



Bridging the divide

Highlights from the 2014
Tax risk and controversy survey

EY

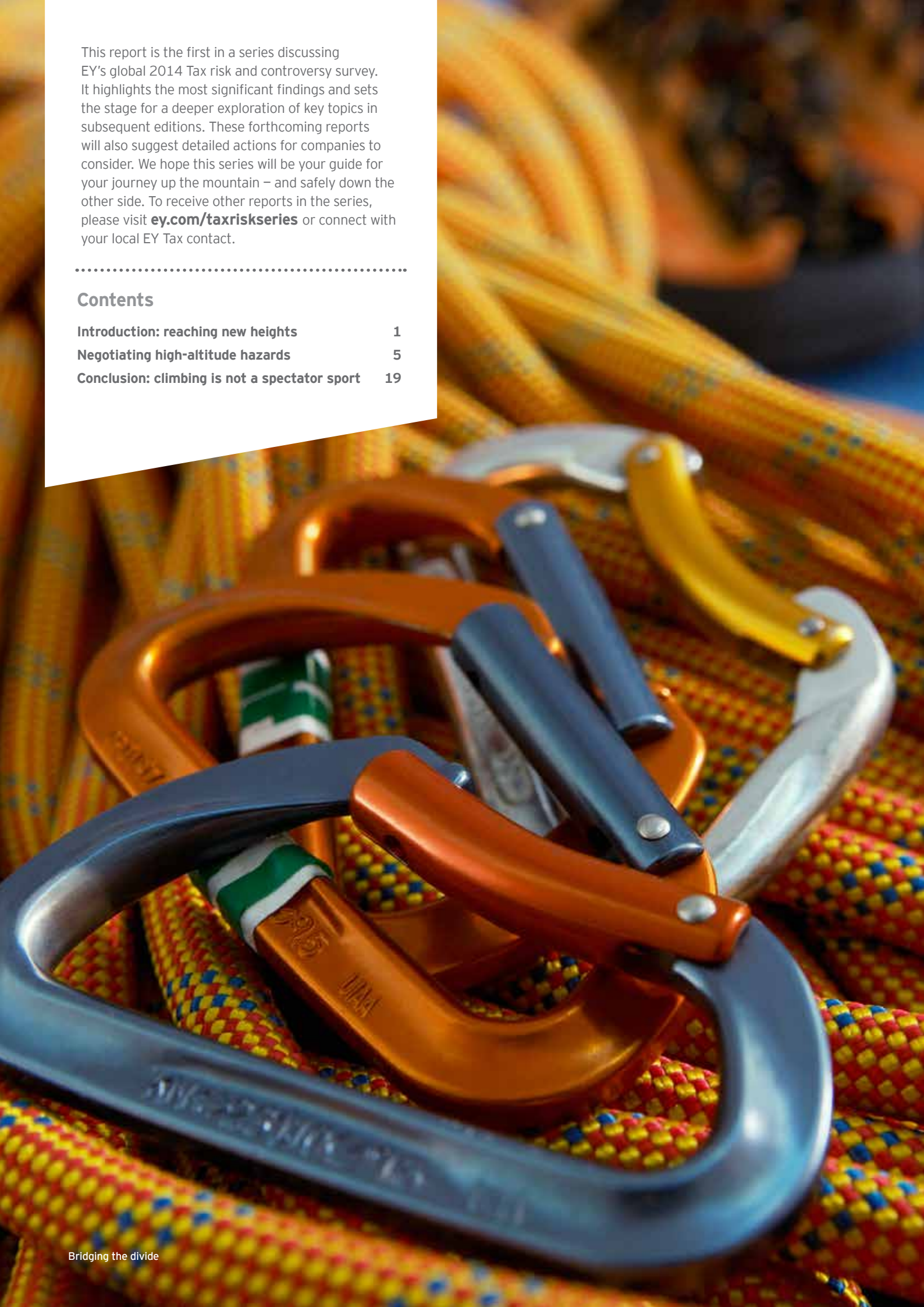
Building a better
working world

This report is the first in a series discussing EY's global 2014 Tax risk and controversy survey. It highlights the most significant findings and sets the stage for a deeper exploration of key topics in subsequent editions. These forthcoming reports will also suggest detailed actions for companies to consider. We hope this series will be your guide for your journey up the mountain – and safely down the other side. To receive other reports in the series, please visit ey.com/taxriskseries or connect with your local EY Tax contact.

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Introduction: reaching new heights

“When you’re climbing at high altitudes, life can get pretty miserable.”

– Sir Edmund Hillary

Mountaineering is equal parts exhilaration and peril. Summiting a peak is a major achievement, but climbers often encounter unexpected hazards, including falls, frostbite, avalanches or high-altitude storms that develop in minutes but can last for days.

Successful expeditions require extraordinary preparation, superior physical fitness, tremendous knowledge of current and future conditions, the most reliable and modern tools and an experienced guide. But even then, climbers must remember that the summit is only the halfway point of a trek: descending, like defending or litigating a major tax position, can be the most challenging part of the journey.

When it comes to tax, businesses have negotiated steep terrain and encountered difficult footing over the last five to six years in particular, and companies have endured increasingly rapid changes to both tax policy and enforcement around the world.

We first reported on the evolution of “tax administration without borders”¹ in 2009 as governments began taking a more global and collaborative approach to enforcement amid a fiscal environment that swung from stimulus to austerity before landing somewhere in between. In 2011, we published the results of the previous edition of this survey, which concluded that “a convergence of trends has created the ripest environment for tax controversy in years.”²

EY’s latest survey of 830 tax and finance executives in 25 jurisdictions on tax risk and controversy, completed in January 2014, indicates that the tensions described in previous reports pale in comparison to the tax risks that companies say they are currently experiencing and anticipate facing in years to come – 81% of all companies surveyed agreed or strongly agreed that tax risk and controversy will become more important for their companies in the next two years. The results of this new survey offer a glimpse of the hazards that must be overcome in order to safely navigate the next steps of the journey.

It is clear from the findings that many companies may wish to consider enhancing their preparations and their tools in order to bridge the divide between current and future risk management frameworks.



¹ <http://www.ey.com/GL/en/Services/Tax/International-Tax/Tax-administration-without-borders--Introduction>.

² 2011-12 Tax risk and controversy survey, EY, 2011.

Route signs

On any trek, flags and signs mark the route for safe passage. The illustrations in the margins of this report both tell a story of their own and complement the text. However you use them, they are designed to enrich your journey.

The report and accompanying graphics make references throughout to “largest” and “large” companies. “Largest” refers to global companies with more than US\$5 billion in annual revenues, and “large” refers to global companies with revenues in excess of US\$250 million.



81%

of all companies surveyed agreed or strongly agreed that tax risk and controversy will become more important for their companies in the next two years.

Overall, companies say their leading source of risk remains transfer pricing. This is consistent with findings in EY's *2013 Global Transfer Pricing Survey* of transfer pricing professionals, which found that 66% of companies identified risk management as their top transfer pricing priority, a 32% increase over results in 2007 and 2010.³ Companies in our *2014 Tax risk and controversy survey* identified indirect taxes and permanent establishment risk as their second- and third-highest sources of tax risk, respectively.

These activities – in particular, transfer pricing – are under unprecedented scrutiny from an ever-growing list of groups, including the news media, national policymakers, activist groups and supranational organizations. Assertions of tax avoidance by any one of those groups often trigger reactions by the others. This cycle has helped keep the issue of tax in the headlines and at the forefront of policy conversations.

Intense media interest in particular has driven new and significant concerns about tax-related reputation risk. Stories and investigations alleging tax avoidance have become even more prevalent in newspapers and TV programs around the world since we last conducted this survey in 2011. As a result, it is not surprising that 89% of the largest companies surveyed (those reporting annual revenues in excess of US\$5 billion) say that they are now somewhat or significantly concerned regarding media coverage of taxes, up from 60% in 2011. Conversely, just 9% say they are unconcerned now, compared to 40% in 2011.

More tangibly, the intense media focus has galvanized policymakers into action. Lawmakers have reacted to news stories by convening parliamentary hearings, proposing legislation and supporting efforts by the Organisation for Economic Co-operation and Development (OECD) to recommend 15 specific areas for coordinated action to protect countries' tax bases.

Our survey respondents say they are feeling the effects. For example, 74% of the largest companies say they feel that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach.

Some countries have already taken steps to implement concepts related to base erosion and profit shifting (BEPS) in the form of new legislation, establishing “working groups” to review existing frameworks and formulate new ones, and in some cases, suspending advance pricing agreements (APAs) or applying future BEPS concepts to previously executed transactions. Even if directionally consistent with the BEPS project, these early actions may actually threaten the coherence of the overall project, creating more uncertainty, greater risk and an erosion of trust between tax authorities and taxpayers.

At the same time, governments continue to pursue day-to-day legislative change and tax reform at the national level. Additional layers of complexity are added as governments strive to balance tax competition with raising enough revenue to fund ongoing spending commitments.

³ 2013 Global Transfer Pricing Survey, EY, 2013.

For example, 85% of US-headquartered companies report that they are experiencing more risk or uncertainty around tax legislation or regulation than they were two years ago. The list of countries either deploying or planning significant tax reform continues to expand.

Dealing with policy and regulatory change is only one part of the landscape. Sixty-nine percent of the largest companies report that they feel tax audits have become more aggressive in the last two years, an acceleration from previous EY surveys. At the same time, many respondents report that they feel some national tax authorities are less amenable to an open and collaborative relationship than they were before. And more than half (56%) of all companies report that APAs have become more difficult to negotiate and secure in some markets.

These mounting challenges are putting more and more pressure on the enterprise. For example, 75% of the largest companies said having insufficient resources to cover tax function activities is a potential cause of tax risk, while 64% agree or strongly agree that insufficient internal communication can jeopardize their success.

Despite this state of flux, the day-to-day business of tax work continues. Indeed, more than half (54%) of large companies surveyed say they have not changed their approach to addressing the tax aspects of their business in the last two years. Among Americas-based companies, the proportion was sharply higher, with 72% of companies saying they have not changed their approach.



85%

of US-headquartered companies report that they are experiencing more risk or uncertainty around tax legislation or regulation than they were two years ago.



74%

of the largest companies say they feel that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach.



68%

of the largest companies report that they feel tax audits have become more aggressive in the last two years.



75%

cited insufficient resources to cover tax function activities.

64%

cited insufficient internal communication.

57%

cited a lack of processes or technology.

Leading sources of operational tax risk for the largest companies (in order of prevalence):



Negotiating high-altitude hazards

For many years, tax departments were akin to solo climbers on the mountain. More recently, it has become necessary for tax executives to team more closely with others for the enterprise to flourish.

Our survey indicates that this integration is already widespread, with 82% of all respondents stating that they have adequate or significant involvement in the general business strategy and planning process.

Increasing the tax department's ongoing involvement – and constant communication – across the enterprise will be essential to successfully manage the four major sources of tax risk our survey identifies.

Four major sources of tax risk identified

1

Reputation risk

An intense focus on business taxation and the reputation risk that can result has driven each of these four areas of concern – as well as being a key concern in its own right.

2

BEPS and legislative risk

Criticism of the “share” of tax paid by companies around the world, including complaints that such percentages are often unfair, have largely driven the second major area of risk facing companies today: the rapid increase in new and potential legislation and regulation. To that end, much attention has focused on the OECD BEPS Action Plan. But unilateral actions by individual governments may be an even bigger source of risk, with the potential to create “global tax chaos” that both the OECD and businesses want to avoid.

3

Enforcement risk

Whatever the outcomes, tax administrators have taken their cue from the shifting conditions and political focus, giving rise to what the survey data indicates is the third area of tax risk facing businesses today: more aggressive, focused tax enforcement and a sense that mutually constructive relationships between taxpayers and authorities are becoming strained.

4

Operational risk

The survey data also indicates that as pressures continue to build, many companies may lack the appropriate resources to effectively manage the first three issues. This growing operational risk spans people, processes and technology and is the fourth and final area to be examined in this report.



1

Reputation risk



89%

of the largest companies are somewhat or significantly concerned about the media coverage of the taxes some companies are paying or their seemingly low effective tax rates. This is up from 60% in 2011. Conversely, just 9% say they are unconcerned now, compared to 40% in 2011.



99%

of all companies surveyed say that managing tax risk and controversy has the same or more importance to them today than it did two years ago.

Groups devoted to scrutinizing the tax affairs of large corporations have existed for decades. But many have gained a higher profile in recent years due to a proliferation of social media tools that allow them to reach supporters increasingly concerned over growing income inequality worldwide and cuts to government-provided services during austere times. Their growing support at the grassroots level has in turn made the news media and policymakers pay more attention to their views. Where they once primarily published research papers and relied on press releases to level criticism, some activists have literally found themselves sitting alongside corporate CEOs and technical experts at the witness table to give official testimony to legislative bodies.

The news media has been an even bigger driver of tax-related reputation risk. Newspapers, online publications and television and radio programs have provided exhaustive coverage of allegations of impropriety. Others have launched their own investigations implying wrongdoing by individuals, specific companies or groups of companies, even as their reporting typically acknowledges not only the legality, but the very commercialism of the actions on which they are reporting. Often these stories – like the reports of activist groups – go viral online, eliciting outrage before their targets can muster an effective response.

.....

“Being compliant with the law isn’t always good enough if a journalist writes about your taxes,” said the vice president of tax of a company heavily involved in digital commerce. “There is a far higher threshold for public approval of a tax position than there is when you are dealing with a tax auditor.”

.....

Tax-related reputation risk creates many tangible challenges for companies, even when the allegations may be of dubious accuracy. A changing of the tax administrator-taxpayer relationship may be one consequence. But more than that, consumer products and internet companies as well as commercial banks have faced organized boycotts of their products or services. Government contractors have faced difficult conversations with their clients. And sometimes, key shareholders have to be reassured.

Our survey results illustrate just how rapidly reputation risk has become a key concern. Overall, there was a 72% increase in the number of companies saying they are somewhat or significantly concerned about media coverage of taxes. Eighty-nine percent of the largest companies say they are somewhat or significantly concerned. The concern is most prevalent in the Americas and EMEA (83% and 76% of all size companies, respectively) but still prominent in Asia-Pacific and the BRIC countries, where nearly 70% of companies say they are concerned.

More than half of all companies are taking proactive steps to manage reputation risks. Fifty-seven percent of large and 65% of the largest companies say they have developed a more structured approach to managing their public tax profile.

Forty-two percent of the largest companies responding say they have changed the way they communicate tax-related information to external stakeholders such as the investment community.

.....

“It’s not been so much about putting in place wholesale changes to formal communications, but more about being more thoughtful about how we talk about our business and taxes in public,” said the European tax director of an industrial products company. But this viewpoint may contrast with peers in other sectors. “Our value is our brand, period,” said the tax director of a well-known clothing maker. “We simply cannot afford a negative news story, so we have taken the opportunity to look at every single moving part of our tax strategy and make sure it’s appropriate.”

.....

Companies in our survey said they have little appetite for engaging the media directly. Among the largest companies, 65% say engaging with the press is a no-win proposition, and only 13% disagree. Some companies have turned this notion on its head and voluntarily published additional information on their economic and social contributions.

.....

“The tax profile of our company is far more dynamic than its effective corporate income tax rate,” said one tax director. “I’m delighted to be fully transparent with the tax authorities because that can lead to better mutual understanding. But I think the public needs to understand that our total tax and social contribution equals a lot more. Our contribution to society is more than just a single number covering income taxes paid.”

.....

It is clear that companies need to act deliberately and assertively to manage this complex and sensitive issue rather than risk being put in a situation where they must react to reputational challenges from a defensive posture. This means every company should ensure that tax, C-suite executives, board members and the audit committee agree on a stance regarding whether to voluntarily disclose additional tax and social contribution information on an ongoing basis. These stakeholders must also recognize that not all markets are the same; a policy that is appropriate for one jurisdiction may not be suitable for another.



42%

of the largest companies responding say they have changed the way they communicate tax-related information to external stakeholders such as the investment community, and 6% of large companies say they have changed the way they communicate to management or company staff as a result of the current debate on tax.



65%

of the largest companies say they have developed a more structured approach to managing their public tax profile.



20%

of the largest companies surveyed agree or strongly agree that publishing the amount of taxes they pay where they operate is prudent.



65%

of the largest companies surveyed agree or strongly agree that engaging with the press on tax issues is a no-win proposition for business.

2

BEPS and legislative risk

Rising activism, media scrutiny and public interest do not go unnoticed by politicians for long.

In February 2013, the OECD released its widely anticipated BEPS report. The report, requested by the G8 and G20, reflected the view of some – but not all – countries that current international tax standards may not have kept pace with changes in global business practices, particularly in the areas of intangible assets and e-commerce.

The report was followed shortly after by the publication of the BEPS Action Plan, which reiterated these themes. It established that, in the OECD's view, gaps in the interaction of domestic tax rules of various countries, the application of bilateral tax treaties to multijurisdictional arrangements and the rise of the digital economy have led to weaknesses in the international tax system. The Action Plan contains 15 actions, each of which is linked to specific outputs that are to be issued in 2014 and 2015.

Many of these actions are already driving change, and the global business community is taking the BEPS project very seriously. The OECD's focus on coordinated action is important because unilateral country action may create double taxation and increase controversy, both of which would be adverse for the global economy. The active involvement of non-OECD members (including Brazil, China and India) in the project is also of high importance. Here too the OECD and business have a common interest in encouraging as many countries as possible to participate in the global dialogue on future international tax standards. It is perhaps no coincidence that our survey respondents identified China, India and Brazil (in that order) as the three emerging markets they felt pose the highest risks. In fact, survey respondents also felt that emerging markets pose more risk

today than they did two years ago. Seventy-eight percent of the largest companies say they agree or strongly agree that entering into or operating in an emerging market significantly increases their levels of tax and controversy risk, up from 67% in 2011.

There can be many reasons for this. Because they are dealing with such rapid growth, many emerging markets countries experience very significant policy, legislative and regulatory change as they try to bring their tax regime up to a more sophisticated level. And even then, the approach to taxing transactions may differ greatly in many areas. Of course, it takes many years for a tax regime unaccustomed to policing cross-border commerce to adapt and mature. Couple this with the fact that many companies will have little or no dedicated resources with strong local tax knowledge or cultural experience and one is left with a highly volatile mix that can flare without warning.

The OECD can play an invaluable role in pressing for common approaches and consistent standards that will provide greater certainty and reduce controversy. In fact, as the OECD itself notes, governments risk "global tax chaos" as they chase dwindling revenues from multinational companies, unless updating the international tax regime is addressed collectively.

The pace of the BEPS project is equally, if not more, important than its stakeholder composition. The pace is driven largely by the G8 and G20 agenda and by national-level politics. Many businesses feel that the BEPS agenda is overly ambitious and that the timetable (with many key elements to be completed by September 2014 and all actions to be completed by 2015) is too accelerated to allow careful consideration and input. That in turn may drive risk.



74%

of the largest companies say they feel that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach.



When asked to what extent they foresee more double taxation for their company in the next two years,

61%

of the largest companies expressing an opinion either agreed or strongly agreed.

.....

“We’re not talking about small changes here,” said the tax director of a Fortune 500 consumer products company. “We’re talking about really significant changes to fundamental parts of the international tax architecture. We can’t risk half the countries in the world agreeing with the OECD and the other half not; that would bring bedlam, and we’d spend most of our time stuck between two arguing governments, not running our business.”

.....

This message is intimately understood by the OECD, with Pascal Saint-Amans, who leads the OECD’s tax work, describing the BEPS project as having a “crazy”⁴ two-year deadline that is causing his group to work at a “frantic” pace.⁵

Uncertainty and concern about the outcomes of the BEPS project pervaded our survey responses. When asked how they thought the BEPS project outcomes might be characterized five years hence, only 4% of large companies believe all BEPS recommendations will be adopted at the national level. No Americas-headquartered companies believe this. Globally, 61% of large companies believe some countries will adopt some OECD recommendations, while 30% of large companies believe the situation will be characterized by relatively limited coordinated action and by increased unilateral actions by countries. In the BRIC nations, respondents were more skeptical than elsewhere; 43% say they foresee limited coordinated action and more unilateral action. These are not results that support certainty.

Double taxation is one potential outcome of uncoordinated or unilateral actions. When asked to what extent they foresee more double taxation for their company in the coming three years, 61% of the largest companies expressing an opinion agreed or strongly agreed, while only 7% disagreed or strongly disagreed.

⁴ James Chessell, “Close tax loopholes, urges OECD,” *The Sydney Morning Herald* website, accessed 4 April 2014.

⁵ OECD webcast held on 23 January 2014, BEPS Action Plan: Update on 2014 Deliverables, www.oecd.org/ctp/beps-webcasts.htm



4%

of large companies believe all BEPS recommendations will be adopted by all OECD countries. Nobody (0%) in the Americas thinks this will happen.

30%

of large companies think the situation will be characterized by relatively limited coordinated action and more unilateral actions by countries.

61%

of large companies believe some countries will adopt some OECD recommendations.

Of the largest companies expressing an opinion,

51%

said that in the last two years they have experienced an increased focus by the tax authorities in their headquarters country on the economic and operational substance of foreign entities in their company's group.



56%

of the largest companies have seen an increased focus by tax authorities on issues related to the tax treatment of intangibles in the past two years.



60%

of the largest companies have evaluated what BEPS means for them but have made no changes to existing structures, and 29% haven't evaluated current structures in any way in response to the BEPS plan.

Increasing disclosure requirements (whether in the BEPS Action Plan or unilaterally) are an additional challenge foreseen by businesses. Ninety-four percent of the largest companies having an opinion on the matter expect an increase in disclosure and transparency requirements globally in the next two years. That's up from 81% in 2011, and not surprising given that a number of countries have already issued unilateral requirements in the area of transparency.

Some disclosure requirements within the BEPS Action Plan have already been issued in discussion form. The business community is very concerned about the burden that will be placed upon them to comply, particularly with the proposed country-by-country reporting (CBCR) template, as are some governments that naturally want to protect business from unnecessary impediments to growth.

The overall uncertainty regarding potential outcomes of the BEPS Action Plan is perhaps reflected in the scarcity of engagement that businesses report between themselves and either the OECD or national policymakers. Of those who said they know where they stand on the issue, 65% of large companies are not currently engaging any policymakers on the topic. Twenty-four percent are engaging with one or more national governments, while only 14% say they are engaging the OECD itself, either directly or indirectly (i.e., through a trade or similar body).

Not engaging is a missed opportunity. Upon the late-January release of the CBCR template, the business community was very concerned regarding the burden that

would have been placed upon them to comply. Reporting at the entity level was proposed, and the volume of data required for each entity seemed to go well beyond the high-level risk assessment exercise that was originally intended. Businesses made their concerns known, with almost 1,200 pages of formal comments and equally robust engagement with all stakeholders. Ten weeks later, the OECD announced that reporting would only be required on an aggregated basis, demonstrating that business input is not only taken into account but, perhaps more importantly, that the window of opportunity to engage on specific issues may be extremely short.

.....
"While the political imperatives behind advancing this new reporting requirement are understandable, I hope that ways are found to better balance the benefit of transparency against the burden to companies," said one tax director who has been engaging closely with the OECD on the matter.
.....

The absence of any BEPS recommendations (whether in discussion or final form) at the time our survey was conducted did not stop the respondents from confirming that the very existence of the BEPS Action Plan is having a galvanizing effect on the perceptions and behaviors of tax administrators. Seventy-four percent of respondents felt that previously acceptable levels of economic purpose within a transaction might not now pass muster. Fifty-one percent of the largest companies said that in the last two years

they had experienced an increased focus by the tax authorities in their headquarters country on the economic and operational substance of foreign entities in their company's group. And 56% of the largest companies have seen an increased focus by tax authorities on issues related to the tax treatment of intangibles in the past two years.

Before any final BEPS recommendations have been issued – let alone passed into national-level legislation – tax directors everywhere report that the pace, complexity and volume of new legislation already strains their limited resources; 85% of Americas-based companies say that the volume and/or complexity of legislation and regulation that must be adhered to is driving new risks.

.....

“We’ve actually put in place a formal tax legislation monitoring system for all the countries we operate in,” said the global vice president of tax for a US-based electronics firm. “We try and stay up to date every single day, but there’s just so much changing that we need to have a deep dive at least once a quarter to make sure we stay fully compliant. But of course, just being aware of the change is one thing. Acting on it is another.”

.....

When it comes to taking action around the BEPS agenda, 60% of the largest companies (those with more than US\$5 billion in annual revenues) reported that they have evaluated what BEPS means for them but have not made any changes to existing tax structures. Twenty-nine percent have not evaluated their current structures in any way in response to BEPS. Eight percent have both evaluated and made changes to structures.



94%

of the largest companies having an opinion on the matter think that global disclosure and transparency requirements will continue to grow in the next two years.



78%

of the largest companies (more than US\$5 billion in revenues) say they agree or strongly agree that entering into or operating in an emerging market significantly increases their levels of tax and controversy risk, up from 67% in 2011. Survey respondents identified **Brazil, China and India** as the top three emerging markets countries they believe have the most significant potential for risks related to tax.



65%

of large companies are not currently engaging any policymakers on BEPS; **24%** are engaging with one or more national governments, while only **14%** say they are engaging the OECD itself either directly or indirectly.

3

Enforcement risk



68%

of the largest companies report that they feel tax authorities globally have increased their focus on cross-border transactions in the last two years.



68%

of the largest companies surveyed report that they feel tax audits have become more aggressive in the last two years.

In previous surveys, we tracked how the enforcement of tax law and regulation has grown more robust, occasionally becoming aggressive. This slow build of pressure has many forces pushing it onward. Government deficits remain stubbornly high. Tax authorities are both collaborating and sharing more information with one another and are increasing their focus on cross-border transactions. And finally, the constant media and political focus outlined earlier may be prompting tax authorities to feel they need to be more forceful with business.

Given its prevalence in past surveys – not to mention significant media focus and the fact that it sits at the heart of the BEPS agenda – it is unsurprising that survey respondents identified transfer pricing as their leading source of tax risk. Indirect taxes ranked second, reflecting the ever-growing popularity of this tax type with policymakers. And permanent establishment risk, the third-highest perceived tax risk, reflects the ongoing forays into new markets for companies looking to expand their supply chain and customer base.

In our 2011 survey, we reported that 57% of the largest companies felt that tax audits had become more aggressive and frequent in the preceding two-year period (i.e., 2009-11). In our 2014 survey, this figure accelerates to 68%. Sixty-three percent of respondents expressing an opinion report that they have experienced a trend toward stricter tax audits or assessments relating to VAT or other indirect taxes; this figure climbs to 79% for Asia-Pacific-based companies and 77% for BRIC-based businesses.

But at the same time as these “underlying” pressures continue to build and layer upon each other, many survey respondents report a new risk as forces continue to collide: the galvanizing effect on tax administration of the OECD’s BEPS agenda. Here, many companies report that tax administration approaches seem to be changing ahead of any law changes that may be made as a result of BEPS recommendations. These early actions may actually threaten the coherence of the overall BEPS project, and where a law has already been changed, will create additional uncertainty once the BEPS recommendations reach the implementation stage.

While some changes (such as new or strengthened general anti-avoidance rules (GAAR)) are written directly into law, others are far more subjective and difficult to identify, let alone manage; 74% of respondents, for example, report that taxing authorities are now challenging existing structures due to changes in the law or in their enforcement approach.

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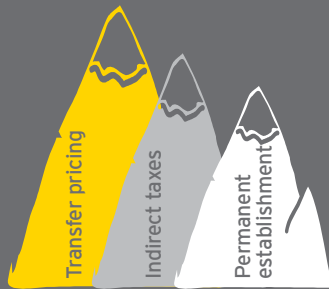
“We’ve heard about certain companies not only being challenged to demonstrate more substance, but actually being taken straight out of the tax authority’s annual compliance program and taken straight into an audit,” says Howard Adams, EY’s Asia-Pacific and Australia Tax Controversy Leader. “It’s like going from one end of the certainty scale to the other in the same day.”

This new approach is alluded to by Chris Jordan, Commissioner of the Australian Taxation Office: “We’re just pausing on the progress of some APAs,” Chris said. He told EY in late 2013: “We just want to understand a bit more about what goes on. We want to test some propositions that have been put to us historically that say there is no taxing right here in Australia because of certain structures.”⁶

.....

APAs have long been a means for tax authorities and taxpayers to mutually agree on a way to reduce risk and, therefore, the volume of disputes in relation to transfer pricing. But many respondents report that APAs are now becoming far more difficult to secure; among Americas-based companies expressing an opinion, this was the case for 63% of respondents. Similar challenges are being experienced in the area of cooperative compliance – the framework approach designed to reduce not only transfer pricing risk, but risk across all tax types. Despite efforts by the OECD to drive higher adoption of cooperative compliance programs, dramatically fewer companies in the latest survey say they have experienced one or more tax administrators seeking to develop a more open and collaborative relationship – a 52% drop, from 56% in 2011 to 27% now.

⁶ An interview with Chris Jordan, Commissioner, Australian Taxation Office. www.ey.com/tpcbriefing

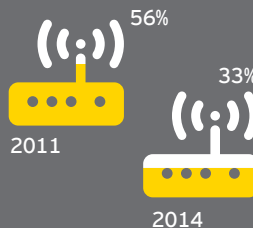


Transfer pricing is perceived to be the highest tax risk area, followed by indirect taxes and permanent establishment risk.



70%

of the largest companies are actively pursuing a more open and collaborative relationship with one or more tax administrations.

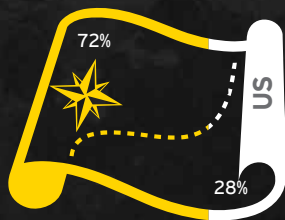
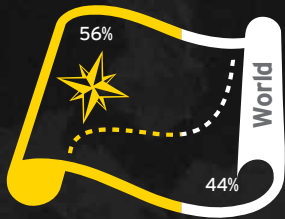


But dramatically fewer companies than two years ago say they have experienced one or more tax administrators seeking to develop a more open and collaborative relationship – a **41% drop, from 56% in 2011 to 33% now.**



63%

of Americas-based companies that expressed an opinion have found one or more tax authorities to be more difficult or challenging with respect to concluding an APA in the last two years.



Despite the accumulation of risks detailed in this report, businesses – particularly in the US – seem quite resolute to maintain their course:

56%

of the largest companies expressing an opinion say they have not become more risk averse when it comes to managing the tax aspects of their business in the last two years, while 44% say they have. The figures increase to

72%

and 28% for US-based companies.

While these changing environmental conditions challenge those on the mountain face today, more experienced climbers are already looking to what may be over the horizon.

Disputes tie up resources, are costly for all involved and can irreparably damage relationships. They are in no one's interest. The future coherence of the BEPS Action Plan is therefore as important to business as it is to the OECD and to governments. There is a direct correlation between the level of collective action achieved and the level of tax disputes globally. Official statistics in relation to tax disputes are typically not published by tax authorities, but the health of mutual agreement procedures (MAPs) between countries can be a useful indicator of the tax system's well-being.

Michael Danilack, the U.S. Competent Authority and IRS Deputy Commissioner (International), reportedly said that efforts to combat base erosion and profit shifting will increase the pressure on MAPs worldwide.⁷ While Action 14 of the BEPS Action Plan does focus on making dispute resolution mechanisms more effective, even Joseph Andrus, Head of the Transfer Pricing Unit for the OECD, has been reported as saying that some of the new rules to come out of the BEPS Action Plan "could in the initial stages lead to more disputes, rather than fewer."⁸

"There's only one thing worse than being stuck in a dispute with the tax authority," said the tax director of a well-known consumer products company. "And that's being stuck between two competent authorities who won't budge or are even telling you that they will give you [the taxpayer] a deal if you agree to give something up."

Again, coherence in the outcomes of the BEPS project will be key to the smooth operation of the cross-border tax architecture.

⁷ "BEPS Effort Seen Likely to Increase Double Tax Disputes," Bloomberg BNA website, www.bna.com/beeps-effortseen-b17179880401/, accessed 4 April 2014.

⁸ Ibid.

4

Operational risk

The right tools are essential to climb a mountain not only triumphantly, but safely. These tools have evolved dramatically since Sir Edmund Hillary first scaled Mount Everest. Moisture-wicking polymers have superseded wool clothing. Climbers carry backpacks made from the same material used to make automobile airbags instead of packs built with an external metal frame. Sir Hillary wore no helmet; the heads of today's climbers are covered with Kevlar.

Our survey shows that many companies may be using outdated tools to make their journey. They may get the job done, but with less comfort and perhaps more risk than is optimal. When it comes to tax, the best toolkit includes knowledgeable people, innovative technologies, effective processes and, where appropriate, the use of revenue authority programs designed to increase certainty and reduce the incidence of dispute.

Companies are certainly spending more time than ever managing tax risk and controversy. Survey respondents say they are spending slightly less time on financial reporting and tax planning than in 2011 (about 5% and 6% less, respectively, among the largest companies) and more time on managing routine compliance and disputes/controversy (about 9% and 11% more, respectively, among the largest companies).

Connectivity between tax and the rest of the business also continues to grow strongly. Eighty-two percent of all companies surveyed believe their tax function has significant or adequate involvement in the general business strategy and planning process. Fifty-one percent report that their company's CEO and/or board of directors have increased their oversight relating to tax risk and controversy management over the past two years, while only 1% report that it has decreased. And 81% of large companies regularly provide briefings or advice to the CEO and/or CFO on how tax risks and tax controversy are being managed – a 53% increase since 2011.

Effective management of complex tax issues relies upon effective policies. Not surprisingly, 55% of all companies report either creating or refreshing their tax risk or tax controversy policy in the last two years as a direct result of the focus on taxes paid by multinational companies.

Fifty-three percent of large companies say they have increased the overall size of their tax function since 2011. Of these companies, the same figure, 55%, attribute the increase to a direct response to the

Leading sources of operational tax risk for the largest companies (in order of prevalence):

75%

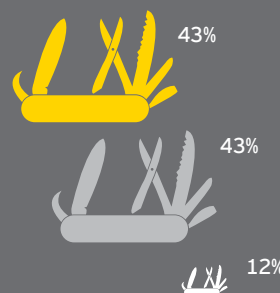
cited insufficient resources to cover tax function activities.

64%

cited insufficient internal communication.

57%

cited a lack of processes or technology.



45%

Only 45% of large companies have "complete visibility" over open tax audits and disputes globally.

43%

43% of all companies use internally developed software or templates to track open tax audits, while 43% use no technology tools at all. Only 12% use a specialist third-party tool from a vendor or professional services company.

In 2013, the largest companies reported spending:

- ▶ Slightly less time on tax financial reporting, including tax accounting and tax provision work
- ▶ Slightly less time on tax planning
- ▶ Slightly more time on routine tax compliance
- ▶ Significantly more time on managing tax controversy, including managing tax audits and any associated remediation work

... than they did in 2011.



59%

of large companies have either created or refreshed their tax risk or tax controversy policy in the last two years because of the focus on the taxes paid by multinationals.

changing tax environment described in this report. But three in four large company respondents say that insufficient tax function resources may still be contributing to increased tax risk or controversy. That is up from 57% in 2011.

The effective deployment of tax function resources may be even more important than their overall number. Indirect taxes and withholding taxes are both areas of significant change and growth for government policymakers. Both have a direct impact on the corporate bottom line, but our survey data shows that there may be a lack of clarity about who manages what within the enterprise: 71% of respondents from the finance or accounting department said their department managed indirect taxes, but 65% of people in a tax role said the tax function was in charge. That's a big divergence from what was reported to be the second-highest tax risk for business, and the same may also be said of withholding taxes. At best, this leads to the inefficient use of resources; at worst, it drives significant risk of trapped tax, new disputes and financial penalties.

Survey data also indicated a fall in the number of companies who reported having a single, readily identifiable individual who has overall responsibility for managing tax risk within the enterprise, from 81% in 2011 to 69% in 2014.

Getting the mix of people, processes and technology right is important because companies say they are typically juggling a significant volume of disputes. For example, 59% of the largest companies reported more than 11 disputes, and 11% said they had more than 100. Just 3% of the largest companies reported having no active disputes. Yet only 43% of large companies globally (i.e., those who may reasonably be expected to have the largest number of disputes) say they have "complete visibility" over open tax audits and disputes around the world.

The good news is that companies appear to know that the right tools can make all the difference. Sixty percent of global

companies say that a lack of processes or technology may contribute to increased tax or controversy risk.

But identifying a problem is easier than solving it. Large numbers of companies report using rudimentary technology – or no technology at all – to manage tax audits and ever-increasing requests for information and data from tax authorities.

Forty-three percent of all companies use no technology or rely on local personnel to manage tax audits and incoming data requests. An identical proportion use internally developed software templates (e.g., Excel spreadsheets), while 8% use an internally developed software application (e.g., Microsoft Access or other custom programming). Twelve percent use software provided by an external vendor, outsourcing, accountancy or a professional services provider. These figures are only slightly higher for the largest companies, where 16% use software provided by an external vendor, outsourcing, accountancy or professional services provider.

Our survey shows similar results across other areas where better use of technology might improve responses to tax-related information management. For example, 46% of all companies use no technology to manage tax modeling, while 34% of all companies use no technology or rely on local personnel for document management and workflow. Thirty-two percent of all companies use no technology or rely on local personnel for data warehousing/archiving, and 41% of all companies use no technology or rely on local personnel for tax calendaring. Finally, 36% of all companies report using no technology or relying on local personnel for legal entity management.

Of course, even the best technology has limited utility if it is not combined with the correct resources, processes and communications – all of which companies tell us they are struggling to deploy in the face of so much change.

Companies also indicate they lack the resources to meet anticipated new demands for greater information reporting and

transparency, including the OECD's proposed country-by-country reporting and transfer pricing documentation requirements. Just 62% of all company respondents believe they have sufficient reporting systems in place to gather and provide that information. Overall, it would seem that as the external pressures mount, the air is becoming a little thinner in the tax function.

The rapidly developing tax risk landscape is clearly driving more and more companies to test their internal controls. Seventy-six percent of the largest companies surveyed say they have a testing and review process as part of their controls environment within the tax function. This is a 62% increase from 2011. Many companies are also taking the opportunity to document their controls in ways that exceed regulatory requirements. Among the same population of the largest companies, 46% of the largest companies say they document their controls in the required jurisdictions, and 21% say they document their controls in more jurisdictions than just those that are required. The same percentage (21%) say they document their internal controls in all jurisdictions in which they operate, whether or not it is required.

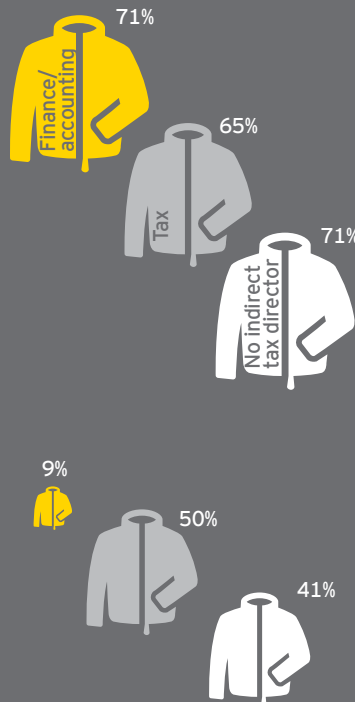
Sixty-two percent of all companies also said they changed the way they document transactions for tax purposes during the last two years. For companies operating in the BRIC nations, that figure increases to 77%. Almost twice as many respondents (91%) cited a desire to reduce compliance risk as the leading driver of this change, far ahead of improving their internal data-sharing capabilities (46%).

As previously noted, 81% of all companies surveyed agreed or strongly agreed that tax risk and tax controversy will become more important for their company in the next two years. But companies are also actively engaged in other activities. On a global basis, companies said managing strategic business transactions and managing tax audits and controversy were their two leading priorities. Yet the survey data reveals significant regional differences of opinion and focus. Among Americas companies, for example, management of the effective tax rate is the leading focus area by some distance, but among Asia-Pacific and EMEA company respondents, effective tax rate management ranked fourth place, behind strategic business transactions, managing tax audits and controversy and securing the effectiveness and efficiency of global tax compliance and reporting.



There has been a significant reduction in the proportion of large companies that say there is a single, readily identifiable person who has overall responsibility for managing tax risk in the enterprise. In 2011, the figure for large companies was 81%, versus 69% now. Among the largest, it fell from 87% in 2011 to

66% now.



When asked who is responsible for managing VAT,

71%

of respondents in a finance role, including 68% of CFOs, said the finance or accounting departments were in charge, 65% of people in tax roles said the tax department was in charge and 71% of large companies say they don't have a global indirect tax director.

Of companies that said they did have such a role, it was not a dedicated role for half (52%) of companies. Of those without a dedicated role, only

9%

said they plan to introduce one in the next two years, 50% said they don't plan to introduce it, and 41% were unsure.

Survey methodology



Our survey was conducted online between November 2013 and January 2014. Two separate online survey instruments were used.

The respondents included 830 tax and finance executives representing more than 20 industry sectors in 25 jurisdictions.

Companies ranging from less than US\$50 million to more than US\$5 billion in annual revenues responded. Thirty-four percent of responses came from companies generating in excess of US\$5 billion in annual revenues.

Responding executives included the following roles: tax director, global head of tax, chief financial officer, financial controller, a functional tax head (e.g., international taxes, indirect tax or employment taxes), financial director, vice president of finance, vice president of tax, other tax role or other finance role.

Figures contained in the report may not add to 100% due to rounding, non-reporting of "don't know" responses and no responses.

Conclusion: climbing is not a spectator sport

When asked why he wanted to climb Mount Everest in 1923 (three decades before Sir Hillary's triumph), George Mallory responded simply, "Because it's there." Mark Wellman, the first paraplegic to climb the famed El Capitan rock formation in California's Yosemite National Park once observed, "Climbing is not a spectator sport."

Both adages are true for tax professionals confronting today's shifting environment for risk and controversy. The forces driving heightened risk can be managed, but bridging the divide of greater uncertainty in business taxation today requires strategy, knowledge, tools and a deliberate plan of action.

Our survey results indicate that companies can do many things to prepare for the expedition. Some of these will be explored in greater detail in subsequent editions of this series, which will incorporate insights from EY professionals and the companies we serve.

The divide between current and future tax risk management models will not be easy to bridge. Enterprises will need to flawlessly execute a well thought-out, well-resourced strategy and at the same time remain flexible enough to deal with today's changing weather conditions. Some of these short-term actions may include:

- ▶ Assessing how the company will comply with new transparency demands, such as country-by-country reporting and transfer pricing documentation requirements, without inviting unwarranted challenges to previously taken positions and without consuming so many resources that oversight of other tax areas is sacrificed.
- ▶ Determining your tax function readiness in terms of the key components of the BEPS Action Plan.
- ▶ Assessing whether your company's current and previous transactions will stand up to increased business purpose requirements – however arbitrary those requirements may seem to be.
- ▶ Making sure your company has the right tools in place – such as APAs, rulings or pre-filing agreements – to manage the impending weather changes.
- ▶ Making sure your company has better visibility and control of any active disputes or uncertain tax positions around the world.
- ▶ Making sure your company has the right resource levels in place to deal with all required tasks.

The past half-decade has been filled with remarkable challenges for tax professionals. The next five years hold even more change. Maintaining perspective will be critical to success.

As the French alpinist Gaston Rébuffat once said, "Climbing is, above all, a matter of integrity."







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