

Can't Knock the Hustle

The Implications of International Reforms for
Audit and Controversy

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Agenda

- IRS New Compliance Approach
- International Enforcement
 - Exchange of Information Pursuant to Treaty
 - International CAP
 - Multilateral Audits
 - Lagging Taxpayer Protections

IRS New Compliance Approach

IRS New Compliance Approach

- 2014 IRSAC LB&I Subcommittee Report
 - OECD Risk Assessment Report
 - Study of risk assessment in Australia, Canada and New Zealand
- 2015 New IDR Process/Limits on Informal Refund Claims
- 2016 LB&I Restructuring
 - Risk and issue based audits replacing continuous audits
 - Continuous examination for the “largest taxpayers”
 - Centralized risk-assessment program for issue selection
 - Campaigns
 - CAP applications suspended

IRS Campaigns

- “Treatment streams” include both outreach/education and audit/penalties
 - IRS webpage updates
 - Issue practice units,
 - Presentations, including at the IRS Nationwide Tax Forum
- Campaigns of interest to large taxpayers
 - Foreign Base Co. Sales Income: Manufacturing Branch Rules
 - Restoration of Sequestered AMT Credit Carryforward
 - Repatriation via Foreign Triangular Reorgs (Not. 2016-73)
 - Section 965 Transition Tax
 - Forms 1042/1042-S Compliance
 - Costs that Facilitate a 355 Transaction
 - Corporate Direct FTC (for taxpayers with excess limitation)
 - Section 956 Avoidance

CAP Program

- 2005 – pilot program with 17 taxpayers
- 2011 – permanent program (LB&I had 7000 employees)
 - **Pre-CAP** – Eliminate open years in a set timeframe
 - **CAP** – Issue resolution in real time, closing agreement
 - **CAP Maintenance** – Reduced scrutiny based on past compliance
- 2016 – 181 CAP taxpayers/New applications suspended
- 2018 - 169 CAP taxpayers/New applications reopened beginning 10/1/18 (LB&I has 4500 employees)
 - Public companies only

2018 Changes for CAP Applicants

- Consideration of “unsuitable behavior”
 - IDR response times
 - Good-faith issue resolution
 - Failure to disclose material items, tax shelters, investigations or litigation
 - Frequent claim filings
 - Failure to resolve issues

- Additional materials
 - Material issues list
 - R&E questionnaire
 - Intercompany transaction template
 - Tax organization chart for transfer pricing issues

Changes in CAP for 2019

- Material issues list is agreed to between IRS and taxpayer
- Examination may be limited due to resources
- Increased timeliness
 - Certain transfer pricing issues – APA required
 - Unagreed issues sent to Appeals more promptly
 - Taxpayer representation letter due 30 days post-return
 - Timeframes established for post-filing review
- CAP Maintenance participants may skip a year
- Future changes
 - Certification of a tax control framework
 - Issue-based resolutions

What's Next? Possibly Australia's Process

- “Big data”
 - Information reporting, data shared from other government agencies
- OECD Justified Trust methodology
 - Understanding the taxpayer's tax governance framework
 - Identifying tax risks flagged to the market (for example, through Taxpayer Alerts, Practical Compliance Guidelines or Public Rulings)
 - Understanding significant and new transactions
 - Understanding why the accounting and tax results vary
 - Analysis of effective tax rate



International Enforcement

International Exchange of Information

- Exchange of Information Pursuant to Treaty
- International CAP
- Multilateral Audits
- Lagging Taxpayer Protections

Exchange of Information Pursuant to Treaty

- Exchange of information provisions and agreements are becoming more prevalent

- Countries are becoming more cooperative
 - Singapore

- Pursuant to OECD guidelines
 - The OECD has been active in facilitating automatic exchange for many years by creating the legal framework, developing technical standards, providing guidance and training, and seeking to improve automatic exchange at a practical level

 - Information exchange should occur widely and freely

 - Exceptions should be applied narrowly

Exchange of Information Pursuant to Treaty

- General Types of Information Exchange
 - On request from one authority to another
 - Principal focus of information exchange
 - Automatically
 - The automatic exchange of information is understood to involve the systematic and periodic transmission of “bulk” taxpayer information by the source country to the residence country concerning various categories of income (e.g., dividends, interest, royalties, salaries, pensions, etc.)
 - Spontaneously
 - Voluntary disclosure of information that one authority thinks may be of interest to the other authority

Exchange of Information Pursuant to Treaty

- General Types of Information Exchange
 - Treaties also permit other methods as well:
 - Simultaneous audits
 - Representatives of one state visiting another to conduct separate or joint interviews or examinations
 - Industry-wide information exchange

Exchange of Information Pursuant to Treaty

- Limited Taxpayer Rights
 - No requirement to notify taxpayer
 - No requirement to let the taxpayer know whether information was shared and, if so, what information was shared
 - No requirement to seek taxpayer input as to whether requested information qualifies for a disclosure exception
 - As a result, if a tax authority already has the requested information, the taxpayer may have no knowledge that an EOI has taken place
 - If the tax authority has to request information from the taxpayer, it may provide an opportunity to discuss the EOI request
 - Tax authorities have latitude in whether and to what extent to discuss the situation

Exchange of Information Pursuant to Treaty

— Potential Exceptions Under OECD Standards

- Relevance
 - The standard is foreseeable relevance, which is broadly construed
 - Intended to prohibit fishing expeditions, but difficult to establish
- Availability under local law and exhaustion of local avenues
 - The standard is whether the requesting authority could have secured the information under its domestic laws and procedures
 - The scope of this exception is not entirely clear and as a general proposition it is difficult to resist a request on this basis

Exchange of Information Pursuant to Treaty

- Potential Exceptions Under OECD Standards
 - Trade and business secrets
 - Facts and circumstances that are:
 - Of considerable economic importance
 - Can be exploited practically, and
 - Lead to serious damage, such as severe financial hardship
 - Potential examples
 - Proprietary formula
 - Sourcing and pricing of raw materials
 - Pricing of sale of goods or services to third parties

Exchange of Information Pursuant to Treaty

- New Internal Revenue Manual on EOI Requests Effective on October 15, 2018
 - Contains a number of changes from the previous 2014 version
 - All exchanges of tax-related information pursuant to international exchange agreements are subject to strict considerations of disclosure and confidentiality, including confidentiality attached to trade and other business secrets
 - International exchange agreements frequently include language limiting the exchange of trade secrets, such as “are not obligated to be exchanged” or “will not be exchanged.” International exchange agreements generally refer to such materials as any trade, business, industrial, commercial, or professional secret or trade process

Exchange of Information Pursuant to Treaty

- New Internal Revenue Manual on EOI Requests Effective on October 15, 2018
 - In general, information may be considered a trade or other business secret protected from disclosure to a foreign Competent Authority if disclosure would cause substantial harm to the taxpayer's competitive position. Information related to transfer pricing may not necessarily be protected from disclosure
 - If a foreign request for information is resisted by a US recordkeeper on the grounds that it constitutes trade secret information which may not be disclosed, the recordkeeper must provide a comprehensive explanation of the legal and/or factual grounds for the recordkeeper's objections to the EOI analyst assigned to the foreign request
 - The US Competent Authority will then consider the recordkeeper's explanation and determine whether the information should be disclosed to the foreign Competent Authority

International Joint Audits

— Simultaneous Controls (EU)

- Article 12 of Directive 2011/16/EU
- Simultaneous controls consist of two or more Member States agreeing to audit, in parallel and each in their own territory, one or more related taxpayers which are of common or complementary interest to their respective tax administrations
- The main aim is to exchange the obtained information

— Joint Audits (OECD)

- A joint audit involves two or more tax administrations that come together and form a single audit team, in order to examine an issue/set of transactions which pertain to one or more related taxpayers (with cross-border economic activities)
- Both tax administrations will have a common or complementary interest in the taxpayer(s)
- The aim of this exercise is to agree on a single audit report at the end and assess the related taxpayers to tax on this basis
- Through this process, the tax authorities are expected to form a more comprehensive understanding of the audited taxpayers' affairs and conclude with an assessment that does not result in double taxation or non-taxation

Multilateral Controls

- Multilateral Controls (EU)
 - Within the framework of the EU Fiscalis Programme, a multilateral control is an arrangement where national tax administrations agree to carry out co-ordinated controls of one or more related taxpayers where the control is linked to a common or complementary interest
 - The Programme Fiscalis 2020 provides no legal basis itself for the execution of multilateral transfer pricing controls but finances the meetings of tax officials as well as their participation in administrative enquiries carried out abroad

International Compliance Assurance Programme

- Pilot program that uses CbC Reports and other information to facilitate multilateral engagements between MNE groups and participating tax administrations
 - Benefits
 - Improved risk assessment based on fully informed and targeted use of CbCR information, an efficient use of resources, a faster and clearer route to multilateral tax certainty and fewer disputes entering into MAP
- New FTA project mapping out jurisdictions' differing approaches to risk assessment with a view to increasing mutual understanding, closer cooperation and convergence

International CAP

- Voluntary process available to large MNE groups headquartered in participating jurisdictions
 - Application process may vary by jurisdiction
 - Identify participating jurisdictions where it has activity and that it wishes to be included in a multilateral risk assessment
 - Tax administrations in these jurisdictions will then confirm whether they agree to participate in ICAP for that MNE group, taking into account factors such as the group's presence in their jurisdiction and its risk profile
 - Multilateral risk assessment conducted under ICAP will not cover all of an MNE group's tax issues but will focus on those associated with transfer pricing, permanent establishments and any other material international issues agreed between the group and participating tax administrations

International CAP

- Provide a package of documents, including the CbC Report, to the lead tax administration
 - Shared among tax administrations participating in the MNE group's ICAP risk assessment
 - Other information held by tax administrations also shared
- A meeting will be held with the group and all participating tax administrations to discuss the content of the CbC Report and other documentation, to ensure a full and consistent understanding of the group's profile and activities

International CAP

- Initial risk assessment will be conducted by each participating tax administration
 - Whether they can gain comfort the MNE group poses no or low risk in the areas covered by ICAP
 - If not, a more detailed and comprehensive risk assessment will be conducted
 - Participating tax administrations will work collaboratively and the MNE group will be kept informed via the lead tax administration
- Following the conclusion of the risk assessment stage, a meeting will be held with the MNE group to discuss the outcomes of the assessment
 - If no or low tax risk on an issue, an assurance letter will be issued setting out these findings, the content of which will vary by jurisdiction
 - The timeline for ICAP will depend upon a number of factors, but in most cases the period from the initial meeting to the issuance of assurance letters should be within 12 months

EU Joint Transfer Pricing Controls

October 2018 – EU Joint Transfer Pricing Forum recommendations

- Exchange of information and cooperation between tax administrations should be used where they are expected to assist in the identification of transfer pricing risks and to contribute to an efficient audit
- It is preferable to take a cooperative approach based on dialogue and trust. A cooperative approach is characterized by communication between tax administrations and taxpayers
 - The taxpayer should be actively involved in the actual auditing activities and have the right to communicate and be heard in accordance with the national provisions. The taxpayer should be timely informed of the steps taken by the tax administrations during the audit
 - At the same time, the taxpayer should be transparent and share in a timely manner the relevant information with each of the tax administrations involved

EU Joint Transfer Pricing Controls

October 2018 – EU Joint Transfer Pricing Forum recommendations

- Member States are encouraged to implement legislation that permits the active presence of visiting foreign officials
- Member States are encouraged to swiftly lay down the legal framework which would allow them to perform corresponding downward adjustments as a result of a common understanding of the facts and circumstances and of the application of the arm's length principle
- Member States should use, in appropriate cases, the possibilities under Directive 2011/16/EU on a real time basis for the purpose of achieving a high degree of coordination, smooth communication and exchange of information during a transfer pricing control
- Member States should ensure that stakeholders are aware of the possibilities and functioning of the available tools for taking a coordinated approach to transfer pricing controls

EU Joint Transfer Pricing Controls

October 2018 – EU Joint Transfer Pricing Forum recommendations

- It is recommended that Member States participate in coordinated transfer pricing controls unless their refusal is based on a reasonable explanation
- It is recommended to agree and sign an audit plan for each coordinated transfer pricing control
- It is recommended that Member States agree a Memorandum of Understanding (MoU), in case they wish to establish sustained coordinated transfer pricing controls program
- It is recommended that each coordinated transfer pricing control finishes with a concluding report

Quasi-Multilateral Audits

- US tax litigation matters provide a ready opportunity for non-US authorities to seek information
 - US cases generally receive wide coverage in the tax press
 - Records are generally public unless subject to a confidentiality order
 - IRS has a large amount of information that can be shared without notifying the taxpayer and with limited exceptions, as previously discussed
 - IRS positions and materials may provide foreign tax authorities with additional arguments

Lagging Taxpayer Protection Mechanisms

- Limited exceptions to information exchange
 - As noted above, exceptions are limited and generally narrowly applied
 - Not clear what recourse, if any, a taxpayer has if trade or business secrets or other protected information is shared
- Limited ability to address substantive consequences of information sharing
 - Different tax authorities may use the same information to reach different and potentially conflicting conclusions that result in the same income being taxed two or more times
 - No multilateral MAP or Competent Authority mechanisms
 - Even a series of bilateral mechanisms do not always provide an effective way to address multilateral consequences

Global Management of Tax Risk

- It is more important than ever for taxpayers to proactively consider tax risk from a global perspective and to develop a comprehensive and integrated global strategy
 - Global risk assessment and management
 - Global audit management and strategy
 - Global information management and strategy
 - Global controversy management and strategy
 - Global coordination of indirect and direct taxation and associated challenges



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