

Day 4, Session 1

Administrative Approaches to Minimising Transfer Pricing Disputes



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Advanced Transfer Pricing Course (General Topics), April 15-19, 2024

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Agenda

- I. Setting the Stage
- II. How to avoid a TP Dispute
 - a) APAs
 - b) Simultaneous Tax Examinations
 - c) Cooperative Compliance Programmes
- III. Conclusions



Section I

Setting the Stage

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- Tax is not just a legal or technical issue – it is front page news
- It is political. Even “moral”
 - E.g. taxpayers being called before U.S. Congress and U.K. Parliament to testify regarding their “aggressive” transfer pricing/tax planning tactics
 - Politicians accuse taxpayers of “engaging in transfer pricing”
 - Increasing pressure on multinational companies (“MNCs”) to pay their “fair share” and be transparent with governments

Different Administrative Approaches

- Audits
 - Joint Audits
 - Domestic Litigation
 - Mutual Agreement Procedure (“MAP”)
 - Advance Pricing Agreements (“APA”)
 - Treaty/EU Arbitration Convention (“EUAC”) Arbitration/ EU MAP Directive
 - Safe Harbours
-
- Chapter IV of the 2022 OECD Transfer Pricing Guidelines

Section II

How to avoid a TP Dispute

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Preventing Disputes

- **Dispute Prevention Techniques**
 - TP Documentation and Benchmarking – becoming more prominent
 - Engagement with Tax Authorities
 - APAs
 - Staying abreast of most recent guidance

Setting the Stage: where you can flag the weak spots...

- An anticipated rise in controversy may be likely to occur in the following areas:
 - **Intangible property:** centralised IP management structures more likely to be challenged if risk allocation does not follow DEMPE functions but, rather, “labels”. A lot of academic commentary on ‘control of risk concept’.
 - **Permanent establishment:** particular focus of commissionaire structures. Remote working as a result of new working world – an upcoming OECD project?
 - **Intra-group financing:** in the wake of Australian Chevron case, intercompany guarantees, letters of implicit support more likely to be questioned by tax administrations. February 2020 OECD publication of on Financial Transactions (now Chapter X of 2022 TPG). See also UK case – Blackrock.
 - **Tax Authorities adopting unilateral measures**

Section II(a)

Advance Pricing Agreements

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Advance Pricing Agreements

- APAs are binding agreements that are entered into between the taxpayer and the tax authorities on
 - (i) the relevant facts,
 - (ii) the arm's length pricing method to be used to appropriately reimburse the taxpayer for its intercompany transactions, and
 - (iii) what constitutes an arm's length result for the taxpayer's functions performed, assets used and risks assumed while performing its functions;
- APAs are a ruling and can serve as efficient dispute avoidance tool
 - provided the tax authorities have resources to implement and operate an APA programme;
- APAs avoid transfer pricing disputes by reviewing and agreeing on the appropriate arm's length return **prospectively**;



Why have APAs?

- An APA is
 - *“An arrangement that determines in advance of controlled transactions, an appropriate set of criteria.....for the determination of the transfer pricing of those transactions over a fixed period of time” (4.134 2022 TPG).*
- Benefits (and pitfalls) set out in the TP Guidelines (Chapter IV 2022 TPG):
 - Eliminate uncertainty to provide a favourable environment for investment.
 - Opportunity for discussion of complex tax issues in a less confrontational co-operative environment
 - Prevent more costly and time-consuming examinations later(?)
 - (Bilaterals/multilaterals) reduce/eliminate double or non-taxation
 - Provide insight into international transactions being undertaken by MNEs which can help tax authorities with future policy.

Unilateral APA

- Domestic legislation
- Administrative guidelines

Bilateral or multilateral APA

- Article 25(3) of the OECD Model Tax Convention
 - *“The competent authorities of the contracting states shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention”*
- Domestic and/or regional administrative Guidelines

Types of APA

- APAs can be issued on (1) a **unilateral basis**, and so only applies domestically. Can be transfer pricing disputes regarding an intercompany transaction in another jurisdiction that could then end up in MAP – duplication of resource?
- To avoid that, APAs can also be entered into on a (2) **bilateral** or (3) **multilateral** basis.
 - The authority for the bilateral (or multilateral) agreement is derived from Article 25(3) – “*doubts as to interpretation of the treaty*” of the OECD MTC.
 - The APA request is made to both (/all) jurisdictions and the relevant facts, applicable transfer pricing method and arm’s length results have to be agreed by both (/all) tax authorities;
- If an APA is bilateral or multilateral, it can greatly help in avoiding double taxation. The UK, for example, discourages unilateral APAs where there is an opportunity to engage in a bi/multilateral APA.



Unilateral APAs - Concerns

- May further incentivise aggressive arrangements by giving certainty on the tax position in the State giving the ruling.
- There is potential for giving different information or narratives to different countries. Potential for double non-taxation.
- Resources and expertise can be diverted on to demand led work and away from less compliant taxpayers.
- Public scrutiny risk may exist for Tax Administrations e.g. “blessing” arrangements – a sense of ‘unfairness’.
- Disclosure of rulings – BEPS Action 5, DAC.
- Rulings giving rise to State Aid.



Typical Drivers for an APA

- Restructuring, tax provisioning and inward investment giving rise to desire for certainty.
- Audit pressure in the other state and a MAP claim being likely on a recurring issue. There is also the possibility of rolling-back APAs.
- Complex issues over intangibles and/or high value services.
- Subjective profit split methods and PE profit attribution e.g. global trading.
- Lack of reliable comparables e.g. for “distribution”.

When to use an APA

APAs can apply

- transfer pricing issues between associated enterprises (Article 9 of the OECD Model Tax Convention)
- attribution of profits to permanent establishments (Article 7 of the OECD Model Tax Convention)

APA most appropriate

- transactions are particularly complex
- after a TP exam, to solve future years on the same basis
- likelihood of double taxation

Fee Structures

- Various fee structures globally:
 - Fixed fee
 - No fee
 - Hourly fee
 - Graduated fee
 - Revenue neutral structure



- An APA is a taxpayer led process – the taxpayer decides whether they want an APA.
- Most Contracting States have a 'pre-filing' process where the taxpayer presents high-level facts of their Transfer Pricing issues that they would like certainty on.
 - Each Contracting State will indicate, at this stage, whether it is something that seems right for an APA.
- The taxpayer will file an APA Application, if each Contracting State has said they would accept the APA into the programme.
- In a bi/multilateral APA, both/all Contracting States will review the APA Application and work with the taxpayer to ascertain facts.
- Each Contracting State will then negotiate with other Contracting States to try and agree the Transfer Pricing Methodology for x years into the future.
- The taxpayer will sign an agreement with each Contracting State to provide them with legal certainty.

APA - Drawbacks

- Similar to rulings, potential APA exchange of information between countries – not necessarily a drawback.
- Bilateral or multilateral APAs are only available if the second/other state(s) has an APA programme in place.
- For tax administrations, having a dedicated APA team is resource intense and may not be a priority for some tax authorities – although more and more are prioritising APA work.
- For tax administrations, steep learning curve and so skilled human resources likely to be recruited away by private practice and companies, requiring ongoing investments in the programme.
- Changing facts of the taxpayer to those presented when requesting the ruling and whether ruling remains applicable – Implications of Covid-19 losses to already agreed APAs?
- Economies may change abruptly and the facts underlying APAs may change as well, rendering the APA agreement no longer valid.



APA Programmes Across the World

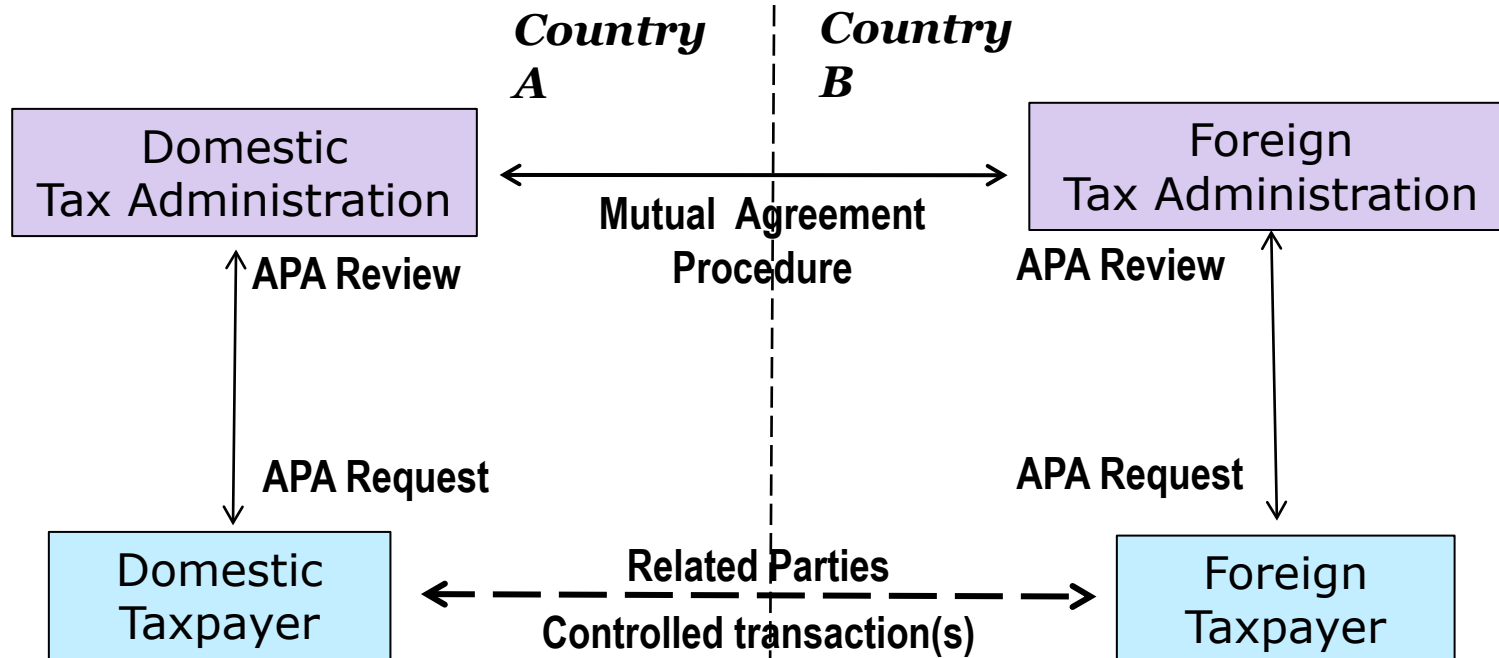
- Some countries agree lots of bilateral APAs most notably the US and Japan.
- Europe was a bit slower off the mark. At the end of 2022, EU State had 1,951 APAs in force.
- The vast majority of EU states' APAs are unilateral (1,221 in 2022 = 63%). However, circa 89% of EU APAs in force were unilateral at the end of 2020, so there is a declining trend of unilateral APAs.
- India introduced its APA programme in 2012 and over the next 11 years to 2023 more than 1,600 applications had been filed in India.
 - In FY 22-23, India entered into 95 APA (62 in FY21-22), of which 32 were bilaterals and 63 unilaterals
 - To 31 March 2023, 516 (was only 271 as at March 2019) Agreements have been entered into since 2012 – most unilateral (81%).
- In the US in 2023, 167 APA Applications were filed, compared to 183 (2022), and 145 (2021).
 - APMA executed 156 APAs in 2023, 77 (2022), and 124 (2021).
- The UK receives about 30-40 applications in a normal year and agrees slightly less than 30 per year, on average, although recent years have slowed (15 agreed in 22-23). Most of UK APAs are bi/multilateral.



Exchange of Information Impact on APAs

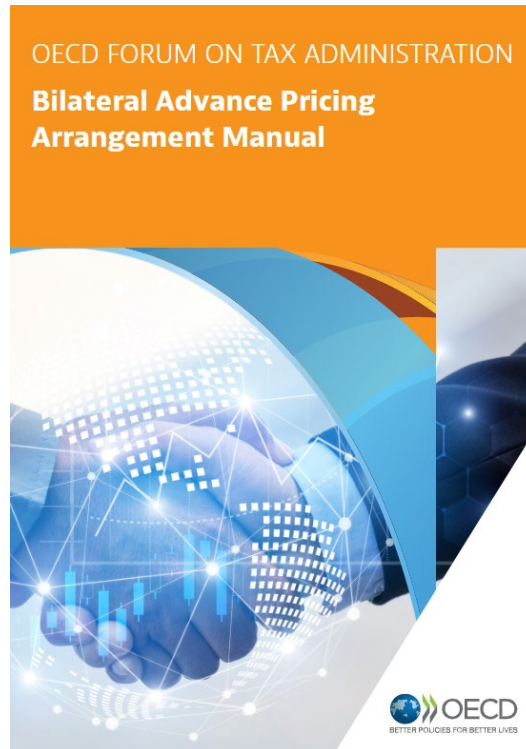
- Double Taxation Treaties generally provide for the exchange of APAs where foreseeably relevant to the other State. However, wasn't utilised as well as it should have been.
- BEPS Action 5 report, Countering Harmful Tax Practices More Effectively, requires spontaneous exchange of certain rulings including unilateral APAs to improve transparency.
- The enhanced EU Directive on Administrative Co-operation in Taxation, "DAC3", goes further requiring exchange of details of unilateral **and bilateral** APAs.
 - UK did this until they left Europe on 31 December 2020.

Process Diagram



Latest Developments

- Two FTA MAP Forum publications: BAPAM and MoMA.



Section II(b)

Simultaneous Audits

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A concept first introduced by the OECD in 2010.

The FTA report “Joint Audit 2019 – enhancing tax co-operation and improving tax certainty” sought to identify the benefits that can arise from the greater use of joint audits as well as the challenges that need to be overcome to ensure that those benefits can be realised as effectively and efficiently as possible for both tax administrations and taxpayers.



Key Elements of a Joint Audit

A Joint Audit is where:

- Two or more tax administrations join together to examine an issue(s)/transaction(s) of one or more related taxable persons (both legal entities and individuals) with cross-border business activities, in which the tax administrations have a common or complementary interest. Key! Seems hard to work if states working against each other.
- The audit work proceeds in a pre-agreed and co-ordinated manner guaranteeing a high level of integration in the process and including the presence of officials from the other tax administration.
- Tax administrations will jointly engage with the taxpayer enabling the taxpayer to share information with them simultaneously.
- Audit teams include Competent Authority representatives from each tax administration to enable the exchange of information.

Simultaneous Tax Examinations

- A form of mutual assistance
- Simultaneous tax examinations is *an arrangement between two or more parties to **examine simultaneously and independently**, each in its own territory, **the tax affairs of taxpayers** in which they have a **common or related interest** with a view of exchanging any relevant information which they so obtain (4.80 2022 TPG)*
- Pros:
 - improves the **adequacy of data** available
 - could reduce **economic double taxation**
 - reduce **compliance costs** for taxpayers
 - **speed up** the process of resolution of issues



Section II(c)

Cooperative Compliance Programmes

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Cooperative Compliance Programmes

- Cooperative compliance programmes are **a form of voluntary disclosure**.
- Taxpayers promise to **notify the tax administration of any issues** with a possible or significant tax risk and to disclose all facts and circumstances regarding the issues without hesitation or reservation.
- In return the tax administration endeavours to **provide timely advice** on significant positions.
- Tax authorities in many countries have implemented, or are taking steps to implement, their own customised approach of cooperative compliance to streamline tax processes.



Cooperative Compliance Programmes benefits for taxpayers and tax administrations

- Benefits for taxpayers
 - Advance certainty and predictability
 - Improved tax risk management
 - Less confrontational audits
 - Improved relationship with the tax administration
 - Cost reduction
 - Reputational gains

- Benefits for tax administrations
 - Better understanding of taxpayer's business
 - Increased certainty and transparency
 - Efficient use of limited audit resources by
 - Focusing on high tax risk cases
 - Reducing the scope of audits performed
 - Minimisation of the number of litigated cases

ICAP Introduction

FORUM ON TAX ADMINISTRATION

International Compliance Assurance Programme

Handbook for tax administrations and MNE groups



 **OECD**
BETTER POLICIES FOR BETTER LIVES

- ICAP was launched in 2018 and is a voluntary programme for open and co-operative multilateral engagements between MNEs and tax administrations
- The programme is designed to provide increased certainty for both MNEs and tax administrations
- After two successful pilots, ICAP was officially announced a continuing programme.
- The UK will be participating in ICAP going forward. A full list of participating jurisdictions can be found on the [OECD website](#).



ICAP - Potential Benefits to MNEs and Tax Administrations

Faster, clearer route to tax certainty

- Managed process with clear timelines
- MNE groups benefit from fewer or more targeted interventions
- Tax administrations gain assurance that risks areas are identified

Fully informed use of MNE information

- MNE groups will talk participating tax authorities through their CbC Report
- Tax administrations have the opportunity to ask questions and share their perspectives as to the tax risks identified

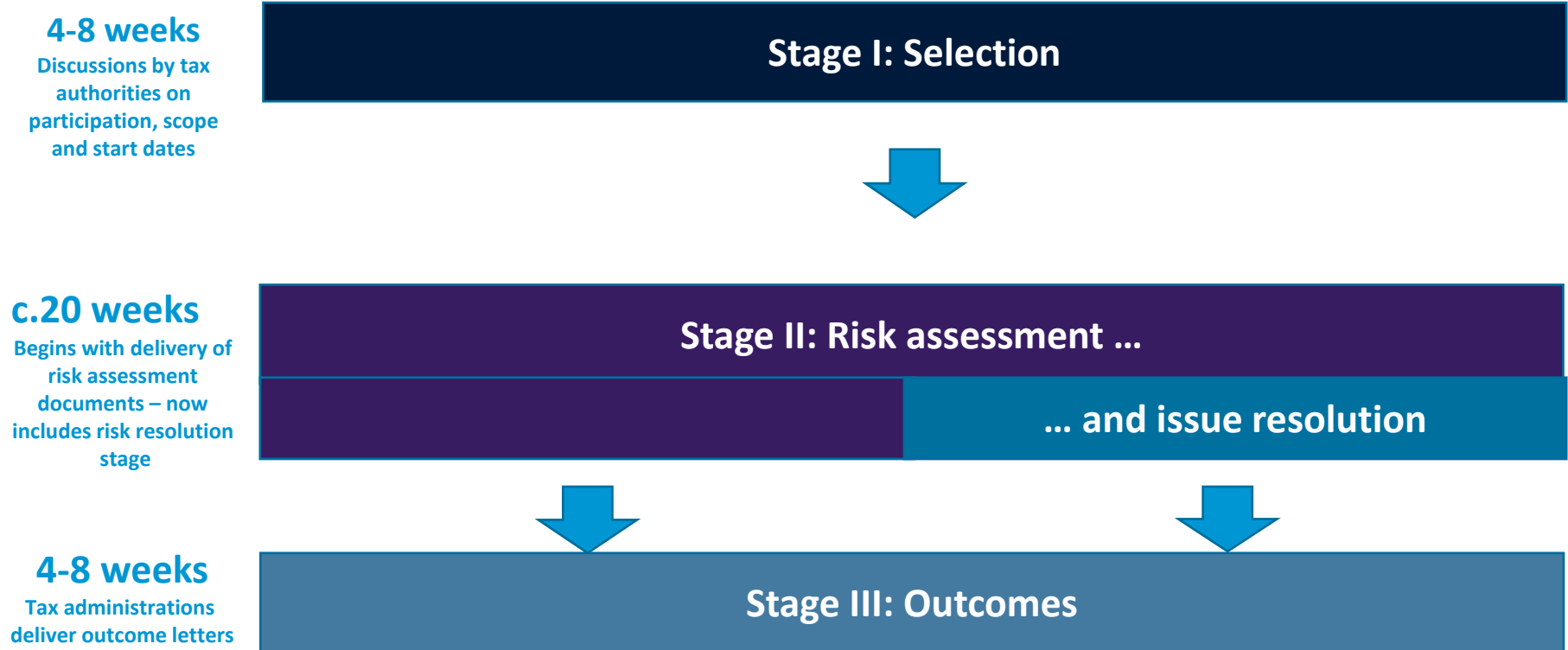
Efficient use of resources

- MNE groups engage simultaneously with multiple tax administrations
 - Co-ordinated follow-up via lead tax administration
- Pilot phases will identify efficiencies

Fewer disputes enter into MAP

- Looking to the future
- Tax administrations will have a better understanding of relevant tax issues
- Differing positions can identified and discussed earlier

ICAP Process and Planned Time Frame



Risk assessment / Issue Resolution

The Heart of the ICAP Process

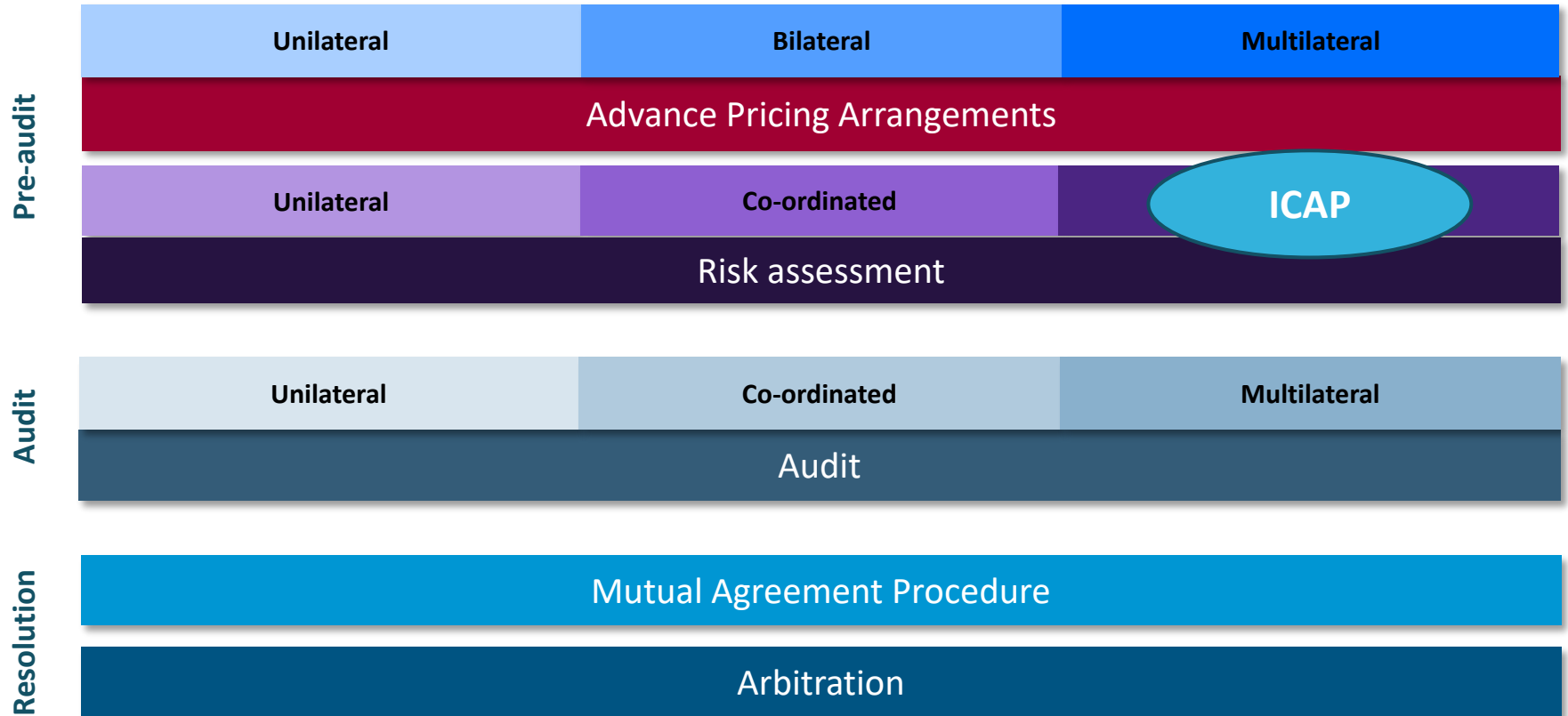
- This stage involves a multilateral risk assessment of an MNE by covered tax administrations working from a common documentation package.
- Typically, at least one multilateral meeting or call will be held with all covered tax administrations and the MNE, but the timing and content of this will vary following discussions with all participants.
- The lead tax administration will organise calls with covered tax administrations and co-ordinates any follow-up questions to the MNE.
- An issue resolution process may be included to reach agreement on the treatment of specific issues within the ICAP process.

Outcome Letters

- Outcome letters are issued at the end of an ICAP risk assessment.
- The format and content is determined by each tax administration, depending on domestic requirements and processes, but may cover:
 - risk assessment findings
 - where an item is assessed as no or low risk, a statement that no additional review is anticipated for a specified period, if there are no material changes
 - details of any caveats, material assumptions or areas where changes must be notified to the covered tax administrations



Routes to Greater Tax Certainty Where ICAP fits in



Section III

Conclusions

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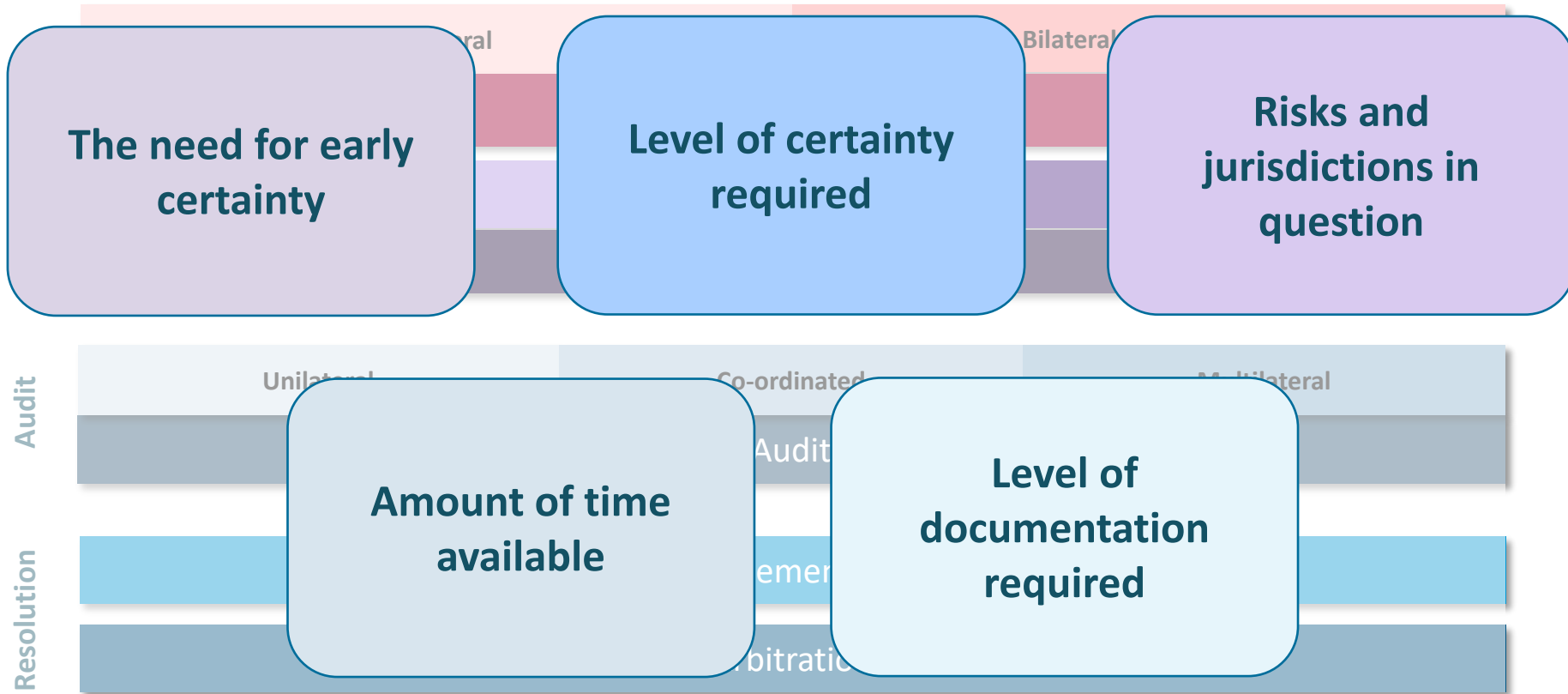


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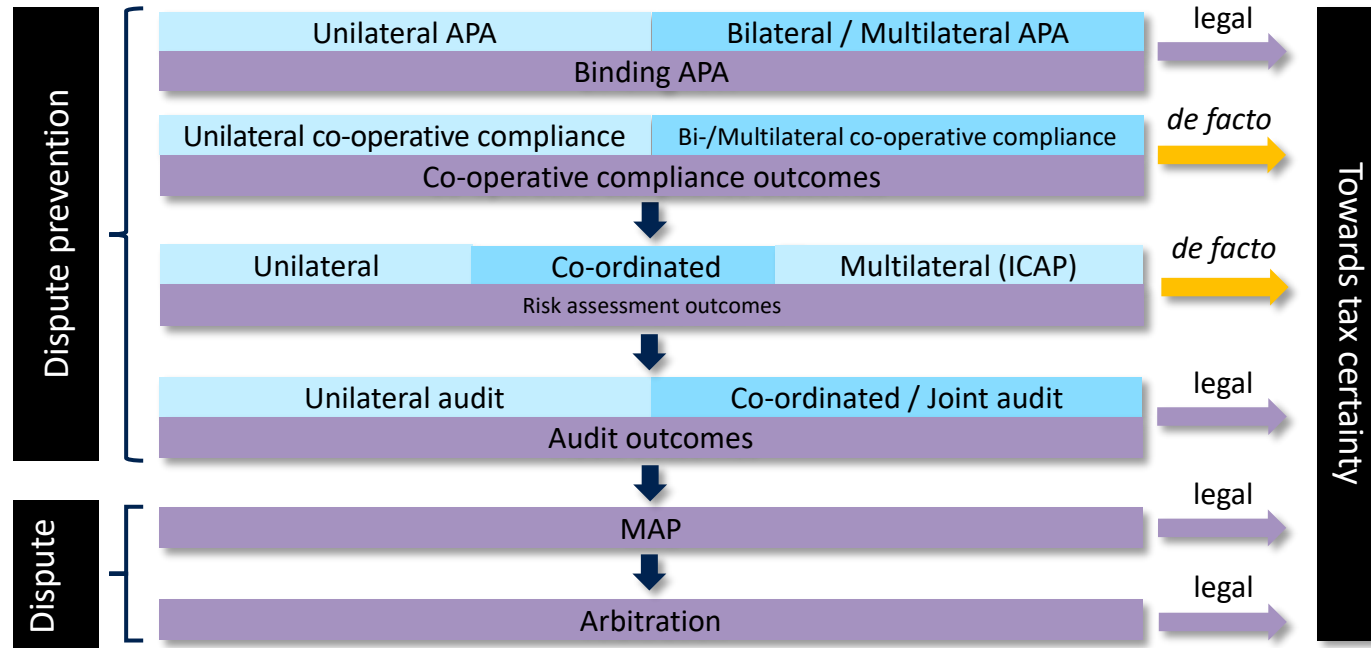


Routes to Greater Tax Certainty

Factors to consider when choosing from different routes



Tax Certainty



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Section IV

Annex



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APAs: Pros and Cons

PROs

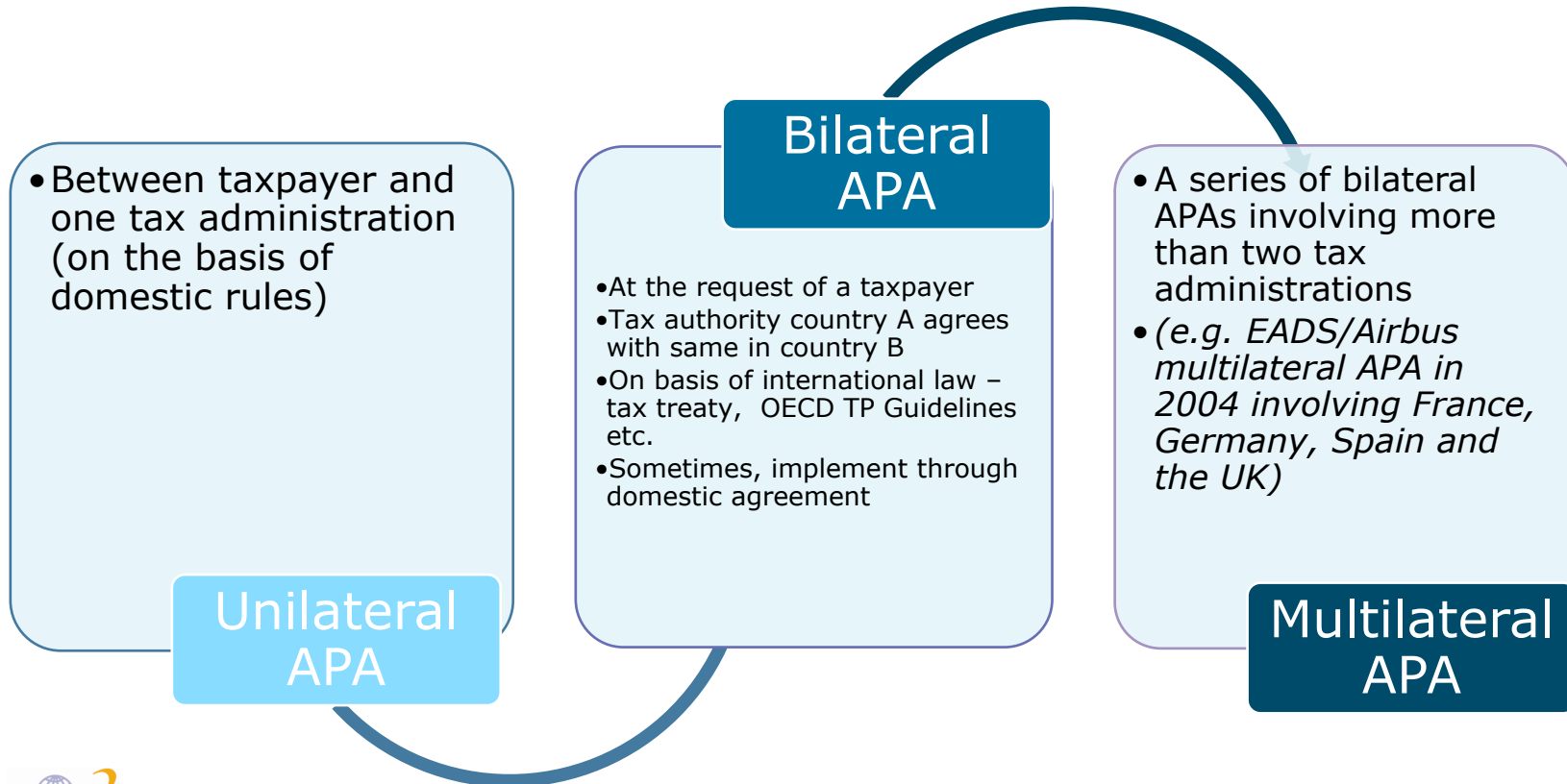
- **Certainty**
- The opportunity to **consult and cooperate**
- **Better allocation of resources** from a tax administration standpoint
- Reduction or **elimination of juridical or economic double taxation**
- Reduction of **disputes**

- Unilateral APAs **may not lead to an increased certainty**
- Increasing BEPS concern related **to lack of transparency** (see Action Plan 5 regarding: harmful tax practices) – exchange of information concerning tax rulings as a priority due to mounting pressure of public opinion
- EU Law: **APAs may be unlawful State Aid?** (e.g. Apple Case in Ireland; Tax ruling of Fiat Finance and Trade with Luxembourg; Tax ruling of Starbucks with the Netherlands)

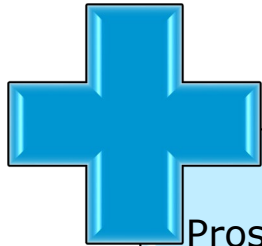
CONs



Unilateral v Bilateral v Multilateral



Multilateral APAs – Pros & Cons



Pros

- Negotiations on a multilateral basis rather than a series of separate negotiations with each tax authority
- Resulting in lower costs and greater certainty for the taxpayer in multiple jurisdictions

Challenges

- Perhaps no method to implement a multilateral agreement (a need for a series of separate bilateral APAs?)
- Exchange of (the same) information between all affected jurisdictions may be problematic in terms of confidentiality if not the same transaction flows

- **OECD**
 - Transfer Pricing Guidelines, IV. F and Annex IV
 - Bilateral APA Manual ('BAPAM')
 - Multilateral on Multilateral MAPs and APAs ('MoMA')

- **Domestic** legislation

- **European Union**
 - Guidelines for APAs in the European Union (2007)
 - Commission Working Document on Guidelines for APAs in the European Union (2007)

Simultaneous Tax Examinations Sources

- OECD
 - Transfer Pricing Guidelines, Ch. IV D
 - 1992 OECD Model Agreement for the Undertaking of Simultaneous Tax Examinations (online available at: <https://www.oecd.org/tax/exchange-of-tax-information/2666483.pdf>)
 - Manual on the Implementation of Exchange of Information Provisions for Tax Purposes (approved by the OECD Committee on Fiscal Affairs on 23 January 2006) (online available at: <http://www.oecd.org/tax/exchange-of-tax-information/36648057.pdf>)
 - Joint Audit Report (2010) (online available at: <http://www.oecd.org/tax/administration/45988932.pdf>)
- EU
 - Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation (online available at: <http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32011L0016>)
 - EU Commission Communication 6.12.2012

Cooperative Compliance Programmes Sources

- OECD
 - Cooperative Tax Compliance Building Better Tax Control Frameworks (2016)
 - Co-operative Compliance: A Framework From Enhanced Relationship to Co-operative Compliance (2013)
- Domestic legislation

