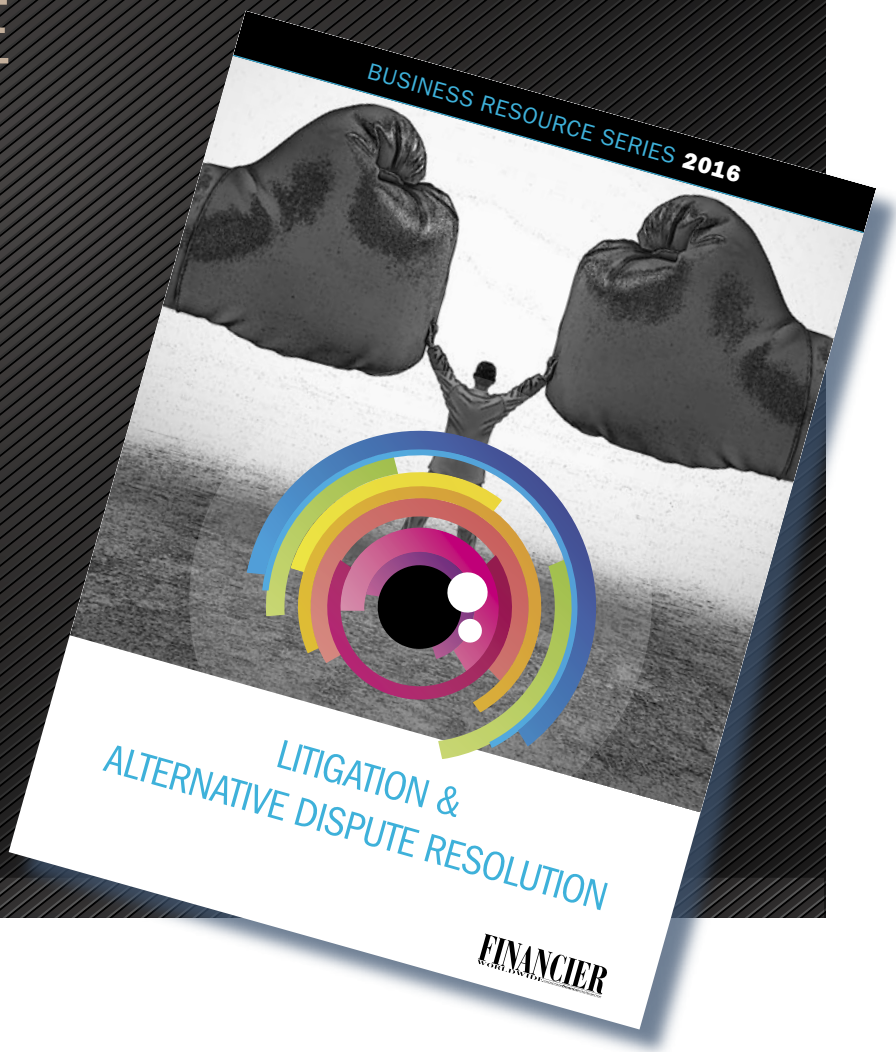
BUSINESS RESOURCE

LITIGATION & ALTERNATIVE DISPUTE RESOLUTION



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Q&A:

Resolving tax disputes

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Kat Gregor is a partner in the tax & benefits department at Ropes & Gray and a founding member of the tax controversy group. Ms Gregor regularly handles disputes with the IRS and other administrative bodies, and assists clients in managing disputes with non-US tax authorities. She represents private investment funds, institutional investors, private companies and high net worth individuals before the US Tax Court, US Court of Federal Claims and other federal and state courts.

FW: COULD YOU PROVIDE A BRIEF OVERVIEW OF THE CURRENT TAX REGULATORY ENVIRONMENT IN YOUR REGION? ARE YOU SEEING AN INCREASED NUMBER OF DISPUTES WITH TAX REGULATORS?

Gregor: In the US, the Internal Revenue Service (IRS) is suffering from a tightened budget, and overall examinations are down. But before taxpayers get too comfortable, this has primarily meant that the IRS has reallocated resources to increase scrutiny of specific industries, transactions and positions. This has meant that certain industries, such as asset management, life sciences and technology companies, for example, are actually experiencing a significant increase in examination activity. We are also seeing the IRS take active steps to make examinations more efficient by pushing taxpayers to be faster in their responses and moving toward formal subpoenas of information more quickly than we have seen in the past. If this trend continues, we expect to see different groups and issues move in and out of the crosshairs, meaning that all taxpayers should be preparing for targeted examinations in the future.

FW: IN YOUR OPINION, DO FIRMS PLACE ENOUGH EMPHASIS ON TAX COMPLIANCE?

Gregor: While we see many companies placing strong emphasis on tax compliance, the meaning of true 'compliance' has shifted in recent years. We have seen an increase in scrutiny of transactions and tax positions, on an international basis, that several years ago were market standard approaches to tax minimisation. The broader cultural climate is unforgiving of large firms' emphasis on reduction of overall tax burden, while many firms view tax minimisation as a duty owed to shareholders. This inherent conflict makes the manner in which firms' document tax planning and decisions ever more important. Firms should add focus to changing the nature of how tax planning is discussed and developed internally, and thinking proactively about how a regulator or the public may view a structuring decision down the road. In some cases, the reputational harm to companies of an aggressive tax position might outweigh the near-term tax savings, but in other cases, simply putting thought into how a tax position is described in email could make the difference in avoiding a public dispute.

FW: HAVE YOU SEEN AN INCREASE IN TRANSFER PRICING DISPUTES IN RECENT YEARS? HOW CHALLENGING IS IT TO BALANCE TAX EFFICIENT POLICIES WITH REGULATORY COMPLIANCE ON TRANSFER PRICING?

Gregor: We have seen an increase in transfer pricing disputes in the US, most notably with the IRS losing several critical cases in recent years. But we think that tide will begin to turn on a global basis, with many jurisdictions pushing back on firms' efforts to shift profits to low-tax jurisdictions as the BEPS initiative takes hold. Many companies will be required to release information to authorities that we expect will form the basis of challenges to transfer pricing on a regular basis. It may be the case that some companies will choose to revisit some of their strategies now in advance of these releases, while others will take a wait

and see approach. In any event, we expect that the next several years will mark great change in how jurisdictions around the globe think about transfer pricing.

FW: TO WHAT EXTENT ARE TAX AUTHORITIES PLACING A GREATER FOCUS ON CROSS-JURISDICTIONAL JOINT AUDITS? WHAT CHALLENGES DOES THIS RAISE FOR MULTINATIONAL FIRMS?

Gregor: Cross-jurisdictional audits are still novel and rare, at least where the US is concerned. We have seen the use of the IRS competent authority office when a multinational firm is subjected to an audit in a treaty country, and while those proceedings can be highly efficient from a taxpayer's perspective, there is little incentive for the IRS to increase resources on this front. We do, however, expect that the trend of the EU policing individual Member States' tax policies and practices will continue. This may lead to more cross-jurisdictional joint audits in Europe, where several higher-tax jurisdictions find it efficient to band together to attack the practices of some of their lower tax neighbouring countries.

FW: NO MATTER WHAT PRECAUTIONS ARE TAKEN, FIRMS MIGHT EXPECT TO BECOME THE TARGET OF REGULATORY AUDIT, ENQUIRY OR INVESTIGATION AT SOME POINT. WHAT IS THE BEST COURSE OF ACTION A COMPANY CAN TAKE IN THE EVENT OF INVESTIGATION?

Gregor: Firms need to approach modern tax controversies the same way that they approach other high-profile litigation – with a close eye on enterprise and reputational risk. Too many firms are caught off guard when there is public outcry over a dispute, or when an audit turns acrimonious quickly. Firms are best advised to bring in counsel early in the process, even when their accounting firm or in-house tax team is handling an audit directly with the IRS, having a higher-level strategic perspective with a focus on larger institutional risk will help protect the firm in the long run. Firms also need to be wary of the potential implications for other regulatory bodies of actions taken during an IRS audit. Often multiple regulatory bodies will be interested in the same underlying transaction, and bringing in counsel who is attuned to the various risks to the firm will help to manage risks from multiple directions.

FW: INEVITABLY, INVESTIGATIONS MAY LEAD TO A DISPUTE. WHAT ADVICE CAN YOU GIVE TO FIRMS ON ACHIEVING THE MOST FAVOURABLE OUTCOME FROM A TAX DISPUTE WITH REGULATORY BODIES?

Gregor: Be prepared. Too often, firms move from the negotiation table at the examination stage to court without an honest and full understanding of their likelihood of success or the nature of documents to be turned up in discovery that may adversely affect the course of litigation. Having a full view of the potential record at trial not only helps to develop litigation strategy that should be executed from the moment of the petition, but also helps to ensure that leaving behind opportunities to settle make sense. Finally, having a clear understanding of the record before filing suit will help minimise the likelihood that embarrassing emails or other documents make it into the public record. Engaging in some pre-trial discovery against

the government can help as well. Putting in a request for the full administrative record under the Freedom of Information Act will help a taxpayer understand the IRS's positions and bases before documents are filed in court.

FW: LITIGATION CAN BE A TIME CONSUMING AND COSTLY PROCESS. DO YOU SEE ALTERNATIVE DISPUTE RESOLUTION METHODS BEING USED MORE FREQUENTLY TO RESOLVE TAX DISPUTES BETWEEN FIRMS AND REGULATORS?

Gregor: ADR is definitely on the rise. There are several avenues to ADR available within the IRS, the most common being the Fast-Track Settlement process, and for years it seemed that taxpayers and exam teams seemed reluctant to use them. However, there has been a big push by the IRS in the last year or two to send matters to Fast-Track where a matter has room for settlement. This is driven, in a large part, by the IRS' budget constraints and is pushing towards more efficient enforcement. But also, many large taxpayers are also seeing the benefit of using a form of mediation that allows more flexibility than the parameters that apply to exam teams seeking to settle an issue. We have also seen a large uptick in the international use of mediation and arbitration forums. Many disputes are heading to the Permanent Court of Arbitration (PCA), particularly where there is a dispute over the application of a tax treaty between two countries. Because so many international tax disputes involve tax treaties, and because most tax treaties contain a provision first requiring a form of mediation, known as mutual agreement procedures, and finally a submission to arbitration, known as international tax treaty arbitration, the PCA is quickly becoming a form of international tax court.

FW: TODAY, TAX CONTROVERSIES ARE REGULARLY THE SUBJECT OF INTENSE MEDIA ATTENTION. WHAT STEPS CAN FIRMS TAKE TO MITIGATE REPUTATIONAL RISK WHEN SUCH DISPUTES ARISE?

Gregor: Even though the IRS is restricted from releasing taxpayer information during an exam, a taxpayer should assume that the information may become public through other proceedings, such as a trial, public securities filings or discovery disputes with the IRS that go to summons enforcement proceedings. When a tax issue comes under scrutiny from a regulator, the first step a company should take is to evaluate the risk of reputational harm to the company. The magnitude of any such risk should inform a company's strategy from the first meeting with the examination team. Beyond ordinary disclosure of a tax dispute, some regulators are capitalising on this increased public scrutiny, with many countries raising threats of criminal prosecution at a rising rate. This only increases the stakes of potential public disclosure. But in reality, the process begins much earlier; a company should be thinking toward potential public disclosure throughout their tax planning and compliance process. In light of the increased attention paid to allegations of tax avoidance by large companies, internal tax teams should be trained to consider the manner and nature that tax planning is documented. Tax directors should focus on resetting the mindsets of internal teams to be sensitive to how shorthand and flip language may one day be taken out of context to be held against a company in the court of public opinion.

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