Tax Assurance. A Risk Management Handbook for Large Business

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Foreword

In the post-BEPS tax transparency era, with Country-by-Country Reporting, reinforced international tax standards and a boost in enforcement by tax administrations in developed and developing countries, large business need to be in control of tax risks, which encompass not only the traditional financial risks of taxes, interest and fines but also, and perhaps more importantly, reputational risks.

In this scenario, tax has become a strategic issue and the board of directors is ultimately responsible for tax risk assurance to shareholders and stakeholders. For this purpose, corporations need a strategy approved at board level and implemented through well-designed and effective tax control frameworks, normally in the broader context of corporate governance frameworks.

This handbook builds on the relevant international standards and best practice to provide guidance for setting out the pillars of a tax control framework and mitigate tax risks of large, complex taxpayers. It discusses the relationship between tax and corporate governance and addresses the key elements of a corporate tax strategy. The pillars of the leading tax control frameworks are also analyzed, including the allocation of responsibilities, appetite for risk, tax risks governance and risk assurance.

The most significant tax risks are examined under the perspective of the post-BEPS environment, with specific attention to headline risks such as transfer pricing, permanent establishment, aggressive financial planning and jurisdictional risks.

The handbook also examines how taxpayers can gain certainty and hedge tax risks by leveraging on services provided by tax administrations, including rulings, domestic and international cooperative compliance and dispute resolution mechanisms.

Disclaimer

The views and opinions expressed in this book are those of the authors and do not necessarily reflect the official policy or position of the institutions they are affiliated with.

The handbook is a conceptual exercise and does not generally contain references to domestic legal frameworks. It is a bona fide exercise intended to support corporate executives, but in no way can it be regarded as legal advice.

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List of Abbreviations

AEOI: Automatic Exchange of Information
ATO: Australian Taxation Office
BBTCF: Building Better Tax Control Frameworks
CCO: Chief compliance officer
CG: Corporate Governance
CIT: Corporate Income Tax
COSO: Committee of Sponsoring Organisations of the Treadway Commission
CRS: Common Reporting Standards
CSR: Corporate Social Responsibility
EITI: Extractive Industries Transparency Initiative
ERM: Enterprise Risk Management
ETR: Effective tax rate
FATCA: Foreign Accounts Tax Compliance Act
FTA: Forum on Tax Administration
ICIJ: International Consortium of Investigative Journalists
JITSIC: Joint International Taskforce on Shared Intelligence and Collaboration
KPI: Key Performance Indicators
KRI: Key Risk Indicators
MCS: Management and Control Systems
MLI: Multilateral Convention to Implement Tax Treaty Related Meas. to Prevent BEPS
MNEs: Multinational Enterprises
M & A: Mergers and acquisitions
NGOs: Non-governmental organizations
OECD: Organization for Economic Cooperation and Development
SAO: Senior Accounting Officer Regime
TCF: Tax Control Framework
TRM: Tax Risk Management

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CHAPTER 1 INTRODUCTION

This book is about tax assurance. In other words, it deals with the need, legally or otherwise established, to provide confidence to shareholders and stakeholders about the correctness of the tax positions taken by the business.

The term "assurance", borrowed from financial auditing, describes the outcome of an audit process whereby the trust of the user of the report in its underlying object is enhanced[1]. Since taxes, especially CIT, are part of financial accounts, any financial audit is also a tax assurance exercise. However, the concept of tax assurance has a broader scope, as it encompasses profit taxes but also indirect, payroll or property tax, third-party information returns and any other tax obligation. For MNEs, it also involves dealing with tax administrations in numerous and diverse jurisdictions.

Looking at tax assurance as a separate element of corporate governance is a recent phenomenon[2] that is gradually attracting interest from business schools[3], scholars, practitioners and public authorities worldwide. It emerged in the early 2000s propelled by the spread of corporate governance frameworks and developments in company law[4], and gained prominence with the offer of cooperative compliance arrangements in OECD countries further to the enhanced relationship concept, born in 2008[5]. Reputational concerns and the need to balance the interests of a diverse range of internal and external stakeholders have boosted the demand for tax assurance.

This book draws on existing research and guidance to present a practical view of how a tax control framework can be planned, implemented, assessed and monitored. It could have focused on tax compliance, or on tax risks management, but I chose *Tax Assurance* because it has a broader meaning and purpose. *Tax Compliance* is, in my view, narrower than *Tax assurance* because it only deals with meeting all the substantive and procedural fiscal obligations. *Tax Risk Management* is a bit broader than *Tax compliance*, since it includes strategic decisions on how tax laws will be interpreted and applied to the business; however, it does not cover the layer of trustworthiness that is implied in *Tax Assurance*.

The current demand for tax assurance responds to CSR codes, regulatory bodies (especially, cooperative compliance arrangements) and society at large, which is increasingly attaching value to transparency in business and public affairs. It also reflects a gradual shift in businesses´ priorities: over the last decade, the focus of corporate tax executives has moved away from achieving a low ETR to keeping tax risks in control[6].

1 Ronald Russo: *Tax Assurance: Nexiology in Taxation?* Tilburg University. 2016. Pg. 4. Available at https://pure.uvt.nl/portal/files/13409933/160604_R.Russo_oratie_.pdf

2 Haroldene F. Wunder: *Tax Risk Management and the Multinational Enterprise*. Journal of Accounting, Auditing and Taxation, Elsevier, vol. 18 (1), 2009. Pg. 15. Available at http://www.sciencedirect.com/science/article/pii/S1061951808000475

3 A Masters´ Programme on Tax Assurance was inaugurated in Tilburg University, the Netherlands, in 2008. See Russo, note 1 supra.

4 Especially relevant was Section 404 of the U.S. Sarbanes-Oxley Act of 2002. This provision requires public companies to issue, as part of their annual financial reports, an internal control report which shall state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting, as well as an assessment of the effectiveness of the internal control structure and procedures. In addition, it mandates that external auditors preparing or issuing the audit report attest to the assessment made by management. (107th Congress of the USA: *An act to protect investors, by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes*. (The Sarbanes-Oxley Act of 2002). Available at https://www.iasplus.com/en/othernews/united-states/sarbanes-oxley-acst-of-2002).

5 In the OECD report about tax intermediaries (OECD: *Study into the Role of Tax Intermediaries*, 2008. Available at *www.oecd.org/tax/administration/39882938.pdf*).

6 In 1998, Arlinghaus surveyed tax managers of the Fortune 500 companies and found that tax risk and tax risk management were not even among their goals, which in turn included managing ETR worldwide. (Arlinghaus Barry P.: *Goal Setting and Performance Measures by tax professionals in Fortune 500 companies*. The Tax Executive, 50(6), 434-442, 1998, available at https://heinonline.org/HOL/Page?handle=hein.journals/taxexe50&div=143&g_sent=1&casa_token=&collection=journals). In 2005, Cummings confirmed that, as recently as the late 1990s, the primary focus of the tax function was management of the corporation´s ETR (see Wunder, 2009, note 2 supra). In contrast, in 2016 the Australian Board of Taxation concluded that there is evidence that the appetite for tax risk has declined over the last decade (Australian Board of Taxes: *A tax Transparency Code, A report to the Treasurer*. Available at https://data.gov.au/dataset/voluntary-tax-transparency-code, 2016. Pg. 12).

The financial and reputational consequences of tax risks have increased significantly[7] and so appetite for tax risk has declined, to the extent that keeping risks in control is the top priority for today's tax leaders, and the tax department's contribution to strategic value now seems to take priority over cost minimization in many areas[8].

Contributing factors are the OECD-G20 BEPS Project[9], the EU anti-avoidance package reinforced by the State Aid doctrine and the emergence of stakeholders that have transformed tax avoidance from a technical issue into a political one. Tax activism by NGOs and, more recently, revelations by the ICIJ, leveraging on the power of social networks, have turned tax risk, which used to be primarily financial, into a reputational one.

In this new scenario, this handbook aims to:

Table 1 Objectives of this Handbook

- Gain greater insight into the concept of tax assurance by private and public sector executives,
- Assist boards in their duty of keeping tax risks in control through effective TCFs,
- Provide practical orientations for the identification, assessment, rating and mitigation of tax risks,
- Advance the quest for international tax good governance standards[10],
- Raise awareness among the business community about cooperative compliance,
- Assist revenue bodies adjust their tax risk management strategies by leveraging on justified trust provided by TCFs; and
- Facilitate the review of tax control frameworks by tax administrations as part of their risk assessment protocols[11].

When Boards and CEOs communicate the priorities of their corporate tax strategy, the possibilities basically rank from *create value for the shareholder* on one hand (meaning *save cash in taxes*) and *pay the legal amount of tax* on the other. If your corporate tax strategy is "*no surprises*", this handbook is for you.

Primarily written for large multinationals of any business sector, it is also valid for domestic and smaller organizations. A critical assumption is that there is not a one-size-fits-all model, and companies will need to consider their circumstances. Another critical assumption is that tax risk is just another risk affecting corporations. Tax risk will be, therefore, encapsulated in the broader context of corporate risk management. A third critical assumption is that a top-down approach is required. It is not possible to implement a TCF if senior executives and company directors are not committed to it.

7 The 13-billion bill that the EU Commission asked Ireland to recover in a State Aid case in 2016 is allegedly the highest tax liability in history, although technically it is not a tax assessment but the recovery of state aid. (EU: *State aid: Commission refers Ireland to Court for failure to recover illegal tax benefits from Apple worth up to €13 billion*. Available at http://europa.eu/rapid/press-release_IP-17-3702_en.htm, 2017).

8 KPMG: *A look inside tax departments worldwide and how they are evolving. Global Tax Benchmarking*. Available at https://home.kpmg.com/content/dam/kpmg/xx/pdf/2018/05/tax-benchmarking-report.pdf 2018, Pg. 2.

9 "*As a result of BEPS, it has become even more crucial for multinational enterprises to be in control of tax risks today*" (OCDE: *Co-operative Tax Compliance, Building Better Tax Control Frameworks*. ISBN 978-92-64-25398-8. 2016, pg. 12).

10 Tax good governance standards are currently undefined. As a Dutch think-tank has put it, "*it would be very beneficial if all stakeholders come together to develop a standard that provides consistent reporting requirements across the globe*" (Rudy Verstappen, Tjierd van der Berg and Hifsa Yonus: *Tax Transparency Benchmark 2017, A comparative study of 76 listed Dutch companies*. VBDO and PWC. November 2017. Available at https://www.pwc.nl/nl/assets/documents/pwc-tax-transparency-benchmark-2017.pdf, Pg. 13).

11 The best practice in this field is currently being applied by Australia´s ATO (see Chapter 11 below).

CHAPTER 2. TAX RISK

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Risk taking is the essence of entrepreneurship and there is no such thing as business without risk because risk is the ultimate driver of returns on investment. This subject is therefore at the heart of the organization: risk-taking, whether private, public or third sector, whether large or small, is what managing an organization is about[12]. Tax risk management ensures that tax risks are identified, monitored, reported and mitigated as appropriate, but... what is tax risk?

I. Definition

Tax risk is the possibility that companies may be paying or accounting for an incorrect amount of tax, or that the tax positions a company adopts are out of step with the tax risk appetite that the directors have authorized or believe is prudent[13]. Tax risk is primarily financial (the possibility of additional assessments, interest and penalties on one hand, or excessive payments if the company has made errors or has not applied tax benefits it was entitled to, on the other), but it also has a reputational dimension: the likelihood that actions emanating from the tax function will subject the company to adverse publicity and erode goodwill, consumer´s trust and brand equity.

Tax risk may also be regarded as the potential that a chosen action or activity, or the failure to take action or pursue an activity, will lead to a tax outcome that is different from what was initially expected[14]. This can happen due to a variety of uncertainties[15], for example, changes in the law, the judicial process, changes in business assumptions, an increased intensity of audits and uncertainty in the interpretation of the law. In turn, the sources of uncertainties may be classified in two: economic and regulatory. The economic component arises from the decisions, actions or inactions by businesses that result in anticipated tax outcomes. The regulatory component arises from the decisions, actions or inactions by tax authorities[16].

In principle, a company can only manage the economic sources of uncertainty, that is to say: the business decisions that will aggravate or mitigate the risks. We shouldn´t forget, however, that in modern tax administrations businesses can also influence their regulatory risk environment by taking actions that will affect their risk ratings by tax authorities, such as signing APAs or entering into cooperative compliance arrangements, thus reducing uncertainty on the regulatory front as well[17].

Looking now only at economic risks, the uncertainties of a company may spring out of three causes[18]:

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12 Institute of Risk Management: *Risk appetite and tolerance to risk*. Available at https://www.theirm.org/knowledge-and-resources/thought-leadership/risk-appetite-and-tolerance.aspx, 2011.

13 ATO: *Tax Risk Management and Governance Review Guide*. Available at https://www.ato.gov.au/Business/Large-business/In-detail/Key-products-and-resources/Tax-risk-management-and-governance-review-guide/, Pg. 1.

14 Neuman, S., Omer, T. and Schmidt, A.: *Risk and Return: Does Tax Risk Reduce Firms' Effective Tax Rates?* American Taxation Association Midyear Meeting: Research-In-Process. Available at https://www.researchgate.net/publication/256046673_Risk_and_Return_Does_Tax_Risk_Reduce_Firms%27_Effective_Tax_Rates, 2013.

15 *There is a distinction to make between risk and uncertainty, because business embraces risks, but steer clear of uncertainties. Risk is an unknown outcome with well-defined possibilities, while uncertainty is an unknown outcome with unknown possibilities*. (One Source, Thomson Reuters. *The Shifting Landscape of Direct Tax and the Right Framework to Address it*. http://ebook-market.com/thomsonreuters1/DT_2_Whitepaper.pdf. 2015. Pg. 2.)

16 Arlinghaus, note 6 supra.

17 See *Cooperative Compliance* under chapter 13.III below

18 Tony Elgood, Ian Paroissien and Larry Quimby: *Tax Risk Management*. PWC, 2004. Available at https://www.pwc.com/gx/en/tax-management-strategy/pdf/tax-risk-management-guide.pdf

- Uncertainty as to the application of the law and practice to particular facts.
- Uncertainty over the facts themselves: whether they are true or whether they are relevant.
- Uncertainty as to how well company systems operate to arrive at the tax results of the business activities and operations.

Managing tax risks is therefore understanding where these uncertainties may arise, making judgements about their potential consequences and deciding a course of action to retain or mitigate the risk. Consequently, the effectiveness of a risk management system will depend to a large extent on the quality of these judgements. This is precisely the core of a tax risk framework: establishing a proper process for making judgements in response to tax uncertainties.

In effect, there are three basic areas of tax that can be managed and controlled. These are:

- The tax charge,
- Tax risk,
- The cost of running and managing the tax affairs of the group[19]

From this perspective, a company´s policy on tax risk management is a trade-off between the value that can be achieved by taking risks (e.g. cash savings derived of tax avoidance structures), the costs that may be implied if undesired events happen (tax charges, penalties, interests, civil or criminal procedures and often reputational damages), and the resources needed to properly manage all this. We will examine the tradeoff between risk and reward under "appetite for risk" in 6.2.2 below.

II. An emerging view of tax risk

Owing to changes in Corporate Governance-related legislation[20], new business models, technology and an increased awareness of corporate tax avoidance after the radical transformation of tax policy and tax administration worldwide caused by the BEPS project, as outlined in chapter 3, a new view of tax risk is emerging[21].

Table 2 An emerging view of tax risk

Traditional	Emerging
Financial risk (overpayments, underbenefits, penalties, indirect costs of handling enquiries).	Financial + Reputational risk
Focus on ETR	Focus on compliance and risk minimization
Focus on CIT	Holistic view, including "under the line" taxes (CIT) and "above the line": VAT, other indirect taxes, local taxes, information returns, etc.
Ancillary function	Strategic importance
Stand-alone	Integrated in ERM frameworks
Domestic	Global

19 Ibídem. Pg. 18.
20 Such as SOX in the US, note 4 supra.
21 Deloitte: *Risk transformation and Tax. Securing the benefits of enhanced tax-risk management,* 2015. Available at https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/2015-deloitte-ireland-risk-transformation-and-tax-deloitte-ireland.pdf

III. Frameworks

In the context of the ever-increasing complexity of business, keeping risks in control requires a robust framework[22]. A framework encompasses culture, capabilities and practices that organizations apply when they carry out their strategy with the purpose of managing risk in creating, preserving and realizing value[23]. A Tax Control Framework (TCF) is the part of the internal control that assures the accuracy and completeness of the tax returns and disclosures made by an enterprise[24].

Having a TCF is important for all stakeholders, but it has a particular significance for revenue bodies because it is central to taxpayers opting into cooperative compliance programs. A TCF generates justified trust, and when revenue authorities perform objective assessments of taxpayers' TCFs, they may obtain empirical evidence that the business is willing and able to provide the disclosure and transparency needed to base the relationship on mutual trust.

Given the consequences attached to having sound TCFs, it might be expected that legislatures have provided minimum requirements, but no country has, so far, published legislation to that effect[25]. In its absence, regard must be given to COSO´s *Enterprise Risk Management*[26] (ERM), the de facto global standard for internal controls[27], although it must be noted that COSO is not tax-specific.

In the search of a framework specifically conceived for tax purposes, a breakthrough was the work of Elgood, Paroissien and Quimby, who in 2004 published *Tax Risk Management* (TRM)[28], a comprehensive guide to handle tax risks that is still the basic reference in this area. Elgood, Paroissien and Quimby´s TRM framework is based on COSO-ERM[29] but replacing COSO´s business objectives with seven types of tax risk identified and described therein. COSO's ERM and TRM are both influenced by company law, and this is reflected in their focus on shareholders and stakeholders.

Coming from a different angle, in 2016 the OECD published a framework focused on tax assurance for revenue bodies: *Co-operative Tax Compliance: Building Better Tax Control Frameworks* (BBTCF)[30]. It was the culmination of a process that had started in 2003 when the Australian Taxation Office launched its *Tax in the Boardroom* campaign, the first attempt at establishing what would later become the enhanced relationship and is currently known as co-operative compliance.

The tax risk framework published by the OECD in 2016 builds on earlier works, notably *Good Corporate Governance*, *the Tax Dimension*[31], which explored the link between tax and Corporate Governance, resulting in the need for the board to ensure that tax does not encourage behavior that is contrary to the long-term interests of the company, to protect transparency and to ensure the quality of decisions in the tax area. It also builds on the 2008 FTA´s *Study into the Role of Tax Intermediaries*[32], which proposed the "enhanced relationship", an innovative way of engaging taxpayers that a few years

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22 A framework is defined as "*a basic conceptual structure to facilitate a common understanding among experts in a field*" (the Merriam-Webster Dictionary).
23 COSO (Committee of Sponsoring Organisations of the Treadway Commission): *Enterprise Risk Management, Integrating with Strategy and Performance. Executive Summary.* Available at https://www.coso.org/Pages/ERM-Framework-Purchase.aspx, 2017.
24 OECD: *Co-operative Compliance: A Framework. From Enhanced Relationship to Co-operative Compliance*. Available at http://www.oecd.org/tax/co-operative-compliance-a-framework-9789264200852-en.htm, 2013, pg. 58.
25 This is partly owed to the difficulty of finding commonality, as TCF tend to be firm-specific, and partly due to reluctance from authorities, as in the Netherlands, to prevent that issuing regulation might lead to a "tick the box" behaviour. See Russo, note 1 supra, Pgs. 9-10.
26 COSO published in 1992 *Internal Control, an Integrated Framework*, then updated it in 2003 with *Enterprise Risk Management Framework* and more recently, in 2017, with *Enterprise Risk Management, Integrating with Strategy and Performance*. (note 23 supra)
27 Wunder, note 2 supra, pg. 16.
28 PWC 2004, note 18 supra.
29 Note 23 supra.
30 Note 9 supra.
31 Jeffrey Owens: *Good Corporate Governance: The Tax Dimension*. In: Schön W. (eds) *Tax and Corporate Governance. MPI Studies on Intellectual Property, Competition and Tax Law*, vol 3. Springer, Berlin, Heidelberg, 2008.
32 Note 5 supra.

later would crystallize into *Co-operative Compliance: A Framework – From Enhanced Relationship to Co-operative Compliance*[33].

This means that in the tax area there are currently two leading frameworks[34], TRM, primarily addressed at shareholders and to some extent at company stakeholders, and BBTCF, designed with tax authorities in mind. They vary in the number of components (5 in TRM, 6 in BBTCF) and in their focus, because TRM is mainly concerned with shareholders and stakeholders, while the FTA´s BBTCF aims at providing tax assurance to revenue bodies. For this reason, companies should not choose one or the other, but rather rely on both, and in chapter 5 we explain how both frameworks are not rival but complementary. The table below compares its components.

Table 3 The two leading tax frameworks, TRM and BBTCF

TRM	BBTCF
Control environment	Tax Strategy Established
Risk assessment,	Applied Comprehensively
Control activities	Responsibility Assigned
Information and communication	Governance Documented
Monitoring	Testing Performed
	Assurance Provided

The Dutch Association of Investors for Sustainable Development (VBDO) has also developed a framework based on six Good Tax Governance Principles[35]. They are as follows:

Table 4 The six building blocks of responsible tax behavior

A. Define and communicate a clear strategy
B. Tax must be aligned with the business and is not a profit center by itself
C. Respect the spirit of the law. Tax compliance is the norm
D. Know and manage tax risks
E. Monitor and test tax controls
F. Provide Tax Assurance

These building blocks are measured through 31 indicators, detailed in Appendix B of the annual VBDO report[36]. We will not detail these indicators here, but the reader is welcome to consult them as they provide an excellent resource to further understand how the principles of good tax governance may be implemented in practice.

33 Note 24 supra

34 They are not the only ones: Belastingdienst, the Dutch Tax Administration, elaborated in 2008 a Tax Control Framework (Netherlands tax and Custom Administration, Co-ordination group on the treatment of very large business, Tax Control Framework, From Focus on Risks to being in Control: a different approach March 2008, available at https://download.belastingdienst.nl/itd/beleid/overige/tax_control_framework.pdf). New Zealand and Australia have also issued a tax control framework, ASNZS 4360:2004, as noted by Demidenko and MacNutt (Elena Demidenko and Patrick McNutt: *The Ethics of Enterprise Risk Management as a Key Component of Corporate Governance*. Available at https://web.actuaries.ie/sites/default/files/erm-resources/92_ethics_ERM.pdf.pdf, 2010, pg. 3). Other authors have proposed their own TCFs, for example Baker and Kloosterhoff (Anuschka Bakker and Sander Kloosterhof: *Tax Risk Management, From Risk to Opportunity*. IBFD, the Netherlands. ISBN: 978-90-8722-070-9, 2010).

35 Note 10 supra

36 íbidem, pgs. 57-58.

IV. Types of tax risk

For the classification of tax risks, TRM provides a very useful and widely used terminology. TRM defines seven tax risk areas, four are specific while the other three are generic (aggregate)[37].

Table 5 Tax risk types in TRM

Tax risk types in TRM
Specific risk areas
1 Transactional Risk
2 Operational risk
3 Compliance risk
4 Financial accounting risk
Generic risk areas
5 Portfolio Risk
6 Management Risk
7 Reputational Risk

A brief summary of the concepts of TRM is below. For a more detailed description, please refer to Elgood, Paroissien and Quimby[38].

Specific risk areas:

Transactional risk

Transactional risks are associated with specific, one-off transactions undertaken by a company. In any transaction there may be uncertainty as to how the tax law will apply and uncertainty arising from specific judgement calls. The more unusual the transaction, the higher the risk. The highest risk will be in tax-driven restructurings.

To mitigate transactional risk, it is important to involve the Tax Department from the onset, to apply consistently a risk assessment framework to make judgement calls, to document all transactions and to monitor implementation.

Operational Risk

It concerns the underlying risks of applying the tax laws, regulations and decisions to the routine, every day operations of a company. To mitigate operational risk a good strategy is to involve closely the Tax Department in the design of business management systems.

Compliance Risks

Compliance risk concerns the risk of missing tax obligations related to the preparation and filing of tax returns, making payments, responding to enquiries from the tax authority and meeting any other statutory obligation, including third-party information returns.

The way to mitigate compliance risks is to set up appropriate systems, processes and procedures, including for extracting information. They need to be up-to-date to legislation and practice.

37 The term ¨generic¨ refers to the notion that it affects several categories of the basic (or ¨specific¨) risks. Portfolio risk, by definition, crosses the four basic areas. Management and reputational risks are also cross-cutting, as they may appear in all basic or specific tax risk areas.

38 PWC, 2004, note 18 supra, pgs. 4-8.

Financial Accounting Risk

Financial accounting risk concerns the accurate determination of tax liabilities in company accounts. This is important for the company and for tax directors, who in many jurisdictions, such as the US, the UK and Germany, may be held personally liable for wrongdoing.

A robust internal control framework, with adequate governance over judgements and assurance by an auditor are effective strategies to mitigate this kind of tax risk.

Generic risk areas

Portfolio risk

Portfolio risk concerns the aggregate level of risk when looking at all the transactional, operational and compliance risks combined. The importance of a portfolio view of risks lies in that each area separately may be below the tolerance threshold but, in the aggregate, the cumulative risk profile may become unacceptable.

Management risk

Management risk occurs when the various tax risks described above are not properly managed. The way to mitigate this risk is to document and implement policies for making decisions that are commensurate with the importance of the risk. Having an adequate skillset in the Tax Department, beginning with its head, is another strategy to mitigate management risk.

Reputational risk

Reputational risk concerns the damage to goodwill or brand value when negative information about the tax affairs of the company is released in the public domain. A strategy for mitigating this risk, aside from lowering the margin of tolerance for the tax risks described above, is to actively monitor and manage corporate reputation.

In addition, we will examine the specific tax issues that create risks more often. According to a recent survey[39], these are:

Table 6 Top 10 activities that present the highest tax risk for companies

1. Transfer pricing of goods and services
2. Indirect taxes, including VAT, GST and Customs
3. Permanent establishment risk
4. Limitation of deductibility of financing expenses
5. Withholding taxes
6. Group charges / allocation of head office expenses
7. Transfer pricing of intangibles
8. Global workforce-related issues, including employment tax risk and social security tax risk
9. Use of losses
10. Transfer pricing of financial transactions

39 EY: *Tax steps into the light. 2017 Tax Risk and Controversy Survey Series*. 2017. https://www.ey.com/gl/en/services/tax/ey-tax-steps-into-the-light 2017, pg. 6

CHAPTER 3
THE CHANGING TAX ECOSYSTEM

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This chapter takes stock of recent developments in the ecosystem where large businesses operate and how they influence the tax positions taken by companies.

I. A fluid business environment

A recurring source of uncertainty is the disconnect between business realities and legal frameworks. Tax laws are typically reactive to business innovations and the lag in producing rules and guidance generates uncertainty. An obvious example is the taxation of the digital economy, but there are many others. Global value chains, the gig economy and other new and emerging business models[40] have put a strain on existing legal tax frameworks, both at the international and domestic levels, adding to a business environment already altered by the digitalization of the economy, trade and investment liberalization, the ease of communications and the logistics revolution. All these factors have contributed to internationalize business, even in the medium and small size segment, and cross-border operations typically aggravate tax risks.

Technology, big data and analytics[41] have transformed the way companies do business, and since revenue authorities also make use of them, they are changing the dynamics of tax compliance and enforcement, further complicating the tax ecosystem. The rapid pace of technological evolution is challenging not only tax administrations, but business as well. Companies with robust data capabilities are better equipped to comply with tax requirements (for instance, Country-by-Country reporting) and at the same time are producing aggregate data that sheds light into the value drivers of the group, the geographical distribution of the value creation process and the main risks linked to it. Other companies, less strong on data capabilities or constrained by legacy

40 The traditional Business model is decentralised. Prior to the ICT revolution, subsidiaries used to operate under a notable degree of autonomy, as a tight coordination was difficult to implement with telephone and traditional mail. Subsidiaries used to have customers and suppliers, manufacturing facilities, sales and distribution networks, R&D programmes, brands and products and, obviously, separate management. The arrival of the Internet and the logistics revolution allowed better coordination and centralised management, with shared strategies, supply chains on a regional or global scale, global designs and brands, manufacturers producing for a global rather than a country market, international sales and marketing networks with customers in far away countries, centrally owned intellectual property and centrally managed supply-chain. The fully-fledged business of the Seventies and Eighties transformed in the 90s and 2000s into functionally specialised units, with centralised management, strategy and risk-taking. MNEs have nowadays a single set of intangibles, including product design, brands, customers and databases. They feature centralised manufacturing, sales and distribution networks and horizontal functions, such as procurement, insurance, treasury or tax for the whole compound. This centralised business model increases business efficiency in a globalized economy but also presents challenges in the tax area as it makes more difficult to identify where each constituent entity earns its profits.

41 Computing capacity is ever-increasing. Hardware is becoming cheaper and software is growing smarter. Recent advances in machine learning and artificial intelligence, coupled with the proliferation of handheld devices that put advanced computing power in a purse or a pocket, are exciting transformations of information technology. Many fields are leveraging the data revolution, and tax is no exception. Understanding how to use these advances as tools to achieve an objective, however, remains a priority.

or disparate IT systems (e.g. through mergers and acquisitions)[42], have weaker tools and less insight into the value drivers or the geographical distribution of risk.

Similarly, tax administrations are at varying stages of building data capabilities, thus refining taxpayer selection and risk assessment procedures. For example, some tax administrations are already leveraging on CBCR data for high-level risk analysis while others will struggle to find any use in them and will probably see handling that information simply as a cost.

Rapid advances in tax technology, in any event, facilitate upstream compliance and are shaping an emerging model of connected compliance that links the information systems of the public authority and those of business, providing real or near-to-real time services, a transparent and reliable environment, and a better user experience. Blockchain, artificial intelligence and the internet of things will surely deepen this trend, and business and tax administrations will have to cope with the rapidly evolving technological environment and adjust the risk control frameworks to the ever-evolving business environment.

II. Corporate Tax, a matter of public interest

Before the crisis of 2008, corporate taxation seldom was front-page news, but in the ensuing years tax became a matter of significant public interest. Faced with bulging deficits, governments needed fresh revenue reservoirs, and they picked up on corporate tax avoidance. A particularly active year was 2012, when allegations of misconduct brought Google, Amazon and Starbucks before the Public Accounts Committee of the UK Parliament[43]. In the parliamentary report, Members concluded that these companies were not paying their fair share and that this practice was widespread[44], and the ensuing public outcry faced them with a massive PR problem. One of them even offered to pay additional tax to stop losing customers on account of the use of aggressive tax avoidance schemes[45].

In December of the same year, the European Union published its Action Plan to Strengthen the Fight Against Tax Avoidance and Evasion[46], and immediately after, the OECD took the lead, launching in July 2013 the BEPS Action Plan[47]. From that moment on, tax became a hotly debated political issue and references to tax avoidance were consistently included in the agendas and communiques of the G-20, raising expectations in governments, the media and the public about a shift in attitudes and behaviors by international business.

After 2015, with more than a hundred countries issuing BEPS legislation further to their membership of the Inclusive Framework on BEPS Implementation[48], taxpayers set themselves in the path to adjust to the new landscape. As a result, businesses are now required to pay attention and comply with an array of BEPS policies. Within large companies, the design, implementation and ongoing monitoring of these policies is the responsibility of the board. It is not unfair to say that tax strategy has moved from the office of the tax director to the boardroom[49].

FATCA and the Common Reporting Standards have also altered the tax ecosystem by forcing financial entities to supply information about foreign accounts to tax authorities. While the impact of these information flows may be higher for individuals than

42 Thomson Reuters: *What to Expect in Today´s Changing Tax World. Global Compliance Report*. https://tax.thomsonreuters.com/onesource/global-compliance-report/, 2016, Pg. 6.
43 UK Parliament: *Public Accounts Committee– Nineteenth Report. HM Revenue and Customs: Annual Report and Accounts*. Available at https://publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/716/71602.htm
44 UK Parliament: Public Accounts Committee's previous questioning of Google https://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2015/corporate-tax-deals-15-16/background/
45 The Guardian: *Starbucks to pay £20m in tax over next two years after customer revolt*, 6 Dec. 2012.
46 COM (2012) 722 final.
47 OECD (2013b): *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264202719-en
48 117 countries as of August 2018. See OECD (2018): *About the Inclusive Framework on BEPS*. Available at http://www.oecd.org/tax/beps/beps-about.htm.
49 Deloitte: *The Global Tax Reset, summary results of the 2017 annual multinational survey*, 2017. Available at https://www2.deloitte.com/lu/en/pages/tax/articles/beps-global-survey.html