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Transfer Pricing 21st edition

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Managing TP locally and globally

The global business environment of 2021 looks very different to how it was this time last year. As expected, the COVID-19 pandemic created significant losses for many businesses. Guidance from the OECD was very much welcomed as businesses sought to work out the best ways to address the impact of the pandemic on TP arrangements.

Businesses across the globe continue to face a range of specific TP challenges. Tax experts in Sweden have the added burden of having to comply with Swedish VAT regulation while following the OECD TP Guidelines, which seems like an almost impossible task.

Russian tax authorities issued guidance in February 2021 on auditing intra-group services, and DAC6 implementation in Italy has introduced compliance activities for intermediaries and taxpayers where intra-group arrangements are required.

However, it is not all doom and gloom. COVID-19 has brought about the adoption of digital technologies and transformation quicker than expected and Indonesia is one country, among many, that has seen significant progress in its digital economy.

MNEs are looking to the future beyond the pandemic and are continuing to rise to the challenges of TP documentation requirements that for many includes a detailed value chain analysis, a vital framework for companies when planning and defending TP policies in the future. Of course, reporting requirements also extend to some Latin American countries, which must comply with BEPS Action 13.

There has been a steady increase in international tax disputes, with mutual agreement procedures (MAPs) increasingly becoming the preferred method to resolve TP disputes. However, in South Korea, there are cases in which TP issues cannot simply be addressed by MAP.

Looking further afield at global mobility, it can be argued that the implementation of the BEPS project by the Multilateral Instrument exacerbates tax and employment problems related to the international mobility of employees.

We hope you enjoy reading the 21st edition of our Transfer Pricing guide.

Lorraine Yardley
Commercial editor
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Transfer Pricing

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The importance of mutual agreement procedures in international tax disputes

Federico Vincenti and Alessandro Valente of Crowe Valente/Valente Associati GEB Partners provide an update on an effective and commonly used dispute resolution instrument, the mutual agreement procedure.

The mutual agreement procedure (MAP) is an instrument for the resolution of international tax disputes whenever a person considers that the actions of one or both of the contracting states' tax administrations result or will result in taxation not in accordance with the provisions of a tax convention or of a tax treaty.

To this end, the MAP allows competent authorities designated from the governments of the contracting states to interact with the intent to resolve the international tax dispute. On October 10 2017, the Council of the European Union issued Directive (EU) 2017/1852 with the purpose of increasing tax certainty in the single market. With Legislative Decree No. 49/2020 published on June 10 2020, the Italian legislator approved the decree implementing EU Directive 2017/1852.

International tax disputes

International tax disputes arise, in principle, where two or more jurisdictions exercise their taxing power in a manner resulting in violation of the bilateral or multilateral treaty for the avoidance of double taxation (double tax convention or DTC) stipulated or an equivalent instrument.

Such disputes can also arise without violation of the DTC (including equivalent instruments) if there is disagreement or uncertainty in relation to the correct application of its provisions.

The existing DTCs provide for the resolution of the mentioned international disputes through the MAP.

Since the number of international tax disputes is steadily increasing (particularly with respect to inter-company cross-border transactions), the presence of accessible and effective dispute resolution mechanisms are critically relevant to ensuring the facilitation of cross-border trade, the tax certainty and the elimination of double taxation for taxpayers.

Considering the above-mentioned goal, several countries introduced some unilateral procedures aimed at eliminating or reducing double taxation (i.e. unilateral downward adjustment in case of upward transfer pricing (TP) adjustment in another state) to be used alternatively or in conjunction with the instrument provided at international level.

OECD provision on the MAP

Article 25 of the OECD Model Tax Convention provides a mechanism, independent from the ordinary legal remedies available under domestic law, through which the competent authorities of the contracting states may resolve differences or difficulties regarding the interpretation of norms.

MAP aims at disputing resolutions through encouraging dialogue and cooperation between the competent national tax authorities involved. This is generally because of a request by the taxpayer affected by the double taxation.

Therefore, the MAP is a key instrument for the taxpayer since it guarantees the proper application and interpretation of tax treaties and ensures that taxpayers entitled to the benefits of the treaty are not subject to taxation by either of the contracting states which is not in accordance with the terms of the treaty.

According to what is provided for by paragraphs 1 and 2 of Article 25 of the OECD Model, competent authorities of contracting states shall endeavour to solve, through a MAP, situations in which taxpayers result in being subjected to taxation which is not in accordance with what is provided for by the applicable double tax agreement.

This procedure can also be used, according to paragraph 3, for the solution of problems related to the interpretation of agreements and for consultations aimed at eliminating cases of double taxation which are not regulated by the agreements themselves.

Moreover, paragraph 4 allows the competent authorities to communicate directly with each other and, if necessary, to carry out a mutual consultation procedure through a specifically appointed commission. Paragraph 5 establishes the possibility of bringing an arbitration procedure aimed at ensuring the effectiveness of the MAP.

The OECD changed the MAP framework in 2020 to ensure an effective and prompt dispute resolution and strengthen the effectiveness of the MAP process, minimising the risks of uncertainty and unintended double taxation.

In particular, Action 14 of the BEPS project 'Making dispute resolution mechanism more effective,' developed a minimum standard with respect to the resolution of treaty-related disputed which should ensure:

- That treaty obligations related to the MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner;
- The implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and
- That taxpayers can access the MAP when eligible.

All 137 members of the BEPS Inclusive Framework committed themselves to implement the Action 14 minimum standard and to have their implementation evaluated through a peer review process. The minimum standard was translated into 21 elements in the following areas:

- Dispute prevention;
- Availability and access to the MAP;
- Resolution of MAP cases; and
- Implementation of MAP agreements.

Along with the adoption of the minimum standard, the BEPS Inclusive Framework members also agreed to a peer review process (launched at the end of 2016) to evaluate the implementation of this standard and to report MAP statistics under a newly-developed reporting framework.

On November 18 2020, the OECD launched a new public consultation on Action 14 regarding the following issues:

- Experiences with, and views on, the status of dispute resolution and suggestions for improvements, including experiences with MAPs in those jurisdictions that obtained a deferral;
- Additional elements to strengthen the Action 14 minimum standard; and
- Additional elements to strengthen the MAP statistics reporting framework.

EU provision on the MAP

The European Commission, in the Communication 'double taxation in the single market' (COM (2011) 712), defines double taxation as the 'imposition of comparable taxes' by two (or more) tax jurisdictions in respect of the same taxable income or capital. This taxation can be related to cases of 'dual residence' or to cases of taxation both in the state of residence and in the state of the source.

Although states adopt unilateral, bilateral or multilateral measures aimed at eliminating double taxation, EU law does not provide for any rule aimed at obliging states to eliminate the so-called 'non-discriminatory' double taxation, as the latter falls outside the scope of the fundamental freedoms.

With reference to the mechanisms for dispute resolution, the main instrument currently existing at EU level is the Arbitration Convention No. 90/436/EC, the aim of which is to define a procedure for the resolution of disputes arising from TP.

In the case of TP adjustment by one of the contracting states, within three years from the notification of the measure, the enterprise may present the case to the competent authority of its state of residence, so that a MAP can be carried out.

If, within two years from the submission of the case, the competent authorities have not reached a mutual agree-

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ment, they shall initiate an arbitration procedure, by setting up an advisory commission which has to express its opinion concerning the modality for eliminating the double taxation at hand, within six months.

Within six months from the date on which the advisory commission delivered its opinion, the competent authorities shall take a decision concerning the elimination of the double taxation. This decision does not have to necessarily conform to the opinion expressed by the advisory commission.

According to Article 8 of the Arbitration Convention, the competent authority is not obliged to initiate the MAP or the arbitration procedure when one of the concerned enterprises is liable to serious penalties arising from the acts that lead to the profit adjustments.

In the communication published on the November 11 2011, the European Commission considered that the existing instruments are characterised by several limits and that they are not always suitable for solving issues related to double taxation.

Despite the existence of the Arbitration Convention and the subsequent adoption and review of the corresponding code of conduct, the arbitration procedures are often long, and the unresolved cases are very numerous.

On October 10 2017, the Council of the European Union issued Directive (EU) 2017/1852 (Directive) 'on tax dispute resolution mechanisms in the European Union' with the purpose of increasing tax certainty in the single market by addressing identified malfunctions of the European Arbitration Convention No. 90/436/EEC and extending its scope of application.

This directive is part of a package of reforms proposed by European Commission to fight tax avoidance. In the context

of such package, Directive (EU) 2016/1164 and Directive (EU) 2017/952 have been adopted and renewed proposals for directives on the harmonisation and consolidation of the corporate tax base have been put forward (CCTB, in document COM (2016) 685, and CCCTB, in COM (2016) 683).

Directive (EU) 2017/1852 constitutes a landmark for EU taxation because it advocates for the establishment of an EU-wide legislative framework to resolve a broad range of cross-border tax disputes.

The previous framework was composed of fragmented MAP provisions that were included in varying member states' DTCs with an exemption for TP issues that were resolved under common rules established in the Arbitration Convention.

The new framework builds upon the existing mechanisms by improving them in accordance with the recommendation of BEPS Action 14.

Furthermore, the Directive has an extended scope, to include all international tax disputes arising between member states, either on the basis of the Double Tax Convention or the Arbitration Convention and in relation to their interpretation or application. This means that the same rules shall apply for the resolution of all such disputes, while before such directive, there was a common framework, at the European level only for TP disputes (under the Arbitration Convention).

The directive should also guarantee the following benefits for the taxpayers:

- The provision of mandatory binding MAP arbitration shall ensure the international tax disputes shall be effectively resolved. As such, competent national tax authorities are encouraged to reach an agreement;
- That effective resolution is guaranteed for all taxpayers and for all cross-border tax disputes in the EU; and
- That tax disputes should be resolved in a timely manner, since the directive prescribes a strict timeframe for the several actions that need to be taken in the context and for the purpose of dispute resolution.

The directive was to have been transposed into member states' legislation by June 30 2019 to apply to tax disputes arising in the EU after that date with reference to tax years beginning 2018.

With Legislative Decree No. 49/2020 published on June 10 2020, the Italian legislator approved the decree implementing EU Directive 2017/1852.

The new provisions introduce elements of novelty and innovation with respect to previous legislation and the best practices and guidance of Italian tax authorities.

The obligation of the interested parties is to submit an application concerning disputed issues within three years:

- From the date of the notice of assessment or any equivalent document that results or could result in a disputed tax treatment; or
- From the time when the measure has been taken or occurs which has given rise or is likely to give rise to the matter in dispute; or
- Starting from the notification of the relevant assessment's notice in cases where the application request has been submitted following the delivery of the statement of findings.

With reference to the relationship between litigation and the MAP, the new rules allow the taxpayer to choose whether or not to enter into litigation. The submission of the application does not prevent the taxpayer form using the means of appeal provided by the national law.

The application must be submitted to the Italian Revenue Agency and to the competent authority of the other member state of interest and must contain various general information (data to identify the enterprises involve, tax periods involved, etc.), as well as the facts and circumstances of the case under disputes.

If the application is granted, the competent authorities of the member states concerned shall endeavour to resolve the disputed matter within two years from the date of the last notification of the decision granting the application.

In the event of failure to reach an agreement between the competent authorities of the member states, Legislative Decree No. 49/2020 allows a person to submit a request for the establishment of an advisory commission or an alternative dispute resolution commission.

This provision is an expression of the legislator's desire not to limit the MAP to mere negotiation between member states. The presence of a third and impartial commission makes it possible to establish a real form if international arbitration between tax administrations.

The rules contained in the Legislative Decree No. 49/2020 apply to applications filed as of July 1 2019 and relating to tax disputes issued concerning tax years starting 2018.

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