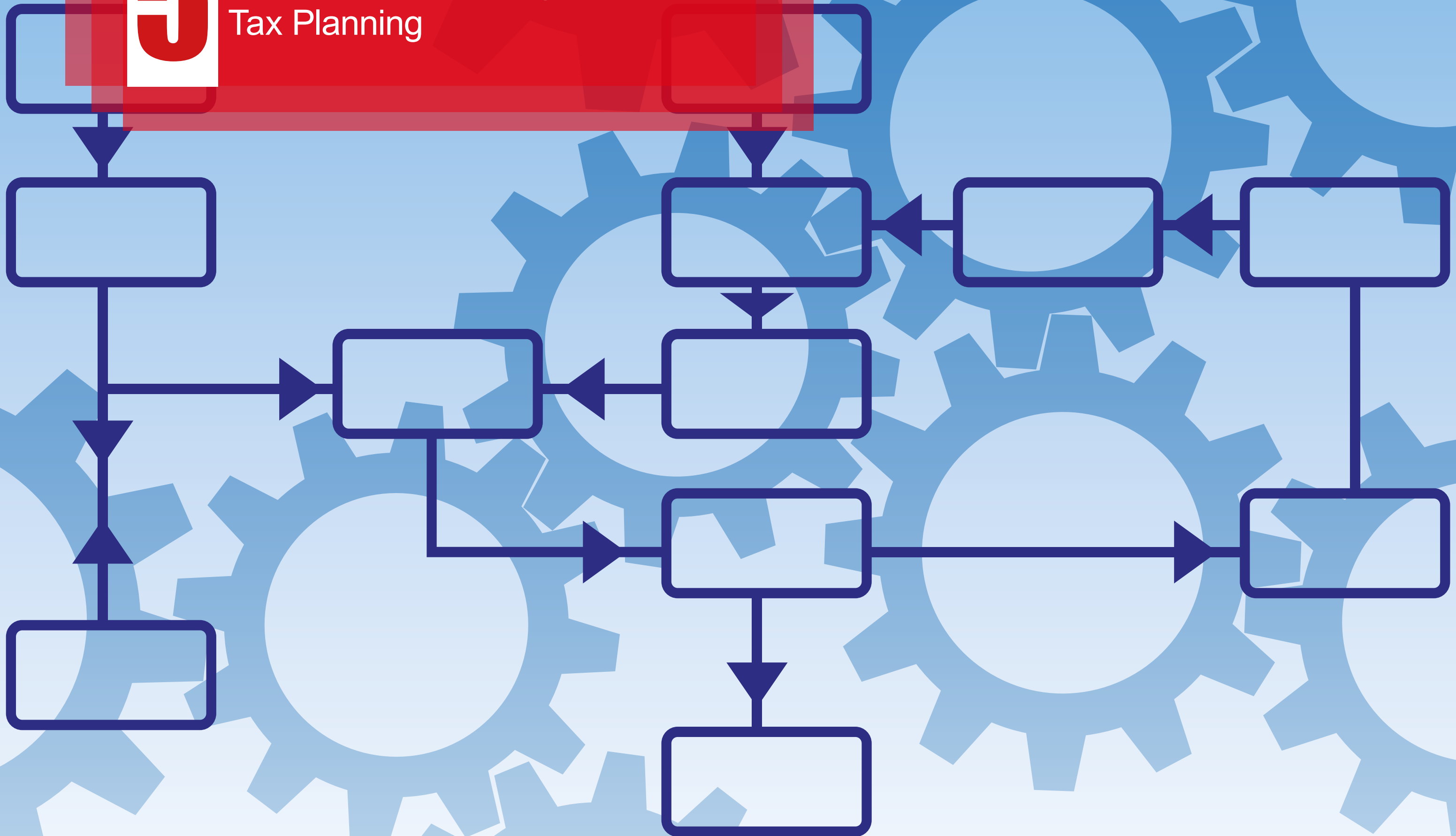
Manual for the Control of International Tax Planning

5 Tools for Combatting International Tax Planning



5.4. Initiatives regarding corporate responsibility and fiscal governance

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5.4. Initiatives regarding corporate responsibility and fiscal governance

IRS

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Internal Revenue Service

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Glossary

APA	Advanced Pricing Agreement
CAP	Compliance Assurance Process
CEO	Chief Executive Officer
CIAT	Inter-American Center of Tax Administrations
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CRA	Canada Revenue Agency
TCF	Tax Control Framework
IRC	Internal Revenue Code
ICF	Internal Control Framework
U.S.	United States
MNE	Multinational Enterprises
FTA	Forum on Tax Administration
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
LB&I	Large Business and International Division
IRS	United States Internal Revenue Service
MITT	Material Intercompany Transactions Template
MOU	Memorandum of Understanding
OTSA	Office of Tax Shelter Analysis
OECD	Organization for Economic Cooperation and Development
PFA	Pre-Filing Agreement
SEC	Securities and Exchange Commission
UTP	Uncertain Tax Position

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5 Tools for Combating International Tax Planning

5.4. Initiatives Regarding Corporate Social Responsibility

5.4.1. Introduction: developing support for responsible tax governance

This chapter focuses on corporate governance initiatives and their link to appropriate tax compliance actions. While tax laws vary by country, each country should recognize the importance of corporate governance in determining whether a corporation is in compliance with all tax provisions.[1] The general requirements of appropriate internal controls, transparency and communication should form part of every corporation's effective tax governance program and should be considered by tax authorities as part of their examination function.

5.4.1.1. Related actions of the Forum on Tax Administration of the Organisation for Economic Cooperation and Development (OECD)

In 2006, members of the Forum on Tax Administration (FTA)[2] met in Seoul, South Korea, to share concerns and experiences with tax challenges. The declaration following that meeting acknowledged that the core activity of every revenue body is the effective administration and implementation of the tax laws, which means collecting the tax legally due under domestic legislation while fully respecting the rights of taxpayers.[3] The declaration also noted continued concerns about corporate governance and the role of tax advisors and financial and other institutions in relation to non-compliance and the promotion of unacceptable tax minimization arrangements. The declaration suggested that responses to these challenges by national revenue bodies could include encouraging top management and audit committees of large enterprises (for example, Chief Executive Officers (CEOs) and boards of directors) to take greater interest in, and responsibility for, their tax strategies.

A Study Team comprised of Her Majesty's Revenue and Customs in the United Kingdom and the OECD Secretariat, working closely with a core group of twelve additional countries, prepared a *Study into the Role of Tax Intermediaries*[4] (Study) that was considered by the FTA at its next meeting in South Africa in early 2008. Following the meeting in South Africa, the FTA issued a Communiqué[5] in which it noted the importance of corporate taxpayers engaging in an enhanced relationship with revenue bodies based on co-operation and trust.[6] Taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs. In addition, the Communiqué noted the work

in progress to explore opportunities for the application of the OECD's Principles of Corporate Governance to the area of taxation.

In July 2009, the FTA issued an Information Note on *Corporate governance and tax risk management*.[7] Corporate boards are accountable to their shareholders for ensuring appropriate corporate governance practices.[8] Good corporate governance is fundamental to good business.[9] How a large business manages tax risk can affect its financial performance and reputation. Both the CEOs and boards of directors of large businesses are increasingly considering tax risk management as part of their overall corporate governance.[10] Surveys by accounting firms found that senior executives are increasingly looking for better insights into tax because of its potential material impact on financial statements; the tax function can no longer focus solely on tax compliance and managing the effective tax rate. CEOs and boards are asking more complex questions about how their organization manages its tax risk exposure.[11]

In April 2010, the FTA issued an Information Note on *Tax Compliance and Tax Accounting Systems*.[12] The note indicated that, due to regulatory requirements and the demands of shareholders, modern businesses need to have in place an Internal Control Framework (ICF). These frameworks enable businesses to ensure that their operating, financial and compliance objectives are met and provide for the proper management of risk.[13] If a taxpayer is "in control," they should be in a position to detect, document and report any relevant tax risks to the revenue body, provided that specific tax requirements, sometimes described as a Tax Control Framework (TCF), are incorporated into the ICF. A TCF focuses on the internal control of tax processes.[14] If the taxpayer is in a position to detect and report any meaningful risk to the revenue body, the role of the revenue body can change to assessing the monitoring system of the taxpayer itself, rather than intrusive auditing.[15]

5.4.1.2. The OECD/G20 Principles of Corporate Governance

The OECD first issued Principles of Corporate Governance in 1999.[16] The current version of Principles of Corporate Governance, issued jointly by the OECD and non-OECD members of the G20 in 2015,[17] discusses the responsibility of the board of directors as part of overall corporate governance[18] and states, "The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board [of directors], and the board's accountability to the company and the shareholders."[19] The board not only is accountable to the company and its shareholders but also has a duty to act in their best interests.[20]

In addition to its responsibility to guide corporate strategy, the board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation.[21] Another important board responsibility is to oversee the risk management system and systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labor, environmental, equal opportunity, health and safety laws.[22] The board helps to set the ethical tone of the company and should apply high ethical standards.[23]

To make the objectives of the board clear and operational, many companies have found it useful to develop company codes of conduct based on guidance such as professional standards or broader codes of behavior and to communicate them throughout the organization.[24] Their actions

could include a voluntary commitment by the company (including its subsidiaries) to comply with the OECD Guidelines for Multinational Enterprises (discussed next).[25]

An additional responsibility of the board is to ensure the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control and compliance with the law and relevant standards.[26] In some countries, companies have found it useful to explicitly articulate the responsibilities that the board assumes and those for which management is accountable.[27]

5.4.1.3. The OECD Guidelines for Multinational Enterprises

The OECD first adopted its Guidelines for Multinational Enterprises (Guidelines) in 1976 as part of the Declaration on International Investment and Multinational Enterprises (MNE).[28] Last updated in 2011,[29] the Guidelines provide a multilaterally agreed and comprehensive code of responsible business conduct that governments have committed to promoting.[30] The common aim of the governments adhering to the Guidelines is to encourage the positive contributions that MNEs can make to economic, environmental and social progress and to minimize the difficulties to which their various operations may give rise.[31]

Observance of the Guidelines is voluntary and not legally enforceable.[32] It also should be emphasized that the Guidelines are not a substitute for, nor should they be considered to override, domestic law and regulation.[33]

In the area of taxation, the Guidelines state the importance of MNEs contributing to the public finances of host countries by making timely payment of their tax liabilities.[34] Tax compliance includes such measures as providing to the relevant authorities timely information that is relevant or required by law for purposes of the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.[35] Enterprises should treat tax governance and tax compliance as important elements of their oversight and broader risk management systems.[36] Corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated.[37]

The commitment by MNEs to co-operation, transparency and tax compliance should be reflected in risk management systems, structures and policies.[38] For corporations, the corporate board is in a position to oversee tax risk in a number of ways. The corporate board should proactively develop appropriate tax policy principles as well as establish internal tax control systems so that the actions of management are consistent with the views of the board with regard to tax risk. The board should be informed about all potentially material tax risks, and responsibility should be assigned for performing internal tax control functions and reporting to the board. A comprehensive risk management strategy that includes tax will allow the enterprise not only to act as a good corporate citizen but also to effectively manage tax risk, which can serve to avoid major financial, regulatory and reputation risk for an enterprise.[39]

5.4.1.4. Inter-American Center of Tax Administrations (CIAT)

CIAT hosts a General Assembly meeting every year where members, associate members and other interested countries and international organizations meet to exchange experiences, discuss and analyze a specific international topic related to issues and challenges of tax administrations.[40] As part of this process, the administrative session of the General Assembly integrated by the CIAT member countries issues a resolution that focuses on the topics and subtopics of that year's program.[41] Member countries and special guests make presentations supporting the identified topics.

In 2011, the topic for the General Assembly was "Tax Morale as Determining Factor in Improving the Effectiveness of the Tax Administration."[42] Two subtopics of discussion were tax morale and taxpayer behavior and the consideration of strategies and mechanism to promote tax morale as a factor in improving voluntary compliance. Presentations relating to taxpayer behavior included Creating taxpayer awareness: Corporate social responsibility and the forums for taxpayer – tax administration dialogue.[43] The presentation from the European Union took note of the benefits from the increasing transparency and voluntary disclosure of information as well as the importance of internal control frameworks; some EU Member States require that the taxpayer develop a tax control framework that forms part of its internal control system.[44]

In 2016, the topic for the General Assembly "Past, Present and Future of the Tax Administration."[45] Presentations during this meeting included a discussion of increased transparency through programs such as compliance with the Foreign Account Tax Compliance Act in the United States[46], compliance with Automatic Exchange of Information through the Common Reporting Standard[47] in much of the rest of the world, and consideration of the fifteen actions identified in the Base Erosion and Profit Shifting project of the OECD.[48]

5.4.2. Corporate governance and tax risk management: a United States (U.S.) example

The following discussion focusses on the experience of the U.S. Internal Revenue Service (IRS) with respect to internal tax governance of taxpayers, in particular of corporations. While there are no federal rules requiring a specific tax governance for businesses, the IRS has taken actions in certain areas that offer a sense of what good internal tax governance involves and how it is linked to appropriate tax risk management. Corporations demonstrate adherence to an appropriate level of tax governance in ways that include maintaining appropriate internal controls and providing effective transparency and communication.

This discussion reviews IRS initiatives designed to confirm that corporations are complying with federal tax laws and that the corporate governance structure ensures that tax compliance activities are appropriate. These examples can be used or modified by any jurisdiction to implement good corporate tax governance or administer existing rules.

5.4.2.1. Establishing internal controls

5.4.2.1.1. The development of internal governance provisions in the United States

In the early 2000's, there were a number of well-publicized financial breakdowns of large and seemingly financially sound corporations. Enron Corporation, which Fortune Magazine had named "America's most innovative company" from 1996 through 2001, declared bankruptcy at the end of 2001 after many financial irregularities were discovered. Enron had hidden liabilities by recording them in offshore entities that were not required to be recorded in Enron's U.S. accounting records; in addition, the review of its financial records was not substantial.[49] WorldCom declared bankruptcy in 2002. Its financial irregularities came from underreporting expenses and overreporting revenues, all accomplished with the knowledge and encouragement of upper management.[50] Tyco Corporation was substantially reorganized because of financial troubles resulting from financial irresponsibility. It inflated its operating income and established improper reserves, again with the irregularities known at the highest operating levels.[51]

One result of the disclosure of these financial irregularities was the enactment of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), passed in part to improve corporate governance.[52] Sarbanes-Oxley requires enhanced financial disclosures that reduced questionable items on financial statements and expanded the requirements for corporate governance. It relies on corporate transparency and a sharing of information. Section 404(a) of Sarbanes-Oxley provides that the Securities and Exchange Commission (SEC) shall prescribe rules requiring certain annual reports required by the Securities Exchange Act of 1934[53] to contain an internal control report, which shall (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting;[54] and (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.[55]

The SEC provided guidance to implement requirements of section 404(a).[56] For example, management must disclose any material weakness.[57] It will be unable to conclude that the company's internal control over financial reporting is effective if there are one or more material weaknesses in such control.

In 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes.[58] FIN 48 became effective for fiscal years beginning after December 15, 2006. FIN 48 was superseded when it was codified in Accounting Standards Code 740-10, although the term is still used. Accounting Standards Code 740-10 is intended to eliminate inconsistency in accounting for uncertain tax positions in financial statements certified in accordance with U.S. Generally Accepted Accounting Principles (GAAP). FIN 48 mandated new rules for recognition, derecognition, measurement and disclosure of all tax positions. A business may recognize an income tax benefit only if it is more likely than not that the benefit will be sustained. The amount of benefit recognized is based on relative probable outcomes.[59] As a result, it is important for businesses to know as soon as possible whether the specific tax treatment of any item will be acceptable to the IRS so that the appropriate financial reserves are booked.

5.4.2.1.2. Tax governance considerations by the Internal Revenue Service

The Internal Revenue Code (IRC) does not include provisions requiring taxpayers to provide specific information about their governance, management or disclosure policies. Nevertheless, the IRS considers that such policies and procedures generally improve tax compliance.[60] Companies that maintain the appropriate internal control structure required by Sarbanes-Oxley and FASB should have a structure that lends itself to an appropriate internal tax governance. Even entities that are not subject to Sarbanes-Oxley can develop an internal tax governance structure that is based on its requirements. Having an appropriate internal tax governance structure may help a taxpayer more easily identify any type of transaction that could be considered to be part of a tax planning structure and ensure that these transactions are not inappropriate and possibly subject to a challenge by the IRS that could affect the taxes recorded in the taxpayer's accounting records.

The IRS has considered tax governance in two situations. Although these are only two examples, these situations show what actions the IRS may consider important in demonstrating that a taxpayer has appropriate tax governance. The first example applies to the small set of public companies that participate in a real-time tax examination process in a cooperative environment and the second example applies to non-profit organizations.

5.4.2.1.2.1. Governance of companies participating in the Compliance Assurance Process

In 2005, the IRS implemented the Compliance Assurance Process (CAP) as a pilot program to determine if a real-time dialogue with taxpayers before a return is filed could improve the tax compliance process. Beginning with nine participants in 2005, the program expanded and has been modified over time. It is now a permanent part of the IRS' portfolio of examination options.[61] The IRS permits qualifying large taxpayers with a history of following good accounting and tax practices to participate in CAP. The Large Business and International (LB&I) Division developed CAP to improve the federal tax compliance of large corporate taxpayers. CAP employs real-time issue resolution tools and techniques. In CAP, the IRS and taxpayer work contemporaneously to achieve federal tax compliance by resolving issues prior to the filing of a tax return. Successful conclusion of CAP allows the IRS to achieve an acceptable level of assurance regarding the accuracy of the taxpayer's filed tax return and to substantially shorten the length of the post-filing examination.[62]

A corporation must apply in each year it wishes to participate in CAP.[63] As part of the application process, the company must complete Form 14234-D, Tax Control Framework Questionnaire.[64] This questionnaire provides the IRS with an understanding of the company's tax governance processes and the system of internal controls that ensure the accuracy and completeness of the company's federal income tax returns, information reporting, tax reporting data and other tax-related disclosures.[65] The corporation must provide sufficient detail in each response to provide the IRS with a clear picture of the company's controls related to tax returns and disclosures.

The IRS first requested completion of the Tax Control Framework Questionnaire for the 2020 CAP year.[66] For the 2021 CAP year, the IRS requires completion of Form 14234-D only by new applicants.[67] A returning taxpayer will have to provide an updated questionnaire if there are material changes since the questionnaire was last completed or if there have been material changes to the taxpayer's tax function, such as a major reorganization, an acquisition or the outsourcing of any part of its tax function.[68]

The use of this type of questionnaire conforms to the FTA suggestion that:

> *"The use of an internal control framework for tax will ensure that a taxpayer has an ongoing and up-to-date view of its tax position and can provide the revenue body with reliable tax information. It will also demonstrate a willingness to deal transparently with revenue bodies who should reciprocate by providing increased and timely tax certainty."*[69]

The Tax Control Framework Questionnaire identifies four main areas that help to provide a picture of a corporation's tax governance procedures.

1. Internal controls.
2. Process for tax risk management.
3. Whether any certifications required under Sarbanes-Oxley assess the effectiveness of the internal controls or the process for tax risk management.
4. Whether external auditors test the internal control framework for tax matters.

In its announcement about the application process for CAP for 2021, the IRS noted that the responses to the Tax Control Framework Questionnaire for the 2020 CAP year were very helpful in providing a full picture of the range of tax controls across the CAP taxpayer population.[70] A review of the information requested on the Tax Control Framework Questionnaire shows how similar it is to the steps that management of a public company follow to demonstrate that it complies with its responsibilities under section 404(a) of Sarbanes-Oxley.

The Interpretive Guidance issued by the SEC in 2007 is organized around two broad principles. First, management should evaluate whether it has implemented controls that adequately address the risk that a material misstatement of the financial statements would not be prevented or detected in a timely manner. The Guidance describes a top-down, risk-based approach to this principle, including the role of entity-level controls[71] in assessing financial reporting risks and the adequacy of controls. The Guidance promotes efficiency by allowing management to focus on those controls that are needed to adequately address the risk of a material misstatement of its financial statements. Second, management's evaluation of evidence about the operation of its controls should be based on its assessment of risk. The Guidance provides an approach for making risk-based judgments about the evidence needed for the evaluation. This allows management to align the nature and extent of its evaluation procedures with those areas of

financial reporting that pose the highest risks to reliable financial reporting (that is, whether the financial statements are materially accurate).[72]

5.4.2.1.2.1.1. Internal controls

The IRS asks for a description of the internal controls that the organization has established and maintained to ensure the accuracy, completeness and reliability of the applicant's tax returns and disclosures.

Internal control helps an entity run its operations efficiently and effectively, report reliable information about its operations, and comply with applicable laws and regulations.[73] Within the U.S. federal government, internal control is defined as:

> *"a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved."*[74]

These objectives and related risks can be broadly classified into one or more of the following three categories:

- Operations: Effectiveness and efficiency of operations.
- Reporting: Reliability of reporting for internal and external use.
- Compliance: Compliance with applicable laws and regulations.[75]

For purposes of the management assessment under section 404(a) of Sarbanes-Oxley, the term "internal control over financial reporting" is defined as:

> *"a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles…"*[76]

While no specific individual is required to provide this executive-level review, the assessment of internal control must be performed at a high-enough level of management to ensure the appropriate level of assurance in the integrity of the internal control.[77]

The FTA identified five elements of a business's appropriate internal control framework: risk assessment, control environment, control activities, information and communication and monitoring.[78] The FTA relied on guidance provided by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), which continues to use these five elements as well as the three major categories of Operations, Reporting and Compliance used in the Standards for Internal Control in the Federal Government.[79]

If weaknesses are identified, it is not enough to disclose these weaknesses in an SEC report; companies should take steps to strengthen its processes so that these weaknesses are eliminated. The SEC recently stated that:

> *"Adequate internal controls are the first line of defense in detecting and preventing material errors or fraud in financial reporting…When internal control deficiencies are left unaddressed, financial reporting quality can suffer."*[80]

A company may have to retain an outside consultant to ensure remediation of the material weaknesses.

5.4.2.1.2.1.2. Tax risk management

The IRS asks for a description of the taxpayer's process for tax risk management, specifically the processes that are used to identify, monitor, prevent and manage risks arising from tax.

The FTA defines tax risk as uncertainty about the interpretation of tax law in relation to particular transactions and the business's view about whether a tax administration could have a different view to its own or the view of its advisors.[81]

There is no requirement that book and tax accounting be identical. In fact, book and tax accounting provisions may differ for many reasons. However, it is important for businesses to understand why the differences arise, the amount of the difference and how likely it is that the tax position will be sustained after a challenge by the IRS. This information helps the company determine whether it is "more likely than not that the benefit will be sustained" in order to recognize the income tax benefit for accounting purposes.[82]

Corporations, as directed by their tax departments and the board of directors and/or upper management, need to ensure that they comply with their tax responsibilities. A good tax risk management process supports this work. The IRS looks for information from the corporation about its process to manage tax risks. For example, the IRS asks for specific information on Form 14234-D to help it determine whether the corporation's tax control framework is appropriate.

As discussed later, corporations that do not report accurate information on tax returns or that fail to file tax forms that they should file may be subject to penalties.[83] These penalties are not deductible for federal income tax purposes.[84] In addition, corporations that file the reports discussed above with the SEC must report certain tax penalties in these SEC reports.[85] The appropriate corporate officers should ensure that they are well-informed about tax return filing and reporting requirements both to minimize the payment of any non-deductible penalties and to eliminate the need to include information in SEC reports.

5.4.2.1.2.1.2.1. Processes to identify and manage tax risks

The IRS asks for information about the processes that the corporation uses to identify, monitor, prevent and manage risks arising from tax. For example, does the chief tax officer (or an equivalent officer) make periodic presentations to the board of directors or one of its designated

committees? Such presentations help inform the board or designated committee about tax risks to prompt appropriate discussions and further investigations, if necessary.

A chief tax officer (or equivalent) who manages tax risks should have a thorough knowledge of any ongoing IRS investigations of the corporation. For example, LB&I has developed Campaigns as a way of identifying issues that may require additional review. Some of these Campaigns may result in the imposition of taxes as well as penalties. A good tax risk management process should identify whether the corporation has engaged in any activity described in a Campaign. If so, the process should help identify any possible problems with the Campaign and ensure that the corporation is taking appropriate steps to address the risks.

5.4.2.1.2.1.2.1.1. LB&I Campaigns

In 2017, LB&I launched its "Campaign process" of examinations.[86] The launch of Campaigns was the culmination of an extensive effort to redefine compliance work and build a supportive infrastructure. The Campaign program allows LB&I to address significant compliance and resource challenges. These Campaigns were identified through LB&I extensive data analysis, suggestions from IRS compliance employees and feedback from the tax community. LB&I's goal is to improve return selection, identify issues representing a risk of non-compliance and make the greatest use of limited resources.

Tax risk officers or other appropriate officials in management should have a thorough knowledge of the status of LB&I Campaigns and the possible exposure of the company to examinations focused on one or more of these Campaigns.

5.4.2.1.2.1.2.2. Guidance on the level of acceptable tax risk

Each company determines its own level of acceptable tax risk. The level of acceptable risk may vary because of the amount of tax involved (for example, a tax liability of $5,000 may be less risky than a tax liability of $5 million) or the complexity of the transaction (the purchase of the shares of a small company may be less risky than a reorganization of many entities that involve several foreign countries and intangibles). If the tax risk is considered low, the board of directors may not require any due diligence other than what the tax department performed. If the tax risk is high or the amount of the tax is significant, the board of directors may require the corporate to obtain one or more opinions from outside attorneys and/or accountants to assess the transaction more thoroughly. The IRS asks for information about any guidance that the board of directors may have provided to management and the tax department as to the level of tax risk that is deemed acceptable by the company. If the board does not provide such guidance, then what does inform the company's acceptable level of tax and tax related risks? If there has been no guidance provided, that may indicate to the IRS that the corporation is not exercising appropriate due diligence with respect to the taxes.

5.4.2.1.2.1.2.3. Policies and procedures for material transactions

The IRS asks whether the company has in place policies and procedures for proper and timely elevation to the board, as well as sign-off procedures, for material transactions.

For CAP purposes, a material issue is defined as any recurring or repeating issue that has a change exceeding the materiality thresholds, or any new issue that exceeds the materiality thresholds, or any other issue that is required to be reserved or reported on Schedule UTP (Form 1120), Uncertain Tax Position Statement.[87] An “issue” is a completed business transaction, a change in accounting method or any other item that impacts the federal income tax liability.[88]

The IRS has developed Form 14234-B, Material Intercompany Transactions Template (MITT), as part of the CAP application process.[89] This form is used by the IRS for risk assessment purposes to review material cross-border transactions between the taxpayer and foreign related parties. The IRS will consider the information in the MITT (along with other information) when determining the transfer pricing compliance risks associated with the taxpayer’s cross border-controlled transactions. For this purpose, a material intercompany transaction is defined as a new or recurring intercompany transaction for which the amount reported for tax purposes and listed on the MITT is greater than the last agreed upon permanent materiality threshold.

5.4.2.1.2.1.2.4. Materiality threshold

The IRS also asks for information about the company’s materiality threshold and how it is established. Materiality thresholds are used in CAP to help the taxpayer know which issues should be disclosed and reviewed.[90] They are not relevant to the adjustments that may be made regarding the tax consequences of such issues, however. Adjustments to issues may be made that are below the relevant materiality thresholds. Some items may be considered significant enough for a compliance review regardless of the materiality threshold or when or how they are identified.[91] Establishing materiality thresholds by the tax officer or board of directors for companies other than CAP participants may help other taxpayers identify at the outset what level of tax risk they consider worth further investigation.

The FTA has noted that the concept of materiality is often discussed in financial reporting frameworks in the context of the preparation and presentation of financial statements. These frameworks generally explain that:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.
- Judgments about materiality are made considering surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.
- Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.[92]

Just as the IRS has no specific threshold for materiality that applies to all its taxpayers in the CAP program, materiality will vary across countries and types of tax. Revenue bodies need to consider the level of transparency about the risks that they would consider as material and therefore meaningful. This could include discussions between the taxpayer and the revenue body over what risks are material.[93]

5.4.2.1.2.1.2.5. Material weakness or financial restatement related to tax matters

The IRS asks for information about material weaknesses or financial restatements. If the company has reported a material weakness or financial restatement related to tax matters in the previous three years, the taxpayer needs to explain it. As discussed earlier, as part of the assessment required by section 404(a) of Sarbanes-Oxley, management must maintain an adequate internal control structure and assess it. Part of this assessment includes a review of material weaknesses and how management responds to them. In 2016, tax accounting was the second leading cause of financial restatements; ninety-eight percent of financial restatements were tax related; and almost sixty percent of reported tax material weaknesses were attributed to insufficient tax accounting expertise, insufficient review and lack of general procedures.[94]

The SEC has issued interpretive guidance for management regarding its obligation to assess the effectiveness of the internal control structure and procedures for financial reporting.[95] The guidance sets forth an approach by which management can conduct a top-down, risk-based evaluation of internal control over financial reporting. An evaluation that complies with this interpretive guidance is one way to satisfy the evaluation requirements for the application of section 404(a) of Sarbanes-Oxley.[96]

Smaller public companies, which generally have less complex internal control systems than larger public companies, can use the guidance to scale and tailor their evaluation methods and procedures to fit their own facts and circumstances. That will help even smaller public companies to conduct an evaluation of internal controls for financial reporting that is both efficient and effective at identifying material weaknesses.[97] Similar provisions can apply to any corporation.

Failing to remediate material weaknesses is a sign of poor internal control.[98]

5.4.2.1.2.1.2.6. Internal audit and the tax function

The IRS asks whether the company's internal audit function is involved in reviewing the tax function and/or tax issues and, if so, whether any significant deficiencies have been discovered in the previous three years. Having internal auditors review a company's tax function provides one more level of review.

5.4.2.1.2.1.2.7 Outsourcing tax functions

The IRS asks whether the company outsources any of its tax function and, if so, what processes and controls are in place for managing risks related to outsourcing any of these functions to an entity outside the company. Outsourced compliance can offer companies benefits such as having more time and resources to focus on planning, risk management and better reporting.[99]

However, outsourcing tax functions could affect the reliability of the tax return information unless the taxpayer exercises a sufficient level of control and supervision over the outsourced activities. While there is nothing to prohibit outsourcing of tax functions, it is simply another factor that may affect the quality of a company's tax governance structure.[100]

Other examples of taxpayer actions that show that taxpayers are demonstrating appropriate tax risk management are discussed below as examples of transparency and cooperation.

5.4.2.1.2.1.2.8. Self-identification of areas of possible tax risk

As part of the tax return process, the IRS requires taxpayers to file relevant forms to identify areas where the IRS may wish to focus its attention. In addition, an internal review of the information on these forms, as well as an internal discussion of the need to file the forms, may help a company assess the quality of its tax control function and could be considered part of the due diligence involved with its tax risk management.

5.4.2.1.2.1.2.8.1. Schedule M-3, Net Income (Loss) Reconciliation

A company may record different book and tax accounting treatment of items. To improve its ability to identify these differences quickly, the IRS requires certain taxpayers to reconcile book and tax differences. For example, the IRS requires large corporations to file Schedule M-3 (Form 1120), Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More.[101] Taxpayers use Schedule M-3 (Form 1120) to reconcile the financial statement net income or loss for the corporation (or consolidated financial statement group, if applicable) to net income or loss of the corporation for U.S. taxable income purposes.[102]

Versions of Schedule M-3 also must be filed by certain partnerships (Schedule M-3 (Form 1065)), foreign corporations (Schedule M-3 (Form 1120-F)), U.S. life insurance companies (Schedule M-3 (Form1120-L)), U.S. property and casualty insurance companies (Schedule M-3 (Form 1120)) and S corporations[103] (Schedule M-3 (Form 1120-S)) with total assets of $10 million or more.

The goal of the Schedule M-3 reconciliation is to increase taxpayer transparency about adjustments made to financial statements when the taxpayer prepares its tax return. This helps the IRS determine whether tax compliance risk is present and assists with the selection of returns and issues for audit.[104]

5.4.2.1.2.1.2.8.2. Form 8886, Reportable Transactions

Form 8886, Reportable Transaction Disclosure Statement,[105] applies to any taxpayer, including an individual, trust, estate, partnership, S corporation or other corporation, that participates in a reportable transaction and is required to file a federal income tax return or information return.[106] The following broad categories of "reportable transactions" are identified on Form 8886.

- Listed transactions
- Confidential transactions
- Transactions with contractual protection
- Loss transactions
- Transactions of interest

These transactions are defined in more detail in the Instructions to Form 8886, which include references to notices, regulations and other guidance defining the terms.[107] Form 8886 provides information needed to evaluate potentially abusive transactions, such as identified tax shelter transactions.[108] The taxpayer reports the amount and nature of the expected tax treatment and expected tax benefits, the total dollar amount of the tax benefits and the anticipated number of years the transaction provides the tax benefits, for example.[109]

In the first year the taxpayer files Form 8886, the taxpayer also must send an exact copy of the form to the Office of Tax Shelter Analysis (OTSA).[110] The OTSA collects and analyzes information about tax shelters and transactions and coordinates LB&I's tax shelter planning and analysis.[111]

5.4.2.1.2.1.2.8.2.1. Form 8918, Material Advisor Disclosure Statement

Anyone who is a "material advisor" to a reportable transaction must file Form 8918, Material Advisor Disclosure Statement, with the OTSA.[112] A material advisor can be an individual, trust, estate, partnership or corporation. A material advisor is someone who provides any material aid, assistance or advice with respect to the organizing, managing, promoting, selling, implementing, insuring or carrying out any reportable transaction; and directly or indirectly receives or expects to receive gross income in excess of $50,000 if the material aid, assistance or advice is provided to an individual and in excess of $250,000 if the material aid, assistance or advice is provided to anyone else.[113]

The IRS sends the material advisor a "reportable transaction number" that the material advisor must provide to all taxpayers and material advisors for whom the first material advisor acts as material advisor.[114] The material advisor must provide this number to the taxpayer when the taxpayer enters into the transaction or, if the transaction is entered into before the material advisor received the number, no later than 60 calendar days from the date the reportable transaction number is mailed to the material advisor.[115] Having both the taxpayer and the material advisor report to the OTSA enables the OTSA to compare reporting and identify gaps and potentially abusive transactions.

5.4.2.1.2.1.2.8.3. Schedule UTP, Uncertain Tax Position Statement

Schedule UTP (Form 1120), Uncertain Tax Position Statement, helps the IRS identify those returns that pose the most significant risks of noncompliance and select issues for examination.[116] Any corporation that issues or is included in audited financial statements and has assets that equal or exceed $10 million must include Schedule UTP when it files its tax return.[117]

The corporation must report any tax positions that it has taken on its U.S. federal income tax return for the current tax year or for a prior tax year if the corporation or a related party:

- Has recorded a reserve with respect to that tax position for U.S. federal income tax in audited financial statements, or
- Did not record a reserve for that tax position because the corporation expects to litigate the position.[118]

If the corporation or related party determines that, under applicable accounting standards, no reserve was required, either because the amount was immaterial for audited financial statement purposes or because a tax position was sufficiently certain, then the corporation does not need to report the tax position on Schedule UTP.[119] The corporation must include a concise description of the tax position on Schedule UTP.[120] In addition, it must provide a reference to the appropriate section of the IRC that supports the position.[121] Although the corporation is not required to report the amount of tax at issue, the corporation must rank by size each tax position.[122]

5.4.2.1.2.1.2.8.3.1. Recording a reserve

A corporation or a related party records a reserve for a federal income tax position when a reserve for federal income tax, interest or penalties with respect to that position is recorded in audited financial statements of the corporation or a related party.[123] A reserve is recorded when an uncertain tax position (also known as a FIN 48 liability) is stated anywhere in a corporation's or related party's financial statements, including footnotes and any other disclosures, and may be indicated by any of several types of accounting journal entries.[124]

Some of the types of entries that, entered alone or in tandem, indicate the recording of a reserve are (1) an increase in a current or non-current liability for income taxes, interest or penalties payable; or a reduction of a current or non-current receivable for income taxes and/or interest with respect to the tax position; or (2) a reduction in a deferred tax asset or an increase in a deferred tax liability with respect to the tax position.[125]

The initial recording of a reserve will trigger reporting of a tax position taken on a return. However, subsequent reserve increases or decreases with respect to the tax position will not.[126]

If a corporation is included in multiple audited financial statements, the corporation must report a tax position on Schedule UTP if a reserve for that position was recorded in any of those audited financial statements.[127]

5.4.2.1.2.1.2.8.3.2. Reserve not recorded based on expectation to litigate

A corporation must report on Schedule UTP a tax position taken on its return for which no reserve for income tax was recorded if the tax position is one which the corporation or a related party determines the probability of settling with the IRS to be less than 50 percent and, under applicable accounting standards, no reserve was recorded in the audited financial statements

because the corporation intends to litigate the tax position and has determined that it is more likely than not to prevail on the merits in the litigation.[128]

5.4.2.1.2.1.2.8.3.3. Tax position taken on a tax return

A tax position taken on a tax return means a tax position that would result in an adjustment to a line item on any schedule or form attached to the tax return if the position is not sustained. If multiple tax positions affect a single line item on a tax return, each tax position is a separate tax position taken on a tax return.[129]

5.4.2.1.2.1.3. Management certifications

The IRS asks public companies applying for acceptance into CAP if any of the certifications required by the taxpayer under a Sarbanes-Oxley section 404 requirement assess the effectiveness of the controls described in response to any of the areas previously discussed.[130] Most applicants to CAP are public companies that are subject to the Sarbanes-Oxley section 404 requirement.[131]

If the taxpayer is subject to Sarbanes-Oxley, the taxpayer must describe how the taxpayer assesses the effectiveness of the controls. If the taxpayer is not subject to Sarbanes-Oxley, the taxpayer must describe the process by which the company does assess the operational effectiveness of the tax-related internal controls.

Information about how management assesses its internal controls, especially those that may impact the company's tax control framework, could be very useful in analyzing the reliability of the information provided in the tax return.

5.4.2.1.2.1.4. Outside auditor review

The IRS also asks if the external auditors perform tests of the internal control framework for tax matters. If so, the company should describe the results of the testing and discuss specifically whether any significant deficiencies have been identified within the previous three years.

Section 404(b) of Sarbanes-Oxley provides that each registered public accounting firm that prepares or issues the audit report for a company shall attest to, and report on, the assessment made by the management of the company. If the outside auditor does test the internal control framework for tax matters, then the IRS asks for information about the results of the testing. The IRS also asks whether any significant deficiencies have been identified within the last three years of the company's audit history. This information will help the IRS determine how reliable the information provided by the company is and provides another example of the importance a company may place on complying with regulatory provisions.

Once the IRS is satisfied that the corporation has the appropriate tax control framework and is accepted into the CAP program, the corporation and the IRS must continue with the transparency and communication to ensure that the tax structure is appropriate.

5.4.2.1.2.2. Governance of non-profit organizations

Beginning in tax year 2008, the IRS required non-profit organizations that must file Form 990, Return of Organization Exempt From Income Tax, to complete Part VI, Governance, Management, and Disclosure, to provide information about the organization's governing body and management as well as its governance policies and disclosure practices.[132] This information is requested to ensure that non-profit organizations are acting appropriately and safeguarding the funds of the non-profit organization. The absence of appropriate policies and procedures can lead to opportunities for excess benefit transactions, inurement, operation for non-exempt purposes or other activities inconsistent with exempt status.[133]

Although the governance structure of companies and non-profit organizations could be very different, it is instructive to review the types of information that the IRS considers important in evaluating the governance policies of such organizations. For example, the IRS requests the following information from non-profit organizations.

1. The number of independent voting members of the non-profit organization's governing body.
2. Family relationships or business relationships between the organization's current officers, directors, trustees or key employees and any other officer, director, trustee or key employee.
3. Whether the organization delegated control over management duties to a management company or other person.
4. Significant changes to the organization's enabling document or other bylaws.
5. Whether the organization became aware of a significant diversion of its assets during the year.
6. Whether the organization had members or stockholders with the power to elect or appoint members of the governing body.
7. Whether the organization contemporaneously documents the meetings held or written actions undertaken during the year.
8. Whether the organization has written conflict of interest and whistleblower policies.
9. Whether the organization invested in, contributed assets to or participated in a joint venture or similar arrangement with a taxable entity during the year and, if so, whether the organization followed a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law and take steps to safeguard the organization's exempt status with respect to such arrangements.
10. A written description of the process, if any, used by the organization to review Form 990.
11. Whether and, if so, how the organization made its governing documents, conflict of interest policy and financial statements available to the public during the tax year. [134]

Thus, as with for-profit entities, the IRS asks for information about the independence of voting members, family relationships, the integrity of assets, contemporaneous documentation of meetings, written policies and public disclosure. A non-profit organization that demonstrates independence and integrity can be seen as having an appropriate internal control.

5.4.2.1.3. Transparency and cooperation

As discussed in section 5.4.2.1.2, a company with a robust internal control framework should have a process to manage tax risk. In the Tax Control Framework Questionnaire, the IRS asks for a description of the company's processes that are used to identify, monitor, prevent and manage risks arising from tax. A company that is open and transparent with the IRS identifies and discloses actions or positions that may affect the company's final tax liability. This may accelerate completion of the tax examination and help the company achieve tax certainty sooner.

A company shows that it has an appropriate corporate tax governance arrangement when it demonstrates transparency. The FTA has stressed the importance of transparency as part of tax governance. For example, in 2009 the FTA stated that "[t]here is a general move by tax administrations towards more collaborative approaches that are built on mutual respect, trust and transparency."[135] At that time, Australia identified "openness and transparency with tax officers" as one element of good governance in relation to tax risk management.[136] Canada indicated that it was revising its audit program to recognize the differences among large businesses with respect to the strength of their governance and their willingness to deal with CRA in an open and transparent manner.[137] As a result,

> *"audits will be eliminated or targeted to specific issues where there is evidence of strong governance and a willingness to work with CRA on an open and transparent basis. Agency resources that are saved from this reduction in auditing will be re-focused to address taxpayers whose governance is weak, or purposely risk tolerant, as well as taxpayers who do not operate in an open and transparent manner."*[138]

In 2010, the FTA referred to an "enhanced relationship" between taxpayers and the tax administration, which "requires commercial awareness, impartiality, proportionality, openness and responsiveness by revenue bodies and disclosure and transparency by taxpayers in their dealings with revenue bodies."[139]

The IRS has established programs that will provide early certainty to a taxpayer if the taxpayer is transparent and cooperative. For example, the IRS has two programs that will provide early agreements to the taxpayer, the advance pricing agreement (APA)[140] and the pre-filing agreement (PFA).[141] Both programs provide for an agreement on one or more specific issues, ideally before the taxpayer files the tax return. The APA program provides certainty of a transfer pricing structure for a certain period of time. The PFA program helps the taxpayer and the IRS resolve issues before the taxpayer files a tax return. If the taxpayer's actual transactions follow the transaction as described by the taxpayer and agreed to by the IRS, the IRS will not challenge the transaction on examination. These programs provide an early, cooperative way for taxpayers to manage the tax risk associated with the transactions in question.

5.4.2.1.3.1. Advance pricing agreement

The IRS introduced the APA program in 1991.[142] In the APA program, the taxpayer and the IRS work together to agree on an appropriate transfer pricing method for a determined number of years in the future. If the taxpayer files its tax return consistent with the transfer pricing method agreed on, the IRS agrees not to make any transfer pricing adjustments for the transactions covered in the APA.[143] The APA process increases the efficiency of tax administration by encouraging taxpayers to come forward and present all the facts necessary for a proper evaluation of their covered transactions and to work towards a resolution of these issues in a spirit of openness and cooperation.

The APA process lessens the burden of compliance by giving taxpayers greater certainty regarding their covered issues and promotes the principled resolution of these issues by allowing for their discussion and resolution in advance before the consequences of such resolution are fully known to either taxpayers or the IRS.[144] There are three types of APAs: a unilateral APA is an agreement between the IRS and the taxpayer only; a bilateral agreement is between the IRS and a foreign jurisdiction; a multilateral agreement includes an agreement between the IRS and more than one foreign jurisdiction.[145]

5.4.2.1.3.2. Pre-filing guidance

In early 2000, the IRS implemented a pilot PFA program.[146] The purpose of the program was to enable both taxpayers and the IRS to resolve before the due date of a tax return the treatment of issues otherwise likely to be disputed in post-filing audits. This cooperative effort was intended to reduce the costs, burden and delays encountered in post-filing examinations. The program allows the taxpayer and the IRS to reach agreement on factual issues and apply settled legal principles to those facts. It does not determine the current interpretation of rules if the interpretation was not well settled, although a PFA may include the application of well-established legal principles to known facts.[147]

The PFA program is available for past, current and future years, although agreements for future years are limited to 4 tax years past the current tax year.[148] The program is available to any taxpayer under the jurisdiction of LB&I that wants a pre-filing resolution of applicable issues that otherwise would be resolved in a post-filing examination. The application for a PFA can be made at any time before the due date (with extension) for filing a return, but if the request is submitted too close to the due date, and the IRS does not have enough time to consider the issue, the taxpayer will not be accepted into the program. This program is elective, not mandatory. Taxpayers participating in the program must pay a user fee.[149] The PFA program is a beneficial way to reach agreement on a contentious issue through a cooperative effort before the return is filed.

The pre-filing program results in a closing agreement relating to the tax treatment of the transaction in question that is binding on both the taxpayer and the IRS. A PFA is available for factual issues, issues that require the application of well-established legal principles or issues that involve a methodology. There is no list of specific eligible domestic and international issues, as long as the issue is not identified as an excluded issue.[150] The IRS must coordinate and consult with the Associate Chief Counsel having subject matter jurisdiction over the issue proposed to be

determined in the PFA.[151] Certain international issues require the concurrence of the Associate Chief Counsel (International).[152]

5.4.2.1.3.3. Compliance assurance process (CAP)

As discussed earlier in section 5.4.2.1.2.1, the IRS implemented the CAP program in 2005 to assess whether a pre-filing dialogue with taxpayers could improve the tax compliance process. The IRS maintains the CAP program for cooperative taxpayers who agree to be timely and cooperative throughout a pre-filing process.[153] CAP is a method of identifying and resolving tax issues through honest, open, cooperative and transparent interaction between the IRS and taxpayers and the contemporaneous exchange of information prior to the filing of a return. Collaborative interaction combined with a sense of urgency is necessary to meet the objective of reaching resolution on the federal income tax liability prior to the filing of the tax return. There should be no communication barrier or filter between the IRS and the taxpayer. Through CAP, the taxpayer should achieve tax certainty sooner and with less administrative burden than conventional examinations.

The taxpayer is expected to make open, comprehensive and contemporaneous disclosures of the material issues. To be considered comprehensive, the material issue must be disclosed in writing and the full disclosure must include the historic facts, surrounding circumstances and proposed tax position to include the law relied upon to develop the position.[154] The IRS may consider the following items for compliance review regardless of when or how they are identified:

- Tax shelters
- Listed transactions
- Transactions of interest
- Fraudulent items
- LB&I compliance initiatives
- LB&I directives
- Emerging issues.[155]

The IRS and the taxpayer sign a memorandum of understanding (MOU) at the beginning of the CAP process. The taxpayer must provide documents as required in the MOU and other application documents to facilitate the review process. The taxpayer may need to request an advance pricing agreement as part of the process as well.[156]

All information provided to the IRS in connection with the CAP is return information protected from disclosure by the confidentiality provisions of IRC section 6103.

5.4.2.1.4. Discouraging non-compliance

Despite the many proactive provisions that the IRS maintains to help taxpayers be compliant and manage their tax risk appropriately, sometimes taxpayers simply do not comply as they should. Such noncompliance could result in the imposition of tax penalties. The payment of these penalties is not a deductible expense for federal income tax purposes.[157]

In addition, in certain, severe cases, an individual – perhaps an employee, perhaps a friend or neighbor – can notify the IRS of this noncompliance and the IRS can follow up with the taxpayer. To reward the notifier, the IRS may pay a whistleblower award (see section 5.4.2.1.4.2).

5.4.2.1.4.1. Penalties

Self-identification and transparency can be an effective means of managing tax compliance risks. The IRS imposes penalties for not filing complete and correct forms and schedules, including Form 8886, Form 8918, Schedule M-3 and Schedule UTP, on time. In addition to penalties for failure to file complete and correct returns on time, the IRS also imposes penalties for failure to pay tax on time and in the correct amount. Possible penalties are discussed next.

The general penalties for failure to file tax returns, which include Schedule UTP or Schedule M-3, can reach 25 percent of the tax due under the return.[158] Additional penalties apply for the failure to pay the correct amount of tax due.[159] Other penalties apply for the failure to file correct information returns.[160] Generally, the penalty for failure to include information with respect to a reportable transaction is 75 percent of the reduction in the tax reported on the income tax return as a result of participation in the transaction or that would result if the transaction were respected for federal tax purposes, with minimum and maximum penalties provided.[161]

5.4.2.1.4.2. IRS whistleblower program

The IRS Whistleblower Office pays money to people who report ("blow the whistle") on persons (for example, individuals, corporations, etc.) who fail to pay the tax that they owe.[162] If the IRS uses information provided by the whistleblower, it can award the whistleblower up to 30 percent of the additional tax, penalty and other amounts it collects.[163]

The IRS may pay awards to people who provide specific and credible information to the IRS if the information results in the collection of taxes, penalties, interest or other amounts from the noncompliant taxpayer.

5.4.3. Conclusion

Appropriate tax compliance is a key feature of successful corporate governance and indicates a corporation's board of directors' commitment to corporate social responsibility. In addition to the internal steps a company can take to meet those goals, tax administrations have the option to design and institute various programs and initiatives to encourage corporations to focus on being principled participants in the global community. This requires the participation of executive-level management at companies as well as a rigorous enforcement of good accounting principles.

Endnotes

1 This chapter discusses tax administration issues relating to corporate tax governance and will not discuss policy issues about this subject. Much work on this subject has been and continues to be performed by many multinational organizations, including the Organisation for Economic Cooperation and Development (OECD).

2 The FTA, created in 2002, is a unique body bringing together Commissioners from 53 advanced and emerging tax administrations from across the globe, including all OECD and G20 members. The FTA is a forum through which Commissioners can identify, discuss and influence relevant global trends and develop new ideas to increase the fairness, efficiency and effectiveness of tax administration, reducing burdens and improving tax compliance and tax certainty. See https://www.oecd.org/tax/forum-on-tax-administration/.

3 Final Seoul Declaration, 14-15 September 2006. See https://www.oecd.org/tax/administration/37415572.pdf.

4 See: http://www.oecd.org/tax/administration/39882938.pdf.

5 Cape Town Communiqué, 11 January 2008. See https://www.oecd.org/ctp/administration/39886621.pdf.

6 The meaning of "enhanced relationship" is discussed in Chapter 8 of the Study. Early disclosure and resolution of issues will give taxpayers tangible benefits in their management of tax risks. In particular, disclosures arising from shareholder reporting requirements or corporate governance issues for publicly traded companies as well as unnecessary audit time can be greatly minimized when complex transactions involving potential tax disputes are resolved early, preferably in real time. A discussion of the enhanced relationship was one of six draft working papers prepared by the Study Team and posted on the OECD's website for public information and comment. See http://www.oecd.org/ctp/administration/39003880.pdf.

7 See: https://www.oecd.org/tax/administration/43239887.pdf.

8 Id., paragraph 1.

9 Id., paragraph 2.

10 Id., paragraph 3.

11 Id., paragraph 26.

12 See: http://www.oecd.org/tax/administration/45045662.pdf.

13 Id., paragraph 24.

14 Id., paragraph 33.

15 Id., paragraph 35.

16 See: https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(99)6&docLanguage=En.

17 G20/OECD Principles of Corporate Governance (Principles) https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf.

18 The Principles state, "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders." Id., 9.

19 Id., 45. While these Principles focus on publicly traded companies, both financial and non-financial, they also serve as a useful tool to improve corporate governance in any company. Id. at page 9. These Principles also have been adopted as one of the Financial Stability Board's key standards for sound financial systems (see: https://www.fsb.org/wp-content/uploads/S120619.pdf, page 2) and form the basis for the World Bank Reports on the Observance of Standards and Codes (ROSC) in the area of corporate governance. See: https://www.worldbank.org/en/programs/rosc#3.

20 Principles, supra note 17, at 45.

21 Id.

22 Id.

23 Id., 46.

24 Id., 47.

25 Id.

26 Id., 49.

27 Id., 45.

28 See: https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0144.

29 See: https://www.oecd.org/daf/inv/mne/48004323.pdf.

30 Id., 3.

31 Id., 15, paragraph 9.

32 Id., 17, paragraph 1.

33 Id., paragraph 2.

34 Id., 60, paragraph 1.

35 Id.

36 Id., paragraph 2.

37 Id.

38 Id., paragraph 102.

39 Id.

40 See: https://www.ciat.org/general-assembly/?lang=en.

41 The resolution issued by each General Assembly. https://www.ciat.org/resolutions-general/?lang=en.

42 See: https://www.ciat.org/Biblioteca/AsambleasGenerales/2011/Ingles/e-book_assembly_2011.pdf.

43 Id., 291 – 302 (presentation by the European Commission), 303 – 322 (presentation by Canada), and 323 – 333 (presentation by a private consultant).

44 Id., 295

45 See: https://www.ciat.org/Biblioteca/AsambleasGenerales/2016/Ingles/2016_GA-50_Mexico.pdf.

46 See Foreign Account Tax Compliance Act (FATCA) at https://www.irs.gov/businesses/corporations/foreign-account-tax-compliance-act-fatca.

47 See the OECD Automatic Exchange Portal at https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/.

48 See BEPS: Inclusive Framework on Profit Shifting at https://www.oecd.org/tax/beps/.

49 The Role of the Board of Directors in Enron's Collapse, S. Prt. 107–70, U.S. Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, July 8, 2002. https://www.govinfo.gov/content/pkg/CPRT-107SPRT80393/pdf/CPRT-107SPRT80393.pdf.

50 See SEC Litigation Release No. 17588 discussing the civil action filed against WorldCom on June 26, 2002. https://www.sec.gov/litigation/litreleases/lr17588.htm.

51 See SEC Brings Settled Charges Against Tyco International Ltd. Alleging Billion Dollar Accounting Fraud, Press Release 2006-58, dated April 17, 2006. https://www.sec.gov/news/press/2006/2006-58.htm.

52 Pub. L. No. 107-204. https://www.congress.gov/107/plaws/publ204/PLAW-107publ204.pdf.

53 Both 15 United States Code (U.S.C.) 78m. https://www.law.cornell.edu/uscode/text/15/78m, and 15 U.S.C. 78o(d). https://www.law.cornell.edu/uscode/text/15/78o, require issuers of public securities to file certain reports.

54 In 17 Code of Federal Regulations (C.F.R.) section 240.13a-15(f). https://www.ecfr.gov/cgi-bin/text-idx?SID=98e7a425a1ae9faca505aae955a13aa4&mc=true&node=se17.4.240_113a_615&rgn=div8, the term "internal control over financial reporting" is defined as "a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles…"

55 15 U.S.C. 7262(a). https://www.law.cornell.edu/uscode/text/15/7262.

56 SEC, Release No. 33-8810, Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934. https://www.sec.gov/rules/interp/2007/33-8810.pdf.

57 See SEC Implements Internal Control Provisions of Sarbanes-Oxley Act; Adopts Investment Company R&D Safe Harbor, Press Release 2003-66, dated May 27, 2003. https://www.sec.gov/news/press/2003-66.htm. A "material weakness" is defined as "a deficiency, or a combination of deficiencies, in internal control over financial reporting…such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis." See 17 C.F.R. 210.1-02(a)(4). https://www.govregs.com/regulations/title17_chapterII_part210_subjgrp17_section210.1-02.

58 See: https://www.fasb.org/resources/ccurl/86/12/aop_fin48.pdf.

59 See Exhibit 4.46.1-1, Glossary of LB&I Terms, in Internal Revenue Manual (IRM) 4.46.1, LB&I Examination Process, General Information and Definitions. https://www.irs.gov/irm/part4/irm_04-046-001#idm139936218148032. Also see: https://www.fasb.org/jsp/FASB/Page/PreCodSectionPage&cid=1218220137031#int48 .

60 See 2019 Instructions to Form 990, Return of Organization, 20. https://www.irs.gov/pub/irs-pdf/i990.pdf.

61 The CAP program, while valuable, remains labor-intensive. The IRS must ensure that its limited resources focus on all taxpayers. See IRS announces adjustments to the Compliance Assurance Process (CAP) program. https://www.irs.gov/newsroom/irs-announces-adjustments-to-the-compliance-assurance-process-cap-program.

62 Compliance Assurance Process (CAP) - Frequently Asked Questions (FAQs), CAP Overview, Q1, https://www.irs.gov/businesses/corporations/compliance-assurance-process-cap-frequently-asked-questions-faqs. IRM 4.51.8, Compliance Assurance Process (CAP) Examinations. https://www.irs.gov/irm/part4/irm_04-051-008.

63 Compliance Assurance Process (CAP) - Frequently Asked Questions (FAQs), How to apply for CAP, Q1, https://www.irs.gov/businesses/corporations/compliance-assurance-process-cap-frequently-asked-questions-faqs.

64 Form 14234-D (September 2019). https://www.irs.gov/pub/irs-pdf/f14234d.pdf.

65 Id.

66 See: https://www.irs.gov/businesses/corporations/statement-of-interest-for-new-applicants-for-cap.

67 See: https://www.irs.gov/businesses/corporations/highlights-and-updates-for-the-cap-2021-application-period.

68 Id.

69 FTA, Tax Compliance and Tax Accounting Systems, supra note 12, paragraph 52.

70 Highlights and Updates for the CAP 2021 Application Period, supra note 67.

71 The term "entity-level controls" in this context refers to aspects of a system of internal control that have a pervasive effect on the entity's system of internal control such as controls related to the control environment (for example, management's philosophy and operating style, integrity and ethical values; board or audit committee oversight; and assignment of authority and responsibility); controls over management override; the company's risk assessment process; centralized processing and

controls, including shared service environments; controls to monitor results of operations; controls to monitor other controls, including activities of the internal audit function, the audit committee, and self-assessment programs; controls over the period-end financial reporting process; and policies that address significant business control and risk management practices. See Commission Guidance 33-8810, supra note 56, page 10.

72 Id. at 4 and 5.

73 Government Accountability Office (GAO), The Green Book. https://www.gao.gov/greenbook/overview.

74 GAO, GAO-14-704G, Standards for Internal Control in the Federal Government, September 2014, 5. https://www.gao.gov/assets/670/665712.pdf.

75 Id.

76 17 C.F.R. section 240.13a-15(f), supra note 54.

77 GAO-14-704G, supra note 74, at 22.

78 FTA, Tax Compliance and Tax Accounting Systems, supra note 12, paragraphs 25 through 29.

79 https://www.coso.org/Documents/COSO-ICIF-11x17-Cube-Graphic.pdf. COSO is a voluntary private sector initiative dedicated to improving organizational performance and governance through effective internal control, enterprise risk management, and fraud deterrence. Five nonprofits are its sponsoring organizations: the American Accounting Association, the American Institute of Certified Public Accountants, the Financial Executives International, the Institute of Internal Auditors, and the Institute of Management Accountants. COSO published Internal Control—Integrated Framework in 1992 and updated it in 2013. Many U.S. public companies adopted COSO's Framework as part of their responsibilities under section 404(a) of Sarbanes-Oxley to select an internal control framework and then assess and report on the design and operating effectiveness of their internal controls annually. See S. McNally, One Approach to an Effective Transition, published by COSO. https://www.coso.org/documents/COSO%20McNallyTransition%20Article-Final%20COSO%20Version%20Proof_5-31-13.pdf.

80 See SEC Charges Four Public Companies With Longstanding ICFR Failures, Press Release 2019-6, dated January 29, 2019, https://www.sec.gov/news/press-release/2019-6.

81 FTA, Corporate governance and tax risk management, supra note 7, at paragraph 19.

82 See: https://asc.fasb.org/section&trid=2144693#d3e28351-109314 and https://asc.fasb.org/section&trid=2144711#d3e33197-109320

83 Penalties are provided in various IRC sections, depending on the nature of the issue. Some penalties are provided in IRC sections 6651, 6662, 6662A, 6663, and 6707A, for example. These penalties are set out in IRC Chapter 68, Additions to the Tax, Additional Amounts, and Assessable Penalties. https://www.law.cornell.edu/uscode/text/26/subtitle-F/chapter-68.

84 IRC section 162(f). https://www.law.cornell.edu/uscode/text/26/162.

85 IRC section 6707A(e). https://www.law.cornell.edu/uscode/text/26/6707A.

86 See The IRS Large Business and International Division (LB&I) Announces the Approval of 13 Additional Compliance Campaigns at https://www.irs.gov/businesses/irs-lbi-compliance-campaigns-jan-31-2017.

87 Schedule UTP. www.irs.gov/ScheduleUTP. Schedule UTP requires the reporting of each U.S. federal income tax position taken by an applicable corporation on its U.S. federal income tax return if the corporation has taken a tax position on its U.S. federal income tax return for the current tax year or for a prior tax year and either the corporation or a related party has recorded a reserve with respect to that tax position for U.S. federal income tax in audited financial statements, or the corporation or related party did not record a reserve for that tax position because the corporation expects to litigate the position.

88 IRM 4.51.8.3.3. https://www.irs.gov/irm/part4/irm_04-051-008#idm140127317266096.

89 Form 14234-B (August 2020). https://www.irs.gov/pub/irs-pdf/f14234b.pdf.

90 IRM 4.51.8.3.3(10), supra note 88.

91 IRM 4.51.8.3.3(9), (10), and (12), supra note 88.

92 FTA, Tax Compliance and Tax Accounting Systems, supra note 12, paragraph 37.

93 FTA, Tax Compliance and Tax Accounting Systems, supra note 12, paragraph 38.

94 J. Bennecke, Tax Internal Controls in an Era of Transparency and Disclosure, July 24, 2018. https://taxexecutive.org/tax-internal-controls-in-an-era-of-transparency-and-disclosure/.

95 SEC, Release No. 33-8810, supra note 56. This obligation is set out in section 404(a)(2) of Sarbanes-Oxley, supra note 52.

96 SEC, Release No. 33-8809, Amendments to Rules Regarding Management's Report on Internal Control Over Financial Reporting. https://www.sec.gov/rules/final/2007/33-8809.pdf. A similar reference to an evaluation that complies with the guidance is set out in 17 C.F.R. section 240.13a-15(c). https://www.ecfr.gov/cgi-bin/text-idx?SID=98e7a425a1ae9faca505aae955a13aa4&mc=true&node=se17.4.240_113a_615&rgn=div8; and 17 C.F.R. section 240.15d-15(c). https://www.ecfr.gov/cgi-bin/text-idx?SID=98e7a425a1ae9faca505aae955a13aa4&mc=true&node=se17.4.240_115d_615&rgn=div8.

97 SEC, Release No. 33-8810, supra note 56, at 6.

98 SEC Press Release, SEC Charges Four Public Companies with Longstanding ICFR Failures. https://www.sec.gov/news/press-release/2019-6.

99 A. Hale and J. Deutsch, Best Practices in Tax Compliance Outsourcing, Tax Executive, September 17, 2017. https://taxexecutive.org/best-practices-in-tax-compliance-outsourcing/.

100 Id.

101 Schedule M-3 (Form 1120) (Rev. December 2019). https://www.irs.gov/pub/irs-pdf/f1120sm3.pdf.

102 Instructions for Schedule M-3 (Form 1120) (Rev. December 2019). https://www.irs.gov/pub/irs-pdf/i1120sm3.pdf

103 The corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income at the entity level. For more information, including how to qualify for status as an S corporation, see S Corporations at https://www.irs.gov/businesses/small-businesses-self-employed/s-corporations.

104 Boynton, Legel, Rupert and DeFilippes; 2011–2012 Schedule M-3 Profiles of Schedule UTP Filers by IRC Section Cited, 61. https://www.irs.gov/pub/irs-soi/15resconrupert.pdf.

105 Form 8886 (Rev. December 2019). www.irs.gov/Form8886.

106 Instructions for Form 8886 (Rev. December 2019), 1. https://www.irs.gov/pub/irs-pdf/i8886.pdf. In limited cases, a regulated investment company (RIC) or an investment vehicle that is at least 95 percent owned by one or more RICs at all times during the course of a transaction is not required to file Form 8886.

107 Id.

108 T.D. 9017, Tax Shelter Disclosure Statements, 67 Fed. Reg. 64799 (Oct. 22, 2002), 64800. http://www.gpo.gov/fdsys/pkg/FR-2002-10-22/pdf/02-26724.pdf.

109 Form 8886, supra note 105, line 7.

110 Instructions for Form 8886 (Rev. 2019), supra note 106, page 3.

111 Abusive Tax Shelters and Transactions. http://www.irs.gov/Businesses/Corporations/Abusive-Tax-Shelters-and-Transactions.

112 Instructions for Form 8918 (Rev. June 2017), Material Advisor Disclosure Statement, 3. http://www.irs.gov/form8918.

113 Id., 1.

114 Id.

115 Id., 4.

116 Preamble to Proposed Regulation section 1.6012-2(a)(4), REG-119046-10, 75 Fed. Reg. 54802 (September 9, 2010), 54803. http://www.gpo.gov/fdsys/pkg/FR-2010-09-09/pdf/2010-22624.pdf. The proposed regulations were finalized with minimal change on December 15, 2010. See T.D. 9510, 75 Fed. Reg. 78160. https://www.govinfo.gov/content/pkg/FR-2010-12-15/pdf/2010-31576.pdf.

117 Treasury Regulations section 1.6012-2(a)(4). https://www.law.cornell.edu/cfr/text/26/1.6012-2.

118 Instructions for Schedule UTP (Form 1120) (Rev. December 2019), 1. http://www.irs.gov/pub/irs-pdf/i1120utp.pdf.

119 Id.

120 Id., 6.

121 Id., 5.

122 Id., 3.

123 Id., 2.

124 Id.

125 Id.

126 Id.

127 Id.

128 Id.

129 Id. For example, a tax position that is reported on a line item on Form 5471 is a tax position taken on a return, even though an adjustment to that line item might not result in the payment of any additional tax.

130 Section 302 of Sarbanes-Oxley, supra note 52, requires management certification of the reports required by section 404(a) of Sarbanes-Oxley. The principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, provide the certification that they have reviewed the report. Among other statements, the certification provides that, based on their knowledge, the report does not contain an untrue statement and that they have designed appropriate internal controls and that they have evaluated the effectiveness these internal controls.

131 As of the 2020 CAP year, only U.S. publicly traded taxpayers that are required to prepare financial statements in accordance with U.S. GAAP were eligible to apply for the program. However, existing CAP taxpayers who are privately held or foreign-owned were given the opportunity to remain in the program if they made the commitment to provide financial statements prepared in accordance with U.S. GAAP.

132 2008 Instructions for Form 990, Return of Organization Exempt from Income Tax. https://www.irs.gov/pub/irs-prior/i990--2008.pdf.

133 2019 Instructions for Form 990, Return of Organization Exempt from Income Tax, page 20. https://www.irs.gov/pub/irs-pdf/i990.pdf.

134 Id., Part VI, Sections A, B, and C.

135 FTA, Corporate governance and tax risk management, supra note 7, at paragraph 28.

136 Id., paragraph 55.

137 Id., paragraph 63.

138 Id.

139 FTA, Tax Compliance and Accounting Systems, supra note 12, paragraph 19. This conclusion is based in part on the results of a previous work published in 2008, Study into the Role of Tax Intermediaries, supra note 4.

140 See: https://www.irs.gov/businesses/corporations/apma.

141 See: https://www.irs.gov/businesses/pre-filing-agreement-program.

142 Rev. Proc. 91-22, 1991-1 C.B. 526. https://www.govinfo.gov/app/details/GOVPUB-T22-230e9ab8cec1063f9dc7bb07bfd4740b/context.

143 Rev. Proc. 2015-41, 2015-35 I.R.B. 263. https://www.irs.gov/irb/2015-35_IRB#RP-2015-41. The scope of the APA program has expanded over time and now includes the resolution of transfer pricing issues as well as other issues arising in income tax treaties or the Code or Regulations where transfer pricing may be relevant, including the determination of income effectively connected with a trade or business within the United States.

144 Id., section 2.02(2).

145 Id., section 1.04. If the United States has a tax treaty with a foreign country that contains a mutual agreement procedure provision similar to Article 25 in the OECD Model Convention, the IRS and one or more foreign jurisdictions can work together to sign a bilateral or multilateral APA that provides agreement on the taxpayer's transfer pricing method for both or all countries.

146 Notice 2000-12, 2000-1 C.B. 727. https://www.govinfo.gov/app/details/GOVPUB-T22-dbe0034be04603c384b4f55402c70daf/context.

147 Rev. Proc. 2016-30, 2016-21 I.R.B. 981. https://www.irs.gov/irb/2016-21_IRB#RP-2016-30. The pilot program was successful and made permanent in early 2001. See Rev. Proc. 2001-22, 2001-9 I.R.B. 745. The IRS concluded that PFAs allowed taxpayers to file more compliant returns within prescribed time frames, were cost efficient, decreased taxpayer compliance burdens, and conserved IRS resources.

148 Rev. Proc. 2016-30, Id., section 3.02(2).

149 Id., section 10.02.

150 Id., section 3.05.

151 Id.

152 Id., section 3.06.

153 See Compliance Assurance Process at https://www.irs.gov/businesses/corporations/compliance-assurance-process.

154 IRM 4.51.8.3.3(3), supra note 88.

155 Draft 2021 CAP MOU, supra note 154, at section 3, and IRM 4.51.8.3.3(12), supra note 88.

156 Draft 2021 CAP MOU, supra note 154, at section 2, and IRM 4.51.8.3.12, supra note 88.

157 IRC section 162(f). https://www.law.cornell.edu/uscode/text/26/162.

158 IRC section 6651(a)(1). https://www.law.cornell.edu/uscode/text/26/6651.

159 Id., IRC section 6651(a)(2) and (3).

160 See, for example, IRC section 6721. https://www.law.cornell.edu/uscode/text/26/6721. The penalty may be waived if the failure is due to reasonable cause and not to willful neglect. See IRC section 6724. https://www.law.cornell.edu/uscode/text/26/6724.

161 IRC section 6707A. https://www.law.cornell.edu/uscode/text/26/6707A#c_2. For more information on penalties relating to reportable transactions, see Instructions for Form 8918, supra note 112, at 4, and Instructions for Form 8886, supra note 106, at 4.

162 See Whistleblower - Informant Award at https://www.irs.gov/compliance/whistleblower-informant-award.

163 IRC section 7623(b). https://www.law.cornell.edu/uscode/text/26/7623.

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Tax Shelter Disclosure Statements. Department of the Treasury Internal Revenue Service. Federal Register (Vol. 67, No. 204, Tuesday, October 22, 2002, Rules and Regulations 64799). https://www.govinfo.gov/content/pkg/FR-2002-10-22/pdf/02-26724.pdf

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Para más información sobre las referencias relativas a las regulaciones de los Estados Unidos, el IRS y la SEC (Formularios, Instrucciones, Comunicados de Prensa, entre otros) por favor vea la nota al pie correspondiente dentro del texto del capítulo.

Manual for the Control of International Tax Planning

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