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EU JOINT TRANSFER PRICING FORUM

**DISCUSSION PAPER ON JOINT AUDITS FOR TRANSFER
PRICING IN THE EU**

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This is a DG TAXUD working paper prepared for discussion purposes. It does not represent a formal Commission or Commission services position or policy.

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1. Introduction

1.1. Background/JTPF Programme of Work

The June 2015 Action Plan for Fair and Efficient Corporate Taxation in the EU¹ intends to promote greater cooperation between Member States in auditing cross-border companies (section 5.2) as instruments, amongst which primarily joint audits, are not being used to full effect.

In this respect, the JTPF report on risk management in TP states² that developing and improving existing legal frameworks and practical guidance on bi- or multilateral TP controls would be useful and highlights the potential that joint audits may have in transfer pricing, both at the audit phase and for the resolution phase.

The latter double benefit appears to be very specific to transfer pricing and may not be that effective in other areas of taxation, such as VAT, excise duties, *etc.* Moreover, amongst issues which are deemed suitable for consideration in a joint audit, transfer pricing holds a an important position³.

At the June meeting, the JTPF gave, consequently, a relatively high priority to this item which is part of the work programme⁴.

Other works are currently being performed in this area and, in particular, a Fiscalis Project Group FPG049 on "Joint Audits" was set up was set up in April 2015 in order to carry out a field-oriented assessment of Joint Audits (JAs). This group gathers specialists of the audit field in tax administrations and is covering all taxes (direct and indirect). It will deliver a report beginning 2016, aimed at identifying the operational state of play, as well as the opportunities and risks for developing a general JA tool at EU level.

¹ *Communication from the Commission to the European Parliament and the Council - A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action* ; 17 June 2015, COM(2015) 302 final and more particularly Section 5.1 Improving Member States' coordination on tax audits and Section 2.2. Improving the Transfer Pricing framework in the EU

² Paragraph 18 of the JTPF Report on TP Risk Management

³ *For illustration, see Report from the Commission to the Council and European Parliament, 12 February 2014 on the application of Council Regulation (EU) no 904/2010 concerning administrative cooperation and combating fraud in the field of value added tax, COM(2014) 71 final, Section 3.6.3 « some Member States have indicated that a joint audit might be effective in cases where quick information exchange is needed, particularly in direct taxation cases where very large companies with subsidiaries could be involved (e.g. transfer pricing) ». See also JTPF Report on Transfer Pricing Risk management and 2015-2017 Program of Work (mentioned below).*

⁴ See Section III of the JTPF Programme of Work for 2015-2019

1.2. Objective of this paper

This discussion paper provides a preliminary assessment of the benefits of Joint Audits (JAs) in the transfer pricing area. It illustrates the specific situation and positioning of transfer pricing *vis-à-vis* JAs and defines the scope of further work to be done in this respect.

In the absence of an EU common definition⁵, a JA is understood for the purpose of this paper as a common audit team, with members of two or more States, examining jointly cross-border situations to arrive on a common conclusion on audit findings.

When Simultaneous Controls ('SC') and Multilateral Controls ('MLC') are mentioned hereafter, they should be construed as defined respectively in the Directive on Administrative Cooperation (2011/16/UE Art.12) and the DG TAXUD Multilateral Control Management Guide (2012)⁶, *ie.*:

- In a Simultaneous Control ('SC'), two or more Member States agree to conduct a control simultaneously, respectively in their own territory, of one or more persons of common or complementary interest to them, with a view to exchanging the information thus obtained;
- In a Multilateral Control ('MLC'), a co-ordinated control of the tax liability of one or more related taxable persons, is organised by two or more participating countries which includes at least one Member State having common or complementary interests. Multilateral controls may be organised simultaneously (*i.e.* as a SC), but this is not obligatory.

Given the above-mentioned particular positioning of transfer pricing and the implications which an effective EU joint audit tool may have in this area, not only at the audit stage but also regarding the resolution phase, it is suggested to the JTPF members to deliver a specific assessment as regards strengths, weaknesses opportunities and threats in the transfer pricing area, with a more comprehensive perspective, *i.e.* not limited to the above-mentioned audit phase. This paper therefore elaborates on

- Why joint audits in the EU could be particularly useful from a Transfer Pricing (TP) perspective and
- The scope of further work at JTPF level.

⁵ As a reminder, the OECD in its 2010 Report of the Forum of Tax Administration describes joint audits as *"two or more countries joining together to form a single audit team to examine an issue (s) / transaction (s) of a company or individual with cross border business activities, perhaps including cross border transactions involving related affiliated companies organized in the participating countries where the taxpayer jointly makes presentations and shares information with the countries and the teams, and the team includes Competent Authority representatives from each country who are involved to resolve potential differences/stalemates"*.

⁶ http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/fiscalis_programme/participating/guide_mlc_en.pdf

2. Why could JA be useful from a TP standpoint?

2.1 *Specific nature of TP*

As said above, the specific nature of transfer pricing raises issues, which are not encountered in other areas of direct or indirect taxation.

TP cases, when audited, immediately involve a double-taxation risk because of the two-sided nature of TP, *i.e.* to avoid double taxation, a primary adjustment in one State requires a corresponding adjustment in the other State.

TP is highly fact specific as the price for each transaction needs to be determined by reference to a comparable transaction. This determination requires "judgement" by the person determining or reviewing TP in several instances of the process. Therefore, TP is potentially more subjective than other areas of direct and indirect taxation and, by this, sensitive to disputes. Differences in opinion may arise on the following steps of the comparability analysis:

- Relevance and weight given to specific facts and circumstances of the case
- Delineation of the controlled transaction under review
- Aggregation of transactions
- Determination of the most appropriate method
- Source of uncontrolled transactions (internal/external comparables)
- Comparability of uncontrolled transactions
- In case of ranges, determining the most appropriate point in the range
- Need for and appropriateness of comparability adjustments

Differences in judgement may not only arise between the MS involved, but also between different bodies within the respective MS, *e.g.* audit department versus Competent Authority in charge of MAP and TP audits vary across the EU with respect to timing and process.

Even more important, some conclusions of the OECD BEPS project in the transfer pricing area will require in the near future a higher degree of cooperation of the process between MS already in the audit phase, if not earlier. For example paragraph 1.55 of the revised Chapter I OECD TPG⁷ requires for cases, where highly integrated functions are fragmented across several group companies to identify the nature of the interdependencies and how the commercial activity to which the associated enterprises contribute is coordinated. This seems not possible to implement effectively when following a separate audit approach and the

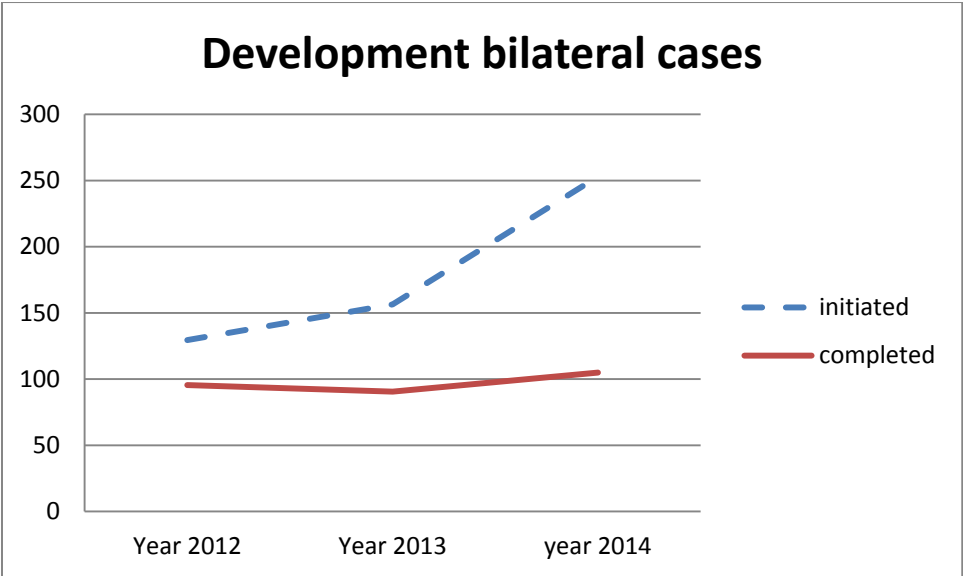
⁷ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2015)

possibility offered by Joint Audits to perform one fully-fledged and coordinated examination of cross border transactions of multinationals would be instrumental here.

2.2 Impact of the current situation and increasing transfer pricing dispute caseload

The specific nature of transfer pricing is also illustrated by the following:

- Transfer pricing disputes seem to increasingly move up to the latest stage in the process, the Mutual Agreement Procedure under the Arbitration Convention (see charts below). This procedure was, however, developed as a last resort mechanism for highly controversial cases rather than as a “mass procedure”. The number of pending cases as well as the number of cases taking longer than 2 years is increasing.



Source JTPF Statistics 31.12.2014 (doc. JTPF/008/2015/EN

- The procedure to resolve transfer pricing disputes under the EU Arbitration Convention is criticised as taking too long and involving a high administrative burden for tax administrations and taxpayers at all stages of the process
- The procedure gets more complicated if the same issue is audited by several MS at several points in time. There is a risk of information asymmetry between all stakeholders (tax administration making the primary adjustment, tax administrations in charge for the compensating adjustment and the taxpayer)
- Long duration makes it difficult to obtain the facts and circumstances ex post which often raises new issues. The reason is that people involved in the process and knowing the facts and circumstances (auditors as well as people in the MNEs’ tax department) often change position after a short time or that companies do not practice contemporaneous documentation.

2.3 Measures taken to address the challenges

Although surely having a positive effect, the measures, which are explored currently (*e.g.* providing clearer guidance, do risk management or Advance Pricing Arrangements ('APA')), seem not to have achieved a complete change of the situation. Furthermore, they seem not be suited for effectively implement some conclusions of the OECD BEPS conclusions (*e.g.* paragraph 1.55 Chapter I of the OECD TPG⁸).

2.4 Potential benefits of Joint Audits as an additional tool

Conditions and practices of carrying out Simultaneous Audits/Multilateral Controls under the existing EU legislative framework have been developed as far as possible. However, these latest developments still do not address some identified specific needs in the area of transfer pricing, which involve a coordinated end-to-end process of collection of facts and data, as well as cooperating in interpreting jointly such data and facts.

Simultaneous Audits/Multilateral Controls seem to focus more on exchange of information and are limited to (i) listing issues to be audited, (ii) sharing some information, (iii) sharing outcome which can still be notified in different manners and based on different legal basis and there is limited room for further improved coordination in this field. This may be sufficient for other areas of taxation but not for transfer pricing.

A Joint Audit could go further and would provide a practical basis for a faster and more precise exchange of information in transfer pricing. The organisation to be set up should allow to solve problems quickly, to carry out a more target-oriented investigation and to have a stricter compliance, as well as a faster process.

For some of the BEPS conclusions (*e.g.* see the above-mentioned paragraph 1.55 of the OECD TPG⁹), a joint audit approach appears to be even essential and the only conceivable implementation tool.

A key element would be providing legal clarity and faster legal certainty by finding a common judgement at the level of stakeholders directly involved in the case. This should particularly be possible in the area of transfer pricing, where the domestic law of the States involved coexists with a comprehensive set of internationally agreed rules (OECD Transfer Pricing Guidelines and EU JTPF Guidance). It could also result in a reduction of costs for both the taxpayer and the involved Member States.

In cases where it is not possible to come to a common position, a joint audit could foresee to clearly identify the reason for disagreement and the differences in positions. By this, Joint Audits could be instrumental in improving TP compliance and dispute resolution “*ex ante*” within EU-28 and in improving the dispute resolution process under the EU Arbitration

⁸ See footnote 7 above.

⁹ See footnote 7 above.

Convention (also, by allowing anticipated as well as more effective and timely coordinated positions towards third countries).

Additional benefits of a Joint Audit approach:

- To address timing differences in audit procedures and reduce long procedures which are highly criticized
- To address frequent information asymmetry situations on the facts and circumstances. Given the level of details and granularity of data and treatments, it seems that joint audits are more effective
- To close the gap between APAs and dispute resolution under the Arbitration Convention
- To contribute to mitigate other risks connected with an inefficient and time consuming dispute resolution mechanism, *e.g.* tax collection risk
- To provide an incentive for voluntary compliance, transparency and tax collection of revenues in the area of transfer pricing.

Administrative costs of joint audits (*e.g.* travel costs) may be reduced by an increased use of new ways of communication offered as part of the EU tools set up to make Joint Audits more efficient and effective.

Because of the particularity of transfer pricing, some specific risk areas would be worth to be evaluated as well as some EU tailored recommendations/techniques at a multilateral level through a common full-fledged approach (pilot projects).

3. Proposed way forward

The above developments reflect the current state of progress of JTPF work regarding Joint Audits and the significant differentiating advantage it will offer, if proposed as a common EU tool, in the transfer pricing area, both at the audit and resolution stage.

JTPF will explore the various aspects a joint audit approach should have for transfer pricing purposes. It will further work on a comparative assessment of this tool *vis-à-vis* other existing tools in administrative cooperation and provide input on the legal and organisational obstacles to overcome for enabling the possibility of an EU wide joint audit approach.

For discussion:

Do you agree with the statements above and the proposed way forward?

The attached appendix provides for a preliminary overview of Joint Audits compared with Simultaneous Audits which will be discussed at the meeting.

Annex - Advantages/Pros & Cons analysis - Distinction between Joint Audits and Simultaneous Audits (highlighting added-value of J.As) – Preliminary overview

NEEDS/SUBJECT	SIMULTANEOUS AUDITS	JOINT AUDITS
Avoid disputes to arise or make them arise at an early stage of the process so that dispute resolution can be prepared in an optimal way	Limited because no element of cooperation. Have a component of exchange of information but limited to (i) listing issues to be audited, (ii) sharing some information in a more or less formal manner, (iii) sharing outcome which can still be notified in different manners and based on different legal basis	Advantage is <ul style="list-style-type: none"> • Transparency, management of time and fully fledged access to information and data processed, • Agreement on legal basis and techniques, • Limited risk of arbitrage, • Dispute prevention by common agreement (no dispute) or possibility of agreeing to disagree but to elaborate the issue (s) for preparing dispute resolution • More efficient time management of procedures, multilateral and pilot approaches
Identifying common transfer pricing risks	Issues may be listed	It could allow a more detailed analysis and also revision of the approach/adjustment of scenarios is possible under JAs which can be crucial under TP
Time management of the tax audits	Time frame may be agreed	Having one team involved and processing the information in real time should avoid losing time – also ‘one single team’ approach will lead to have the taxpayer not lagging behind in one country compared to the other
Management of data and information	Limited	Full-fledged and coordinated treatment/interpretation of data with a joint approach on both sides of the border(e.g. use of tools, IT processing, economic valuation), something which is key for TP
Risk of arbitrage and profit shifting by taxpayers – Increased reassessed tax basis and effective collection of tax revenues	Arbitrage is possible	Due to parallelism and unique procedure, arbitrage seems impossible. It gives a clear incentive for taxpayer, also willing to cooperate
Legal certainty/clarity	No	Legal certainty is normally ensured as a result of the one single audit procedure
Anticipation of tax collection and risks of bankruptcy	Not possible (outcome of audits are shared and no possible strategy)	Anticipation possible
More efficient, less costly and feasible management of multilateral tax audits (advantage of one single team) – eg cases of multilateral management fees issues, low value adding services	Not effective	Clearly an advantage as for instance one country could be chosen as a model with duplication
Tax administration knowledge, sharing of practices and creation of “niches” in transfer pricing// pilot tests	Not systematic	Optimal (on the field)