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PERSPECTIVES

TRENDS IN LARGE-SCALE CORPORATE TAX DISPUTES: WHAT TO EXPECT IN 2023

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The beginning of the year is often a time for thinking about what the coming months may bring. In the corporate tax world, change on a grand scale is afoot with the introduction of the Organisation for Economic Co-operation and Development's (OECD's) Pillar 2 proposals for a global minimum rate of corporate tax. That will throw up many compliance issues and transactional complications to keep tax teams busy planning for the future.

But they may also be faced with tax authority challenges to historic tax positions, and it can be useful to anticipate the areas in which those may arise. Some particular themes we are tracking in the coming year are set out below.

Pressure to raise more tax

The world economy is under tremendous strain, with many economists predicting a global recession in 2023. Governments under pressure often look to 'big business' to fill revenue gaps in their budgets, and inbound investors in particular can find themselves in the firing line. In 2022, we saw a wave of tax rate rises, windfall taxes and aggressive positions being taken by tax authorities in tax audits and assessments, and we expect more of the same in 2023. This is not just an issue for lower-income

countries – high costs of borrowing and inflation have created intense economic and political pressure for finance ministers across the globe. Taxpayers are also facing the pinch, and so may be less willing to settle and more inclined to fight their corners.

Against this background, over the next 12 to 24 months we expect to see an increase in large-scale domestic tax litigation and in investor-state and commercial tax disputes – with a focus in particular on corporate income tax, windfall taxes, retroactive taxation, novel taxes and onerous tax administration and compliance requirements in the energy, telecommunications and technology sectors. We also expect to see more tax-related post-M&A disputes and warranty and indemnity (W&I) claims, as buyers find themselves stuck with significant unexpected tax liabilities following acquisitions.

Focus on 'purpose' tests

In the UK, we have seen a significant uptick in the application of anti-avoidance rules which apply a 'main purpose' test to challenge historic arrangements on the basis that the transactions in question were motivated or structured with tax benefits in mind. A number of these cases have reached the UK courts and many more are being pursued in the background.

This is not just a UK trend. Many jurisdictions around the world have introduced general anti-avoidance rules which rely on 'purpose'-based tests, and we are seeing those also used more regularly as a tool for challenging historic tax planning – something we expect to continue during the course of the coming year.

'Purpose'-based tests are also relevant in a cross-border treaty context, where certain benefits (for example, a reduced rate of withholding tax on interest paid from one jurisdiction to another) are contingent upon it not being a main or principal purpose of any relevant person to take advantage of that benefit. The interpretation of the principal purpose test in the UK/Ireland double tax treaty was recently considered by a UK tax tribunal (*Burlington Loan Management DAC v HMRC*) and, while that decision provided some useful guidance, it is unlikely to be the final word on the matter.

Indeed, in addition to the focus in recent years on substance-based treaty challenges, we expect to see more examples of purpose-based challenges given the increasing use of principal purpose tests in double tax treaties.

Increasing criminal challenges

For some time now, tax authorities across Europe have been adopting a more robust approach in tax audits involving large corporates, and one manifestation of that is the increased use of criminal powers.

Potential criminal liability has been a feature of tax audits in Italy for many years and the Guardia di Finanza (colloquially, the tax police) is commonly involved in Italian tax audits, especially those involving cross-border issues. Historically it has been less common elsewhere in Europe for potential criminal prosecution to be raised in corporate tax audits, but that is starting to change.

In France, cases are now automatically referred to the criminal prosecutor if the tax authorities bring a challenge on anti-abuse grounds or apply a penalty of 40 percent or more of the tax due and while additional circumstances must exist for the matter to be referred, the thresholds are fairly low. We have also seen tax authorities in other jurisdictions adopt a tougher approach in imposing penalties

and referring cases to fraud investigators where they suspect taxpayers of seeking to defend the indefensible or deliberately trying to mislead them by supplying inaccurate information during tax audits. This may be in part because it has been harder since the pandemic to meet in person and to develop and retain healthy levels of trust between tax authorities and corporate taxpayers.

In a context where tax disputes are becoming increasingly criminalised, a trend we expect to grow is the use of deferred prosecution agreements (DPAs) – that is, arrangements whereby the taxpayer will agree with prosecutors to pay a penalty in return for the settlement of tax evasion charges. DPAs and other forms of tax amnesties have been in use in the UK and the US in different forms, and this has inspired other jurisdictions to follow suit.

The main benefit of a DPA is to avoid prosecution and any admission of guilt (thus also avoiding some of the secondary consequences of a criminal sanction, such as exclusion from public procurement). France introduced DPAs in its domestic law seven years ago (primarily for financial offences such as money laundering and tax fraud). French DPAs are public (they must be confirmed by a judge, and the agreement will be published) but the amount of publicity they attract is typically considerably less than a criminal trial. Even so, several recent tax cases in France have given rise to high-profile DPAs, including a major transfer pricing matter involving alleged over-charging of royalties for the use of intellectual property by a US multinational to its French affiliates – the penalties agreed with the prosecutor in this single dispute were in excess of €1.2bn.

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Focus on particular sectors and areas of risk

As tax authorities target their resources, they will naturally focus their attention on areas of high risk and as a result we often see waves of tax authority enquiries in particular sectors.

Equity trading by financial institutions has long been the focus of European tax authorities, including in Italy and Germany, but is under particular scrutiny in France at the moment, with a number of ongoing audits focusing on the withholding tax treatment of French source dividend equivalent payments ('manufactured dividends') paid under stock loans and derivatives. While these have historically not been subject to withholding tax, French tax authorities are now taking the position that withholding tax should apply, in the same way as it does to French source passive income (for example, portfolio dividends). This has prompted the reassessment of many French payers of manufactured dividends (usually banks), with potentially billions of euros at stake.

We expect that the financial sector will remain a focus area for tax authorities across Europe during the next year, with both banks and financial sponsors in the spotlight. Other sectors that are likely to remain on the radar of tax authorities include energy, infrastructure and other cash-generative businesses (with a focus on base erosive payments and provisions and profit repatriation), media and sports organisations (mainly in relation to indirect and employment taxes) and technology and life sciences companies (as regards the tax treatment of royalty payments and R&D costs in particular). And, in a high inflation and higher interest-rate environment, we expect more valuation disputes and disputes relating to the pricing and quantum of intragroup debt, so economists can expect to remain busy.

'Spillover' challenges

The majority of the trends described above are emerging in a number of different jurisdictions and, in part, that seems to be the consequence of tax authorities looking over their shoulders to see what their counterparts are doing (in some instances facilitated by increased transparency stemming from more systematic information exchange between tax authorities).

Multinational taxpayers should do the same: an audit or assessment in one jurisdiction could easily spill over to another if similar structures have been used across the group, and taxpayers should, more than ever, be alert to challenges affecting their peers that have the potential to become sector-wide issues.

Another aspect of 'spillover' is tax investigations leading to regulatory or political challenges. Tax stories remain newsworthy and can be difficult to defend because there remains a perception (whether or not justified) that 'big business' is not paying its fair share. As a result, taxpayers need to be ready to deal with adverse publicity which can give rise to challenges and enquiries from multiple sources. This focuses the need for discipline in marshalling the evidence and arguments and considering strategy and any public disclosures

carefully. In a challenging economic climate and with Pillar 2 looming, it is more important than ever for businesses to be able to direct resources to planning for the future rather than clearing up the past. CD

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