Tax Controversy
2021

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Lexology Getting The Deal Through is delighted to publish the eighth edition of *Tax Controversy*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Ecuador and Taiwan.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Richard Jeens of Slaughter and May, for his continued assistance with this volume.

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Introduction

Surveying the general tax landscape this year, it is clear that covid-19 has presented significant challenges for taxpayers and tax professionals alike. While many organisations and tax professionals have focused on the immediate response to covid-19 and how best to support impacted businesses, our experience and the contributions in the chapters that follow suggest there is far greater scope for tax-related controversy going forward as tax authorities look for means of restoring public finances. Four main themes stand out: paying a 'fair share', digital tax, information tracking and enforcement.

Transparency, morality and paying a 'fair share' of tax

The dramatic changes in 2020 have been widespread and, in so many cases, tragic. Perhaps unsurprisingly, this has accelerated one of the key themes of the tax controversies landscape – and that of the tax landscape more generally – whether businesses and individuals are 'doing the right thing'. This has been relevant to whether businesses can take government support as well as whether they pay their 'fair share' of tax.

As has been seen in recent years, there has been a steady but significant change in perception about what is (and is not) acceptable tax planning. In the context of covid-19, this has made the simple fact of being resident in specific jurisdictions enough to render certain businesses undeserving of the support they seek. For example, Denmark, Poland, France and Scotland have all banned companies registered in (or otherwise connected with) 'tax havens' from accessing initiatives designed to support business through covid-19. Similarly, in the UK, a number of well-known businesses, especially those owned by high-profile individuals, have been subject to public criticism when seeking government support due to the perception of not paying the 'right' amount of tax or of otherwise being undeserving.

One very practical implication of this for tax controversies has been the increased need for transparency. That has been driven by shareholders and other stakeholders seeking to mitigate the reputational risk associated with perceived 'tax avoidance' (for them as investors and the taxpayer group in question) and new tax reporting standards, such as that being developed by the Global Reporting Initiative. This would include disclosures on tax strategy, governance and country-by-country reporting, on the basis that increased tax transparency 'informs public debate and supports the development of socially desirable tax policy'. With tax as a tool of social (and political) policy, handling and resolving any tax controversy must now consider broader reputational issues upfront and alongside the technical arguments.

Digital taxation

For many tax professionals and businesses, the ability to work from home or remotely has proved critical in recent months. However, that digital interconnectedness illustrates one of the other big themes that has emerged this year, namely the uncertain tax landscape around digital taxation. This uncertainty has recently been fuelled by unilateral digital services tax (DST) measures in the UK, France, Spain, Italy and Austria, among others. Likewise, some authorities have already signalled that DSTs are an attractive means of restoring public finances as the severe financial impact of covid-19 becomes better known. For example, the EU Commission has proposed a DST as part of its attempt to finance a €750 billion recovery plan. The political and fiscal motives for such moves are obvious: large and profitable businesses appear to be operating in any given jurisdiction while paying only a tiny amount of tax.

However, from a practical (and tax controversy) perspective, unilateral measures will inevitably lead to greater complexity, increased compliance costs and more cross-border litigation for businesses. As the OECD's Secretary-General has commented, a 'proliferation of uncoordinated and unilateral measures… [will]… negatively affect global growth […] deepen the covid-19 economic crisis and hinder the post-crisis recovery'. This is exacerbated by the broad trade conflicts, be they the US imposition of tariffs on French goods or restrictions on exports from China.

In this context, the US's withdrawal from talks with its European counterparts over the OECD's proposals under Pillar 1 and Pillar 2 of the Inclusive Framework is unfortunate. As is well known by now, the OECD's proposals provide for new nexus and profit allocation rules (Pillar 1) and a global minimum rate of tax (Pillar 2). They are an attempt to reflect the globalised world we live in, where businesses can significantly participate in a country's economy without necessarily contributing to its upkeep. The OECD estimates that the combined effect of its proposals alone would amount to global tax revenue gains of up to US$100 billion, or 4 per cent of global corporate income tax. The OECD is optimistic that international consensus can be reached before the end of 2020, even if it may be several years before its measures are fully implemented.

Whether this optimism is well placed remains to be seen. In particular, there are undoubtedly technical difficulties with the proposals, such as the risk that businesses are subject to conflicting assessments under Pillar 1 in several jurisdictions. This will necessarily require tax authorities to coordinate to ensure that the risk of double taxation is eliminated, something that has historically been very difficult to achieve (and less likely in the short term, given the fiscal and resource pressures on tax authorities).

In response, the OECD has suggested developing an innovative early dispute prevention process that would be triggered before a tax assessment is issued and would involve representative tax review panels. This proposal is also accompanied by those to develop other dispute resolution mechanisms should the early dispute prevention process be unavailable or inappropriate. This includes strengthening existing mutual agreement procedures (which could be addressed during the review of action 14 of the base erosion and profit shifting (BEPS) project), as well as developing appropriate mandatory binding dispute resolution mechanisms, which could include employing mandatory binding arbitration. It is unclear whether the form of such arbitration would be reasoned or 'baseball' style – where tax authorities are encouraged to make a reasonable proposal, lest the panel of arbitrators

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select its competitor's proposal. However, both of these options suffer from their own drawbacks. The likely presence of multiple interested parties will necessarily slow down any reasoned arbitration procedure, while any 'reasonable' proposal submitted under baseball-style arbitration may not always be reasonable to all other interested authorities.

Whatever the outcome in the short to medium term, in the interim, organisations (and their advisers) will no doubt see more disputes involving digital taxes (and organisational planning to address the risk of such taxes).

Information and tracking

Coupled with (and in some respects justified by) the increasing political focus on taxpayer transparency, the third theme that emerges this year is the continued focus on the ability of tax authorities to collect, process and act upon taxpayer information.

While existing information exchange regimes appear to be working well, with tax authorities obtaining data on 84 million financial accounts held offshore and uncovering assets worth €10 trillion last year alone, it is recognised that more could be done. The EU Commission has recently signalled its intention to invest in new digital tools as part of a shift towards real-time processing of tax information and to improve cross-border recovery of tax. Similarly, the OECD has suggested that authorities with increased revenue needs as a result of covid-19 should invest in new technologies to increase compliance (and therefore revenues), while reducing the burden on taxpayers.

Tax authorities are also continuing to refine and expand the disclosure obligations that taxpayers are subjected to, with the EU's latest directive on administrative cooperation in respect of tax matters (DAC 6) having come into force earlier in 2020.

DAC 6 requires intermediaries facilitating cross-border transaction within the EU to report transactions featuring certain 'hallmarks' to the local tax authorities. A report does not necessarily mean that a transaction is illegitimate, but rather provides local authorities the opportunity to proactively scrutinise transactions deemed to be higher risk. Despite such reports being neutral, the UK tax authority has already began joining up this reporting tool with a reporting framework specifically designed for tax avoiders. As a result, taxpayers who report under DAC 6 may find that they risk being perceived as a tax avoider unless they can demonstrate that this alternative framework is inappropriate.

Although the reporting deadline for reports under DAC 6 has been deferred by many tax authorities as a result of covid-19, a surge in taxpayer investigations and disputes should be expected in the near future once authorities begin actively considering such reports.

Looking forward, authorities are also continuing to advance their own proposals to improve tax transparency. For example, the EU Commission has confirmed its intention to continue with proposals on public country-by-country reporting (building on action 13 of the BEPS project). The UK is also consulting on a requirement for certain businesses to notify the local tax authority where they adopt uncertain tax treatment in an attempt to tackle the £4.9 billion legal interpretation tax gap.

Enforcement (mindset and procedure)

What approach then, have authorities taken to enforcement, given the rising concern around tax fairness and transparency? Again, we have seen authorities strengthen existing measures on tax evasion and avoidance. For instance, in France, the constitutional court recently confirmed that tax cases may now be automatically transferred to a public prosecutor for investigation for tax fraud following changes to previous rules in late 2018. Now confirmed, it is expected that this change will result in around 2,000 cases being referred to the French Public Prosecutor each year. In Italy, changes have been made to the minimum criminal sentences that may be passed for tax violations, with the minimum threshold for such penalties reduced and related powers expanded. Likewise, Norway is the latest (of many) jurisdictions that have given their tax authorities the ability to launch dawn raids, including on residential buildings.

In terms of ongoing disputes, some jurisdictions have seen enhanced focus on reaching settlements with taxpayers. Temporary measures were introduced in Brazil last year to allow the authorities to settle certain tax disputes, such as where a common issue was in dispute with several taxpayers or where the tax at stake was minor. Similarly, in February 2020, India granted corporate taxpayers the option of settling pending direct tax cases by paying the disputed tax without penalties or interest. While these measures were introduced to resolve large backlogs of cases, it remains to be seen whether the uptake has been sufficient as covid-19 impacts business cash flows.

However, and perhaps cognisant of the need for tax authorities to be seen to take defensible positions, we have also seen continued disagreement (and litigation) about technical positions in disputes across a range of business sectors. More everyday examples from the UK include the taxable status of self-employed football referees, as well as the distinction between company 'vans' and 'cars' for the purposes of social security contributions. Similarly, albeit more specialist, is the growing dispute about the taxable status of cryptocurrency, which is not helped by the differing assessments of its legal status between jurisdictions.

Tax tribunals have also continued to be relatively pro-tax authority, particularly in case where the dispute in question concerns tax evasion or avoidance. That has been the case in procedural as well as substantive matters. For instance, the Australian courts have allowed the tax authorities' use of privileged material even when that material had been stolen from the taxpayer's lawyers. Tax authorities have also shown themselves as increasingly willing to exhaust the powers available to them to put pressure on taxpayers when disputing tax liabilities. For instance, in Ecuador, the authorities are increasingly using fast-track tax assessment procedures to raise disputes, which leave taxpayers with little time to prepare a defence.

It is unclear whether the financial strains created by covid-19 will result in a shift in approach by tax authorities. Some fear that a major decline in revenues will push tax authorities to pursue disputed tax more aggressively. Others hope for increased cooperation, with a focus on resolving differing tax positions in real time and avoiding costly litigation. In practice, we expect much to depend on the cultural response of tax authorities in different jurisdictions, which in turn will require taxpayers to engage expert support in each of the relevant jurisdictions.

What does the future hold?

Tax controversies look set to remain a challenging area for the foreseeable future as businesses grapple with an uncertain tax environment.

Taxpayers who have benefitted from short-term measures implemented in response to covid-19, such as deferrals to filing and payment deadlines, will need to remain alert as to how this may affect their (legal and public) compliance obligations in future. Similarly, taxpayers should brace themselves for long delays in resolving tax disputes in jurisdictions where tax hearings were paused or otherwise restricted as a result of covid-19.

Across the tax landscape more generally, we may begin to see that the losses established this year influence the tax behaviour (and the appetite for tax risk) of businesses for years to come. A number of European countries have already enacted or announced proposals to modify their tax loss rules so that this year's losses may be set off against prior year profits or rolled into the future. Some may use this as an opportunity to settle historical liabilities, or as a hedge against future liabilities.

We may also see changes to international group structures as businesses shift their operations closer to their end consumers. This will be

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driven partly by the disruption caused to existing global supply chains (including by longer-term measures, such as travel restrictions), as well as in response to measures incentivising inwards investment. Likewise, the days of stateless or otherwise 'residual' profits being untaxed are likely to be over, whether as a result of direct enforcement (such as the European Commission's state aid investigations) or reputational pressure. Such operational changes may in turn lead to changes in the type of tax disputes practitioners can expect to see in the future, with tax authorities moving away from traditional disputes around supply chains and low-tax holding companies and on to questions of residency, digital taxes and place of supply questions.

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