Chapter 3

Costs and benefits

59. Whenever an auditor is pursuing an audit that goes beyond a purely domestic context there is the question of whether to use international tax co-operation. The auditor may conclude that no international tax co-operation is necessary because, for instance, the taxpayer has provided all relevant information and there is no reason to believe that any of the information is either incorrect or incomplete or that the case has any other material international ramifications. There are other situations where the auditor requests particular information using information exchange instruments and can complete the audit on the basis of the information obtained. And there are situations where enhanced tax co-operation and in particular Joint Audits may be the best course of action.

60. This chapter first discusses costs and benefits of Joint Audits relative to the alternative course of action – typically a separate domestic audit(s) possibly followed by MAP. Based on this analysis, earlier work of the FTA and the experience of the Expert Group members it then identifies particular situations where the use of Joint Audits should be considered. This chapter ends with an example on how to visualise the benefits of Joint Audits.

3.1. Key benefits

61. The key benefits of Joint Audits include the following:

- a joint approach to fact finding involving the participating tax administrations and the taxpayer, thus
  a. avoiding misunderstandings, different version of reality and ensuring that there is one conversation, rather than several conversations with potentially different outcomes
  b. achieving a holistic overview of taxpayers' business structures as well as cross-border transactions due to a better quality of information that is exchanged during a Joint Audit procedure that allows more targeted examinations in the future
  c. a more efficient and faster process compared to separate audits followed by MAP
  d. reduced burdens for taxpayers and tax administrations compared to separate audits especially where they subsequently result into a MAP case
  e. compared to MAP following unilateral audits, no need to undo decisions that have already been taken, with positions that may have become entrenched and with the difficulties that this may entail

- ability to leverage off the auditing experience and expertise of other tax administrations that can also support the improvement of each tax administrations' own case selection and auditing methods
- a better understanding of the differences in legislation that can subsequently support better risk assessment and a better allocation of resources
- enhancing the compliance of MNEs when early tax certainty can be achieved and a higher tax risk posture becomes increasingly unattractive.

62. The experience of the Expert Group Members also bears this out. In almost 100% of the Joint Audit cases undertaken, participants could achieve common view also accepted by the taxpayer thus closing the case and avoiding further resource and time intensive procedures. Expert Group Members also reported that after the conduct of a Joint Audit they understood particularities of other legislations that had previously caused concerns but could now be placed in the right context, thus streamlining the risk assessment process for the future.

63. Furthermore, internationally operating taxpayers started to approach their tax administrations independently and suggested to be selected for a future Joint Audit. Business representatives consulted during the course of this Project even stated that the value of early tax certainty can sometimes outweigh the cost of a somewhat higher tax burden.

3.2. Costs

64. On the cost side there are mainly the time and resource implications of a Joint Audit. Costs are higher relative to a purely domestic audit and timelines of the audit understood in a narrow sense, i.e. without consideration of any subsequent procedures (litigation/MAP), are typically longer. This is mainly the result of (i) additional time to initiate and conduct the audit as a result of the necessary co-ordination between the participating tax administrations; (ii) costs for travel and accommodation during the conduct of the audit; (iii) the need for language skills, and (iv) the need for experts or an expert team proficient in international tax matters as well as procedural particularities regarding information exchange and audit co-operation.

3.3. Optimising the cost-benefit-ratio

65. In order to optimise the cost-benefit-ratio the right case selection for Joint Audits is key. Drawing on the above, earlier work of the FTA and the experience of the Expert Group Members, cases for which the use of a Joint Audit may be the best course of action include the following:

1. there are reasons to believe that a domestic audit alone even if supplemented by information exchange or other forms of international tax co-operation would be less efficient or less successful in developing a full understanding and appreciation of the facts

   This is not only true for cases that show indications of aggressive tax planning for instance involving double dips, artificial cash movements, or dividend "washing". Joint Audits can also facilitate the analysis of complex tax structures drawing on the expertise of other tax administrations in order to better arrive at a correct assessment, preventing both, double taxation or double-non taxation and is not limited to transfer pricing disputes, but may also be helpful in determining the residence of a taxpayer or the existence of permanent establishments, etc.

Multilateral case example

Members of the Expert Group reported a case where six jurisdictions decided to conduct a multilateral Joint Audit to address a transfer pricing risk that involved a low tax jurisdiction. The Joint Audit was initiated by one jurisdiction that invited a number of jurisdictions to discuss the potential of joining forces on the risks detected and audit the case jointly.

The six jurisdictions agreed on a co-ordinated plan, on collective information requests and a clear timetable. The group appointed a delegation of auditors from three jurisdictions to operate and negotiate with the business on behalf of the group of tax administrations. The collective work of the tax authorities strengthened the negotiation position of the individual jurisdictions and it was efficient from an overall perspective while resources of three tax administrations worked on behalf of the group. They reached an agreement where a substantial part of the profit in the low tax jurisdiction was reallocated to the group of co-operating jurisdictions.

This reallocation caused an adjustment of the tax assessments for the taxpayer in the respective jurisdictions. Yet by one co-ordinated audit, the taxpayer obtained certainty about his tax position in all the jurisdictions involved. So ultimately it brought benefits to all parties involved.

Intra group financing structure – Germany and the Netherlands

Germany as member of the Expert Group reported about an intra-group financing structure that had been analysed in a Joint Audit. The particularity of the case was that the German tax administration had already requested information from the Dutch tax administration to understand the financing structure of the concerned MNE several years before the conduct of the Joint Audit. Both the request and the answers had been prepared diligently and in an exemplary manner. Nevertheless, it was only when the same MNE was selected for a Joint Audit that both audit teams achieved a comprehensive understanding of the facts, which ultimately resulted in an adjustment of the tax on both sides with additional tax being assessed.

Even though they had already received valuable information before, the tax administrations were only able to identify the financing structure correctly after examining the taxpayer jointly.

2. where particular issues, a transaction or series of transactions lead a tax administrations to the view that a tax examination on a unilateral basis may result in double taxation, for example in case of a cross-border business restructuring

Country example – Italy and Germany

Italy shared insights on a Joint Audit that it had conducted with Germany. The Joint Audit was focusing on transfer pricing issues and was selected because of business restructuring activities that led to changes in the transfer pricing methodology between the concerned Italian and the German entities. Italy and Germany agreed to examine the risk allocation, the evaluation of an exit charge for the relocation of functions and certain other transactions.

Country example – Italy and Germany *(continued)*

The Joint Audit showed that the operating margin of the German entity was above the arm's length range of the conducted benchmark analysis. This led to an upward adjustment of the operating margin of the Italian company and to a corresponding downward adjustment of the operating margin of the German company for the years at stake. The Joint Audit took approximately 12 months from the initiation until the re-assessment of the taxes and taxpayers was closely involved during the whole procedure providing information on the background of the re-organisation.

Due to the complexity of the re-organisation and the fact that one tax administrations had to do a corresponding downward adjustment of its tax-assessment, both tax administrations concluded that it would not have been possible to provide the concerned taxpayer with tax certainty within such a short timeframe through a purely unilateral approach. Both tax administrations considered it very likely that this case could otherwise have resulted in double taxation and therefore to a potential MAP. The Joint Audit allowed both tax administrations to understand the business rationale behind the restructuring activities thus allowing them to achieve a common understanding of the correct taxation, which would have been much more challenging had separate position already been adopted, relevant personnel not been available anymore and a tax assessment already finalised after a domestic audit.

3. the case under consideration is similar to types of cases that are already part of the existing MAP pipeline

Country example – US and Canada

The country example already contained in Chapter 2 illustrates the benefits of Joint Audits in cases where the same types of transactions continuously lead to double taxation for the taxpayer.

The taxpayer had already eight years under MAP and not changed his business model and transfer pricing method in the past. Yet there were no signs that the years following the latest year under MAP would stay undisputed. The USA and Canada acknowledged that only the decision to jointly audit the concerned taxpayer and to achieve a common understanding of the relevant transactions could bring an end to further years going into MAP and requiring further resources for many years. With the Joint Audit the USA and Canada were not only able to prevent further years of going into MAP by agreeing on a transfer pricing method for the future but were also able to achieve agreement for the years already under MAP.

4. a treaty partner has requested a Joint Audit, the information contained in the request indicates that a Joint Audit would be an appropriate action and the requested tax administration has a common or complementary interest in conducting a Joint Audit

   Several participants of the Project reported that there were indications that tax administrations sometimes rejected the invitation to participate in the Joint Audit out of concern that the audit may result in the lowering of their tax assessment.

5. the taxpayer has suggested a Joint Audit, the information contained in the suggestion indicates that a Joint Audit would be an appropriate action and the respective tax administrations have a common or complementary interest in conducting a Joint Audit[1]

6. two treaty partners experience an expansion in cross-border trade and investment and a Joint Audit would help build relationships and facilitate a better understanding of each other's auditing rules, practices and procedures.

   All participants in the Project confirmed that good relations with the personnel of the other tax administration and a high level of trust were the key element for the conduct of a successful Joint Audit. In several examples that were made by participants it was highlighted that an agreement was achieved despite several obstacles as a result of good and close relations between the tax administration's personnel in charge. It was also confirmed that the successful engagement via a Joint Audit has wider benefits beyond the particular Joint Audit itself.

7. a case has made no or little progress in MAP and there is reason to believe that a Joint Audit intervention has the potential to unlock the situation

   As outlined in Chapter 2 and in the Example above the conduct of a Joint Audit can not only prevent a case going into MAP but also support the resolution of disputed years that are already under MAP. This is because a Joint Audit allows a joint fact finding procedure that builds the basis for further conclusions, which are not entrenched yet by the time a Joint Audit is conducted. It is therefore imperative that the personnel conducting the Joint Audit is different from those that developed the positions taken in the MAP procedures to allow an unbiased examination of the case.

8. APA negotiations have taken a long time and a Joint Audit would allow to create tax certainty for past years and/or otherwise assist in resolving the issues for future years[2]

9. a joint or separate risk assessment has led two or more tax administrations to the view that a particular issue, transaction or series of transactions presents a material international tax risk.

   This could for instance be the result of a joint tax risk assessment of two or more tax administrations, which may find a series of transaction to be low risk, thus not requiring audit resource, but that conclude that there is one particular transaction where the risk assessment process itself does not give the level of assurance needed and an audit is warranted. To maximise the benefits of the joint risk assessment process and to minimise the risks of divergent tax assessment, resulting in possible double taxation, they decide to take the issue up via a Joint Audit.

66. Where a tax administration decides to pursue the audit as a Joint Audit, it should do so as early as possible in the process to support a common fact finding process and to limit the risks of tax administrations taking different positions. This may also limit the risk that a year may be closed in the other jurisdiction and result in a more real time audit.[3] It also ensures that both jurisdictions co-operate on an equal footing and co-operate with a similar level of engagement thus supporting the creation of a trustful relationship.

3.4. Measuring benefits

67. Alongside the successes shared, Expert Group Members also raised the issue that they are all facing the challenges of capturing the success of Joint Audits in management information.[4] Most tax administrations measure the success of a tax audit in figures covering numbers of audits conducted, additional yield, completion time, and other aspects depending on strategic goals defined.[5] Since the benefits of Joint Audits are not fully captured within this range of metrics or if narrowly applied such metrics might even indicate that Joint Audits are not beneficial, tax administrations are challenged to assess the benefits from a wider perspective. While the costs can be easily measured by an "old school" approach tax administration should also evaluate the Joint Audit programme over the longer term and include criteria like enhanced taxpayer compliance, improvement of risk assessment and streamlined resource allocation.

68. To be able to assess the benefits of a Joint Audit tax administrations should first consider how they want to evaluate the effectiveness of Joint Audit activity. For evaluating the success of an action, there are different phases that can be evaluated:

1. Plan evaluation

A solid plan forms an important precondition for an effective and efficient Joint Audit. The reasons to start a Joint Audit, the description of the goals, and the expected outcome should be clearly defined and be the result of a structured planning process. The plan evaluation allows analysing the quality of the Joint Audit plan, both ex ante and ex post.

2. Process evaluation

A streamlined process is key for an effective and efficient Joint Audit. The evaluation of this part of the Joint Audit supports the analyses whether the process of the conducted Joint Audit went according the initial plan; it bridges the findings of the plan evaluation and outcome evaluation.

3. Outcome evaluation

The outcome evaluation is a synthesis of information about the costs of a Joint Audit in relation to the benefits, and answers to what level the objectives of a Joint Audit are met. There are hard and soft indicators to measure the costs and benefits and it is not always easy to quantify the outcome of an individual Joint Audit, especially potential long-term effects. In the end it involves some level of professional judgment to decide whether a Joint Audit met its objectives.

69. When evaluating a Joint Audit Programme as a whole tax administrations should set clear goals and use concrete short and intermediate goals that are measurable over a shorter time frame. It is also important to distinguish between output (e.g. number of audits) and outcome (e.g. better insight in business structure) and improved co-operation between tax administrations (e.g. better tax compliance, less MAP cases).

70. The matrix below illustrates different perspectives how different benefits of Joint Audits can be evaluated. In the left column, the key benefits of Joint Audits are mentioned and an example of the type of questions a tax administration may want to consider to indicate whether the objectives were met. Some objectives can be considered as benefits for the tax administration whereas others may serve primarily the interest of the taxpayer

and might influence tax compliance. However, it is important to realise that enhancing taxpayer compliance cannot be measured after one audit, but should be assessed over a longer time period.

71. The matrix only illustrates a limited number of examples of soft indicators and can be altered or optimised according to specific needs.

Cost & Benefit Matrix	Stakeholders		Indicator		Evaluation of		
	Tax Administration	Taxpayer	Hard Indicator	Soft Indicator	Plan	Process	Outcome
Fact Finding							
better understanding of relevant facts and circumstances	■			■		■	
better understanding of taxpayers' structures and transactions	■			■		■	
uncovering agressive tax planning structures	■			■			■
resolving pending MAP	■	■	■				■
more efficient information gathering process		■		■		■	
Leverage of audit experience and expertise							
increase of knowlegde on other audit approaches, audit cultures and legislation	■			■			■
Enhancing the compliance of MNEs							
indicators that suggest that level of compliance increases	■			■			■

72. The Project showed that the information currently collected to measure the outcomes of Joint Audits varies widely. To facilitate an evaluation of the Joint Audit practice in the future, jurisdictions could therefore collect the same set of information and degree of detail. The information to be gathered would relate to situations where a Joint Audit was conducted and situations where a Joint Audit was proposed but rejected by the requested tax administration.

73. The information in situations where a Joint Audit was conducted could include basic information such as (i) the partner jurisdiction(s), (ii) whether the subject of the audit was on transfer pricing or others), (iii) the duration of the Joint Audit (beginning with the proposal and ending with the conclusion of the Joint Audit with a final report[6]), (iv) whether a common view was achieved.

74. In situations where a Joint Audit proposal was rejected, information could include (i) the requested tax administration, (ii) the reason, why the Joint Audit proposal was rejected, e.g. procedural obstacles (no alignment of audit cycles), no available resources (indication whether it was offered to conduct the Joint Audit at a later time), (iii) whether the case was subject to a subsequent procedure (e.g. a MAP).

75. When discussing and designing the requirements for the evaluation procedure it is important to clearly define the expected results beforehand (i.e. to manage expectations) and to be clear which data is needed, to ensure that these data points are collected during the Joint Audit process. As the full impact of a Joint Audit may not be visible until sometime after the conduct of a Joint Audit, especially when relating to long-term outcomes like taxpayers' behaviour, jurisdictions may want to revisit their assessment of the outcomes of Joint Audit cases after a certain time period. This was a lesson learned by Expert Group Members who reported that it is often difficult to report the results of Joint Audit activity after a period of time from a central level. In practice, there are often several

departments involved (e.g. audit department, local tax inspector, competent authority on central level, analysts from MAP team) and the experience is that it is difficult or takes extra time to trace information of the final outcome, especially the benefits that are labelled as "soft indicator" in the matrix.

3.5. Recommendations

1. Develop guidance to ensure that appropriate cases are considered for Joint Audits including where
   - there are reasons to believe that a domestic audit alone even if supplemented by information exchange or other forms of international tax co-operation would be less efficient or less successful in developing a full understanding and appreciation of the facts
   - particular issues, a transaction or series of transactions lead a tax administration to the view that a tax examination on a unilateral basis may lead to double taxation, for example in case of a cross-border business restructuring
   - the case under consideration is similar to types of cases that are already part of the existing MAP pipeline
   - a treaty partner has requested a Joint Audit, the information contained in the request indicates that a Joint Audit would be an appropriate action and the requested tax administration has a common or complementary interest in conducting a Joint Audit
   - the taxpayer has suggested a Joint Audit, the information contained in the suggestion indicates that a Joint Audit would be an appropriate action and the respective tax administrations have a common or complementary interest in conducting a Joint Audit
   - two treaty partners experience an expansion in cross-border trade and investment and a Joint Audit would help to build relationships and facilitate a better understanding of each other's auditing rules, practices and procedures
   - a case has made no or little progress in MAP and there is reason to believe that a Joint Audit intervention has the potential to unlock the situation
   - APA negotiations have taken a long time and a Joint Audit would allow to create tax certainty for past years and/or otherwise assist in resolving the issues for future years
   - where a joint or separate risk assessment has led two or more tax administrations to the view that a particular issue, transaction or series of transactions presents a material international tax risk.
2. Set clear short, intermediate and long-term objectives and develop an evaluation framework that allows an assessment whether these objectives were met.
3. Collect relevant data to facilitate a full evaluation of the Joint Audit practice and the learning.

Notes

1. See Chapter 5.
2. See Chapter 2.
3. An early engagement in the Joint Audit process might also limit the risk that a certain tax period becomes time barred in the requested jurisdiction and allows the requested tax administration to move a tax period up in the audit timeline in order to make a Joint Audit possible.
4. There is currently no international agreed evaluation criteria in place that allows an evaluation of different Joint Audit Programmes, apart from the FISCALIS Programme that collects certain statistical information from European countries.
5. See Chapter 7.
6. See Chapter 7.

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