

## RECENT DEVELOPMENTS IN THE FORUM ON TAX ADMINISTRATION

Prepared Remarks of  
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Thank you. It's a great pleasure to be here among friends and colleagues from all over the world and it's an honor for me to have the opportunity to address all of you at today's lunch.

As the program indicates, I was asked to provide a short report on the Forum on Tax Administration's recent meeting, held just three weeks ago in Moscow. I quickly agreed to make this my topic, as the FTA is rapidly becoming a very important multilateral body and the matters before it are very significant. I'll do my best to highlight those matters this afternoon and perhaps give you sense of how the FTA operates as well. I'll also take the opportunity to share some of my personal views on the challenges facing FTA, and indeed facing tax administrations in general, as they continue to grapple with impact of the modern global economy on the administration of international tax matters.

I'll start by describing some of the major current areas of focus for the FTA and some of its projects and accomplishments in those areas. I should note that the different focus areas are typically underpinned by either a network or a sub-group dedicated to the particular subject matter.

In the large business area, a large business network just completed work on a report on "cooperative compliance," which, in my opinion, is really a fine piece of work for which much credit goes to the Netherlands for leading the group of 26 countries in this particular network and for taking the laboring oar on assembling the report. Many countries have developed, or are in the process of developing, particular approaches to ensuring compliance by large business taxpayers that capture some or all of the principles reflected in the report, whether these approaches go under the label of horizontal monitoring, enhanced engagement, or compliance assurance, as is the case here in the United States. The fundamental principle of cooperative compliance is that compliance can be greatly enhanced through reaching understanding, which in turn is based on commercial awareness, impartiality, proportionality, responsiveness, and openness through mutual disclosure and transparency.

There is far more to say about each of these so-called "5 pillars" than I have time for today. In fact, I have been thinking that dedicating an entire conference to these concepts would be very worthwhile. The report addresses each thoroughly and I commend it to you if you have not already read it. The report also goes on to address various ancillary issues and one particularly important one from my point of view is compliance risk management.

Interestingly, both taxpayers and tax administrators are independently engaged, in one way or another, in analysis of global tax risk. Implicit in the FTA's cooperative compliance report is the notion that these two separate exercises should be merged to a degree and respective risk assessments shared and openly discussed. Personally, I think this is critical for tax administrations and multinational businesses alike, and I believe Will Morris said something along these same lines on yesterday's first panel.

Rather than try to explain at the moment why I think transparent, cooperative risk assessment is so important, let me go on to another key FTA area of focus and I'll come back to risk assessment as I wrap up. The FTA has a subgroup devoted to compliance of small and mid-size enterprises. Here too, a final report was produced for the Moscow meeting and presented to the FTA delegates by Norway, which deserves much credit for leading the subgroup and producing a very fine report focused on maximizing compliance by engaging and involving the taxpayers and stakeholders in this important taxpayer segment. This approach, like the cooperative compliance report, comes at compliance through efforts to engage and understand, rather than through enforcement efforts alone, although the small and mid-size approach relies more on working through intermediaries and stakeholders than it does through direct engagement with particular taxpayers. The thinking reflected in this report is cutting edge and comprehensive, and again, I commend the report to anyone interested in this particular area.

Next, I'll mention the work of the FTA's offshore compliance network, which has also been very active. The network participants updated the data in the OECD's survey of offshore voluntary disclosure programs; developed a decision tree to help guide those designing such programs through key strategic choices; documented available tools and techniques for detecting signs of offshore evasion in financial data; and prepared a catalogue of tactics and best practices to help all network members develop or refine their strategies for dealing with offshore evasion. It was widely agreed in Moscow that the work of this group must remain a top priority within FTA, and as I'll mention in a minute or two, I think we'll see future work include projects to enhance processes for data exchange and data analysis.

Also worth highlighting is the work of FTA's taxpayer services subgroup, which recently has been focused on the discipline of using demand management strategies to address demand for taxpayer services. Here, commissioners all face the same problem of having to meet growing demands for service with dwindling resources, but rather than merely share stories of woe about respective problems, a fairly rigorous framework for establishing a demand management strategy was prepared and set forth in the report along with several case studies of specific problems successfully addressed by project participants. Again, excellent work was produced, this time under the leadership of Australia.

I'll pause here to point out that that, while the FTA operates as a standalone body in certain respects, it was created in 2002 by the Committee of Fiscal Affairs and is fully supported by the OECD secretariat, the staff of which does an absolutely tremendous job in facilitating the work of the FTA. I'll pause a few seconds longer to thank the secretariat team, through Pascal, for that terrific support without which the FTA might be a mere shadow of itself.

Okay, so with that overview of the current work of FTA, now let me turn more specifically to the meeting in Moscow. First, I think it's fair to say that the meeting was heavily imbued with the very colorful global discussion now taking place about international tax enforcement challenges, as they relate to both offshore compliance of individuals and the phenomenon in the business arena we now know as BEPS. Both these areas were subjects of plenary presentations, and there was also a breakout session dedicated to brainstorming new ways tax administrations can work together to address compliance issues raised by multinational enterprises. Both the BEPS challenge and the older, but still very intense, challenge of dealing with individual offshore accounts made for a great deal of engagement and a high level of energy in the FTA discussions, not only in the formal sessions but also in the many side-bar conversations that took place throughout the two-day meeting. Personally speaking, it's always interesting for me to compare FTA discussions with the multilateral commissioner-level meetings that used to take place during my first government stint in the 1990s. In those days, commissioners seemed much more tentative with each other and, for the most part, discussions were limited to commissioners sharing with one another what they were focused on respectively. In contrast, the FTA today is clearly about developing ways to work together to address problems. In other words, commissioners and other tax administration officials now see specific compliance challenges not simply as challenges we share but as shared challenges.

I think this as a very important dynamic. Increasingly, it's becoming obvious that tax administrations indeed can be more effective working together than working alone. Sharing good ideas is important, but actively working to develop joint approaches to specific compliance matters and to align compliance procedures and administrative practices can pay substantial dividends. Let me give you two examples of what I mean, both of which were discussed at the Moscow meeting.

As you may have seen, the tax administrations from the United States, Australia, and the United Kingdom issued press releases about four weeks ago indicating that we each have acquired a substantial amount of data revealing a multitude of trusts and companies holding assets on behalf of individual residents in jurisdictions throughout the world. As we indicated in the press releases, the data reflects extensive use of such entities organized in a number of jurisdictions.

Now, in working together to analyze the data, the three tax administrations I just mentioned uncovered information that may be relevant to other tax administrations; so we decided to offer to share the data with those other administrations. This effort was discussed in a general session at the FTA meeting in Moscow, and I think it provided not only a feel-good moment, but also an interesting ah-ha moment. That is – and this may be a simple point, but it's one worth focusing on – when countries have access to large amounts of information and have spent time developing ways to analyze it, they can and should share with other countries not only the data itself, but also the data analytics that go along with it. I dare predict that, as time goes on, we'll likely see more of this type of effort to share not only raw data but also the analytical approaches to using particular types of data sets. Countries share a fundamental common interest in combatting offshore tax evasion and I

think there is now a wide-spread understanding that we can be far more effective working together in this area than working alone. And, of course, as we soon begin to intensively share account information under FATCA and its progeny, our working together on data collection and analysis will be put to the supreme test.

The second example of coordinated tax administration potential I'd like to highlight is the FTA's new project on our mutual agreement procedures (MAP). As you're likely aware, over the past year or two, there have been frequent discussions about whether or not our bilateral mutual agreement procedures are working properly. It's been discussed at OECD CFA meetings and the OECD held a two-day CTPA Roundtable dedicated to the subject back in January of 2012. It's also become a favorite topic for panels at conferences, and, in fact, we had a panel on the problems with MAP at this conference here last year.

Figuring out why all the attention on MAP is pretty simple. Data collected by the OECD each year indicates that nearly every OECD-member country has experienced a sharp increase in both MAP inventory and cycle time. Increasingly, multinational companies have been caught up in unresolved MAP cases that can drag on for years. Naturally then, the multinational tax community has begun to declare this unacceptable.

One basic problem is sheer volume. As we all know, over the past decade, tax administrations around the world have begun paying much closer attention to international tax compliance, and this focus might well grow in light of the attention the BEPS discussion is garnering. In turn, dedication of examination resources in this area has led, and likely will continue to lead, to an increase in the number of tax adjustments proposed on multinational enterprises. Correspondingly, the number of double-tax cases before competent authorities will likely rise, and additional pressure will be brought to bear on our mutual agreement procedures.

At a meeting of the CFA in June 2012, several countries expressed support for a multilateral project that would focus on MAP improvements to help mitigate the problem. There was also consensus at that CFA meeting that the most appropriate body for a MAP project would be the FTA. So to follow up, the United States took lead in designing and proposing the project to FTA, and I'm pleased to say it was approved by the FTA Bureau just prior to the Moscow meeting.

Now let me describe what the MAP project entails. First, the Bureau agreed to establish a subsidiary body of the FTA, comprised of competent authorities (CAs) with responsibility for MAP in their respective jurisdictions. In the new forum, the CAs themselves will engage on matters affecting the overall efficiency of the mutual agreement procedures. It's also been agreed that the preferred way to adopting consensus goals is for the MAP CAs to develop, and work in accordance with, a forward-looking strategic plan containing specific commitments and milestones.

Although the strategic plan is not yet written, based on our preliminary conversations, it will likely focus on number of fundamental systemic issues, if you will. Let me provide you with a few examples:

First we have resources: It's very important that MAP functions be allocated budget and hiring authority to ensure that resources are sufficient to meet workload demands. A number of countries are clearly understaffed in this area and expectations are that the new forum will discuss normative MAP staffing levels, common approaches to training, and other resource issues, and then recommend implementation strategies as appropriate.

Second is empowerment: That is, it's critical that all CAs be fully empowered to reach a principled resolution in every MAP case. The authority of CAs to resolve cases comes directly from bilateral treaties signed by ministers and ratified by legislators. Yet, in some countries, empowerment of the CA function seems impaired by its position within the tax administration, or by other factors such as performance metrics or revenue-collection goals. These factors can seriously impede the authority of a CA to reach fair, principled, and swift solutions, or to reach resolution at all. Although this is a somewhat sensitive area, expectations are that the new MAP forum will explore these issues and make recommendations to the extent appropriate.

Third is relationships and posture: The success of the mutual agreement procedures depends on strong CA relationships founded on mutual trust; in turn, trust engenders an environment of cooperative productivity in which CA representatives are postured to reach resolution at the MAP table. While the very existence of the new MAP forum should help with the trust factor, I think we may see the forum addressing relationship-building ideas and exploring whether we can agree on the appropriate posture at the MAP table – in other words, should MAP staff be engaged in tough negotiations to identify the winner and the loser, or should MAP staff be working together to find the appropriate principled resolution with a goal of mutual satisfaction?

Last, but not least, is procedural enhancement and innovation: The new forum will provide us with a venue for identifying enhancements in a number of procedural areas including – whether our respective internal processes can be improved; whether we can agree to protocols for elevating difficult cases; whether there are ways to better manage the taxpayer's involvement in MAP resolution; whether we can accelerate issue resolution by, for example, finding ways to favor advance pricing agreements over post-adjustment MAP cases and ways to “roll forward” post-adjustment resolutions to cover future years; whether we can advance development of multilateral case procedures and establish a comfort level with multilateral processes; whether we can establish generally applicable approaches that can be captured in bilateral or multilateral MOUs; and last, and I think very importantly, whether our MAP programs are sufficiently aligned with our respective examination programs in terms of position development, MAP access, and global awareness.

Now, by way of an aside, let me point out one other MAP dynamic that I personally believe warrants some discussion, if not in the new forum, then elsewhere. And that's the extent to which MAP resolutions should bring to bear new or expanding policy considerations, or considerations raised at political levels. I suggest that tax administrators dealing with even cross-border matters need to be quite cautious and circumspect about this. To illustrate my point, let's consider a hypothetical. Let's assume that Country X seeks to appropriately tax non-resident companies based on profits earned at source, and let's further

assume that the cost of labor in Country X is low relatively speaking. Now, if examinations in Country X lead to a number of transfer pricing adjustments not very well supported based on accepted principles, to what extent should Country X's competent authority defend these adjustments by invoking arguments based on notional concepts of location savings, perhaps in combination with references to ill-defined intangibles, to support the positions of Country X's examination function? Or, to what extent should Country X's competent authority deviate from previously accepted principles to respond to pressures to generate more revenue, or to respond to general saber rattling about tax avoidance? As I said, I believe these questions need to be discussed. In my view, competent authorities attempting to resolve years-old cases have an obligation to apply objectively the law as it was at that time, not the law as they might like it to be, or that policymakers suggest it might be going forward. And, as we work to respond to the current debate, or as we engage in the future tax policy discussion Pascal announced yesterday, I hope we take time out to say clearly that, until we agree on new principles, the existing principles are the ones tax administrators should resort to and rely on, particularly in dealing with cases from years ago.

To come back to finish my discussion of FTA's new MAP forum, I should point out that the FTA Bureau determined that membership in the forum should be open to the MAP CAs in all FTA-member countries. We do hope and expect, however, that any participating CA will commit to act in accordance with the strategic plan as adopted by the group and will attend MAP forum meetings to discuss its progress. We think the CAs participating in the forum must be willing to work to make improvements and must be willing to be accountable for the success or failure of the mutual agreement procedures.

So these examples – enhanced exchange and analysis of data on offshore holdings and the FTA project to enhance MAP – are just two examples of ways in which I see tax administrations being drawn more closely together. Further, I'll note that working together to align both EOI and MAP procedures and practices should pay substantial dividends in another important respect. That is, these types of very real and practical efforts could well lead to better understanding of the compliance problems themselves. International tax matters are indeed complex, and in attempting to address them, it's important not to over-react or to lean too heavily on what I sometimes call a top-down approach. It's easy – in fact far too easy – to assume, for example, that if businesses are lowering their effective tax rates, they must all be engaged in overly aggressive tax planning in every possible way. And it's easy – again, far too easy – to assume, for example, that if transfer pricing principles are not adequate to achieve appropriate results in some cases, then they aren't at all adequate, and are necessarily being abused, in all contexts. I submit that broad assumptions like these make matters worse for tax administrators rather than better, as they flail about attempting to take aggressive measures that in the end cannot possibly be effective because they're poorly grounded and in the end can only mean losing sight of real compliance risk in a chaotic environment.

Let's go back to my Country X example to emphasize this point. Let's assume that Country X hears about the BEPS project and quickly concludes that all multinational businesses are avoiding taxes through transfer pricing; so they ratchet up their transfer pricing examinations and, in the name of preventing base erosion, make adjustments on inbound companies regardless of the companies' investment structure. Let's also assume that many of

these companies invest into Country X directly from countries with higher tax rates than Country X. Now, if Country X's competent authority is wont to defend the positions of its examination function based on ill-defined policies, he or she will have even more to work with – location savings plus anti-BEPS policies if you will – and the problem is exacerbated. But put the practices of the competent authority aside. Even without such considerations, the situation is problematic because Country X's tax administration has conducted a very poor sort of top-down risk assessment. Thinking it has taken action against BEPS, and maybe even patting itself on the back for it, in fact, Country X has merely mounted an attack on the tax base of its treaty partners and left the problem for the competent authorities to sort out.

This type of situation must be avoided and, in my opinion, can only be avoided if tax administrators are willing, and able, to discuss compliance risk together. This means they must evaluate risk from a global perspective and take into account the specific transactions that present that risk. This approach I often refer to as bottom-up risk assessment. As tax administrators, we must look at particular situations and be clear as to what problems they raise; we must not, and cannot successfully, depict a compliance strategy by painting with a broad brush. Moreover, if we don't discuss risk early and together, we'll impede our ability to ever effectively identify real risk, because we'll spend far too much time squabbling amidst the chaos of what essentially amounts to a war over revenue.

Personally, I see coordinated, intelligent global risk assessment as the frontier of effective international tax administration. I believe tax administrations need to identify tax risk clearly, focus on this risk multilaterally, and be transparent about these assessments. And, as I indicated earlier, global compliance risk management obviously is of keen concern to both tax administrators and taxpayers. So bringing these respective analyses together in a transparent dialogue involving both governments and taxpayers is critical, as is recognized by the FTA's cooperative compliance report, as I already mentioned.

Let me end by reading a very short passage from the FTA cooperative compliance report, one that defines "proportionality," which is one of the five pillars, my favorite in fact.

*Proportionality* is all about the choices revenue bodies make in allocating resources, deciding which taxpayers, which tax returns and which tax issues to prioritize bearing in mind the overall revenue consequences. Risk management is an essential tool for revenue bodies that want to ensure and efficient allocation of resources.

Now, I know that this seems like a terribly mundane definition, but to me there's an awful lot packed in there. It's perhaps obvious that revenue bodies are making choices about allocating resources every day, but what isn't so obvious is just how difficult this is to do well, and therein lies the rub.

Thank you for your attention. I hope you enjoy the rest of the conference and I look forward to working with all of you in the future to improve international tax administration.