Tax Controversy 2022

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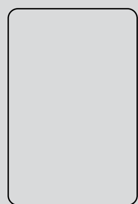

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Slaughter and May

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

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

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

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

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

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Global overview

Richard Jeens

Slaughter and May

Introduction

Surveying the general tax landscape this year, it is clear that, alongside the very significant economic and health impact of the covid-19 pandemic, the pandemic continues to impose significant burdens on taxpayers, tax authorities and tax professionals alike. While many organisations and tax professionals have focused on the immediate response to the pandemic and how best to support impacted businesses, our experience and the contributions in the chapters that follow suggest there is far greater scope for tax-related controversy going forward as tax authorities look for means of restoring public finances, both through an increased 'tax take' and more robust collection measures.

Covid-19: a snapshot

Over the past year, governments across the world have taken swift and decisive action in response to the pandemic, delivering record levels of support to their economies and relief to taxpayers (with estimates placing the total amount of support at around US$16 trillion and rising).

Tax policy has – unsurprisingly – played a pivotal role in delivering that support. Immediate steps were taken in many jurisdictions to provide relief through the tax system to businesses and households as the effects of virus containment policies were felt. However, as short-term relief measures have gradually been withdrawn, governments have shifted their focus towards the wider role that tax policy and administration can play in stimulating future growth and reducing the considerable deficits built up during the past 12 months or so.

Some countries, such as Peru, Brazil and Germany, have proposed temporary wealth taxes as a means of shoring up public finances; a measure that is likely to resonate with recent public attitudes of tax fairness, but perhaps also incentivises taxpayers to take steps to mitigate their personal burden. Indeed, Argentina has recently raised over US$2.4 billion from a controversial wealth tax in order to 'pay for the pandemic'. However, more generally, there is a reticence on behalf of policymakers and governments to increase taxation in the near term out of concern that this could stunt economic recovery (an expectation shared with many tax professionals, with only slightly more a tenth of those recently surveyed by Ernst & Young indicating that they expect higher taxes this year). Other measures are, therefore, likely to be explored in the first instance, including improving the enforcement and recovery of existing taxes, as well as investigating and prosecuting tax abuses that have resulted from the generous support schemes announced in response to the pandemic.

The management of tax disputes relating to covid-19 measures and the pressures of increased and more aggressive tax authority enforcement activities are becoming increasingly important issues that are likely to take centre stage in boardroom discussions over the next year.

Cross-border taxation

At a global level, the past year has also seen progress towards greater international coordination of taxing rights, most notably on the issue of digital taxation. However, even with recent headline-grabbing reforms, multinational groups continue to face the prospect of being drawn into complex and costly multilateral disputes in an attempt to avoid double taxation.

In July 2021, the G20 agreed to proceed with the OECD's proposal on Pillar 1 and Pillar 2 of the Inclusive Framework, which provides for new nexus and profit allocation rules and a global minimum rate of tax. Importantly, these proposals also pave the way for the repeal of the patchwork of unilateral digital services taxes implemented by the UK, France, Spain, Italy and Austria, among others.

However, while the commitment to move forward with Pillar 1 and Pillar 2 is a positive development, not least for the sake of reducing the risk of double taxation and associated disputes, detailed questions (both technical and political) still need to be answered.

In particular, details of how the dispute prevention and resolution procedures under Pillar 1 are intended to work in practice are yet to be finalised (and, perhaps more troubling for those impacted by the global minimum tax rate, no formal mechanisms have been proposed for Pillar 2). In addition, while there is a general commitment by OECD members to withdraw existing unilateral digital services taxes, it is not yet clear whether the EU Commission will abandon its proposals to implement a digital levy on goods and services sold within the EU. It, therefore, remains to be seen what practical impact Pillar 1 and Pillar 2 will have on the tax controversies landscape.

The OECD's 'blueprint' for dispute prevention and resolution procedures under Pillar 1 anticipates that a standardised self-assessment return and documentation package will be developed for use in all jurisdictions. This will be filed with the lead tax administration (in most cases, the jurisdiction in which the ultimate parent entity is located), which will then validate and exchange the information with other affected jurisdictions. If this process works, this should reduce the administrative burden on multi-national groups in complying with Pillar 1 and ensure consistency in its application.

There will also be an ability for businesses to submit a request for early tax certainty to the lead tax administration, with potential escalation to a 'review panel' (consisting of six to eight tax authorities) or a 'determination panel' if consensus cannot be reached. Importantly, a business may withdraw its request for early tax certainty if it does not agree with the outcome of the review, choosing instead to rely on domestic procedures in each jurisdiction or the multilateral agreement procedure, if available. However, withdrawing from this process will result in significant costs where domestic procedures are used in several affected jurisdictions.

The OECD envisages that a significant majority of multinational groups will submit a request for tax certainty in the first few years following the introduction of Pillar 1. However, if tax administrations (perhaps cautious about the new regime) defer to a review panel too often, the potential benefits of the early tax certainty will be reduced, especially if tax administrations lack resources to progress review decisions.

Notwithstanding the above, taxpayers are likely to continue to spend time navigating the significant areas of uncertainty remaining in the international context. Two examples that stand out are, first, EU

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state aid investigations and challenges to past structures and rulings, as the recent cases concerning Apple, Amazon and Nike demonstrate, and, second, a number of double tax treaty cases, which have focused on technical arguments such as the meaning of terms such as 'business' and 'business profits' for the purposes of determining which jurisdiction can exercise its taxing rights. It is also frequently the case that diverted profit tax investigations will engage transfer pricing considerations and vice versa.

Tougher enforcement?

While tax audit and litigation activity slowed during 2020 owing to the impact of the covid-19 pandemic on tax authorities and courts and tribunals, governments have now largely resumed collection and enforcement activities.

Our experience and those of the contributors of the following chapters suggest that future enforcement activity is expected to focus on two key areas: first, the wrongful (or fraudulent) use of covid-19 support measures and, second, tougher enforcement of existing tax regimes so as to ensure the prompt collection of taxes considered due.

Dealing with the first, tax authorities are acutely aware of the opportunities for abuse that have arisen out of the covid-19 pandemic and are now taking steps to recover amounts wrongfully claimed. For example, in the UK, a Taxpayer Protection Force has been established to investigate and prosecute fraudulent claims under the UK government's covid-19 job retention and subsidy schemes, with nearly 13,000 investigations commenced to date. Likewise, in Italy, the national tax authority has turned its attention to investigating grants approved since the beginning of the covid-19 pandemic. However, tax authorities will also need to grapple with the novel fact patterns that have arisen as a result of the pandemic and what this means for taxpayers. For example, in Spain, a recent tax ruling held that days unwillingly spent in Spain because of the pandemic should be taken into account for the purposes of determining tax residency, a move which could potentially lead to double taxation of mobile workers (or organisations for which they work).

Meanwhile, the impact of the pandemic on government budgets is expected to result in tax authorities more aggressively pursuing revenue from existing sources in the absence of new taxing rights. This theme can be seen in a number of recent announcements by governments around tax authority funding. For example, the US has announced US$80 billion in funding for its tax authorities, which it is hoped will result in them being better equipped to conduct effective audits of taxpayers. The UK has announced a further £180 million in funding to, among other things, support investment in new IT systems and recruit additional compliance staff. Similarly, Canada has announced an additional C$304.1 million in funding to tackle tax avoidance and evasion. Organisations and tax professionals should therefore expect heightened levels of enforcement over the next few years.

Tying in with tax enforcement activity is the continued push towards greater tax transparency, with increasing demands for more detailed information placed on taxpayers and third parties. For example, the EU Commission has recently confirmed its intention to implement public country-by-country reporting for multinational groups with consolidated revenues of more than €750 million if they are EU parented or otherwise have EU subsidiaries or branches of a certain size.

A key part of this measure is the requirement for businesses to provide a narrative addressing any material discrepancies between the amount of income tax reported as accrued and the amount of income tax paid. It is expected that this will bring greater public scrutiny to bear on such companies and will accordingly result in a more informed public debate around tax compliance. However, with greater public scrutiny comes the risk of reputational damage for such companies and increased political pressure on tax authorities in relation to which entities they focus their attentions on.

The future

Tax controversies look set to remain a challenging area for the foreseeable future as both governments and businesses grapple with an uncertain tax environment and the long shadow of the pandemic. Although, particularly in an international context, moves to increase tax authority coordination and transparency are steps that should provide taxpayers with improved certainty in the long run, the significant budgetary pressures created by the pandemic look set to push governments and tax authorities to take a more active and aggressive approach to enforcement and disputes. Taxpayers should, therefore, expect increased scrutiny of their affairs and have this in mind with regard to future transactions and operations.

More generally, a more active and aggressive approach to enforcement by tax authorities in response to the pandemic is expected to have consequences for tax professionals in a broader litigation context. In particular, disputes over which party should bear historical tax risk in an M&A context are likely to increase, with market practice on risk mitigation or allocation evolving through more extensive warranty and indemnity packages (particularly around grants and tax deferrals provided in response to the pandemic) as well as specific tax-liability insurance.

Given all of this, it is (and will remain) important for organisations to be able to provide contemporaneous evidence to substantiate the terms of and rationale for transactions, including by way of external advice or the preservation of relevant documents, and then marshal this effectively when called upon. As much as this may lead to increased administrative costs for taxpayers in the short term, this will likely produce savings in the long term, especially when engaging with tax authorities or their requests for information while protecting privileged material and guarding against third-party claims.

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