STATEMENT

OF

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ON

ADVANCING
INTERNATIONAL TAX ADMINISTRATION

SUBMITTED TO THE

IRS OVERSIGHT BOARD

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I am Carita R. Twinem, Vice President-Tax for Spectrum Brands Holdings, Inc., located in Madison, Wisconsin, and I am here today in my capacity as International President of the Tax Executives Institute. The IRS Oversight Board was created pursuant to the IRS Restructuring and Reform Act of 1998 to improve the IRS so that it may better serve the public and meet the needs of taxpayers. On behalf of TEI, I am pleased to submit this statement in conjunction with the Board's May 1, 2013, Public Forum on Advancing Tax Administration.

Today, our worldwide international tax systems are at a critical juncture. Our economies are becoming globally integrated as a result of advances in technology, the increasing mobility of capital, and the increasing importance of services and intangible assets as value drivers in the global supply chain. This dynamic environment presents taxpayers and tax administrators around the world with significant challenges to develop or refine approaches to tax compliance and administration that properly reflect these new realities. My remarks today focus on three broad themes that we believe should inform their efforts: 1) transparency, 2) commercial awareness, and 3) clear and certain pathways to resolution.

BACKGROUND ON TAX EXECUTIVES INSTITUTE

Tax Executives Institute was established in 1944 to serve the professional needs of in-house tax practitioners. Today, the Institute has 55 chapters located in the United States, Canada, Europe, and Asia. Our 7,000 members are accountants, attorneys, and other business professionals who work for 3,000 of the leading global companies and are responsible for conducting the tax affairs of their companies and ensuring their compliance with the tax laws. TEI represents the business community as a whole, and our members work with the tax code in all its complexity, as well as with the Internal Revenue Service, on almost a daily basis. Many of our members work for companies that are under continual examination by the IRS's Large Business & International Division. TEI is dedicated to assisting the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. We are proud of our record of working with regulators, including the Internal Revenue Service and the Canada Revenue Agency, as well as the Organisation for Economic Co-operation and Development, and other authorities to develop best practices and help improve tax administration.

DISCUSSION

Over the past few decades, U.S. companies have, at an ever accelerating pace, expanded nearly all facets of their business operations into foreign jurisdictions. At the same time, however, the U.S. worldwide international tax system has become outdated and dauntingly complex. This has created significant compliance challenges for U.S. multinationals and administrative challenges for the IRS. Complying with the tax laws of foreign jurisdictions is also complex, particularly in light of the different languages, economic systems, and customs that multinationals confront when attempting to comply with foreign tax requirements.

Most multinational businesses view tax liabilities (and the associated compliance costs) as business expenses that must be managed like any other expense. Multinationals possess neither unlimited time nor unlimited resources to dedicate to their tax compliance and reporting obligations. Indeed, owing to the economic downturn, business taxpayers (and the IRS alike) are struggling to do more with less. Nevertheless, multinationals continue to strive to "get it right" the first time within the practical constraints of their business resources.

Against this background, obtaining certainty and avoiding unanticipated outcomes are key objectives when managing business issues, and multinational enterprises place a high value on their ability to finalize tax positions in a timely and efficient manner. Three aspects of international tax administration are central to achieving these objectives. First, transparent relationships with tax administrators – multinationals seek to partner with tax administrators to create transparent, cooperative relationships that foster certainty and efficiency and benefit both parties. Second, examinations based on commercial awareness – the complex business arrangements common to multinational taxpayers require industry-aware revenue agents whose actions reflect, at a minimum, a baseline understanding of the taxpayer's industry and the international aspects of the taxpayer's operations. Third, clear and certain pathways to resolution – disputes are inevitable when dealing with complex commercial issues, and multinational businesses need clear regulatory guidance and efficient issue resolution mechanisms to settle disputes, afford certainty of result, and minimize double taxation. Each of these dimensions is discussed below.

Transparent Relationships between Taxpayers and Tax Administrators Are Essential

The relationship between taxpayers and tax administrators has historically been more adversarial than collaborative, with corporate tax departments and revenue authorities often harboring "us versus them" mentalities. In many countries, including the United States, this mindset appears to be slowly shifting towards a more cooperative and collaborative approach. Several objective trends are encouraging this shift. Widely publicized financial scandals involving public corporations, such as Enron and WorldCom in the early 2000s, have increased the sensitivity of corporations to adverse publicity on financial matters, including tax issues. Many countries have adopted stricter corporate governance standards concerning financial matters, including the degree to which top corporate officers must assume responsibility for tax matters (*e.g.*, the certification requirements of the Sarbanes–Oxley Act of 2002). As important, financial accounting standards have evolved to require greater disclosure of tax reporting in general, including uncertain tax positions. The IRS has reacted to this environmental shift by promulgating disclosure forms, such as Schedule M-3, Schedule UTP, and Form 8886, which enhance return disclosures for greater transparency. This confluence of events has created an atmosphere that promotes compliant tax behavior and provides tax authorities greater insight into the tax affairs of multinational taxpayers than previously available.

By its nature, international tax compliance breeds tax risk and uncertainty. Multinationals must juggle multiple — often conflicting or contradictory — tax reporting obligations and requirements in multiple jurisdictions. Instituting proper controls to manage and reconcile those risks is expensive and time consuming. Moreover, multiple tax authorities examining the same transaction often interpret the facts and law in ways that result in irreconcilable adjustments and double taxation. Because of this risk and uncertainty, an increasing number of multinationals are seeing an economic incentive for "partnering" with tax administrators in a cooperative relationship rooted in transparency and trust. Such a relationship encourages compliant taxpayer behavior and also creates audit efficiencies that free government personnel to focus on other objectives. Thus, it results in a win-win scenario for governments and taxpayers.

The importance of transparency in this enhanced relationship cannot be overemphasized. A cooperative compliance arrangement is beneficial to revenue authorities only if they receive proactive disclosures from taxpayers fully explaining their tax processes and material business transactions. Likewise, the arrangement is beneficial to taxpayers only if they receive certainty about the scope of the examination the revenue authority will undertake and the timeline for completing the work. Without transparency, the system breaks down and loses appeal to both parties.

Several countries, notably Australia, Canada, the United Kingdom, and the Netherlands, have successfully implemented cooperative compliance arrangements that have a high degree of transparency. Generally speaking, these countries classify taxpayers based on objective risk assessment criteria, which are openly shared with taxpayers. After the risk assessment is concluded, taxpayers are informed of their risk rating and then have an opportunity to improve that rating by taking objective, measurable steps. Transparency in the risk assessment process is critical because it allows revenue authorities to influence taxpayer behavior. Taxpayers with favorable risk ratings are not subjected to normal course, detailed audits. Rather, the examination follows a course of "trust but verify" and focuses on areas where material tax issues may arise. Thus, in these programs, taxpayers have certainty that if they conform to favorable risk assessment criteria, they will not be subjected to lengthy, normal course examinations. History has shown that taxpayers are willing to improve internal controls and forgo aggressive tax behavior to obtain the benefits of increased certainty and efficiency in the audit process.

Such audit programs require fundamental changes in the manner in which revenue authorities conduct their business. Importantly, performance evaluation indicators must be changed to help influence audit *quality*, rather than audit *quantity*. Revenue agents must be encouraged to focus on material issues that may uncover significant lapses in compliance and discouraged from pursuing marginal theories with no clear compliance objective. In other words, the scope and degree of examination procedures employed must be *proportional* to the perceived tax compliance risk. In addition, revenue authorities and taxpayers must engage with one another with an increased level of trust. Revenue agents must understand that the vast majority of multinational taxpayers are not pursuing aggressive tax schemes aimed at stripping tax revenues from governments. Rather, they are doing the best they can to comply in an organized and efficient manner with the complicated and often conflicting international tax systems administered by the various countries in which they conduct business. When a multinational taxpayer organizes its operations to fit within a beneficial tax regime enacted and administered by a country, the taxpayer is not engaging in nefarious or aggressive behavior and should not be treated as if it were. Corporate tax departments are expected to control their overall tax expenses in the same manner as other cost centers within a multinational organization. Finally, all revenue agents involved in an examination, regardless of whether they are auditing domestic or international issues, must follow a unified approach, adhering to common principles of targeted issue selection and timely audit completion. Changes such as these do not occur quickly or easily. Successful implementation requires strong leadership and a targeted period over which the changes can evolve.

The IRS's Compliance Assurance Process (CAP) is an example of this type of cooperative compliance program. CAP participants have generally been pleased with program results, and the IRS professionals charged with implementing and administering the program should be commended. As CAP continues to evolve and expand, we encourage the IRS to stay true to CAP's guiding principles of risk-based, "trust and verify" examinations within a designated timeframe. In addition, we are hopeful that IRS leadership will evaluate the cooperative compliance programs administered by other countries and consider not only increasing the levels of transparency in the CAP program, but also incorporating elements of a cooperative compliance system into non-CAP examinations so more taxpayers will have an opportunity to participate in this type of examination. We believe enhancing the certainty surrounding CAP audits and broadening the use of cooperative compliance principles would ultimately benefit the IRS and taxpayers alike. TEI members have practical experience with cooperative compliance programs administered by many different countries and would be pleased to share their experiences.

Another area of transparency that is vital to an efficient audit involves the manner in which information is requested. Tax administrators often request documents and other information without discussing with taxpayers the issues or compliance risks being pursued. Oftentimes, it is difficult to respond to such requests, and taxpayers frequently spend significant time and effort producing information that turns out to be of minimal or no relevance. Revenue authorities also expend considerable time and resources sifting through the information produced. Providing the underlying rationale for an information request would assist taxpayers in responding, accelerate the audit process, and make more efficient use of revenue authorities' resources.

Examinations Based on Commercial Awareness

We live in a complex global environment with complex laws and regulatory requirements. Multinationals must consider a myriad of business needs and legal regulations when structuring cross-border business transactions. More often than not, these business issues shape the form of transactions, coupled with building tax-compliant and tax-efficient operating structures. From a tax perspective, the typical dichotomy is that tax requirements inform the business issues that drive the business decision. Tax issues and business issues are closely linked, and thus, it is rarely possible to fully understand a complex tax issue absent knowledge of the underlying business issues.

When examining a transaction, we strongly encourage revenue authorities to gain an understanding of the commercial context and realities in which transactions and associated tax planning take place before reaching legal conclusions. This requires revenue agents, international examiners, economists, case managers, and supervisors to be knowledgeable about not only the industry in which the taxpayer operates and commercial risks associated with that industry, but also the countries in which the taxpayer operates and structures commonly used by businesses operating in those countries. Unfortunately, revenue authorities in some countries have a tendency to examine transactions in a vacuum, limiting their focus to home-country tax laws and failing to consider the correlative impacts their adjustments will have on returns filed in other countries. Such a narrow perspective frequently leads to irreconcilable adjustments that disregard the economics underlying a transaction and cause prolonged disputes. This is particularly problematic in the current environment where governments have begun to challenge longstanding corporate structures, not because they fail to adhere to the law, but rather because they are perceived as creating inequities.

We encourage audit teams to study and become knowledgeable about a multinational taxpayer's operations before starting an examination. A rich source of information for this purpose is the prior year's audit file, as well as the team members who conducted the prior year audit. The examination of a multinational's income tax return often generates a trove of knowledge concerning a taxpayer's structure, accounting systems, and business affairs. This information provides a springboard for examining subsequent years' returns and helps to provide the commercial awareness necessary to evaluate tax issues in the return. We encourage audit teams to review this information and also to confer with members of the prior audit team to gain additional insight into the taxpayer's business. We also encourage audit teams to meet with taxpayers at the beginning of an audit and allow taxpayers to explain their business and structure to the audit team. Multinational taxpayers are generally eager to educate exam teams on general business matters because business awareness is critical to tax awareness, and we have found that personal interaction is invaluable to this process. We strongly urge tax authorities to focus on this critical element in the tax administration process.

Clear and Certain Pathways to Resolution

It should come as no surprise that multinational taxpayers favor fair, efficient, and timely issue resolution tools. Fundamentally, from the taxpayer's perspective, useful issue resolution tools share the following characteristics: 1) they facilitate reaching agreement on the facts, 2) they resolve disputes more quickly, consistently, and efficiently than traditional litigation, and 3) they result in a binding, final resolution that is not litigable after the fact (this is very much a concern of taxpayers with respect to certain countries). Finally, in the international context, issue resolution should minimize, if not eliminate, double taxation.

An often overlooked issue in international tax administration is that jurisdictions frequently fail to reach agreement on the facts prior to addressing the legal issues. Moreover, revenue officials have a tendency to interpret the facts in their own favor, rather than in an objective and impartial manner that considers the ramifications their factual findings may have on tax reporting in other countries. This problem is heightened when a dispute escalates to competent authority proceedings where revenue officials from two countries attempt to reach agreement on the facts underlying an issue and the taxpayer does not participate in the negotiations. In such circumstances, each revenue official may have their own characterization of the facts (which may differ considerably from the *real* facts), and stalemates are common. Direct taxpayer involvement in such proceedings may mitigate this problem. Having the taxpayer at the table explaining the facts underlying the legal issue to both countries simultaneously and answering any questions posed would prove beneficial to all parties. Further, requiring countries to agree to a common set of facts before addressing the legal issues would improve competent authority proceedings.

Differences in economic perspectives, culture, and language also present challenging obstacles to resolving disputes in proceedings involving multinationals. Direct communication between the taxpayer and the revenue authority is frequently the best and most efficient means of dealing with these difficulties. Professional translators and note takers should be employed wherever possible in alternative dispute resolutions, and taxpayers should be given the opportunity to review the ensuing transcripts to correct the inevitable vagaries of oral presentations.

The second and third characteristics of effective alternative dispute resolution tools – timeliness and finality – are intertwined. Absent finality of resolution, multinationals shy away from these tools because of the risks of incurring significant time and costs and then walking away empty handed. That is, taxpayers are reluctant to pursue alternative dispute resolution if there is a possibility that they will end up in litigation with tax authorities anyway. At the same time, to be more timely than traditional litigation, the alternative measure must necessarily employ different procedures, which may make tax authorities – and in certain cases taxpayers – reluctant to engage. Timeliness and certainty are particularly important in the current financial reporting environment, where there is greater focus on the recording and subsequent modification of financial reserves for tax risks. As a result, the efficient and final resolution of tax disputes flows through to a business's financial statements on a more timely basis, providing shareholders and potential shareholders with more accurate and useful information upon which to base their investment decisions.

The final critical element of issue resolution in the international context is the elimination of double taxation. The principal tool for elimination of double taxation is the mutual agreement procedure (MAP) under the income tax conventions between the United States and other countries. Regrettably, however, the conventional MAP procedure is cumbersome to invoke and the time to completion of a typical case can average up to four years. Indeed, the time to completion depends on many factors, ranging from the state of the case's factual and legal development, to the number and length of meetings between the competent authorities, and to the relationship between the competent authorities. As a result, alternative dispute resolution mechanisms have been developed to expeditiously and efficiently dispose of bilateral (and more recently multilateral) cases of double taxation.

Two examples of effective alternative dispute resolution procedures are mandatory binding arbitration and advance pricing agreements. Mandatory binding arbitration provides the certainty of resolution that resonates with multinationals and, when conducted efficiently, provides an effective tool for resolving disputes. TEI has long supported the Treasury Department's efforts to include mandatory binding arbitration clauses in tax treaties.

As important, APAs are an effective mechanism for avoiding disputes and ensuring certainty on transfer pricing issues. Regrettably, however, the APA process has become an extended and costly pursuit – both within and outside the United States – thereby limiting its utility. To improve the program, TEI recommends that the IRS work with its foreign counterparts to identify and eliminate the bottlenecks that inhibit timely APA agreements. Indeed, tax authorities should apply the principle of proportionality to the scope of their review of the underlying facts and circumstances of an APA submission.

Ideally, the IRS and other tax authorities would devote as many resources as needed to fulfill the demand for APAs as, in the end, an efficient and well-run APA program results in substantial cost savings to both sides. The IRS's recent reorganization of its APA and Mutual Agreement programs into the new APMA program is a step in the right direction, and we are hopeful that the time needed to complete APAs will decrease.

Finally, it is important to note that the issue resolution mechanisms addressed above are all enhanced by clear and timely administrative guidance. U.S. international tax provisions are dauntingly complex, and the lack of administrative guidance continues to be a significant source of uncertainty for U.S. multinationals. The time and expense of promulgating administrative guidance is a sound investment for tax authorities because proactive guidance promotes taxpayer compliance, increases audit efficiency, and reduces disputes. We embrace the philosophy of providing "pretty good guidance"—*i.e.*, guidance that resolves most issues without addressing every possible legal issue—and encourage the IRS to continue its efforts to provide such guidance.

CONCLUSION

Tax Executives Institute commends the IRS Oversight Board for holding this important public hearing and looks forward to working with the Board and the IRS to improve international tax administration.

TAX EXECUTIVES INSTITUTE, INC.

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