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Around the world, taxpayers continue to address a variety of tax dispute issues. Revenue authorities are introducing new compliance programs in efforts to increase collections with fewer resources. Legislative changes arising from the Organisation for Economic Co-operation and Development's (OECD) Action Plan on Base Erosion and Profit Shifting (BEPS), European Union (EU) tax reforms and other anti-avoidance initiatives, are transforming the regulatory landscape for tax. All of these changes are occurring at a rapid pace and creating fertile ground for tax disputes.

Multinational organizations face mounting challenges to protect against, prepare for and resolve disputes with tax authorities in multiple jurisdictions. This article series, developed by KPMG's Global Tax Dispute Resolution and Controversy Services Network (GTDR&C), explores key jurisdictions across the globe to provide you with what you need to know to stay current.

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Canada

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Within Canada's federal government, attitudes continue to harden against tax evasion and aggressive tax avoidance, with the 2015 and 2016 federal budgets closing perceived loopholes in the tax law and devoting significant sums to strengthen the Canada Revenue Agency's (CRA) enforcement capabilities.

In its 2015 federal budget, the former federal government said that since 2006, it had introduced "over 90 measures to close tax loopholes, clarify tax rules, reduce aggressive international tax avoidance and improve the integrity of the tax system."[1] In the 2016 federal budget, Canada's new government, elected in October 2015, committed 444.4 million Canadian dollars (CAD) over 5 years for the CRA to enhance its efforts to crack down on tax evasion and combat tax avoidance.[2] Both budgets reiterate the government's pledge to support the OECD's BEPS project and act on certain of its recommendations.

Pressure to collect more revenue

Ongoing economic weakness, increasingly urgent infrastructure needs and a will to keep corporate tax rates competitive globally continue to put pressure on the CRA to increase revenue. In addition to pursuing tax evasion and avoidance, the CRA is responding with new approaches to raise revenues by improving compliance across the board.

The shift in approach is evident from the new vocabulary that the government is using to announce anti-avoidance measures. Now announcements on loophole-closing and other anti-avoidance initiatives are framed as measures to enhance compliance and generate more collections from the existing tax base.

The CRA is also working to make more frequent and extensive use of its powers to demand information from taxpayers.

For example, based on a recent court win that is pending appeal, the CRA is going after the analyses of uncertain tax positions that public companies are required to complete to support tax reserves under Canadian generally accepted accounting principles. The analyses in these tax working papers can provide a list of issues for the CRA to consider on audit. Whether the CRA will prevail on appeal remains to be seen. Nevertheless, the CRA's approach in this regard reflects its stepped-up efforts to gather more data about taxpayers' affairs.

Among other tools at its disposal, the CRA is active in requesting and sharing information with other tax authorities under tax treaties and information exchange agreements. Tight deadlines for taxpayers to respond to CRA information demands are being strictly enforced. Late taxpayers are suffering arbitrary but binding assessments based on missing or incomplete information. Assessing positions that were rarely invoked in the past are used more frequently, and taxpayers are seeing transactions on the basis that, for example, the arrangement is a sham or amounts were not laid out to earn income. Assessments are being issued that contain multiple positions that are considered binding and valid, even where the CRA's various positions are in conflict.

[1] Department of Finance Canada, 2015 Federal Budget, 21 April 2015, page 349.

[2] Department of Finance Canada, 2016 Federal Budget, 22 March 2016, page 218.

New compliance initiatives

In addition to flexing its administrative powers to demand information and raise assessments, the CRA is undertaking a number of initiatives to boost compliance and collections:

— **Offshore Tax Informant Program:** Through this program, the CRA provides financial rewards to whistle-blowers who provide information about offshore tax compliance. Where the information leads to assessments of CAD100,000 or more in additional tax, the informant is entitled to 15 percent of the additional tax raised. Over 2,000 calls were received under this reporting program in the CRA's last reporting period ended in 2014.[3]

— **Reporting of electronic funds transfers:** Considerable tax audit activity is being driven by the requirement that financial institutions, including casinos, are required to report to the CRA all electronic funds transfers exceeding CAD10,000.

— **Expanded foreign reporting rules:** Corporations and individuals are required to make detailed and complex disclosures about their assets held offshore. Steep penalties can be levied for failing to provide this information, regardless of whether any Canadian tax is owed on income from these assets.

— **Expanding relationships with other governments:** In addition to making more use of information-sharing agreements, the CRA is using the collection provisions of Canada's tax treaties to pursue tax debts offshore.

— **Data analytics:** The CRA's Integrated Risk Assessment System links data from the CRA's various systems and runs it against sophisticated software to benchmark taxpayer activity and update risk assessment models. The system generates an automated risk assessment score for large corporate taxpayers, which can then influence the CRA's audit coverage of each large file.

Areas of focus

Areas of particular focus for CRA auditors include:

— 'BEPS-like' cross-border financing structures involving hybrid arrangements, cross-border debt and treaty-based structures

— transfer pricing, especially as it relates to royalties, management fees, reinsurance, hedging and other financial transactions

— business travelers, which is one area where arbitrary assessments are being raised when foreign parties fail to respond to CRA information requests; audits in this area have resulted in multi-million dollar assessments

— verification of foreign tax credits, which is now required in the form of proof of foreign taxes paid issued by the other jurisdictions' tax authorities

— 'treaty-shopping' arrangements and transactions, although the CRA's particular focus in this area is unclear.

Minimizing potential Canadian tax disputes

In this environment, many tax disputes can be preempted by having clear, comprehensive document of your facts and tax positions and by responding to CRA demands for information within their set timeframe. It's also important to keep adequate, up-to-date books and records in the event that the CRA asks for supporting data for financial statements.

If you are behind on your filings, consider making an application under Canada's permanent voluntary disclosure program. Although you must meet numerous conditions to qualify, voluntary disclosure can help you get back on side with the CRA while avoiding potential penalties and interest.

Bear in mind that the CRA will risk-assess your tax filings against your peers to pinpoint any anomalies. As a result, one of your best ways to defend against potential tax controversy is to ensure your compliance is of the highest quality and your various filings and submissions to the CRA are made on time.

[3] CRA Annual Report to Parliament 2014-2015, page 50.

United Kingdom

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Within the UK, tax remains high on the agenda with the public, politicians and the media. The HMRC's recent high-profile victory in achieving a sizable settlement from a global technology company suggests this priority on tax fairness and transparency will continue, especially as new legislation is introduced to strengthen HMRC's enforcement powers.

New UK proposals in this area include a requirement for large businesses to publish their tax strategies annually, a new framework for cooperative compliance, and some so-called 'special measures'. Many UK-based companies will also be affected by the European Commission's (EC's) recent anti-avoidance tax package.

Publication of tax strategies

Under a new proposal, about 2,000 of the UK's largest businesses (including partnerships and building societies) will need to publish descriptions of:

- their corporate group's approach to governance in relation to UK taxes
- the group's attitude toward tax planning as it affects UK taxes
- the group's approach toward dealing with the UK tax authorities
- the level of risk that the group is prepared to accept in relation to UK taxes.

If the rules are passed, the first disclosures for most affected companies would be due by 31 December 2017.

HMRC is still consulting on the proposals, and they may change before enactment. Companies that already publish this information voluntarily should ensure their current disclosures fulfill the final requirements, while other companies should be putting in place the documentation to support this disclosure.

As the proposals apply to UK subsidiaries of international corporate groups with group turnover exceeding 650 million British pounds (GBP), even relatively small UK subsidiaries companies could be caught by the proposals. Companies should review their potential obligations carefully, since non-compliance could attract steep severe penalties.

Framework for cooperative compliance

HMRC's proposed framework for cooperative compliance is essentially a code of conduct agreement to govern behavior of large businesses in dealings with HMRC. The first draft of the proposals was widely criticized, as they seemed to present a one-sided list of demands for taxpayers only.

Following consultations, the current proposals are more balanced in setting behavioral expectations for both sides. For example, large businesses would be expected to agree to fully and promptly disclose information about material transactions with a tax element in real time, while tax authorities would agree to be prompt and open in their dealings with taxpayers. It currently seems likely that the finally implemented version of these proposals will be voluntary.

'Special measures'

The UK government also proposed a series of 'special measures' that target persistently uncooperative large businesses. For those companies that fall within this regime, the most significant of these measures bars them from relying on the defense of 'reasonable care' in cases of errors in their tax documents. For these companies, any such error could attract a penalty of 30 percent of underpaid tax, regardless of the reason for the error. A further sanction could see businesses being publicly named as subject to special measures.

EC anti-tax avoidance package

The EC's proposed anti-avoidance tax package, introduced in January 2016, would apply to all entities that are located or have operations in the EU and therefore covers UK-based companies. Some of these measures simply mirror OECD BEPS recommendations in areas such as treaty abuse, permanent establishment definitions and transfer pricing guidelines. However, technical differences in the translation of other measures related to, for example, hybrids, interest deductibility and controlled foreign companies, could contain traps for the unwary.

The package also puts forward some unilateral measures that go well beyond the OECD recommendations, for example, with proposals that would introduce exit charges and require publication of country-by-country tax reports.

These proposals are subject to consultation, and the timing of their potential enactment is unknown. However, as many of these regulations are expected to become law in the foreseeable future, UK companies should prepare to face the challenges of complying with these various anti-BEPS rules.

Practical UK tax developments

Within the UK, HMRC has embarked on several projects that aim to improve compliance:

— **Diverted profits tax:** The HMRC is risk assessing businesses that may have diverted profits and which may be subject to the new diverted profits tax, and it has prioritized tax audit resources to manage these issues.

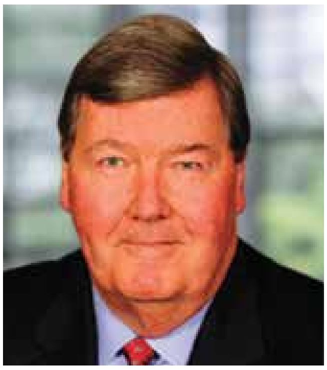
— **Accelerated payment and follower notices:** The UK's move to demand upfront payment for disputed taxes relating to disclosed tax avoidance schemes has changed the economics of tax disputes by creating cash flow implications for companies wishing to pursue disputes. Additionally, after HMRC has won in the courts new regulations allow HMRC to issue 'follower notices' requiring payment of tax from other taxpayers with similar arrangements. The new regime has been subject to judicial review, but it is likely that HMRC will succeed to collect the disputed tax in the majority of cases in which accelerated payment and follower notices are issued.

— **High-risk corporates program:** This program, which taxpayers can enter voluntarily but often is initiated by HMRC through a board-to-board engagement, allows for highly intensive audit activity to clear all outstanding tax disputes through a dedicated resolution process. With tax disputes on the rise, this program is expected to be used more regularly going forward.

Stand your ground

Despite these developments, it remains possible to avoid UK tax disputes in many cases and to reach acceptable settlements when disputes arise. In the current environment, it's advisable to avoid rushing into compromises with HMRC. Take time to manage your relationships with HMRC, understand their positions and know your options so you can access the optimal dispute resolution alternative. As long as your case is on firm footing, standing your ground can be the key to achieving a better outcome.

United States



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After 5 to 6 years of budget reductions, staff attrition and limited hiring, the US Internal Revenue Service (IRS) is showing signs of strain. The fractious tone of the current US election campaigns makes it seem unlikely that the IRS' budgetary situation will improve anytime soon. In the meantime, the IRS is taking steps to address its resource limitations. The IRS Commissioner has tasked all divisions to re-design their operations to suit the current budget reality.

Shift in approach

To this end, the IRS' Large Business and International division is being re-focused to shift away from comprehensive audits of large enterprises and toward centrally worked identification of specific compliance risk issues. The revamped organization is designed around nine 'practice areas', with five subject-matter practice areas devoted to broadly defined areas of tax risk covering:

1. pass-through entities
2. enterprise activities
3. cross-border activities
4. withholding and international individual compliance
5. treaty and transfer pricing operations.

The other four practice areas cover geographically designed practice regions.

With three of the five new subject-matter areas devoted to cross-border areas, international taxation will remain a key focus of the reorganized division.

Campaigns and treatments

The IRS' new approach comes with a new vocabulary that includes 'campaigns' and 'treatments', though the specifics of these new terms remain to be seen. Subject matter experts within the five subject-matter practice areas will be heavily involved in identifying specific tax risks and developing related guidance material and advice. The IRS will then determine which risks warrant issues-based 'campaigns' to identify and eliminate specific instances of risks and the 'treatment' best suited to the risk's mitigation — whether through tax audits, softer letter-writing campaigns, or other means.

When tax audits are selected as the appropriate treatment, the audits will be centrally selected, serviced by a mix of local and national resources, and subject to campaign-wide collaboration. Campaign agents will be specially trained to deal with the selected issue and will usually confine their investigations to that issue only.

With this approach, audit teams should be more prepared and coordinated from a technical standpoint. However, taxpayers who find themselves subject to multiple campaigns at the same time may find this new audit approach difficult to navigate.

Keeping focus on international matters

As anti-BEPS measures are introduced in the US and other countries worldwide, the IRS has concerns about its ability to keep up with the surging audit workload these changes are expected to create for its international tax audit programs. As a result, the IRS is undertaking additional initiatives to improve compliance and enforcement in the international tax area:

- **Transfer pricing compliance:** The IRS is expected to breathe new life into its advance pricing agreement and mutual agreement procedure programs, which have seen dwindling participation since 2012–13 due to a leadership change.
- **Expanded litigation strategy:** The IRS has taken the controversial step of involving external tax litigators in tax audits where litigation is a likely outcome. With this move, the IRS appears to be trying to improve its track record in achieving transfer pricing court decisions in its favor. However, the practice raises serious concerns about taxpayer confidentiality and access to information.
- **International Practice Units:** The IRS has begun publishing International Practice Units (IPU), which instruct IRS agents on the technical treatment of various tax issues. Over 100 IPUs have been issued to date, and the window into the tax authority's positions can greatly improve certainty over how the IRS will dispense with particular issues in practice.

The reorganization represents a significant shift in the approach to international audits, and it will take some time until the implications for businesses are fully known. Similarly, it could take several years before changes arising from the OECD's BEPS project and individual jurisdictions' anti-avoidance measures are implemented and in force. International companies are advised to closely monitor these developments and their potential impact on their tax processes and structures.

New developments in Argentina, Brazil and Mexico

Argentina

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For companies doing business in Argentina, the tax and business environment is changing for the better. The country's new government, elected in December 2015, is already taking steps to shift the direction of the tax authorities away from politically motivated collections and toward more technically oriented compliance activities.

In efforts to raise desperately needed tax revenues, Argentina's previous government passed a number of amendments designed to extract more taxes from international transactions. Most cross-border transactions were treated as suspect, and more onerous penalties were adopted for non-compliance with tax laws governing international activity.

Within the tax authority, technical tax resources were replaced with non-technical appointees and the tax system was used as a tool to intervene in the private economy. Sanctions for non-payment of tax on cross-border transactions included cancellation of taxpayer identification numbers and the rejection of import/export permits and tax certificates needed to bid for state contracts. Such serious consequences encouraged businesses to keep a low profile where taxes were concerned.

Since the new government took office in December, work is being done to restore tax expertise in the tax administration and improve its image. As a result, disputes are now being settled on technical grounds and companies doing business in Argentina are gaining more certainty over the tax treatment of their cross-border transactions.

System discourages tax appeals

Argentina's tax system is based on self-assessment. Taxpayers determine their taxes owing and file tax returns, which the tax authorities review for accuracy and completeness. If the tax authorities make an adjustment and the taxpayer disagrees, administrative and judicial levels of appeal are in place to resolve the issue.

Between the audit and administrative appeal stages, however, there is no possibility for mediation between the taxpayer and the tax authority. If a taxpayer disagrees with an adjustment, the tax authority either confirms or abandons it. If confirmed, the administrative appeal is initiated. At this point, fines may be applied for omissions or failure to report income. Criminal charges can be laid if the tax authority believes fraud is involved and the adjustment exceeds 400,000 Argentine pesos (ARS) about 27,000 US dollars (USD)). It can take from 8 to 10 years to settle the case through the administrative and judicial appeal levels.

Tax authority relationships are key

Lack of formal mediation, possible criminal charges and protracted timelines for resolution can discourage companies from pursuing appeals. However, there are informal ways that taxpayers can avoid criminal charges or adjustments entirely. At the outset of a tax audit, companies are advised to file complete documentation in writing, setting out their positions and providing evidence in support. In particular, this initial documentation should demonstrate a lack of criminal activity.

Companies should also strive to develop a good working relationship with their auditors. This opens the possibility that potential disputes can be settled informally before the audit is closed. Even if an adjustment is proposed, previously submitted evidence and cooperative relationships can preempt the imposition of severe criminal charges at the administrative appeal stage and reduce the costs and time needed to settle the matter.

The tax authority have considerable room for discretionally decisions within the law. For these reasons it is important to maintain a good relationship and keep communication channels open. Based on the experience of KPMG in Argentina, this informal approach is often effective and its degree of success depends on the strength of the relationships of the parties involved.

Provincial taxes add more costs and complexity

On top of their national tax obligations, taxpayers in Argentina must also manage their provincial tax burden in each of the 24 provinces they do business in. The provincial governments face their own fiscal challenges, and they are becoming much more aggressive in their audit and assessing practices. This is compounding the existing tax complexity and creating serious concerns for businesses.

One widespread problem arises from provincial advance tax payment requirements. Many corporations have had difficulty obtaining credits in respect of their advance tax payments, especially where the excess payments greatly exceed the taxes due. Pursuing these refund claims can be time-consuming and costly, especially when dealing with tax authorities in multiple jurisdictions.

Amnesty regime on hold

Since December 2014, Argentina's national tax authority has been cracking down on undeclared investments held in offshore accounts, making income and wealth tax adjustments and filing criminal reports. To complement this initiative, the tax authority had considered introducing a tax amnesty regime.

Taxpayers who receive an adjustment for undeclared offshore accounts are advised to file a rejection of the adjustment with the tax court. That way, these taxpayers could potentially benefit if Argentina puts in place a tax amnesty regime in the future.

Court decisions open tax reduction opportunities

As a result of recent Supreme Court decisions and the economic crisis, many financially struggling companies in Argentina are taking action to reduce their tax bills. Companies are attempting to save tax by taking filing positions based on two decisions in particular:

- The Supreme Court has ruled that Argentina's minimum presumptive income tax should not apply to companies in periods in which no income is generated. As a result, companies are taking the position that the minimum tax does not apply on the basis of their accounting and tax losses.
- The Supreme Court has ruled that the different rates of tax imposed by the provinces are unconstitutional because taxpayers are required to pay more or less tax solely based on where the work is done. For companies with industrial activities, turnover tax rates can range from 1 to 5 percent, depending on the location, so the tax savings resulting from this ruling can be substantial. For that reason these days there are many case before the Supreme Court in relation to turnover tax.

While Argentina's new government is actively working to improve the country's tax administration, the tax environment remains difficult. Foreign companies doing business there should be sure to have a sound, well-documented business purpose for their structures and transactions. Establishing favorable relations with the tax authorities can also go a long way toward reducing the potential for tax disputes or easing their consequences.

Brazil

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With the Brazilian government in a state of disarray following its president's impeachment proceeding in April 2016 and with the country in urgent need of more revenue, only one thing is certain: tax burdens in the country will continue to rise and the aggressiveness of its tax authorities will continue to increase. Against this backdrop, a number of recent developments are presenting additional tax challenges for companies with operations and investments in Brazil.

Revamped CARF opens following corruption scandal

The Administrative Council of Tax Appeals (CARF), Brazil's second-level federal administrative court, resumed its trials in December 2015. Its trials were suspended in March 2015 because of federal police investigations into corruption within the council for favoring companies.

To reduce the possibility that one or a group of judges could manipulate outcomes, the re-opened CARF has been modified in several ways: the number of judges and panels are reduced, the number of judges on each panel is increased, and groups of similar cases can be decided at the same trial session. Panels still are required to have an equal number of judges representing the tax authorities and taxpayers. Taxpayer representative judges can no longer practice law, however. This has caused a turnover of more than 80 percent of judges representing taxpayers and raised concerns over the CARF's jurisprudential consistency in new cases.

Indeed, several high-profile cases affecting large numbers of taxpayers have been heard since the CARF resumed, and the majority of the decisions have gone against the taxpayers. Tax issues involved in these cases include:

- amortization of goodwill
- retroactive payments of interest on net profits
- capital gains on the exchange of assets
- the 30 percent limitation on compensation for tax loss carryforwards on corporate mergers and wind-ups.

Given these early experiences with the revamped CARF, companies are advised to re-evaluate their tax dispute resolution strategies. Previously the CARF offered a good alternative for achieving a favorable outcome. Now companies may be better off going straight to a judicial review.

Tax Review Board — list of top audit targets

Brazil's federal tax authorities (RFB) annual audit plan for 2016[4] specifies eight issues as targets for tax audits:

1. tax planning focusing on the creation of amortizable assets
2. tax planning involving private equity funds
3. taxation of profits generated abroad
4. cigarette, beverage and fuel sectors

[4] Available at: http://idg.receita.fazenda.gov.br/dados/resultados/fiscalizacao/arquivos-e-imagens/plano-anual-fiscalizacao-2016-e-resultados-2015.pdf.

5. social contribution on payroll — individual companies *(Pejotização)*
6. omission of income based on electronic invoices (NF-e)
7. omission of income based on suspicious inconsistent financial flows
8. social security offset informed in GFIP (social contribution declaration form.

Of course, Brazilian tax auditors will not restrict their investigations to these issues only, especially given their imperative to raise collections. All taxpayers, especially large companies, should thoroughly review their tax risks and take steps to mitigate them accordingly.

Focus on 'suspicious inconsistent financial flows'

A recent Supreme Court decision struck down a constitutional challenge and established tax authorities' right to access the banking and credit card data of taxpayers without judicial authorization. Combined with the accounting and fiscal records that taxpayers in Brazil must electronically submit, the banking and credit card data will provide the tax authorities with extensive information about taxpayers' financial activities. It is expected this information will be digitally analyzed to identify the 'suspicious inconsistent financial flows' that are targeted in the TRB's 2016 audit plan.

Provisory decisions

A second Supreme Court decision allows the courts to impose criminal sentences on a provisory basis after an appeal court decision has been made but before the legal appeal process has been exhausted. Whether this ruling will be applied to tax disputes remains to be seen. Together with changes to the Code of Civil Procedure introduced in March 2016, the ruling could help taxpayers execute their decisions faster, but, on the other hand, allow tax authorities to enforce tax foreclosures more quickly. The current 3- to 7-year timeframe for resolving tax disputes could be significantly shortened as a result.

Mexico

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As in Brazil and Argentina, Mexico's tax authorities are under pressure to raise collections and they are adopting more aggressive tax audit procedures. Similar to Brazil, Mexico is using data analytic processes to identify audit targets by flagging inconsistencies in taxpayers' reported profits and tax accounts from year to year. The Mexican Tax Authority (MTA) has set up audit programs that focus on six specific issues:

1. deductions for payments made abroad on a pro-rata basis
2. deductions for marketing and advertising expenses
3. back-to-back loans
4. royalties paid to foreign residents regarding intangible assets generated in Mexico
5. value-added tax refunds
6. aggressive tax planning in relation to the OECD Action Plan on BEPS.

Focus on foreign marketing and advertising expenses

Item two on the tax authority's list is a significant source of controversy. The MTA frequently decides that marketing and advertising expenses paid to foreign related parties are not deductible for the following reasons:

— Duplicative payments are made both locally and abroad to related parties.

— There is no evidence (e.g. documentation) of any deliverables connected to payments to foreign related parties and how those deliverables help generate income in Mexico.

— There is no economic analysis, guidelines or other evidence to establish an economic benefit to Mexico that justifies deductibility of these expenses.

— The amounts paid to foreign related parties are not in line with the arm's length principle.

In short, the MTA often denies marketing and advertising expenses paid to foreign related parties because they do not relate to any income earned in Mexico. Once the decision is made, it is up to the taxpayer to produce documentation to prove otherwise — and usually within a tight timeframe.

Taking a preventive approach

KPMG in Mexico advises taking a preventive approach to protect deductions for foreign-paid marketing and advertising expenses. By maintaining an up-to-date defense file, you will be able to quickly and effectively respond to any questions from the MTA as they arise. The file should include documentation that supports the business reasons for the expenses. It should also address the MTA's possible arguments regarding related-party deliverables, economic connection and benefits to Mexico, and arm's length transfer prices. By involving a multidisciplinary team of tax, transfer pricing and dispute resolution specialists, the objective is to ensure a defense file that covers all the bases.

Managing audit queries in this area on a reactive basis is more difficult. The same documentation would be needed to support your marketing and advertising expense deductions, but it would need to be assembled and delivered within legal deadlines. In these cases, opening a communication channel with the tax authority is recommended so you can present your defense and provide answers to the MTA's questions about these expenses, for example, in a roundtable meeting format. Again, it is advisable to involve tax, transfer pricing and dispute resolution professionals to help manage these discussions and avoid adverse MTA determinations.

Mediation with Mexico's Taxpayer Ombudsman

As part of the audit defense, Mexico's Taxpayer Ombudsman (Prodecon) can be brought in to independently mediate a disputed matter before an assessment is issued. During this mediation, taxpayers and tax authorities can arrive at a binding conclusive agreement to resolve the issue and avoid litigation.

Since this service was introduced in 2011, outcomes have proven to be better than expected. Taxpayers are able to bring new facts and arguments to the table, ensuring the MTA has fully considered all the issues. Once a conclusive agreement is reached, no assessment will be issued and you may also gain relief from any related tax penalties.

Launching an administrative appeal

Once an assessment is issued, you may opt to launch an administrative appeal. Again, you will have a chance to bring new facts and arguments for consideration, lines of communication with the MTA can be kept open, and a settlement can be agreed without litigation. Furthermore, you will not be required to offer a warranty for any disputed taxes while the appeal is pending. The Taxpayer Ombudsman will not be involved to mediate discussions though, so a conclusive agreement should be sought before an administrative appeal where possible.

Litigation brings good prospects at higher costs

If a dispute over marketing and advertising expenses does end up in litigation, precedents on their deductibility as an indispensable business expenditure may work to your advantage. At this stage, expert witnesses should be brought in to validate your analysis of the tax, transfer pricing and economic issues. Provided that your analysis is sound and your documentation is strong, you have a reasonably good chance of a favorable outcome. However, the extra time and costs involved at the litigation stage can be considerable.

While the discussion above has focused on disputes involving marketing and advertising expenses, many of the dispute resolution approaches and programs apply equally to other disputes with the MTA. Whatever the potential area of tax risk is, your best bet is to keep a defense file on hand, take a preventive approach, and involve multidisciplinary team of professional advisors to help avert disputes before they arise.

New developments in Australia, China and Malaysia

Australia

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When it comes to the global project to stem tax base erosion and profit shifting led by the OECD, Australia has been a trail-blazer, moving ahead of other countries by adopting a variety of BEPS-related proposals. International tax issues have become a hot topic for Australian media, and the heads of tax of a number of global companies have been called to testify on corporate tax avoidance before a senate inquiry.

Doing more with more

When Australia's current Commissioner of Taxation took office 3 years ago, his marching orders to the Australian Taxation Office (ATO) were to 'do more with less' by seeking new relationships with large companies based on engagement, trust and a cooperative approach to settling tax issues.

Recent statements from the Commissioner signal a shift in attitude, indicating intentions to take a harder line on perceived tax evasion backed by investment that will empower the ATO to 'do more with more'. Australia's most recent budget earmarked almost 680 million Australian dollars (AUD) for the ATO. The funds are being used to set up a tax avoidance task force and to recruit 1,000 additional international tax auditors, with the goal of raising AUD3.7 billion more in tax revenue. With other tax authorities equally committed to increasing their share of global tax revenue, levels of tax uncertainty and disputes are rising ever higher for international companies with business and investments in Australia.

Australia's multinational anti-avoidance law

The Australian government has adopted a series of tax legislative measures targeting international companies and BEPS. One of the most significant is the country's two-limbed implementation of measures similar to the diverted profits tax recently put in place by the UK.

The first limb is the 'multinational anti-avoidance law' (MAAL), which took effect on 1 January 2016. The MAAL takes aim at multinational enterprises with AUD1 billion or more of global revenue that supply goods or services to Australian customers but have no or limited taxable presence there.

More specifically, the MAAL targets arrangements that shift Australian profits into low-tax jurisdictions and/or avoid the creation of an Australian permanent establishment where reducing Australian or foreign taxes was a 'principal purpose' of entering the arrangement — which may be one of several purposes. By contrast, application of Australia's general anti-avoidance rule requires a single 'dominant purpose' of achieving a tax benefit, so the MAAL threshold is lower and the 'principal purpose' test could be applied to a broader range of circumstances.

The ATO took an innovative approach to the MAAL's implementation by introducing guidelines for a 'client experience roadmap.' The guidelines encourage taxpayers potentially affected by the MAAL to come forward and discuss with the ATO whether the MAAL might apply in their circumstances. Potential penalties of 100 percent may be applied by the ATO when raising MAAL assessments against taxpayers, however those that engaged with the ATO prior to 31 March 2016 to explore potential MAAL exposure may receive penalty reductions.

Taxpayers that did not take up the ATO's offer now face aggressive audits, and any advisors that have recommended and implemented restructures for taxpayers to avoid MAAL exposure may face promoter penalties.

Consultations toward a diverted profits tax

On 3 May 2016, the Australian government released a consultation paper on a new diverted profits tax (DPT), which forms the second limb of its approach modelled on the UK example. Australia's DPT is aimed at companies that enter into arrangements that divert profits from Australia to a country where the income/profits is subject to a tax rate that is less than 80 percent of the Australian relevant tax rate (e.g. less than 24 percent) and there is insufficient economic substance. The 40 percent tax would apply to income years starting on or after 1 July 2017, regardless of whether the transaction was entered into before that date.

The ATO's assessment process for the DTP could prove onerous for taxpayers. Under this process, the ATO could raise a provisional assessment within 7 years of the related tax return's filing date. Taxpayers would have a mere 60 days to respond with further factual information, before the ATO issues its ATO's final assessment. Taxpayers would then have 21 days to pay the additional assessed tax, regardless of whether the amount of tax assessed is ultimately reduced during the ATO's subsequent final review or the taxpayer decides to appeal the assessment before the courts.

Current areas of tax audit focus

In current audits of multinational companies, ATO officers are devoting special attention to:

— transfer pricing

— stapled structures, especially structures involving infrastructure projects

— hybrid arrangements and cross-currency interest rate swaps

— tax avoidance arrangements

— marketing and procurement hubs

— tax residency of corporations

— characterizations of revenue versus capital.

With the extra funds allocated in Australia's 2016 budget, the ATO is expected to ramp up its examinations of these and other international tax issues. In addition to building capacity, the ATO is forming multidisciplinary teams involving specialists in tax, law, economics and valuation and is working to engage these teams earlier in the audit process. ATO officers have become more strategic in determining which tax issues warrant their attention and which issues are most worth pursuing through the courts. Fewer tax cases are being brought before the courts and the ATO's success rate for those cases that are litigated is improving as a result.

In its approach to tax audits and reviews, the ATO is making more use of sophisticated data matching tools to identify taxpayers whose tax positions vary from industry trends (e.g. fluctuations in royalty payments to offshore parent) and analyzing those variances to determine audit targets.

For taxpayers, these developments are combining to create a much more difficult tax audit environment in Australia. With taxpayer's being put to proof much earlier in the tax audit and dispute process, businesses are advised to provide complete documentation of their facts and tax positions as early in the process as possible, and ideally at the time transactions are undertaken and tax positions contemplated or adopted.

China

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Partner, Tax
KPMG in China

Businesses in China face an equally difficult tax audit environment. China's tax system has undergone complex changes in the past 5 years. Considerable tax uncertainty has resulted, but no advance tax rulings are available to gain assurance over how complex transactions would be treated. With interest on unpaid taxes payable at 18 percent per year and penalties ranging from 50 to 500 percent of unpaid amounts, businesses need to manage their relations with tax authorities carefully to improve their negotiating positions and help avoid or mitigate adverse findings during tax audits and investigations.

Businesses in China may need to deal with up to three categories of a tax audit:

1. The Audit Department of the State Administration of Tax (SAT) undertakes special audits on selected types of transactions and selected large group companies.
2. The SAT's Large Enterprise Bureau (LEB) focuses on inspecting the tax risk management practices and controls of selected large companies as part of the 'Qianhu Plan' discussed further below.
3. Local tax authorities conduct their own tax inspections, often targeting cases of non-compliance reported by members of the public or reviewing specific industries or transactions identified in the SAT's guidance.

China's Qianhu Plan for strengthening its tax and financial systems

China's Qianhu Plan, introduced in 2015, aims to strengthen the country's tax and financial systems in order to stimulate economic development. As part of this plan, a tax risk diagnostic platform is being built and tested on some of China's largest companies — referred to as 'important minorities'. The goal is to facilitate enhanced controls for companies that generate the main sources of tax revenue while lightening the tax burden on small and midsized entities. By analyzing Big Data from companies' finances, profit indices and the tax status of key large enterprises, the SAT aims to build and validate a comprehensive model for the analysis of large enterprises' tax risks.

Enterprises selected for the pilot program include industry leaders, companies in emerging industries with significant growth prospects, and companies that pay the largest proportion of China's total tax revenue. Through the pilot project, guidelines on tax risk analysis are being developed for companies in the construction, electricity, insurance, automotive, security and banking industries. Internet-based companies were considered for inclusion, but it was determined that the issues involved were too complex to be tackled at this point through the program.

The pilot also entails creating risk analysis guidelines for four subject areas, namely, cross-border investment, equity transfers, financial subsidies and related-party transactions.

As the SAT shifts its emphasis toward a more risk-oriented, data-driven approach, businesses will see the tax audit environment change significantly. Some businesses have opted to set up parallel systems to run tax diagnostics similar to those of the SAT. While this approach opens opportunities for businesses to identify and correct possible compliance lapses, this information could work against the business if the SAT seeks access to the business' data and underlying systems.

Given the data-driven nature of the SAT's process, it will be important for taxpayers to engage with the SAT early in the risk analysis process to influence the nature and extent of the SAT's analysis. Once the inspection is complete and the audit enters the verification and review stage, it may become more difficult to negotiate disagreements over facts or tax law interpretations and the resultant audit outcome.

Once the first pilot program is complete, the SAT will roll out the program across China and commence a second group of pilot work. The end game is to modernize large enterprises' tax management and have a modern fiscal and tax system in place by 2020.

Key tax audit changes for 2016

In addition to the changes for large companies under the Qianhu Plan, the SAT introduced several changes to its general tax audit procedures for 2016:

- **Tax audit categories:** The SAT no longer chooses special audit targets by industry. Targets are now selected based on specific types of transactions and transactions undertaken by large group companies.
- **New audit method:** Based on an idea tested in 2015 and expected to be adopted broadly this year, the SAT is both selecting cases for audit and forming audit teams on a random basis. With randomly selected teams, cross-provincial audits are expected to become more common as a result.
- **New tax audit protocol:** The SAT's new protocol to reinforce tax authorities' internal control of tax audits clearly defines the duties and abilities of tax officials, enforcement procedures, timelines and the types of documentation to be issued to taxpayers. While the new protocol will likely make the audit process more transparent and efficient procedurally, taxpayers will be afforded less opportunity to negotiate with their tax auditors.
- **Transition from business tax to value-added tax (VAT):** As part of this transition, banks that previously paid business tax to a local tax bureau now pay VAT to the state tax bureau. As a result, the bureau can access data on a business's fund flows by cross-checking against its tax reporting or requesting that information from the bank directly. KPMG in China has noted a trend toward state tax bureaus requesting such information in some tax audits.
- **Focus for 2016 tax audits:** Top priorities for the SAT's tax audits in 2016 include:
  - tax treatment of business tax and VAT during the final stage of China's national VAT rollout, which started on 1 May 2016
  - personal income tax issues involving high-income expatriates, zero-filing expatriates and foreign artists and athletes
  - cross-border equity transfers, direct and indirect equity transfers and deductibility of outbound related-party payments (e.g. royalties, service fees)
  - fraudulent claims for export tax refunds
  - special tax invoices for gold trading
  - fraudulent invoices for agricultural products, including credit vouchers and VAT special invoices.

Planning your approach to tax audits

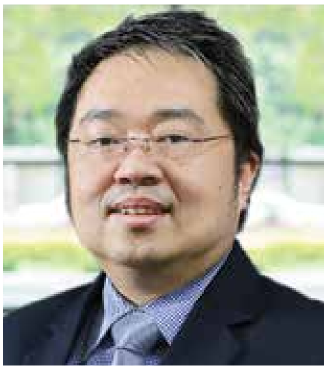
Once Chinese tax authorities have raised an assessment, the prospects of having it overturned administratively or on appeal are slim. Taking a strategic approach to tax audits and investigations can help you reduce your chances of receiving a negative assessment or negotiate a less unfavorable result.

While the investigation and negotiation are in progress, it's important to show a proactive attitude and establish good relations, relying on good communication skills and efficient channels to negotiate and reach agreement with tax authorities about any contentious matters. Be vigilant about providing relevant, consistent information and documentation to the tax authorities by their deadlines, and take care not to give rise to additional issues.

Finally, once the inspection results are determined, you and your team should assess the potential benefits of undertaking an appeal after paying the relevant tax, interest and penalties. In addition to completing any necessary accounting and tax adjustments, you should monitor the implications of these adjustments on other taxes currently and on your company's tax planning arrangements going forward.

At each stage in the audit process, assistance from tax professionals who have developed experience and relationships through dealings with China's tax authorities can be invaluable.

Malaysia



Lian Seng Soh
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Declining petroleum prices have drastically reduced Malaysia's resource tax revenues over the past 5 years, but revenues are beginning to rebound following the implementation of a goods and services tax (GST) in 2015. Corporate income and withholding taxes still comprise the majority of tax revenues, and the Malaysia's tax authorities are aggressively seeking to increase amounts collected through all of these income streams.

Separate bodies enforce income and indirect taxes

Currently, enforcement of income taxes and indirect taxes (i.e. customs, GST) are divided between the Inland Revenue Board of Malaysia (IRB) and the Royal Malaysian Customs respectively. These bodies operate independently and recently, the two authorities have expressed the need to look into the possibility of merging their activities, but they will remain separate in the near term until the government forces the issue.

Presently, as companies work to comply with their new Malaysian GST obligations, the customs department generally is taking a friendly approach to GST audits. However, companies with sizable GST refund claims can expect to undergo a full-scale GST audit.

Audit programs for income taxes

For income taxes, the IRB has different audit programs that cover corporate taxes, transfer pricing, withholding taxes, payroll and tax incentives.

The IRB recently restructured its corporate tax audit program to separate its audits of large businesses (with turnover of USD13 million) and small and midsized enterprises. The large business unit also focuses specific industries, including property development, financial institutions, manufacturing and transportation, and on high net worth individuals with USD1 million or more of annual income. Areas of audit focus include deductibility of expenses, particularly issues involving incurred expenses versus provisions, related-party transactions and performance bonuses.

The IRB also established a special branch for conducting transfer pricing audits. Under Malaysia's tax rules, taxpayers with cross-border related-party transactions are required to check a box on their tax returns to say whether they have prepared transfer pricing documentation. A 'no' answer will raise a red flag and prompt the tax authority to expedite a transfer audit for that taxpayer.

In withholding tax audits, the IRB has recently shifted its focus away from full-scale audits of Malaysian permanent establishments making withholding tax refund claims. The IRB has narrowed its interpretation of Malaysian withholding tax rules on payments for services provided offshore and subjecting them to much more scrutiny. Based on examinations of underlying contracts, the IRB takes the position if there are portions of the payments that include IT services, the IRB has narrowed its interpretation that such payments could have payments for royalties (e.g. for the right to use software) and that withholding tax therefore applies.

In tax incentive audits, the IRB has been targeting claims for reinvestment allowances, investment tax allowances, and 'pioneer status' incentives.

Expediting audits to accelerate collections

Recognizing that faster audits can quicken collections and help shore up Malaysia's finances, the IRB sets and strictly enforces tight timelines for its audit processes. Generally, taxpayers are only given 21 days to reply to audit queries or produce requested documentation. Once an assessment has been raised, taxpayers have only 30 days to pay the additional taxes, and taxes are still payable even if the taxpayer launches an appeal.

Dispute Resolution Department introduced

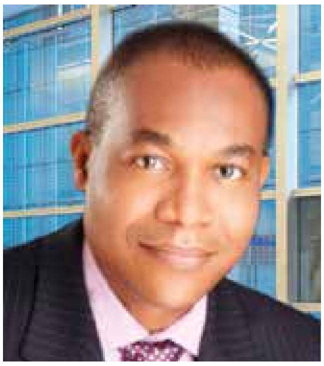
A new process introduced in 2013 introduced an intermediate step between the audit and appeal process. Before the case is heard at the Special Commissioner of Income Tax, the IRB would normally refer the case to Dispute Resolution Department (DRD), which is staffed with senior tax technical officers and officers with legal expertise. The department is only empowered to review the case again and based on some recent cases, the DRD would try to persuade taxpayers to resolve their case at this stage rather than pursuing a judicial appeal.

As another means for raising more tax collections, the IRB introduced a tax amnesty program in 2016. Taxpayers who come forward and volunteer to regularize their taxes can have any related penalties and interest waived. Taxpayers undergoing an audit or investigation can opt to pay outstanding amounts immediately and have their penalties reduced from 45 percent to 25 percent of the extra amount.

Given the fast pace of Malaysia's audit processes, companies doing business there are advised to ensure they have complete documentation in place to support their tax positions. That way, they can move to respond to audit activity quickly and effectively within the IRB's relatively short timeframes.

New developments in Nigeria, South Africa and Turkey

Nigeria



Victor Onyenkpa
Partner,
KPMG in Nigeria

Until the past few years, the Nigerian government paid little attention to tax matters as it could comfortably depend on revenues from the country's crude oil resources. But plunging crude oil prices have created new revenue pressures, and the Nigerian government is going after tax revenues with a vengeance. Now the Federal Inland Revenue Service (FIRS) is more likely to raise assessments and defend them aggressively through Nigeria's administrative and court appeal system.

Nigeria operates a self-assessment tax system. Taxpayers calculate their taxes due and file returns, and the FIRS reviews the return, asks for clarifying information, and either accepts the filing or raises an administrative assessment for taxes considered unpaid.

A taxpayer who disagrees with an assessment may file a notice of objection within 30 days of its receipt. At this point, the FIRS may ask for additional information. Based on further review, the FIRS may abandon the assessment or issue a Notice of Refusal to Amend the Tax Assessment — automatically triggering the appeal process. The taxpayer then has 30 days to launch an appeal to either administrative Tax Appeal Tribunal (TAT), which hears matters of fact, or the Federal High Court FHC). Cases not resolved at these levels can be appealed to the Judicial Division of the Court of Appeal or and as the final resort, to the Supreme Court.

The majority of taxpayers begin their appeal at the TAT, but almost all TAT decisions are appealed to the FHC and the majority of the TAT's decisions are then overturned. Questions have been raised about the competence of the TAT to hear tax cases, as Nigeria's constitution gives jurisdiction over tax matters to the FHC. Three constitutional challenges have been heard by the FHC, with inconsistent judgments. In two cases, the FHC agreed that the TAT has no jurisdiction. In the third case, the FHC held that the TAT's role is to assist the FHC, not usurp it.

The current situation is causing some taxpayers to skip the TAT stage and take their case to the FHC directly, where the majority of recent cases have favored taxpayers. The high proportion of taxpayer wins may be due to the FIRS' failure to conduct appropriate internal reviews before making assessments. It could also stem from the FIRS' use of in-house lawyers — who are seen as less rigorous than those in private practice — to test the strength of FIRS's positions and determine which cases to litigate. Where the TAT finds against the taxpayer, the taxpayer is required to pay the amount at issue, even if they are taking their appeal further.

In addition, TAT decisions do not always address the tax law principle in question in the dispute. In a recent value added tax (VAT) dispute, for example, the TAT ignored the legal definition of 'imported service' and found VAT applied to a service that met the definition because the specific service itself was not exempt under the law.

In addition, from the audit stage through to the higher courts, taxpayers face considerable uncertainty from issues such as:

— the FIRS' application of contradictory provisions in the tax law, even where the inconsistency has clearly resulted from amendments over the years that were made without considering their impact on other provisions

— contradictory judgments issued by the FHC, resulting in uncertainty over which judgment to follow (as in the constitutional challenges to the TAT's jurisdiction)

— the FIRS' routine practice of raising assessment refusal notices well beyond the official 30-day cut-off.

Nevertheless, as more tax cases are heard by the courts, their understanding of the issues is expected to increase, improving the quality of their judgments and providing more precedential certainty for taxpayers.

In today's current environment, it's more important than ever to have good documentation to back up your tax positions. Also keep in mind that the FIRS' determination to maximize collections means it is open to negotiations 'without prejudice', so you may get a better outcome by working out a settlement, especially given the length of time it takes for court proceedings to conclude. The most effective negotiations occur at the highest levels within the FIRS, so you may be able to achieve optimal results by involving third-party advisors who have developed experience and relationships with the FIRS' senior officials.

South Africa

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Despite weak economic conditions, South Africa's tax authorities are achieving record tax collections, with growth in tax revenues climbing faster the country's GDP in recent years. Tax revenues topped 1 trillion South African rand (ZAR) for the first time in 2015-16, exceeding its target by more than ZAR0.2 billion.[5]

The four main revenue contributors were:

— personal income tax: 36 percent

— value added tax: 26 percent

— corporate income tax: 18 percent

— customs and excise duties: 14 percent.[6]

The South African Revenue Service (SARS) has achieved these results by wielding the new and expanded powers it enjoys under the Tax Administration Act (TAA). The act took effect in 2012 and is intended to balance the rights of the tax authority against those of the taxpayer. The SARS is the TAA's main architect, however, and the frequent amendments that the SARS has made — often to overturn taxpayers' successful objections — have greatly strengthened its hand.

Powers granted to SARS under the ITA include the following:

— **Third-party information requests:** the SARS has the right to demand information about taxpayers from their business associates.

— **Third party payments:** the SARS has the right to demand suppliers re-direct their payments to taxpayers to the SARS to cover the taxpayer's tax debts.

— **New powers of SARS to interview:** the SARS has the right to enter taxpayers' business premises and interview employees.

— **Search and seizure:** the SARS has broad powers to search premises and seize assets in cases where the SARS suspects fraud or that the taxpayer is liquidating assets to protect them from collection action.

— **Jeopardy assessment:** the SARS has the right to accelerate collections in cases where it believes a delay would put the collection at risk.

However, no detailed regulations have been provided to guide the SARS in exercising its new powers. In the case of employee interviews, for example, Australia has set out detailed guidelines to help avoid adverse outcomes due to information from unknowledgeable or disgruntled employees, including requirements for written questions and responses, for employees to swear oaths and for employees to be prepared to testify in court if needed. The lack of such rules casts considerable doubt on the quality of information received by the SARS from employees.

A number of other trends are propelling levels of uncertainty and tax disputes even higher:

— Tension between various SARS divisions is impeding communication, creating silos and resulting in multiple requests to taxpayers from different divisions on the same or similar issues.

— The courts have supported taxpayers' rights to correct administrative actions in a number of cases, but taxpayers in similar situations are not pursuing corrections on their own behalf due to the prohibitive time and expense involved.

— The SARS suspects virtually all transfer prices as profit shifting strategies and is increasingly aggressive in challenging taxpayers' positions.

— The SARS looks to more developed tax systems (e.g. Australia, Canada, UK) for ideas to employ at home and tends to simply 'copy and paste' other countries' laws in domestic legislation without providing guidance or sufficiently knowledgeable audit resources to enforce them.

— Global tax transparency and disclosure is in focus, with South Africa signing on to exchange of tax information

[5] Business Day, 30 April 2016.

[6] "4 taxes that helped SARS collect R1trn", Fin 24.

agreements, country-by-country reporting and common reporting standards. Among other things, South Africa scrapped its withholding tax on service fees in favor of new requirements for taxpayers to formally disclose their transactions with foreign suppliers, which essentially gives SARS a shopping list of items to target on audit.

But perhaps the biggest concern for international companies is the escalating aggression of the SARS' audit practices. It is changing its views without warning on previously accepted administrative ruling and practices. Its strict enforcement of requirements to pay taxes in dispute is prompting taxpayers to settle or abandon appeals, regardless of their position's strength. It is automatically initiating audits on claims for refunds. And it is challenging prescription (statute-barred) periods in the tax law, requesting information beyond the 5-year limitation period — sometimes as far back as 10 years — and using that information to assess years within the limitation period or to allege fraud for earlier years so the limitation no longer applies.

Companies in South Africa have some mechanisms available to help them manage tax risk, although these mechanisms are not as effective as they could be. Advance rulings do not carry the certainty they did in the past, given the SARS' recent tendency to overturn them. Legal privilege may be available, but the SARS is inclined to oppose attempts to assert it. Taxpayers can take complaints over the SARS' administrative practices to the Tax Ombudsman, but its findings are not binding on either the taxpayer or the SARS. The SARS' practices can also be challenged under the Promotion of Administrative Justice Act, but this is generally not worth the considerable time and effort.

Taxpayers may have better experiences under South Africa's voluntary disclosure programs:

- The regular voluntary disclosure program gives companies the opportunity to regularize their tax defaults with SARS and any exchange control violations with the South African Reserve Bank.
- A special voluntary disclosure program, which will run from 1 October 2016 to 31 March 2017, allows taxpayers to regularize their tax affairs related to foreign assets. This program is designed to help taxpayers get onside with their foreign asset reporting in advance of new tax information exchange measures and common reporting standard being implemented as a result of the OECD's Action Plan on BEPS.

The SARS' Alternative Dispute Resolution program is also worth considering. Even if this route proves unsuccessful, it does not affect your ability to take the dispute back to the usual process for objections and appeals for further consideration.

In the near term, tax complexity is likely to increase. From new taxes on carbon, sugar and tires to withholding taxes on management fees and increases to the rate of VAT, companies in South Africa will need to manage changing obligations in an increasingly fractious tax audit environment. More change may come through forthcoming recommendations of the Davis Commission. This government committee is considering how the tax system should evolve, and it is likely to call on the government to derive an even greater share of revenue from personal income taxes.

Companies with investments and business in South Africa can protect themselves and minimize potential tax controversy by being proactive about tax management and being open and honest in dealings with the SARS. Ensuring that your documentation retention and tax management policies are up-to-date is critical. Given the SARS' recent tendency to request information beyond the 5-year limitation period, consider not keeping documentation beyond the 7-year period required by company law. Finally, you should take steps to ensure your board and C-suite executives are aware of the heightened commercial and reputational risks that disputes with the SARS might entail.

Turkey

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Head of Tax Services
KPMG in Turkey

Like most countries, Turkey is seeking to increase its tax revenues. But where other countries are aiming for higher collections with fewer resources, Turkey is investing heavily in beefing up its audit staff. In the past year, the number of tax auditors has risen from 4,000 to 10,000 — a 250 percent increase.

In another move to improve audit effectiveness, the Auditing Board was recently reorganized into four specialized sub-divisions:

— Large Scale Taxpayers Group

— Organized Fiscal Evasions Group (i.e., tax shelter issues)

— Thin Capitalization, Transfer Pricing and Offshore Income Group

— Small and Medium-size Enterprises Group

The resulting audit focus, along with the relative inexperience of the new audit staff, is driving a surge in tax assessments, disputes and appeals, especially in the area of transfer pricing.

Turkey's Revenue Administration is leading the government's transformation to the 'e-state', and investments are being made in making the tax system digital. All tax returns can be filed electronically, and e-bookkeeping, e-invoicing and similar systems have been made compulsory for a considerable number of taxpayers in the recent years. This is allowing the administration to develop a database with extensive information on taxpayers, and it is applying data analytic techniques to efficiently track and select taxpayers for tax audits.

The reorganization of the Auditing Board is promoting the standardization of tax audits in order to eliminate different applications of audit practices and treatment of taxpayers. As part of this initiative, a 'hearing committee' application was introduced. Through hearing committee meetings, taxpayers have the chance to explain their cases to tax auditors (excluding the auditor performing the audit) before the final tax audit report is issued. Unfortunately, taxpayers are not informed of the outcome of these hearings or whether an assessment will result, which has limited this tool's effectiveness.

Rising number of transfer pricing disputes

All of the above initiatives are fueling the increased number of transfer pricing audits and assessments, especially for cross-border transactions. In particular, the tax authorities are challenging royalty and management fee payments from Turkish entities to related non-resident.

Royalties are being challenged on the basis of the royalty rates applied. Tax auditors generally use secret comparable rates as the base for tax assessments, and it is difficult for taxpayers to mount an effective defense against a comparable that is undisclosed. Also complicating the evaluation of royalty rates is the absence of an official local database for comparable analysis. The tax authorities may reject information in databases commonly used in industry (e.g. Amadeus, Orbis) because they are not officially recognized in the regulations.

In challenging management fees from Turkish entities to related non-residents, the Turkish tax authorities sometimes claim the services include a transfer of know-how that should be considered and reclassified as royalty and subject to withholding taxes. Alternatively, the authorities claim that the services are not actually performed, or that some or all of services are not for benefit of the Turkish entity, based on application of a benefit test or an argument that the Turkish entity is already performing the services.

Customs and stamp taxes under scrutiny

The tax authorities' focus on audits of customs and stamp taxes are also helping cause the rise in tax disputes:

— Through broadly focused post-clearance customs audits, the tax authorities are going beyond the value of goods declared to examine stamp duty of contracts, withholding taxes for royalty-license agreements, resource utilization support fund payments, transfer pricing procedures and cross border transfers.

— Turkey's stamp tax is being strictly enforced on many kinds of signed documents, primarily business agreements and contract. The statute of limitation for the stamp tax is not limited to 5 years. Rather, stamp tax applies as long as the contracts are in effect, and disputes are arising over whether the conditions for the stamp tax's application are met and over the scope of the stamp tax base.

Procedure for negotiating assessments and penalties

When tax disputes arise, resorting to the courts is unlikely the preferred option due to the time and expense involved for the taxpayer and tax authorities alike. As an alternative dispute resolution mechanism, Turkey has introduced a Tax Settlement Procedure for use after tax audits. The procedure gives taxpayers the chance to negotiate the amounts of tax assessed and penalty, and the tax authorities are given discretion to reduce assessed amounts based on the negotiation. The procedure can be invoked either before or after an assessment is made.

Advance pricing arrangements and mutual agreement procedure

Turkey also has an advance pricing arrangement (APA) program and mutual agreement procedure (MAP) clauses in its tax treaties, but, unfortunately, neither has proven effective in providing tax certainty and reducing tax disputes.

Taxpayers may pursue APAs for less complicated items, such as royalties. They may be hesitant where more complex items are concerned because they generally believe an APA application will draw tax audit attention to uncovered years, especially if the APA is not successfully concluded.

The tax authorities are equally hesitant about entering MAPs to resolve tax disputes. Because the MAP is optional, the tax authorities often choose not to use it due to the length of time involved and the uncertainty that the investment of time would bring success.

A new bill for amnesty and incentives

Why amnesty? There are two basic reasons: global and internal.

The global one is related to overwhelming 'transparency initiatives' from a combination of public pressure and political willpower at both the G20/OECD, the US and EU levels has resulted in a paradigm shift in the global tax landscape. Therefore, the Turkish government would like to give an opportunity to taxpayers to open a 'white paper' before 'automatic exchange of information' measures from BEPS, FATCA and CRS.

The internal one is related to local developments. Recently, following the statement made by the Minister of Finance that "the government would submit a re-structuring pack for tax debts" to the Turkish Parliament, the submission of the 'Bill on Restructuring of Certain Receivables' to the Turkish Parliament came on 22 July 2016 and it has been enacted on 3 August 2016 and published in the Official Gazette on 19 August 2016.

The amnesty bill provides various opportunities ranging from restructuring 'overdue payables', 'voluntary declaration', 'pending court cases' and 'a voluntary disclosure regime' for Turkish taxpayers having undisclosed assets out of Turkey. Taxpayers who come forward under the regime will be able to bring undisclosed foreign-held assets with protection from audits and assessments for tax, customs and foreign exchange regulation purposes.

In addition, the bill would introduce a new voluntary filing option, allowing taxpayers to make a voluntary disclosure of a tax filing failure or omission before a tax audit takes place. Principal amounts of tax would still be payable, but penalties would be reduced to 20 percent of the penalty otherwise payable.

According to the bill, the taxpayers who voluntarily increase their tax bases for corporate income tax, withholding tax and VAT bases concerning the years 2011, 2012, 2013, 2014 and 2015 will not be further subject to a tax audit related to the years and type of taxes that they have applied (e.g. implying an immunity against a potential audit/challenge by the tax office, which is referred to as 'Tax Amnesty').

The tax base increase rates according to tax types and minimum increase in tax bases are presented on the following table for corporate entities.

Tax base increase in corporate tax

Year	Tax base increase rate (%)	In case of a Loss declaration, minimum base increase (Turkish Lira)[7]	Tax rate over the increased tax base (%)	Reduced tax rate over the increased tax base (%)[8]
2011	35	28.000	20	15
2012	30	29.650	20	15
2013	25	31.440	20	15
2014	20	33.470	20	15
2015	15	37.940	20	15

The provisions with regard to 'pending court cases'

We will try to clarify, in the following table, what the opportunities are for receivables and penalties that fall within the scope of the bill, based on section headings:

Overdue receivables (meaning, in summary, receivables, in definite tax amounts, which are overdue, and for which lawsuit may not be filed):

	Tax reduction	Late payment charges	Payment method
Past due receivables	0% reduction	instead of late payment charges, interest calculated based on Domestic-Producer Price Index (50% reduction for this portion in cash payment)	Cash payment or payment to be made in 36 months in 18 instalments

Receivables based on continuing tax inspections (in summary, since the tax inspection has not yet been completed, the tax amount is uncertain):

	Tax reduction	Penalty reduction	Late payment interest	Payment method
Receivables for which inspection is ongoing	50% reduction	100%	instead of late payment interest, interest calculated based on Domestic — Producer Price Index (50% reduction for this portion in cash payment)	Cash payment or payment to be made in 36 months in 18 instalments

Receivables that have not yet become definite or that form the subject of disputes with ongoing lawsuit process (in summary, receivables where the tax amount is definite, and which have been made subject of dispute by way of filing lawsuits):

	Tax reduction	Penalty reduction	Late payment interest	Payment method
Disputes before tax court (pre-appeal)	50% reduction	100%	instead of late payment interest, interest calculated based on Domestic — Producer Price Index (50% reduction for this portion in cash payment)	Cash payment or payment to be made in 36 months in 18 instalments

[7] The minimum increase in the amount of tax base, as presented above, will alternatively apply if there is no tax base in that year due to carried forward tax attributes, deductions, exemptions etc.

[8] Applicable if; relevant years' tax returns are declared and paid on time and no application is made under the Law with respect to definite/indefinite/disputed tax receivables.

Receivables at the appeal stage (that have been resolved by the tax court) which have not become definite or that form the subject of disputes with ongoing lawsuit process (in summary, the lawsuit is at the appeal stage, and dispute has not been finalized):

	Tax reduction	**Penalty reduction**	**Late payment interest**	**Payment method**
If the tax court ruling is in favor of the taxpayer	80% reduction	100%	instead of late payment interest, interest calculated based on Domestic — Producer Price Index (50% reduction for this portion in cash payment)	Cash payment or payment to be made in 36 months in 18 instalments
If the tax court ruling is against the taxpayer	0% reduction	100%	instead of late payment interest, interest calculated based on Domestic — Producer Price Index (50% reduction for this portion in cash payment)	Cash payment or payment to be made in 36 months in 18 instalments
If the tax court ruling has been finalized by the Regional Administrative Court or State Council against the taxpayer	50% reduction	100%	instead of late payment interest, interest calculated based on Domestic — Producer Price Index (50% reduction for this portion in cash payment)	Cash payment or payment to be made in 36 months in 18 instalments
If the final decision is partial approval (against the taxpayer) and partial reversal (partially in favor of taxpayer)	0% reduction for the tax amount approved through ratification, 80% reduction for the amount partially reversed through ratification by amendment	100%	instead of late payment interest, interest calculated based on Domestic — Producer Price Index (50% reduction for this portion in cash payment)	Cash payment or payment to be made in 36 months in 18 instalments

Finally, the bill would introduce a corporate income tax exemption for the establishment of regional headquarters and management centers in Turkey. To benefit from the exemption, all costs of these structures must be covered by foreign corporations and not financially associated with the accounts of a resident or non-resident entity in Turkey. The law would also offer payroll tax exemptions for the employees registered in these structures.

New developments in Ireland, Luxembourg and Switzerland

Ireland

Liam Grimes
Director,
KPMG in Ireland

Tax is topical in Ireland these days as developments on a number of fronts continue to attract media and public interest. For example:

- The European Commission's decision that Irish transfer pricing rulings granted to the Apple group constituted illegal state aid has made headlines, and the public and main political parties support the Irish government's decision to appeal the decision.
- A pending tax court decision on Ireland's general anti-avoidance rule is garnering considerable attention.
- A recent idea was floated by a government minister that returned emigrants should be granted a special 30 percent tax. Whereas this idea generally attracted a negative response (and is unlikely to be introduced) it did encourage lively debate.

Ireland is somewhat unique in that it publishes details of tax defaulters quarterly. In cases where a settlement of tax arrears exceeds 33,000 euros (EUR) and no qualifying voluntary disclosure of previously undisclosed tax liabilities was made in advance of Revenue commencing, Revenue will publish details about the defaulter, including their name, address and amount of tax arrears. The press generally picks up the names of the largest settlements and will identify the names of public figures and celebrities who have appeared on the list. Political and public support for punishing aggressive tax planning has been rising.

Carrot-and-stick approach

Under Revenue's carrot-and-stick approach, taxpayers with undisclosed tax arrears can avoid being featured on the list by coming forward with the details unprompted. Publication can also be avoided for prompted disclosures, provided disclosure is made before an audit actually begins. Penalties are reduced for both unprompted and prompted voluntary disclosures.

The Defaulters List is just one of a rising number of tools and powers being added to the tax authority's arsenal. One new power allows Revenue to examine taxpayers' credit and debit card spending through access to information from merchant acquirers.

New Revenue initiatives

The Irish Revenue is making increasing use of data analytics and third-party data in its enforcement practices. Under the Revenue's Risk Evaluation Analysis and Profiling (REAP) initiative, a range of tax data is mined to identify potential areas of tax risk. The REAP initiative assigns levels of tax risk to taxpayers using a traffic light system:

- green ratings are assigned to taxpayers who are presumed to be compliant, which includes most taxpayers
- amber ratings are assigned when the REAP system flags a potential item of tax risk
- red ratings signal potential high-risk taxpayers or situations, prompting Revenue to initiate queries, audits or investigations.

Revenue is also moving toward fully electronic audits. Most current audits are conducted electronically to some degree, and in certain cases taxpayers are required to submit their records online. Revenue is starting to carry out 'cloud audits' by asking for and receiving access to taxpayer's internal servers and data so auditors can interrogate them remotely.

Finally, the Revenue is making greater use of information exchange with tax authorities of other countries. For example, a bilateral agreement with Switzerland will give the Revenue online access to the details of Swiss bank accounts of account holders with addresses in Ireland. With this information, the Revenue is expected to initiate additional queries and audits.

Audit focus areas

The Irish Revenue's current areas of audit focus include:

- transfer pricing in general and correlative adjustments in particular, with significant testing being carried out before tax refunds are issued as a result of transfer pricing adjustments made in other tax jurisdictions
- claims made under Ireland's tax incentive regime for promoting research and development.

The Irish Revenue's audit approach includes efforts to ensure that officers carrying out tax interventions such as a general sweep of shopping malls, are highly visible. Officers wear distinctive vests, for example, when testing electronic point-of-sales systems or monitoring the activity of subcontractors in the construction industry.

Encouraging better compliance

Self-review is a recently adopted technique to encourage compliance. Under this program, taxpayers will receive a letter from Revenue asking them to conduct a self-review of, for example, their payroll taxes and submit a report to Revenue. Such reports are considered as unprompted disclosures, so reduced penalties and non-publication on the Defaulters List would apply if unpaid taxes are detected during a self-review.

The Irish Revenue is also relaunching its Framework for Cooperative Compliance. Under this voluntary program, Revenue will enter agreements with individual large businesses setting out what each side needs to do to enable the business to achieve compliance. Companies are assigned a case manager to act as a liaison, conduct joint reviews of tax risk and help resolve issues. Case managers may also inquire into details of the company's tax governance, including its tax budget and future plans.

Revamped tax dispute resolution processes

Taxpayers in Ireland are seeing significant changes to the country's dispute resolution processes. Under a revamped complaints process, taxpayers can make a complaint on a range of issues regarding Revenue's treatment of their tax affairs in parallel with the formal appeals procedure. Complaints are reviewed by senior reviewers within Revenue, and, if not resolved, by an external reviewer. The system may benefit taxpayers since the decisions of external reviewers are binding on the tax authority but not on the taxpayer, which allows other options for recourse to remain open.

Further, a revamped tax appeals process has moved from semi-formal hearings conducted by tribunals to more formal court hearing, resulting in a backlog and making it more costly and time-consuming to pursue tax cases in court.

This activity is taking place at a time of increasing resource constraints within the Irish Revenue. For the past few years, many senior officials have been devoting their attention to the OECD international project to curb BEPS and how it will affect Ireland's tax regime. The Irish Revenue also faces demographic challenges due to the current wave of retirements, and it is working to fill the gap by recruiting and integrating a high number of experienced tax and legal professionals.

In this environment, companies can reduce their tax audit burden and avoid the consequences of non-compliance – including exposure on the Defaulters List – by conducting regular tax reviews in conjunction with their professional tax advisers. The Irish Revenue looks favorably on companies that regularly engage in tax health checks and may be more likely to waive or reduce penalties if they detect incidents of inadvertent non-compliance.

Luxembourg

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The environment for tax disputes in Luxembourg has changed significantly in recent years. In the past, the tax certainty conveyed by country's binding tax rulings practice reduced occasion for disputes, and disputes that did arise tended to involve smaller businesses that did not meet their obligations under their rulings.

Previously, European Union court decisions were a primary cause of tax disputes involving Luxembourg. The European Free Trade Association's 2004 decision in Fokus Bank (E-1/04), the European Court of Justice decision in Aberdeen (C-303/07) and other judgments found that withholding taxes on cross-border dividends impeded the free movement of capital. These decisions opened the door for taxpayers to file claims for refunds of withholding taxes paid to a number of non-compliant European jurisdictions, including Austria, Finland, France, Norway, Poland, Spain and Sweden.

With more than 4,000 refund claims filed in over 15 countries by KPMG in Luxembourg alone, Luxembourg saw unprecedented growth in the volume of tax disputes and an increase in the size and sophistication of professional advisers to service them.

Recent events have disrupted the tax certainty that Luxembourg's tax ruling system previously provided:

— In November 2014, the International Consortium of Investigative Journalists leaked almost 600 private Luxembourg tax rulings, creating questions over the propriety of these agreements.

— The European Commission put the ruling practices of EU member states under the microscope. Starting with investigations of specific tax rulings in Belgium Luxembourg, the Netherlands and Ireland, the project was expanded in early 2015 to cover tax rulings throughout the EU. The decisions published so far indicate that the tax benefits granted by certain rulings are state aid and that affected taxpayers could be forced to repay up to 10 years of back taxes. These decisions are being challenged before the European courts.

— Entry into force of the automatic exchange of information arising from the OECD's BEPS proposals will give tax authorities new powers to review tax rulings granted by other jurisdictions, in some cases retroactively to ruling granted as early as 2010.

Now Luxembourg tax rulings can be a source of insecurity, and the number of ruling applications has dropped from about 2,000 annually in 1998 to 2014, to just over 700 applications in 2015.[1] Taxpayers are increasingly seeking a measure of tax certainty by relying on tax opinions instead.

Like many tax authorities, Luxembourg's tax authority is gearing up to manage the enormous amount of taxpayer data becoming available under automatic tax information exchange. As in Ireland, taxpayers will be required to file their tax returns electronically, starting in Luxembourg in 2017. Luxembourg's tax authority has indicated that it will employ data analytics to identify areas of tax risk and target audit activity accordingly.

Further, Luxembourg's procedural law allows the tax authority to accept returns as filed, with the possibility of raising reassessments within the next 5 years. Given the high amount of taxpayer data that is becoming available, Luxembourg's tax authority is expected to increase its focus on returns after they have been filed.

Unlike the past, where binding advance tax rulings diminished the potential for tax assessments, Luxembourg's tax authority now has more time to examine tax filings, more information about their tax positions in other countries, and improved ability to base its assessments on actual (rather than forecast) results.

Unsurprisingly, the increase in assessments has come with increase in tax disputes. Complaints filed against the tax authority have climbed from 338 in 2000 to 1,316 in 2015.[2] Bilateral tax disputes and mutual agreement procedures are also rising, and this trend is expected to continue as Luxembourg and other countries work to implement the OECD's BEPS proposals in their domestic law. Withholding tax refund claims (e.g. based on *Aberdeen*) will also grow until the EU member states align their laws, which is not expected to occur in the near future.

As in Ireland, companies in Luxembourg stand a better chance of weathering the current climate and avoid tax disputes by conducting a tax diagnostic review to identify and mitigate any potential tax risk exposure.

[1] See Véronique Poujol, "La fabrique de rulings au ralenti," *Paperjam*, September/October 2015, page 52; and *Rapport d'activité Administration des Contributions Directes 2015*, page 14.

[2] Administration des Contributions Directes.

Switzerland

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Companies with business or investments in Switzerland are also dealing with a significantly changing tax landscape, most importantly due to the new Corporate Tax Reform III (CTR III) legislation. These measures, passed by the Swiss parliament in June 2016, are subject to a referendum that is expected to be held in early 2017. The reforms are also subject to referendums at the cantonal level. If the Swiss public votes in the bill's favor, the reforms would likely take effect in 2019.

Tax changes affecting international companies

The bill takes into consideration the OECD's BEPS action plan and requests by the EU and aim to provide a corporate tax system that is generally in line with current international standards. Some of the most important changes for international companies are:

— the elimination of longstanding tax regimes that the EU has considered harmful, including the tax preferences for holding, mixed and principal companies and for finance branches

— reduction of corporate income tax rates at the cantonal levels to bring combined federal-cantonal rates down to 12–18 percent, depending on the canton

— introduction of a patent box regime based on the OECD-approved modified nexus approach, a notional interest deduction and a super deduction for research and development expenditures

— capital tax relief for financings such as participations, patents and similar rights, and intercompany loans.

Once these changes are in place, they are largely expected to benefit both taxpayers and the Swiss federal and cantonal tax authorities. The reforms should ensure the Swiss tax rules are acceptable internationally and provide a level playing field while maintaining the country's tax competitiveness.

Additional tax changes are being made in response to the OECD's Action Plan on BEPS. These include:

— introduction of country-by-country tax reporting and master file/local file documentation requirements, starting in 2017 (Action 13)

— changes to the permanent establishment definition (Action 7)

— changes to align transfer pricing policies with OECD's guidelines on the location of value creation (Actions 8–10)

— automatic exchange of tax rulings, for 2018 and later years (Action 5).

Complex tax dispute resolution environment

Switzerland is structured as a confederation, with taxes levied at the federal, cantonal and communal level. This has led to a complex and somewhat peculiar structure for resolving tax disputes, which can be summarized as follows:

— **Cantonal tax authorities** assess and, if necessary, audit domestic taxes levied at all three levels. The cantonal tax authorities are also the starting point for resolving tax disputes.

— **The federal tax authority** reviews assessments made at the cantonal level, especially in cases that may involve withholding taxes (see below). Domestic tax disputes and litigation can be initiated at either the cantonal and federal levels.

— **The State Secretariat for International Financial Matters** (SIF) gets involved where a disputed element of tax raises an international tax dispute with a foreign entity or tax authority. The SIF would manage the international aspects of settling the dispute (e.g., through a Mutual Agreement Procedure (MAP). It would also advise and instruct the cantonal tax authority on how to manage the domestic aspects of the dispute.

Another wrinkle is that the federal tax authority also takes charge of enforcing the tax rules for related-party transactions. Switzerland does not have transfer pricing regulations in place. Rather, in the context of transactions with related parties (or persons close to related parties), any cost or income element that is not commercially justifiable may be considered as a hidden profit or monetary benefit and subject to withholding tax. The federal tax authority makes these assessments and also instructs the cantonal tax authorities on any resultant corporate income tax adjustments.

Despite the complexity of this system, it generally worked well for taxpayers. Domestic disputes were often dealt with and settled without litigation, while international disputes handled by the SIF were generally settled with mutually acceptable outcomes.

As tax changes are implemented in Switzerland and internationally, the volume of tax domestic and bilateral disputes and litigation is expected to increase significantly. Switzerland's 26 cantonal tax authorities may interpret and apply the new rules differently and with varying degrees of aggressiveness. The additional information that the tax authorities will gain on cross-border transactions, subsidiaries and permanent establishments that Swiss and international tax authorities will drive disputes at the international level.

In response, the Swiss authorities are being compelled to adopt more formalistic approaches, leaving less room for negotiated settlement and more need for alternative dispute resolution techniques. In fact, Switzerland's first arbitration cases will commence in the next few months, and this technique is expected to be used more frequently in the coming years.

However, it seems likely that the Swiss tax environment will remain attractive, characterized by low tax rates, internationally accepted tax incentives (e.g., patent box, R&D super deduction), and taxpayer-friendly tax authorities. The extent of tax change means some tax uncertainty is unavoidable, but Switzerland's well established rulings culture should help address points of ambiguity and lead to more predictable outcomes going forward.

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