currently six to seven years for most purposes although a longer period could be introduced (for example, a 17-year period has been discussed for certain other matters). However, a recent administrative instruction has limited the application of this retroactive enactment to cases where the assessment is not complete before 1 April 2012 and where a notice for reassessment has been issued before that date. In spite of this, the retroactive enactment remains a source of worry and surprise to stakeholders and may face challenges based on its constitutional validity. The implications of retrospective rules could have significant implications for previous tax disputes.
India continues to complete negotiations for even more TIEAs. India has also negotiated/renegotiated its income tax treaties with 40 countries including Switzerland, to broaden the scope of the exchange of information article to specifically allow for the exchange of banking information and ownership. The extent of these efforts demonstrates how the Indian government is creating a robust framework of information exchange to track unaccounted income going forward. Taxpayers should expect an increased sharing of information that will provide the government with even greater taxpayer transparency.

### GAAR enacted with future effect

Like many other countries, the Indian Government has enacted a GAAR scheduled to take effect from Assessment Year commencing 1 April 2014 to curb aggressive tax planning. Under the provisions, an arrangement (including a step in or a part) would be considered to be an ‘impermissible avoidance arrangement’ if it is undertaken with the main purpose or has as one of its main purposes of obtaining a ‘tax benefit.’ It must either:

- create rights or obligations, which would not be created if the transaction was implemented at arm’s length
- result, directly or indirectly, in the misuse of the provisions of the income-tax law
- lack commercial substance in whole or in part
- be entered into or carried out by means, or manner which would not be normally adopted for bona fide purposes.

Once effective, it is expected that this provision will become a standard, well-used tool by authorities to curb tax avoidance.

### Payments for software, equipment usage, and transmission

A new law with retroactive effect from 1 June 1976 provides that the payment for a right to use computer software is taxable as a royalty, regardless of the medium through which the software is transferred. Similarly, payment for use or right to use equipment is taxable as a royalty regardless of whether the payer has possession or control of the equipment, the location of the equipment, or direct usage of the equipment. Further, payment for transmission by satellite, cable, optic fibre or similar technology is to be considered as payment for usage of ‘process’ and is therefore considered taxable as a royalty. Such amendments may be effective 1 June 1976, but the tax authorities may only have the power to review transactions within the seven year period previously mentioned. An even stricter limitation provided by an administrative instruction may apply as well.

This enlarged scope of what constitutes a “royalty” is a further indication of India’s desire to seek more revenue by going against traditional tax principles. Earlier these questions were matters of intense debate and litigation. With respect to software payments, for example, the Karnataka High Court has held that payment for shrink-wrapped software or off-the-shelf software amounts to a royalty under Indian tax statutes and also under the relevant articles of income tax treaties. Accordingly, such payments should be subjected to Indian corporate income withholding taxes. The Delhi High Court, on the other hand, has held that where software is integrated with the hardware and is an integral part thereof, it is an arrangement for the supply of goods and cannot be classified as a royalty. Although the question of whether there are different interpretations under tax treaties still remains, the conflicting verdicts by these courts have fuelled debate over this issue. A retroactive amendment of the law may be sought to resolve this matter.
Openness and early engagement
HM Revenue & Customs (HMRC) is continuing to develop tax compliance processes that are based not only on objective risk assessments but also a policy of open and upfront engagement around issues as they arise. The UK’s largest businesses are now expected to engage in a regular transparent dialogue about tax positions in real time, or as close to it as possible. Those who do not do so face higher risk assessments and potentially more inquiries. A number of new approaches and regulations enable this policy. For example, the UK authorities may utilise information disclosure powers which allow them to issue statutory notices requiring more immediate disclosure (before relevant tax returns have been filed). In addition, the Senior Accounting Officer regime requires large groups to sign off on the appropriateness and accuracy of their tax reporting systems on an annual basis.
This approach is intended to assist both taxpayers and the tax authority to identify the areas of most significant risk as early as possible. As a result, the appropriate resources can be applied on a timely basis and resolution may be sought as efficiently as possible. For example, pre- or post-transaction clearances and APAs may be used, as well as more informal discussion and agreement. Because of these benefits, there is little doubt that this trend will continue for large businesses and the approach is likely to expand for other taxpayers. An administrative process is already in place extending the same treatment to wealthy individuals, and the authorities are also underway developing a similar process for smaller businesses.

**Subtle shifts in the dispute resolution environment**

New dispute resolution guidance has recently been published, which outlines a directional trend with respect to UK dispute resolution – the UK tax authorities appear to be moving away from a reliance on litigation. The new ‘Litigation and Settlement Strategy’ guidance clearly indicates that the tax authority should assess whether issues can be resolved by considering alternative legal analyses which might enable the parties to reach settlement. In addition, the guidance encourages the use of alternative dispute resolution (ADR) approaches including formal and informal mediation in appropriate cases. Trials of mediation processes have taken place over the past few months and the UK authorities have accepted them as successful and are therefore keen to apply such techniques more widely. So, the application of appropriate ADR processes is expected to become a key part of the resolution of UK tax disputes going forward.

In addition to an apparent willingness to reach settlement for either specific stand-alone issues or a portfolio of open disputes, the UK authorities have also identified a number of more generic issues where opportunities for settlement exist outside of litigation. These include:

- historic controlled foreign company positions
- the application of employment taxes to employee benefit structures
- certain financing structures involving convertible loan instruments.

The UK authorities are also offering relatively flexible ways for taxpayers with untaxed overseas assets to reach settlement through their Liechtenstein Disclosure Facility (LDF). Under the LDF, taxpayers with either undeclared or disputed liabilities can, in some circumstances, obtain certainty at reduced cost. These opportunities further illustrate the increasingly keen focus on early dispute resolution which the UK tax authorities are likely to continue in the coming years.
**Litigation trends affecting controversies**

A number of cases recently heard by the UK courts and tax tribunals are poised to have a significant impact when taxpayers consider litigation to resolve their disputes. UK courts appear willing to take a broader and more purposive interpretation of taxing statutes than previously expected, particularly in cases of a perceived aggressive tax position. The case of PA Holdings, heard in the Court of Appeal, represents an excellent example of this trend. It involves a dividend payment that was re-characterised as employment income taxable at a higher rate, on the basis that the payment formed part of an arrangement to remunerate employees. Courts also appear generally supportive of taxpayer arguments founded on procedural challenges. For example, there have been a number of recent decisions involving tax penalties where the tax tribunal found against the UK tax authorities and took a supportive view of the ‘reasonable excuse’ provisions under which penalties may be waived. Additionally, the UK authorities have suffered a number of reversals in cases surrounding their ability to assess historic tax positions. These trends are expected to continue, although the introduction of a GAAR (described below) may result in a less activist approach to statutory interpretation in some cases.

**General anti-avoidance rules**

At the request of the government, a committee recently reported on proposals for the introduction of a GAAR in the UK (the so-called Aaronson Report) to target artificial and abusive tax avoidance schemes. HMRC has since published a consultation document and draft legislation accepting the conclusion of the Aaronson Report that HMRC should not introduce a ‘broad’ GAAR. Instead, HMRC wants to introduce something targeted at what it considers to be artificial and abusive arrangements. The UK government intends for the proposed GAAR to have a narrower application than most general anti-avoidance rules found in other jurisdictions. HMRC does not want the GAAR to impact the ‘centre ground of tax planning’, resulting in sufficient certainty for taxpayers with respect to the tax treatment of transactions as well as the UK retaining a tax regime that is attractive to businesses. At the end of the consultation period (14 September 2012), HMRC will produce revised legislation with the aim that it will be introduced in Finance Bill 2013.

**Retrospective legislation for tax avoidance transactions**

The UK has employed a regime under which, since 2004, tax avoidance transactions must be reported to the tax authorities. The regime has been subject to periodic amendment since its introduction, with the scope extended almost annually. Historically, there have been two types of reporting required. Advisers have been required to make a report to the tax authorities where arrangements triggering specific hallmarks are discussed with clients. A reference number is then provided to the adviser, who passes it to the client for inclusion in their tax return when filed. The regime has recently been enhanced, with additional penalties for non-compliance and a new quarterly reporting obligation for tax advisers under which lists of clients using disclosed arrangements must be provided.

The regime enables the UK authorities to obtain early visibility of new tax planning arrangements, and to take legislative action to counteract them when necessary. Most recently, HMRC enacted blocking legislation that focused on arrangements involving the acquisition of debt at a discount. Controversially, the legislation was partially retrospective. The UK authorities have utilised retrospective legislation in the past, although this has not been a regular occurrence. Although there are challenges underway to the application of retrospective legislation founded on European Union law, it appears that the UK authorities believe this to be an appropriate and legally justifiable approach. The possibility of retrospective legislation, albeit on a very limited basis, creates significant uncertainty for UK taxpayers going forward.
The possibility of retrospective legislation, albeit on a very limited basis, creates significant uncertainty for UK taxpayers going forward.
Disclosure and transparency initiatives imposed on U.S. taxpayers are dramatically increasing to enable more effective risk assessment and audit selection. One of the most publicised information reporting initiatives is the so-called FATCA law (Foreign Account Tax Compliance Act) that was enacted in 2010 in an attempt to deter and identify offshore tax evasion by U.S. persons holding foreign accounts and foreign assets. A major provision of the legislation generally requires all foreign financial institutions to enter into agreements with the Internal Revenue Service (IRS) to collect documentation and perform due diligence sufficient for it to identify these U.S. persons or face increased withholding on their income and gains. The legislation gave the U.S. Treasury broad regulatory discretion and an extensive set of proposed regulations was released in February 2012. The new regulations will likely tie-up valuable IRS resources over the next several years as the IRS moves to finalise them and will likely add greater complexity for audits of financial institution and insurance industry taxpayers in the coming years.
In addition, the FATCA rules will likely continue to increase tensions between the United States and certain countries over the collection and disclosure of such information.

**Joint audits: A new era begins**
The U.S. government’s long-standing desire to exchange tax-related information with other governments has undergone a fundamental shift with the introduction of joint audits. The IRS has disclosed the completion of its first joint audit with Australia as well as the successful conclusion of a joint audit with the UK, culminating in a bilateral APA. The IRS has recommended that U.S. multinational companies embrace this approach as a new core methodology and promotes it as an efficient process for both taxpayers and tax authorities. In this regard, joint audits may enable the two countries involved to agree on the facts upfront and the CA from the respective countries may get involved much earlier in the dispute process. Governments contemplate that joint audits should be completed within 12 to 18 months of the start date, which may be far less than a traditional audit when taking into account the potential time to resolve a dispute using the CA process. For these reasons, the IRS is poised to expand their use of joint audits over the next few years, particularly with those countries in which they have already occurred. Despite their potential benefits, joint audits may not be expected to occur in those countries that have legal obstacles to the collaborative nature of the joint audit process (such as Hong Kong which has certain domestic disclosure laws that may be prohibitive).

**A shift in exam targets**
The IRS has begun to revamp its corporate taxpayer audit process in 2012 with a stated strategy of shifting away from large case exams, effectively de-emphasising the size of the taxpayer as a primary determinant of risk. Instead, the IRS will pursue an approach based on the assessment of risk posed by the taxpayer. Although it will take time to implement, it is a move that is hailed by many tax practitioners and will help shape the U.S. audit landscape for years to come. Resources devoted to large corporate audits (with assets of $1 billion or more) will be shifted to exams involving flow-through entities, financial products and businesses with either international operations or assets of $250 million or less. It is unlikely though to result in the IRS omitting to audit any one of the Fortune 100 corporations. At the same time, the IRS is directing revenue agents to engage in a ‘robust exam planning process where agents and taxpayers discuss issues and the plan to audit those issues,’ including an agreed upon response time for taxpayers to answer Information Document Requests (IDRs). The IRS appears ready to follow a judicial summons approach going forward if taxpayers do not answer IDRs in a timely manner – an action that has been historically rare for IRS examining agents to pursue.
In the coming years, multinational companies will increasingly attempt to identify and resolve U.S. tax issues and potential controversies in advance to reduce risk and achieve greater certainty for the future.
The rise of mandatory binding arbitration provisions

U.S. multinational enterprises can expect increasing levels of tax controversy as the IRS steps up its enforcement activities, particularly in the international tax and transfer pricing areas. This will continue to place a strain on traditional dispute resolution methods, such as administrative appeals and mediation. In addition, tax controversies with respect to cross-border transactions involving double taxation by the United States and a foreign jurisdiction are also expanding. Where an income tax treaty applies, the MAP allows the CAs of the treaty governments to use their ‘best efforts’ to resolve disputes. Requests for assistance under the CA process in the United States have dramatically increased over past years and this trend is expected to continue over the next three to five years. This will also place tremendous pressure on the entire CA process – an important traditional dispute resolution option. As a result of this increasing strain on traditional methods, the IRS will likely seek new alternatives for managing and resolving these disputes.

One of the newest dispute resolution techniques is the recent inclusion of mandatory binding arbitration provisions in U.S. income tax treaties. The inclusion of this clause promises to ultimately speed up the CA process in cross-border disputes. An unfortunate downside to the CA treaty procedures is that they do not require deadlines by which the countries should reach agreement. As a result, controversies may remain unresolved for a period of time, generally between three and five years. Mandatory binding arbitration, however, mandates a process that will generally compel resolution and thus having these provisions loom over the dispute can influence the parties to resolve the controversy before the arbitration process begins. So far, mandatory binding arbitration provisions have been included in four U.S. income tax treaties including Canada, Germany, France, and Belgium (a U.S./Swiss protocol not yet fully ratified also contains this clause). The next five years could potentially mark the introduction of at least fifteen new arbitration provisions given the U.S. Treasury Department’s typical schedule of negotiating around three or so new treaties or protocols a year.

Enhanced taxpayer desire to reduce uncertainty and risk

In the coming years, multinational companies will increasingly attempt to identify and resolve U.S. tax issues and potential controversies in advance to reduce risk and achieve greater certainty for the future. Various pre-filing processes exist that continue to be used by taxpayers including taxpayer-specific private letter rulings. Pre-filing agreements (PFAs), in particular, are likely to gain in popularity. These involve a collaborative approach for taxpayer-specific issues that are post-transaction and factually specific and that might have otherwise been addressed during the audit process. PFAs have been specifically noted by IRS leadership as an effective ‘issue resolution tool’ that may enable resolution in a more transparent, timely, and efficient manner. IRS officials have also encouraged the use of the so-called Fast Track Appeals process in existence since 2006, but recent reports have shown declining participation in this programme and the IRS Advisory Council has suggested that the IRS consider closing it.

Another IRS audit programme that enables taxpayers to reduce uncertainty and risk is the now permanent compliance assurance process (CAP) programme. This programme requires extensive cooperation and transparency from participating taxpayers, is focused on larger corporations, and is administered by the Large Business and International (LB&I) Division. Initially launched with just a few taxpayers, participation in the programme has grown quickly in size, although it is not without some sacrifices by taxpayers. The programme involves not only resolution of prior year audit periods, but also current year real-time audits, resulting in taxpayers having to respond quickly to document and information requests. Although the process typically requires additional dedicated resources, the ability for larger companies to reduce risk and financial statement impact from the creation of tax reserves can be appealing for certain corporate executive suites and may grow in participation over the upcoming years.

Opportunities to reap the benefits of an APA

Multinational taxpayers are also seeking greater certainty with respect to cross-border transfer pricing – an area of increased scrutiny by the IRS – as evidenced by the increased number of requests to the IRS APA programme. This programme recently revealed that it received a record high number of APA submissions in 2010 for the third straight year (144 requests), although submissions dropped in 2011 to only 96. Unfortunately, the APA completion rate has been abysmal and the 2011 tax year was no exception. The programme revealed that pending APAs increased from 350 in 2010 to 445 in 2011. Over the past year, the IRS has been revamping the programme and combining the APA programme with the Tax Treaty Office staff that handle MAP transfer pricing cases into one office within the LB&I Division. One of the primary goals of the newly revamped Advanced Pricing and Mutual Agreement (APMA) office is to enable the IRS to work through this large backlog of APA requests more efficiently and place the IRS in a stronger position to address the continuing surge. Ideally, taxpayers should be able to reap the benefits of this new organisation over the next several years.
What are the pivotal challenges on the horizon?
Q: Do you have a thorough understanding of how specific countries choose which companies to audit? Is the approach by the tax authorities expected to change and if yes, will that make your company more susceptible to an audit?

**Thirst for revenue will drive audit frequencies and efficiencies**

**Doing more with less**

In the coming years, fiscal deficits will cast a long shadow for many governments forcing tax authorities to seek greater revenue but with smaller administration budgets. This fact will merge with the fundamental trend that tax principles and rules in most jurisdictions evolve year-on-year into an increasingly complex system for businesses and tax authorities to manage. How will revenue authorities face both challenges? The tax audit and controversy environment in the next several years will be marked with enhanced changes to audit and dispute approaches. Faced with cost-cutting demands, tax authorities will seek new ways to ‘do more with less’ – tackle the administration of increasingly complicated tax principles, increase revenue collection, and maximise efficiencies.

The global tax community is experiencing signs of this movement. Certain countries have already recognised the need to pursue administration changes to drive efficiencies. Most of the countries described in this publication are either currently using or are shifting to a more efficient risk-based assessment method to help tax authorities identify which taxpayers and issues to audit (as compared to historical methods such as taxpayer refund requests). Another telling example is the creation of the OECD Forum on Tax Administration’s ‘Working Smarter’ project. In January 2012, the task force released a report which focused on measures tax administrations may take to reduce costs and increase efficiencies. Specifically with respect to tax audits and disputes, the report recommends that tax authorities seek improved capabilities and processes surrounding risk identification and workload selection.

Evaluating which countries may be more poised to choose your company for an audit may well impact how you allocate tax or financial resources. Even more significantly, it may have a fundamental impact on your tax planning strategy.
Q: With respect to the major jurisdictions in which your company is operating, is there an expected reorganisation of resources by the tax authority to focus on a particular area, such as transfer pricing?

Early identification and mitigation of risk
Tax disputes between tax authorities and taxpayers can be expensive and use up resources. Going forward, tax authorities will more frequently ask how they can reduce disputes to drive efficiencies. Some tax authorities already see the benefit of early identification and mitigation of material risks as an effective strategy. One way to do this is to craft procedures and processes that force revenue agents to work with taxpayers on a real-time basis and thus identify problems or potential disputes at an early stage and take steps to resolve them. Taxpayers are already experiencing this change in approach in certain countries such as the UK, but this trend is likely to expand rapidly, with each revenue authority customising its own approach.

Strategic allocation of resources
The drive for more audit and dispute efficiencies is likely to have an increasing effect on how revenue authority resources are allocated. Given the need to do more with less, revenue authorities will likely seek new ways to reorganise operations to streamline resources. Certain tax authorities have more recently reorganised their internal staff to be better aligned with their strategic objectives. In China, the SAT established the Large Business Taxation Department to focus on taxpayers that are key sources of revenue. Similarly in India, the ‘Large Taxpayer Unit’ scheme focuses on corporations that pay tax above a certain threshold. In addition, the IRS in the United States has made internal organisational changes to create a new transfer pricing practice, an area which the IRS is intensely scrutinising. This latter change is now permanent after various pilot cases and aims to focus transfer pricing personnel that have greater experience onto specific U.S. tax audits. These organisational changes also allow for enhanced continuity with the APA and CA functions, an expansion in the resource base and elimination of duplicate cases and issues, as well as an improvement in the process for selecting cases for litigation.

A review of your positions in that jurisdiction may highlight an inconsistency or inadvertent absence of documentation, allowing you to address it and reduce risk. There may be a change then in the nature and extent of discussions with an authority prior to the location of particular functions or entities.
Has your company engaged in transactions that could be subject to an existing or future GAAR? Which countries does your company operate in that may be contemplating the introduction of a GAAR?

Rise in tax controversies relating to anti-avoidance provisions

More and more countries have pursued the enactment of general anti-avoidance legislation as it relates to tax-motivated transactions. While countries such as Australia and Canada have had GAAR legislation for 20 to 30 years, many countries such as Germany and China have more recently adopted general anti-avoidance statutes. India has also enacted a GAAR that targets impermissible avoidance arrangements but such provision is not effective until 2014. In addition, other countries have announced plans to introduce GAAR legislation. This will likely yield an environment in upcoming years where a number of cases across jurisdictions will be litigated to form an additional foundation of law surrounding these new provisions. Tax authorities are likely to 'test' these provisions and their outer limits so they can obtain even more practical parameters of when these provisions should be applied. This may be especially true in situations like those in Australia where severe and costly penalties surround the application of these provisions.

A review of such transactions may serve to identify potential financial exposure areas and eventually lead to audit management efficiencies and risk reduction. The possible application of a GAAR might also affect the degree of certainty about the implications of planned or possible structuring, financing or other longer-term strategies.
What techniques are the local tax authorities considering to further enhance cooperation with taxpayers? Would it be more efficient from an overall cost perspective to gain certainty upfront with a tax ruling or similar arrangement as opposed to the costs of managing a contentious tax audit?

**Balancing 'across the table' cooperation with aggressive enforcement**

**Achieving upfront certainty**

It is likely that opportunities for expanded 'across the table' cooperation between tax authorities and taxpayers in the near future will dramatically increase. Both stakeholders generally seek an open, transparent, and cooperative relationship with respect to tax compliance and risk. Although tax administrations may be motivated by their goal to reduce future disputes, multinational enterprises may also pursue cooperation to identify and resolve issues and potential controversies in advance to reduce risk and gain upfront certainty. In the coming years, more pressure will be placed on achieving such certainty as the finance function for the typical multinational enterprise may become more risk adverse. As a result, taxpayers may want to seek approaches to achieve certainty such as obtaining rulings, pre-filing type agreements, and APAs, as well as pursuing accelerated and streamlined audits.

APAs in particular will likely become an even more useable and sought after tool for both taxpayers and tax authorities over the coming years. More countries are introducing APA programmes such as Hong Kong and India, or are revamping their programmes to handle the increased demand, such as the United States. Other countries like China continue to complete ground-breaking APAs that serve as important milestones for their transfer pricing regime. APA programmes can have a tremendous impact on reducing the number of taxpayer disputes and controversies given that their approach seeks to achieve upfront certainty going forward, even allowing APA terms to apply retroactively for a period of years. A competing factor, however, may be the resource shortages in tax administrations, as evidenced by the Canadian tax authorities potentially scaling back resources applied to their APA programme. The shortage of resource is apparently also preventing the Chinese APA programme from accepting many new requests. Going forward, taxpayers will likely accept an increased time commitment to obtain an APA in order to reap the benefits of an advance agreement to achieve certainty.

**Identifying real opportunities to reduce risk at a reduced cost can be a welcome opportunity.**
When considering an investment in a particular territory where the tax authority is adopting more aggressive measures, do you gauge the type or amount of the investment so as to limit potential tax exposure? Are there ways of doing business in a specific jurisdiction which give you greater protection against tax risks? Are any jurisdictions auditing your company engaging in aggressive enforcement tactics such as specific industry SWAT teams?

**Focus on revenue collection**

Some things simply go hand in hand: although cooperation between taxpayers and tax authorities will likely expand, so will aggressive enforcement and collection practices. Countries such as Brazil have adopted a number of initiatives over the years to increase enforcement and exponentially increase collection levels. Brazil’s introduction of SPED is one such example along with Canada’s expansion of their normal reassessment period. Tax authorities are also engaging in increased foreign site visits, as well as specialised ‘SWAT’ teams for specific companies or industries. Other aggressive tactics include extensive interviews of company personnel, use of outside experts, requests for large amounts of documentation, intensive factual investigations, the issuance of standard pattern information document requests, and even threats of judicial summons enforcement.

What about criminal enforcement measures? The last few years have also seen a trend for revenue authorities to more habitually utilise criminal enforcement sanctions against more high profile, established corporate taxpayers. For example, taxpayers in Germany are experiencing an increased tendency by the German tax authorities to call in the Criminal Investigation Department for Tax Evasion even in situations where a taxpayer is merely late to file their self-assessment forms. This broader trend has also been noticed in South Korea and now in Spain. With the need for greater revenue, companies may increasingly see the use of these tools in the normal course of conduct as this trend unfortunately may be here to stay.

If yes, proper pre-audit planning is an excellent mitigation technique going forward so that your company is able to potentially minimise response times and better manage in-house resources.
**Enhanced horizontal teaming among tax authorities**

What we might call ‘horizontal teaming’ among tax authorities on a global scale should continue to expand through the enhanced exchange of information networks, intergovernmental organisations, and other endeavours such as joint audits. The relationships and agreements between governments may become increasingly important because of a growing number of mechanisms under local law that may in fact penalise countries that do not engage in reciprocal relationships. An excellent example is the anti-avoidance measures introduced in India to discourage transactions with persons located in any jurisdiction which does not effectively exchange information with India. Horizontal teaming is also illustrated by the joint audit approach, which the United States has been pursuing. The increased teaming between federal and state level revenue authorities as evidenced in China and Brazil also demonstrate this direction going forward.

**Growing external pressures to resolve disputes**

External factors may increasingly drive taxpayers to seek early settlement of disputes with tax authorities in the coming years. Historically, information regarding tax audits and disputes has been considered a private matter between the company and the tax authority in many countries. Going forward, however, such information is likely to become more at risk of public disclosure and attention. How may this information become public? Disputes rising to the level of litigation where court filings are involved generally become public information in many jurisdictions. Public disclosure of significant tax controversies may be required in a company’s public financial statements or otherwise demanded by non-governmental organisations (NGOs.) In some countries, a leak may occur to the media. Whatever the mechanism, the disclosure can ultimately lead to far reaching dissemination and form the foundation for broader public debate of the issue. High profile disputes such as the Vodafone case in India and the GlaxoSmithKline cases in the United States and Canada are telling examples of this trend.

Companies that are compliant taxpayers and good corporate citizens seek to avoid potentially negative publicity affecting stakeholder perceptions. Early dispute settlements may help avoid the limelight and may contribute to a growing trend to resolve controversies. Unfortunately, this may also collide with external public scrutiny affecting tax authorities. As fiscal deficits rise, tax authorities will be more intensely reviewed by politicians to capture the largest amount of revenue possible and set a precedent for other taxpayers. This political interference could place pressure on tax authorities to aggressively pursue large tax assessments and prolong the settlement process, with certain cases proceeding to judicial litigation.
Do you realise that you may need to discuss greater details surrounding your international business activities and related tax positions with tax authorities so as to manage multi-jurisdictional controversies? How important is a particular jurisdiction to your business in terms of your willingness to bring disputes to a higher level for resolution? Are jurisdictions contemplating changes regarding their dispute resolution programmes that would allow your company to resolve specific issues in a more timely and efficient manner?

Influence from the BRIC countries

Brazil, Russia, India, and China (BRIC) are having a measurable impact on the world’s economy. But how will these countries impact global tax policy trends in the tax controversy arena? These jurisdictions have more recently confronted certain norms and traditions surrounding tax audits and disputes. From Brazil’s unique SPED system to India’s retrospective legislation, these countries have tested the outside limits of historic tax principles. These developments, while perhaps effective for improving revenue for their respective jurisdictions, may ultimately provide a chilling effect if their practices trigger an exceeding amount of risk and uncertainty for businesses. However, the processes and policies embraced by the BRIC countries will likely begin to shape future outcomes and have a direct influence on global audit and controversy trends if their endeavours generate increased revenue collection while not hindering economic development. Moreover, if the BRIC countries do not join the OECD, it may adversely impact the importance of the OECD’s view and recommendations going forward.

Multi-jurisdictional tax disputes

Over the next several years, a greater number of multinational businesses will be involved in not only bilateral disputes involving two jurisdictions, but also multi-jurisdictional disputes where more than two countries are involved. Companies increasingly have dispersed business operations worldwide invariably triggering multi-jurisdictional controversies involving various tax authorities. Notwithstanding this development, there are no multi-lateral income tax treaties-only bilateral treaties. The practical effect is that there is no mechanism to assist taxpayers in this situation. What remedies may the taxpayers pursue? These practical problems cast a spotlight on the lack of available dispute resolution techniques in these multi-jurisdictional circumstances.

From a purely conceptual and policy perspective, the establishment of an international court of tax justice could alleviate these problems by serving as an impartial body or arbitrator for such multi-jurisdictional tax disputes. A host of considerations and challenges would arise with this approach, including national sovereignty, jurisdiction, rules of evidence, and enforcement of decisions. Would there be any ability to appeal the decision? If so, to what authority? The successes and failures of various trials and pilots from different jurisdictions could be considered and leveraged. Although an international court of tax justice is theoretical in concept, the future tax audit and controversy environment may demand grand ideas that enable practical and efficient solutions for all stakeholders.

The emergence of a new pilot programme could save your company valuable resources.
Proactive actions to look at

Evaluating the future tax audit and controversy landscape has become a business imperative
Reactive is out; proactive is in. But taking a reactive approach is no longer even an option. Acting only when an audit arises was a more traditional, historical approach, but it is unlikely to yield adequate financial risk reduction going forward for many companies. Instead, adopting a proactive and coordinated strategy with respect to tax audits, disputes, and your tax planning approach may yield successful risk reduction, financial benefits, and other resource-driven benefits. What actions should your company look at now?

**Strategic Risk Assessment**
An efficient first step may be an initial Strategic Risk Assessment (SRA) designed to identify possible weaknesses, gaps, and inconsistencies in your company’s tax audit defence strategies and documentation requirements. This may entail an analysis of several factors such as your company’s current and prior material tax audits and disputes around the world, as well as your company’s structure, transactions, operations, and history. A common starting point may be to identify your primary markets and those markets most important to your business going forward. What are the key audit issues in those markets? When an investment into these markets was made, were tax considerations taken into account in the resulting structure such as how the operation should be funded and how intercompany transactions should be managed? Does your company have adequate documentation for material transactions and operations? Is there a framework for producing robust documentation that avoids expensive duplication of data collection efforts?

**Internal policy planning**
You may also consider an entire host of internal planning techniques such as real-time monitoring of country-specific developments. Your company may also look at coordinating and aligning issues across jurisdictions, anticipating potential arguments, and crafting defensive strategies. This may also include developing sound in-house policies and procedures. You may also wish to craft a coordinated plan on how to effectively manage audits and examinations when and where they occur, i.e. a virtual roadmap of what resources to mobilise when an international tax audit begins. How will you respond to large document information requests, as well as requests for interviews, depositions, or facility tours?

**Global Coordination Hub**
In the current environment, it is not unusual for companies to be confronted with multiple overlapping tax investigations concurrently. Moving away from a decentralised approach to international tax audits and disputes toward a coordinated approach using a Global Coordination Hub can yield significant efficiencies for taxpayers. Under this methodology, all audits are linked together with one location, giving your company the ability to coordinate and manage information, positions, and documentation on a real-time basis. You could link this in with a more centralised approach to your tax function as a whole, including how you manage your compliance. This more streamlined and integrated method could potentially produce other additional benefits.

**Managing external opportunities**
How your company’s tax computations, and the underlying positions, will ultimately be handled by the tax authorities depends at least in part on their view of your company. Your approach to tax strategy can include how you manage your interactions with those authorities. Another opportunity is obtaining pre-clearance or pre-filing rulings such as unilateral, bilateral, multilateral, and synthetic APAs. These may serve as excellent insurance policies, saving your company’s resources, time, and money while decreasing risk exposure.

Effective techniques also include building enhanced relationships with tax authorities. Examples include the IRS CAP initiative, streamlined audits in South Korea, horizontal monitoring in the Netherlands, and ‘enhanced relationships’ in the UK. Moreover, participation in the OECD and United Nations tax policy debate, as well as efforts to help shape the development of new legislative, regulatory, and administrative remedies for resolving tax disputes, may yield beneficial opportunities to have your company’s voice heard.

**Resolution frameworks**
Once a dispute has been identified, what’s the best path to achieve efficient resolution? Before taking initial steps, think about proactively documenting a resolution framework to help you make an informed decision. This framework can summarize not only the available resolution options, but also practical insights about the dispute resolution landscape now and going forward. How are the tax authorities applying penalties? Is this approach trending in a certain direction? What potential information may need to be disclosed in future litigation? These considerations can help you weigh the various strengths and weaknesses of each potential step toward resolution. It may also help you balance the technical merits of the dispute with the indirect impact on other aspects of your business keeping in mind the overall objective of maximizing shareholder value.

**Trends on the horizon**
How can your company benefit from future perspectives? Evaluating the future tax audit and controversy landscape – albeit a difficult task given its dynamic nature – has become a business imperative. These and other forward perspectives should be built into every aspect of your company’s proactive and coordinated business strategy. A tax audit and dispute strategy is an essential part of your tax strategy, and should help shape your company’s day-to-day actions and longer-term planning.
Real-time, local country guidance, specialised knowledge, and local country connections
Let’s talk

How can PwC help?
PwC’s Tax Controversy and Dispute Resolution (TCDR) Global Network can help you address and resolve your company’s tax audit and dispute challenges using strategic global planning and local tactical implementation. The TCDR Network provides a full range of corporate tax controversy and dispute resolution services for audits and disputes arising anywhere in the world and can assist at all stages of the international tax dispute life cycle. TCDR team members around the world include former government officials and can deliver real-time, local country guidance, specialised knowledge, and local country connections – a valuable combination that enables an in-depth understanding of local processes and procedures. We focus specifically on preventing tax controversies, proactively managing audits, and creatively resolving tax disputes to reach timely and successful results.

The TCDR Network works closely with the Tax Policy and Administration Network in helping you reach solutions that also take into account current trends and forward-thinking expertise. Our relationships and knowledge involving supranational bodies, policy makers, and tax administrations can help you gain valuable perspectives when managing tax controversy challenges.
For more information, please do not hesitate to contact the following members of PwC’s Tax Controversy and Dispute Resolution (TCDR) and Tax Policy and Administration Networks:

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