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**Dispute avoidance and resolution**

# Chapter 2 on Approaches to Avoiding Disputes of the Handbook on Avoidance and Resolution of Tax Disputes

**Note by the Subcommittee on Dispute Avoidance and Resolution**

*Summary*

This note is presented FOR DISCUSSION AND APPROVAL at the twenty-first session of the Committee.

The note includes the final version of Chapter 2 (Approaches to Avoiding Disputes) of the proposed *United Nations Handbook on Avoidance and Resolution of Tax Disputes*, which was finalized by the Subcommittee on Dispute Avoidance and Resolution at its online meeting on 3-4 September 2020.

At its twenty-first session, the Committee is invited to discuss and approve the attached final version of Chapter 2 for inclusion in the proposed Handbook.

1. At its twentieth session (held online from 22 to 26 June 2020), the Committee examined a first draft of Chapter 2 on Approaches to Avoiding Disputes of the proposed *United Nations Handbook on Avoidance and Resolution of Tax Disputes.* It was then noted that a few written comments made by participants in the Subcommittee on Dispute Avoidance and Resolution remained to be discussed by the Subcommittee. There were no other interventions on that draft chapter and Committee members and Subcommittee participants were invited to send written comments on the draft before 15 August 2020.

2. Each of the written comments previously received on the draft were discussed at the online meeting of the Subcommittee held on 3-4 September 2020, when the Subcommittee approved the attached revised version of the Chapter.

3. At its twenty-first session, the Committee is invited to approve the attached version of Chapter 2 for inclusion in the *United Nations Handbook on Avoidance and Resolution of Tax Disputes*.

# Chapter 2

# Approaches to Avoiding Disputes

## Table of Contents

## 2.1 Introduction

### *2.1.1 Overview*

1. For a country's income tax system to operate efficiently and effectively, it is essential that its government and tax administration provides dispute avoidance mechanisms. These mechanisms seek to prevent disputes between the tax administration and taxpayers, which is to the benefit of both parties.

2. This chapter explores various approaches to avoiding disputes that are generally available to prevent domestic and international income tax disputes from arising between the tax administrations and the taxpayers. Relevantly, the chapter discusses different aspects of creating the environment for avoiding disputes, such as by developing tax policy and legislation with a level of global awareness which is clear and accessible for taxpayers to understand their rights and obligations, and therefore less likely to lead to disputes arising.

3. The goal of this chapter is to assist developing countries with the further development and implementation of dispute avoidance strategies by describing a number of different approaches to avoiding disputes used around the world. Some of the dispute avoidance approaches may be more appropriate for consideration and implementation by the developing countries when their tax administrations have more resources, including staff with the requisite experience and capability. The chapter also considers the potential benefits for taxpayers and tax administrations should such dispute avoidance mechanisms be effectively implemented.

### *2.1.2 The types of disputes addressed in this chapter*

4. This chapter deals with mechanisms which can prevent disputes that may formally arise between the tax administrations and the taxpayers in relation to income taxes. A dispute is taken to formally arise where an audit results in the tax administration issuing a reassessment for additional income tax payable by the taxpayer or a demand for payment of tax to which the taxpayer does not agree.

5. The income tax disputes which can arise between a tax administration and the taxpayer prior to, or during the audit may be in relation to the facts, the interpretation of the tax law and/or the application of the tax law to the taxpayer's factual circumstances.

6. Illustrations of the types of disputes which can arise between a tax administration and the taxpayer at any stage up to, and including the audit (i.e. before the audit results in the tax administration issuing a reassessment for additional income tax payable by the taxpayer or a demand of payment of tax) include disputes in relation to the following matters:

- the amount of taxable income or tax calculated by the taxpayer;
- the taxpayer's choice of transfer pricing method used to value transactions between the taxpayer and its associated enterprises;

- the availability or computation of deductions, exemptions, credits, including foreign tax credits;
- the availability of losses;
- the character of items of income for tax purposes;
- the existence or non-existence of a permanent establishment; and
- the taxpayer's country of residence.

### *2.1.3 Benefits of avoiding disputes*

7. Countries should consider adopting a range of dispute avoidance mechanisms discussed in this chapter as there are many material benefits of avoiding disputes for the tax administrations and the taxpayers.

8. From the taxpayer's perspective, an effective dispute avoidance mechanism will provide the taxpayer transparency, certainty and a greater understanding of their rights and obligations under the tax law which, in turn, will enable them to make informed decisions about their tax affairs. Such mechanisms will also result in compliance cost savings for the taxpayer. By preventing a dispute with the tax administration, the taxpayer will avoid the unnecessary costs and delays associated with a formal dispute proceeding to litigation.

9. From the tax administration's perspective, the development and implementation of an effective dispute avoidance mechanism will enable the tax administration to direct their resources to higher risk taxpayers and areas of the law. Such a mechanism will also provide the taxpayer with transparency which will promote trust and confidence in the tax administration and the integrity of the tax system and consequently encourage voluntary compliance by the taxpayer. Similarly to taxpayers, by preventing a dispute with a taxpayer, the tax administration will save costs and time associated with a formal dispute proceeding to litigation and will for both the taxpayer and tax administration avoid the uncertainty as to its outcome.

### *2.1.4 Summary of approaches to avoiding disputes*

10. While there are considerable differences in the structure and legal form of the different types of dispute avoidance mechanisms that countries have adopted to deal with income tax disputes, these can be placed within a few general categories. Some of the mechanisms, such as advance pricing arrangements, are binding on the tax administration. Other mechanisms, such as the provision of guidance and so-called "cooperative compliance", tend to be non-binding in nature but are instead aimed at ensuring taxpayers have a better understanding of how a tax administration interprets and applies tax law. The common feature of such mechanisms is that they seek to provide taxpayers with a better understanding of how a tax administration will approach a taxpayer's tax affairs with the aim of avoiding disputes arising.

11. The first approach to dispute avoidance, discussed in section 2.3.1, is the provision of guidance and advice by the tax administration. Such advice may be provided directly to a

taxpayer or may take the form of a publicly available explanation of how a tax administration interprets relevant tax law. Both approaches seek to ensure taxpayers better understand how a tax administration will apply the tax law to their particular circumstances. The extent to which such guidance is binding on a tax administration will depend on its nature and the laws of the country concerned.

12. The next group of approaches to dispute avoidance concern the way in which tax administrations may work with taxpayers to arrive at a better understanding of each other's position ahead of a taxpayer finalizing their tax position. These include advance agreements/pre-filing agreements (section 2.3.2), which involve a tax administration agreeing or raising objections to the tax consequences of a transaction or arrangements in advance of a return being submitted, advance pricing arrangements (section 2.3.3) which takes a similar approach for transfer pricing, and the relationship between the taxpayer and the tax administration (section 2.3.4) focusing on "cooperative compliance" (section 0) and "relationship managers" (section 0), which enables a taxpayer to discuss their affairs with the tax administration at regular intervals, and/or prior to a transaction or arrangement to seek certainty of its tax treatment and therefore potentially resolve any issues before a dispute arises.

13. Voluntary cooperation between taxpayers which are multinational enterprise groups and the countries in which they operate is discussed in section 2.3.5, which discusses the International Compliance Assurance Programme and section 2.3.6, which describes the joint audit process.

14. Section 2.3.7 discusses the independent review of a statement of an audit position, a mechanism that seeks to resolve differences of view in the course of an audit.

15. The final approach to avoiding disputes, which is described in section 2.3.8, is the use of mediation during the audit stage. Mediation seeks to bring the taxpayer and tax administration together with the aim of setting out their respective positions and identifying potential solutions in an attempt to reach an agreement. The mediator may come from within the tax administration or be entirely independent of both parties.

## 2.2 Creating an environment for avoiding disputes

### *2.2.1 Clear and accessible legislation and interpretative guidance*

16. The first and likely most effective way of preventing tax disputes is to ensure that taxpayers can easily determine their tax rights and obligations under the tax law as envisaged by governments, and therefore can easily fulfil their obligations and understand their rights.

17. Specific attention should be given during the legislative process to the question of whether the tax laws can be reasonably understood and implemented by taxpayers. Governments normally have a standard approach to transforming policy into legislation and regulations. This approach addresses the clarity of the legislation, the ability of taxpayers to meet the requirements, the compliance cost for affected taxpayers and the resources required by the tax administration to implement such legislation. Ideally, as part of the process, there

should be a public consultation process prior to finalizing the legislation and passing it into law. This would provide stakeholders with the opportunity to provide relevant insights to the legislator on the effectiveness, the ability to implement and the compliance costs of the proposed tax legislation. Moreover, once the legislation and supporting regulations are adopted, it is also important that these are published in a way that make them easy for the taxpayers to access.

18. In order for a public consultation process to be effective, governments may consider conducting the process as follows:

(a) by releasing the text of the proposed draft tax laws and any accompanying explanatory memoranda, in preference to making an enunciation of the proposed amendments to the tax laws and/or the underlying principles of such proposed laws. In this context, it could be expected that governments will elaborate on the validity of proposed draft tax laws under multilateral initiatives (such as, recommendations of the UN and BEPS minimum standards as proposed by the OECD/G-20) with the country's existing tax, legal and constitutional framework. For instance, the relationship between the anti-avoidance rules and constitutional principles has been highlighted in public consultations of countries planning to introduce tax laws in accordance with several action items of the OECD/G-20 BEPS initiative;[1]

(b) by ensuring that the relevant stakeholders have sufficient time to review, consider and provide submissions on the proposed draft tax laws, and its potential impact on their interests; and

(c) governments interested in broadening the scope of the participating stakeholders in the legislative process may invite experts, taxpayers, individual businesses or business associations to present their views regarding the operation of the proposed draft tax laws before the legislative branch.

19. Following the public consultation process by the government, but prior to the proposed draft tax laws becoming law, the government can decide whether or not to make any amendments to the proposed draft tax laws to take into account any of the stakeholders' views. Where the government amends the proposed draft tax laws taking into account the stakeholders' views on uncertainty, unnecessary complexity, or unintended tax consequences of the proposed draft tax laws, it may re-release the amended proposed draft tax laws for further consultation before proceeding to pass the new tax laws, or it may proceed to pass the new tax laws. Where the government passes the new tax laws, this will likely result in the new tax laws being more certain, less complex and operating as intended with the effect of preventing, or at least, minimizing the number of disputes arising between the tax administrations and the taxpayers.

1 This approach has been undertaken by the governments in Australia, Brazil, Canada, Italy, India, the Netherlands, Poland, Singapore, South Africa and the United Kingdom which have released drafts of the proposed tax laws for public consultation on a range of topics from the anti-avoidance rules, transfer pricing documentation requirements, withholding taxes and indirect taxes.

20. In contrast, where the government does not amend the proposed draft tax laws taking into account such stakeholders' views, the outcome of this process will have the effect of providing taxpayers transparency and an opportunity to prepare in advance for the entry into force of the new tax laws.

### *2.2.2 Putting domestic legislation and administration in an international context*

21. In designing and passing the domestic legislation into law, governments will generally be conscious of the interaction of the domestic legislation with the legislation of other countries and with the international obligations which are in place, for example, those obligations under bilateral tax treaties. Such global awareness is important to prevent double taxation and tax disputes and is relevant to all phases of introducing and administering tax legislation with cross-border implications, including by ensuring that the availability of tax treaty benefits is clearly communicated to the taxpayers in scope.

22. As international tax issues, such as for example transfer pricing, are considered priority audit areas for many tax administrations, the audit function needs to have a level of global awareness that allows for effectively auditing compliance with the domestic legislation, but also assessing whether bilateral tax treaties have been interpreted and applied appropriately. Without such global awareness it could, for example, either be that cross-border BEPS issues are not detected, or that adjustments are raised which result in double taxation, while avoidance of double taxation should be available based on the relevant tax treaties.

### *2.2.3 Legal environment*

23. Even though governments generally have the best intentions, it can be difficult to anticipate all possible fact patterns and issues and therefore to draft legislation that prevents tax disputes in all situations. For this reason, many countries have dispute avoidance mechanisms in place which provide certainty in advance on cases which come up and for which the interpretation of the tax legislation is not necessarily straightforward. With that, such dispute avoidance mechanisms prevent tax disputes and provide tax certainty.

24. Dispute avoidance, as referred to in this chapter, is part of public (tax) law and hence, it is subject to the same procedural and substantive restrictions that apply to other parts of public law. This should be considered in the design of tax laws, as well as their interpretation, where public law does not allow for the same flexibility as, for example, commercial or civil law.

25. With respect to any agreement/solution with taxpayers related to domestic law and tax treaties, the tax administration should always be compliant with the rule of law and the principles of good administration as applicable in their country. Furthermore, it needs to be considered whether there is a good system of oversight of the arrangements concluded and of checks and balances to ensure the law is followed and that unfair favouritism is avoided. Such oversight will help provide a framework within which the tax administration will be able to make decisions related to tax disputes without being overly concerned with suspicions of impropriety.

26. An important aspect to consider when designing, implementing and administering tax legislation is that taxpayers should be treated equally before the law. This applies to not only to all dispute avoidance mechanisms, but also to audits. However, it does not mean that all taxpayers have to be dealt with in an exactly similar way. Differences in the taxpayers' attributes (e.g. size, sector etc.) may require different approaches in the cooperation between them and the tax administration. Equality before the law requires that any differentiations made between taxpayers are based on the law and are well reasoned without arbitrarily favoring specific taxpayers or groups of taxpayers over other taxpayers.

#### *2.2.4 Risk-based approaches*

27. As tax administrations get more access to information from country-by-country reports ("CbC reports"), master and local files and exchange of information with treaty partners this should help countries to develop more sophisticated risk assessments. When combined with new technologies, such as artificial intelligence, this should help countries to develop these risk assessments. This will enable them to focus on the high risk sectors and high risk taxpayers. That, in turn, should lead to a reduction in the number of disputes and may enable the tax administration to resolve disputes with high risk taxpayers in a more effective manner as they will be able to allocate more resources into such cases.

### 2.3 Approaches to dispute avoidance

#### *2.3.1 Guidance and advice provided by the tax administration*

28. An integral part of the self-assessment system is the provision of different forms of guidance and advice by the tax administration to taxpayers in order to assist them with understanding how the tax law applies to their particular circumstances. Such guidance and advice could be effective in preventing disputes from arising. This would occur where the tax administration's guidance and advice is clear, accurate, consistent, and accessible to the taxpayer with the result of providing the taxpayer transparency, certainty and a greater understanding of their rights and obligations under the tax law enabling them to make informed decisions about their tax affairs.

*Guidance*

29. A tax administration may provide guidance on how the tax law operates generally. Guidance is general in nature and simply expressed, to assist taxpayers and their advisors to understand and meet their obligations under the tax laws administered by the tax administration. Guidance can be provided in various forms as shown in Box 1 below, which describes the guidance provided by the Australian Taxation Office.

30. The extent to which guidance is binding on a tax administration depends on the laws of each country.

***Box 1: Guidance – Australian Taxation Office***

a. Practical compliance guidelines – provide broad administration guidance, addressing the practical implications of tax laws and outlining the Commissioner's administrative approach.

b. Oral guidance – given by the phone or in person at a shopfront on matters of a general, straightforward or simple nature.

c. Written guidance –

   i. The tax administration's website – provides extensive information, general in nature and often simply expressed, to assist taxpayers and their advisors to understand and meet their obligations under the tax laws administered by the Commissioner.
   ii. Decision impact statements – set out the Commissioner's view on the implications of a particular court or tribunal decision.
   iii. Media releases and speeches – brief announcements of the Commissioner's position on a newsworthy topic.
   iv. Consultation – this includes matters under consultation, papers for comment, and how to get involved in consultation.

d. Audio and visual guidance – the tax administration's podcast "TaxinVoice", which enables taxpayers to listen to the latest tax information in order to meet their tax obligations.

e. Taxpayer alerts – warn taxpayers of the Commissioner's concerns about new or emerging high-risk tax arrangements or issues to assist taxpayers with making informed decisions about their tax affairs.

f. Interpretative decisions – is an edited version of a decision the Commissioner has made on an interpretative matter and gives an indication as to how the Commissioner might apply a provision of a law.

g. Law administration practice statements – provide direction to the tax administration staff on approaches to take when performing certain duties involving the tax law administered by the tax administration.

h. Tax administration's website tools and calculators – assist the taxpayer with self-assessing a tax liability or entitlement.

*Advice*

31. A tax administration may provide advice on a taxpayer's obligations or entitlements under a provision of a tax law, which is generally in the form of a ruling. Generally, a public ruling sets out the tax administration's interpretation of the law. It is a published statement of the tax administration's opinion of how a provision of a tax law applies, or would apply, to taxpayers in relation to a class of schemes or to a class of taxpayer generally, rather than in respect of the specific circumstances of a particular taxpayer. For examples of the different

types and forms of advice which could be provided by a tax administration, see Boxes 2 and 3 below, which describe those provided by the Australian Taxation Office, and the Kenya Revenue Authority, respectively.

32. The issue of whether or not advice is binding (legally or administratively) on the tax administration will depend on the laws of each individual country. For example, in Australia, the effect of the advice or ruling being legally or administratively binding on the Commissioner of Taxation ("Commissioner") who administers the tax laws is that where a taxpayer relies on the advice, and it is subsequently found to be incorrect, or misleading[2] and results in the taxpayer making a mistake, the law will protect the taxpayer from the imposition of a tax shortfall, interest on the tax shortfall and a false or misleading statement penalty.

***Box 2: Different forms of advice – Australian Taxation Office***

a. Public rulings – set out the Commissioner's interpretation of the law, and include:

   i. Product rulings – provide certainty to participants on the tax consequences of an arrangement, provided it is carried out as described in the ruling.
   ii. Class rulings – provide certainty to a specific class of participants by explaining how a relevant provision of the tax law applies to them in relation to a particular scheme.
   iii. Law companion rulings – provide clarity and certainty on the Commissioner's interpretation of new legislation.

b. Private rulings – provide certainty on how a tax law applies to a particular taxpayer in relation to a specific scheme or circumstance.

c. Early engagement for advice – this can be requested by the taxpayer for advice on a complex transaction being considered, or implemented.

d. Oral rulings – given over the phone, it is the Commissioner's opinion of how a provision of a tax law applies to an individual in their specific circumstances.

e. Administratively binding advice – provided in a limited range of circumstances in relation to certain laws which the Commissioner administers but is unable to provide legally binding advice.

***Box 3: Different forms of advice – Kenya Revenue Authority***

a. Binding public rulings – set out the Commissioner's interpretation of the law,

2 For example, this could occur in the following instances:
(a) where there have been legislative changes since the advice was given;
(b) a tribunal or court decision affected the tax administration's interpretation of the law since the advice was given; and
(c) for other reasons, the advice is no longer considered appropriate (e.g. if the advice has been exploited in an abusive or unintended way).

i. A public ruling sets out the Commissioner's opinion on the application of a tax law in the circumstances specified in the ruling.
ii. The public ruling is binding on the Commissioner until the ruling is withdrawn, it is however not binding on the taxpayer.

b. Binding private rulings – provide certainty on how a tax law applies to a particular taxpayer in relation to a specific transaction entered into or proposed to be entered into.

33. Since a ruling that a tax administration of a country issues with respect to cross-border issues only deals with the application of that country's domestic law and its own interpretation of its treaties, it does not address the application of the domestic tax law of other countries that may be relevant with respect to these issues nor the interpretation of the relevant treaties by these other countries. Also, countries that are members of the BEPS Inclusive Framework should be mindful of the obligation to spontaneously exchange information with respect to rulings that could potentially raise BEPS concerns.[3]

*Development and management, or enhancement of guidance and public advice*

34. As the provision of guidance and public advice[4] by the tax administration to taxpayers could be effective in avoiding disputes from arising, tax administrations may wish to develop and manage such guidance and advice, or enhance their existing guidance and advice. This could involve the following:

(a) assessing the risk associated with the issue;

(b) working with industry and tax professionals to identity topics for future guidance and advice, and to update existing guidance and advice, as required;

(c) consulting stakeholders early and frequently throughout the process to obtain their practical assistance with identifying the most important issues and developing the most effective form to address those issues;

(d) ensuring that appropriately qualified officials of the tax administration produce the guidance and advice with the right tools to support them;

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3 This obligation relates to taxpayer-specific rulings which are "(i) rulings relating to preferential regimes; (ii) unilateral APAs or other cross-border unilateral rulings in respect of transfer pricing; (iii) cross-border rulings providing for a downward adjustment of taxable profits; (iv) permanent establishment (PE) rulings; (v) related party conduit rulings; and (vi) any other type of ruling agreed by the FHTP that in the absence of spontaneous information exchange gives rise to BEPS concerns" OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241190-en, page 47. That report also indicates to which countries the relevant information must be exchanged (page 53).

4 Public advice provided by the tax administration refers to advice which sets out the tax administration's interpretation of how the law applies to taxpayers in general, as opposed to how it applies to a particular taxpayer's circumstances.

(e) ensuring the guidance and advice is tailored, clear, current and accessible; and

(f) ensuring the guidance and advice is provided at the time required, in the most appropriate form and via the most effective channel.

### *2.3.2 Advance Agreements/Pre-Filing Agreement*

35. As countries seek to provide certainty to taxpayers and reduce their compliance costs, variations on the advance ruling concept have emerged. The goal of these advance rulings is to allow a taxpayer to obtain certainty on an issue, by engaging directly with the tax administration in advance of a dispute on a particular issue. This early engagement benefits both the taxpayer and the tax administration, by allowing for up-front discussions and resolution, thereby obviating the need for protracted discussions on the issue at a later date. For an example of such an advance ruling, see Box 4 for a description of the Pre-Filing Agreement ("PFA") issued under the Pre-Filing Agreement Program ("Program") of the U.S. Internal Revenue Service ("IRS").

***Box 4: Pre-Filing Agreement Program - IRS***

In the U.S., the IRS offers its corporate taxpayers the opportunity to enter into the Pre-Filing Agreement Program ("Program"), which oversees the issuance of a Pre-Filing Agreement ("PFA"). If accepted into this Program, the taxpayer will undergo an examination of a specific issue in advance of the return being filed, with the end goal of obtaining a PFA, a form of closing agreement which binds both the taxpayer and the tax administration.[5]

A critical difference between a PFA and other types of advance rulings is that the PFA will only be provided with respect to a "closed transaction" for which a position has not yet been taken on a return. The PFA does not comment on or provide guidance on a prospective or future transaction. Rather, it provides an opportunity for the taxpayer and the tax administration to discuss an issue and a position in advance of filing, in order to agree on the treatment to be reflected on the return.[6]

*Pre-Filing Agreement Process*

In order to obtain a PFA, a taxpayer must submit an application to the PFA Program Manager. The application must provide certain basic information including the taxpayer's name and address, as well as a statement of the relevant facts, the issue to be considered and an analysis of the relevant law. Specific guidance on the contents of the submission is provided in publicly available guidance.[7] The availability of this public guidance is a best

5 *See*, Revenue Procedure 2016-30.

6 The PFA is akin to the U.S. Compliance Assurance Program ("CAP") which provides a taxpayer with a "real-time" audit, allowing them to agree their return positions in advance of filing. CAP is a form of cooperative compliance (*see*, section 2.4.3). Where the CAP exam provides certainty on the overall return, the PFA provides certainty on one specific issue.

7 *See*, Revenue Procedure 2016-30.

practice, as it provides taxpayers with knowledge of the Program, the process and the expectations of the tax administration.

If accepted into the Program, an examiner is assigned to the matter, and an examination of the issue is commenced. The same procedures for gathering information which are used during an examination, apply during the PFA process.

The taxpayer and the tax administration then enter into a discussion of the technical issue and work to reach an agreement on the position to be taken on the tax return. This agreement is memorialized in a PFA.

*Pre-Filing Agreement*

The PFA is a form of closing document which legally binds both the taxpayer and the IRS to the terms of the agreement. Once executed, the PFA cannot be re-opened absent a showing of fraud, malfeasance or other bad faith act. Because of the binding nature of the PFA, it is important that both parties to the agreement carefully review the terms and agreement clauses.

In the U.S., it is customary for the taxpayer to provide the first draft of the PFA, which is then reviewed and revised in collaboration with the tax administration. Generally, the legal division at the IRS will become involved in the drafting and revision process, as the PFA is binding.

*Benefits*

The PFA provides an excellent tool for taxpayers and tax administrations to achieve certainty in advance of a return being filed. The benefit of certainty to both the taxpayer and the tax administration is clear; by addressing and agreeing issues in advance of filing, the need for post filing activity is eliminated. Thus, both the taxpayer and the tax administration conserve resources and time.

### *2.3.3 Advance pricing arrangements*

*Introduction*

36. An advance pricing arrangement ("APA") is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables, appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. This could be an effective

tool in avoiding disputes between tax administrations,[8] especially since a large part of MAP cases relate to transfer pricing.[9]

37. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations.[10] An APA can be concluded unilaterally, bi- or multilaterally. Questions of transfer pricing can occur on different levels. First, they can be discussed between a taxpayer and the tax administration of the country of residence. Secondly, as they arise in cross border transactions, they can be a matter between the tax administrations of different jurisdictions.

38. The legal basis for unilateral APAs can be found in the respective domestic tax law, either in legislation on transfer pricing, in specific legislation or in general procedural rules. The legal basis for bi- or multilateral APAs can be found in international treaties such as double taxation conventions ("DTCs"). Usually provisions implementing Article 25 of the UN or OECD model conventions on the Mutual Agreement Procedure ("MAP") serve as a basis for bilateral APAs. While some countries consider that such an international treaty provision is a sufficient basis for a bi- or multilateral APA, other countries require more specific domestic and international legislation for the conclusion of such an arrangement. Relevantly, the final report on Action 14[11] includes as an element of the minimum standard with respect to the resolution of treaty-related disputes through MAP that "countries with bilateral APA programmes should provide for the roll-back of APAs in appropriate cases, subject to the applicable time limits (such as statutes of limitation for assessment) where the relevant facts and circumstances in the earlier tax years are the same and subject to the verification of these facts and circumstances on audit."[12] Further, the final report also includes the best practice, which is not part of the minimum standard, that "countries should implement bilateral APA programmes", with the explanation "as soon as they have the capacity to do so."[13] An APA, as defined and used by the UN and OECD is based on the Arm's Length Principle ("ALP").[14]

39. A bi- or multilateral APA can also be a tool for avoiding future disputes between tax administrations. Legally they are usually based on the same provisions in the DTCs as common

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8 See Section C.4.4.2.2. 'Advance pricing agreements' of Chapter C.4 'Dispute Avoidance and Resolution' in the United Nations Practical Manual on Transfer Pricing for Developing Countries 2017.

9 As indicated in Chapter 4, transfer pricing cases and cases related to the attribution of profits to permanent establishments represented 54% of MAP cases reported under the MAP statistics for 2017.

10 OECD TPG Para 4.

11 OECD (2015), *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241633-en.

12 Ibid paragraph 33, page 21. See also minimum standard 2.7 in Annex "Action 14: The Minimum Standard on the Resolution of Treaty-Related Disputes through the MAP and the Best Practices" to Chapter 4.

13 Ibid paragraph 48, page 30. See also best practice 4 in Annex "Action 14: The Minimum Standard on the Resolution of Treaty-Related Disputes through the MAP and the Best Practices" to Chapter 4.

14 The ALP is incorporated in Article 9(1) of both the UN and OECD Model Tax Convention. This provision says: [Where] conditions are made or imposed between two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

dispute resolution mechanisms and they follow comparable procedures. An APA is an individual arrangement between its signatories. Therefore, standardized templates are usually not available. Some key elements of APAs include: i) the parties of the agreement, ii) methodology, iii) comparability analysis, iv) critical assumptions[15]; and v) duration/termination of the APA.[16]

*Establishing an APA programme*

40. The goals of an APA programme, which are in particular avoiding future conflicts and offering an attractive governance environment, need sustainable and enduring commitments.

41. The following issues should be considered by a country wishing to establish an APA programme:

(a) Employees with specific skills. In particular, employees should have knowledge of, and experience in tax law, transfer pricing and domestic procedural law. In addition, communication and organizational skills are important;

(b) The personnel running an APA programme need access to certain resources, many of which are similar to those used by transfer pricing auditors. Most importantly, this will likely mean access to commercial databases to allow a comparability analysis. In addition, bi- and multilateral APAs will necessitate face-to-face meetings between representatives of the tax administrations and this will mean travel and subsistence costs. In some countries, like Canada, taxpayers meet the travel expenses of a tax administration during APA negotiations;

(c) For a suitable procedure it is important to take into account the following: (i) target time frames for each stage; (ii) more targeted documentation/ information; (iii) increased tax administration resources; (iv) focus on bilateral APAs; and (v) greater use of benchmarks /safe harbours;[17]

(d) There should be consideration of any collateral issues, such as a roll back of the APA result to income years prior to those covered by the proposed APA, and an agreement with the taxpayer on the approach to resolve those issues; and

(e) As developing countries gain more experience with unilateral APAs, which provide them with tax certainty, to the extent that their treaty network make it possible, they may wish to explore the option of bilateral APAs, and eventually multilateral APAs.

15 Critical assumptions are a core element of an APA since they reflect the factual assumptions under which the applied method is considered to be appropriate. Generally, an APA applies only under the condition that the critical assumptions are met.

16 There is also often a lack of clear deadlines or timeframes, but that could be solved.

17 TAX CERTAINTY DAY Item 3 – Advance Pricing Arrangements, 16 September 2019, OECD Conference Centre

*Funding of an APA programme*

42. Alternative sources for funding an APA programme can be considered by tax administrations wishing to establish such a programme. Usually the expenses of an APA programme are met from that tax administration's budget. However, some countries charge a fee to taxpayers making use of the programme, which may be particularly attractive for less developed countries. Such fees take various structures including a fixed, hourly or graduated fees structure, or a revenue neutral structure.

*Brief description of a developing country's APA programme*

43. For a brief description of an APA programme of a developing country, see Box 5 below, which describes Indonesia's APA programme.

***Box 5: Indonesia's APA programme[18]***

Indonesia reported that it has introduced an APA programme in 2010, under which it is allowed to enter into unilateral and bilateral APAs. The legal basis of this programme is Article 32A of Law No. 7 of 1983 concerning Income Tax Law as amended by Law No. 36 of 2008 and the MAP provision of the relevant tax treaty. Article 32A stipulates that Indonesia's competent authority is authorised to enter into agreements with treaty partners to determine the transfer price between associated enterprises. The authority competent to handle APA cases is, pursuant to Article 58(1) of Regulation No. 74 (2011), the Director General of Taxes of the Ministry of Finance.[19]

Article 58 of the Government Regulation No. 74/2011 concerning Taxation Rights and Obligations Fulfilment Procedure also includes rules relating to Indonesia's APA programme. This provision, for example, stipulates that an APAs shall bind the tax administration and the taxpayer during the period the APA applies and that the tax administration cannot make adjustments on matters already agreed in the APA.

Further to the above, Indonesia issued Regulation No. 7/PMK.03/2015 of 12 January 2015.[20] Article 2(2) of this regulation prescribes that taxpayers may submit an APA application, provided that they have operated business activities in Indonesia for at least three years. As to the period that can be covered by an APA, Article 4 stipulates that this is for a maximum of three fiscal years in case of an unilateral APA and a maximum of four fiscal years in case of a bilateral APA. Furthermore, this regulation contains information on Indonesia's APA programme and how its runs that programme in practice. In particular this concerns information on: (i) which government authority is competent for handling APA requests, (ii) what an APA is and what the requirements for obtaining an APA are, (iii) by whom they can be requested, (iv) what steps have to be followed in the process, (v) a detailed list of

18 This brief description of Indonesia's APA programme appears in OECD (2019), *Making Dispute Resolution More Effective – MAP Peer Review Report, Indonesia (Stage 1): Inclusive Framework on BEPS: Action 14*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/deb42398-en, pages 19-20.

19 The Government Regulation No. 74/2011 concerning Taxation Rights and Obligations Fulfilment Procedure is available at: https://www.pajak.go.id/sites/default/files/2019-03/PP-74-2011%20%28EN%29.pdf.

20 Available in English at: https://www.pajak.go.id/sites/default/files/2019-03/PMK-7-2015%20%28EN%29.pdf.

information to be included in an APA request, (vi) time limits for the submission of an APA request, (vii) the implementation of an APA and (viii) the possibility to renew an APA.

Further to the above, Indonesia also includes information on its APA programme on the website of the Ministry of Finance.[21] This website reproduces the information included in Regulation No. 7/PMK.03/2015. It is there stated that the information contained on the website should be read in conjunction with Regulation No. 7/PMK.03/2015.

With regard to the timing of the submission of APA requests, Articles 6 and 7 of the APA regulation requires taxpayers to submit a written pre-lodgement request to start the process, whereby such a request should be filed no later than six months before the beginning of the fiscal year covered by the APA.

### *2.3.4 Relationship between the taxpayer and the tax administration*

*Cooperative compliance*

*2.3.4.1.1 Overview*

44. Cooperative compliance is one way in which tax administrations can develop an overall compliance strategy that encourages greater transparency and voluntary compliance by multinational enterprises ("MNEs"), and in the process, obtain a greater understanding of how MNEs operate, make decisions and manage their tax exposure. This approach could have the effect of avoiding disputes from arising between the tax administrations and the taxpayers.

45. Cooperative compliance refers to a concept that builds on a reciprocal relationship of trust and cooperation between the tax administrations and the taxpayers. It is a relationship that favours collaboration over confrontation and is anchored more on mutual trust than on enforceable obligations, with both parties going beyond their statutory obligations by, for example, providing more information.

46. Cooperative compliance can also assist countries to create a tax compliance climate that provides an environment which is more conducive to business.

*2.3.4.1.2 Relevance of cooperative compliance to developing countries*

47. The cooperative compliance model has a number of characteristics that suggest it could play a positive role in the strategic response of developing countries to improve tax compliance by taxpayers and prevent or minimise tax disputes between the tax administrations and the taxpayers.

48. Under a cooperative compliance approach, the tax administration may engage early with the taxpayer to discuss the tax consequences of a proposed transaction or arrangement. Where this occurs, the parties will be able to identify if they have any differences of opinion on the tax issues, and therefore potentially resolve those tax issues before the taxpayer undertakes the

21 Available at: http://pajak.go.id/apa-map.

transaction or arrangement, or files its position. Where the tax administration and taxpayer identify and resolve their tax issues prior to the taxpayer undertaking the transaction or arrangement, or the filing of its position, the cooperative compliance approach will have had the effect of preventing disputes from formally arising.

49. Cooperative compliance assists with building the capabilities of tax administrations by improving commercial awareness, and familiarising MNEs with the concerns of the tax administrations. The introduction of cooperative compliance could improve the knowledge of tax administrations in this area. Tax administrations that have already segmented their taxpayer population by size and economic sector may find it easier to implement the model, as they have already recognized the differentiating qualities of large taxpayers and specific industries.[22]

50. Cooperative compliance also improves the tax transparency as a result of the greater openness and responsiveness expected of both the tax administration and the MNE. In some developing countries a lack of transparency has had a corrosive effect on the relationship between government and taxpayer businesses, and in the worst case, has facilitated corruption and other dysfunctions.[23] As a result, cooperative compliance may play a role in improving the legitimacy of the whole tax system, by contributing to tax compliance and assisting with eliminating corruption. The concept of cooperative compliance enshrines a set of principles that ensure that the officials of the tax administration dealing with taxpayers' affairs will adhere to the principles that underpin a transparent relationship.

51. The implementation of cooperative compliance should also result in the better management of resources by the tax administration so that it can focus on those taxpayers that engage in aggressive tax planning facilitated by nondisclosure, which is particularly important for developing countries that struggle with limited resources and capabilities. From the perspective of taxpayers, it should result in greater proportionality of actions undertaken by the tax administration.

*2.3.4.1.3 Tax control framework at the heart of trust*

52. An essential feature of the cooperative compliance model is the tax control framework ("TCF") within an MNE. This is understood as "*the part of the system of internal control that assures the accuracy and completeness of the tax returns and disclosures made by an enterprise*."[24] It gives legitimacy to the cooperative compliance programme by providing a clear and objective basis on which the tax administration can base its decision to trust the statements made by the taxpayer. Box 6 below gives an overview of the features of the TCF.

***Box 6: Features of the TCF as used by MNEs***

22 IMF, Current challenges in revenue mobilization: Improving tax compliance. April 2015, p. 16.

23 var Kolstad, Arne Wiig, and Aled Williams, CMI, Tackling corruption in oil rich countries: The role of transparency, February 2008 - No. 3.

24 OECD (2013), *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*, OECD Publishing, http://dx.doi.org/10.1787/9789264200852-en, p 58.

The TCF typically includes the following features:

- **Tax strategy**: this should set out the strategic objectives of the business, the role of the tax administration, and its approach to ensuring compliance with the law. It should to address all aspects of the business at all levels, from the strategic to the operational. In particular, it should set out the business' attitude to and appetite for tax risk. The strategy should be owned at Board level.
- **Comprehensiveness**: the TCF should cover all policies, procedures and processes that can affect the correct assessment and reporting of tax liabilities.
- **Responsibility**: the TCF should be developed by the senior management and approved by the Chief Financial Officer ("CFO") or the Board. It should provide that any tax strategy is executed by a sufficient number of people with the right skills and experience.
- **Governance**: the TCF should describe the mechanisms, processes and relations by which tax issues are controlled and directed. The prime responsibility for ensuring the system works according to the declaration provided in the TCF should lie with the Board.
- **Testing**: this feature of the TCF refers to its maintenance and monitoring. The system should contain feedback tools which aim at preventing, detecting and correcting errors. Regular testing of the TCF should make it possible to assess whether the system is adequate. The TCF should be dynamic, so that it responds to changes in the underlying business and issues that have arisen from the regular testing of the integrity of the control regime.
- **Assurance**: is provided when all the other features of the TCF are fully implemented. That is what provides assurance to all stakeholders, including the tax administration, that the taxpayer has an effective system which enables it to control all tax risks and issue reliable tax outputs.

53. A TCF that has all the above features delivers the justified trust that is central to the cooperative compliance model.[25] It enables the tax administration to focus on assuring the integrity of the control processes of the MNEs, rather than trying to routinely undertake its own verification of the way in which individual transactions have been recorded in taxpayers' accounting systems.

#### *2.3.4.1.4 Developing countries have different options in designing a legal framework for cooperative compliance*

54. Although the developing countries' legal systems differ, there are some fundamental principles common to most jurisdictions where the rule of law applies.[26] The rule of law

25 E.v.d. Enden & K. Bronzewska, The Concept of Cooperative Compliance, op. cit. note 12, p. 572.

26 See: Statement of UN Secretary-General, Fundamental Principle of Rule of Law 'Our Best Hope for Building Peaceful, Prosperous Societies', 11 April 2011. Available: http://www.un.org/press/en/2011/sgsm13505.doc.htm.

requires that "all persons and authorities within the state, whether public or private, should be bound by and entitled to the benefits of laws publicly and prospectively promulgated and publicly administered in the courts."[27] This concept of the rule of law implies some limitations imposed on governments and their actions. Among these, two principles features are prominent: the principles of legal equality[28] and legal certainty.[29]

55. In respect of the principle of legal equality, there may be some concerns that cooperative compliance violates this principle, because the model is designed only for a select group of the largest taxpayers.[30] However, upon a closer look at the cooperative compliance model, it shows that it relates to taxpayers who are in a different circumstances than the majority of taxpayers due to the size and complexity of their tax affairs. It is often the case that larger taxpayers are subject to additional tax reporting and compliance obligations (transfer pricing documentation being a good example). Moreover, the model and its benefits are justified as an integral part of a risk-based approach to managing tax compliance. Some questions could also be raised about programmes that grant benefits above and beyond the greater tax certainty and reduced compliance costs associated with cooperative compliance. Nevertheless, even in these cases, these programs should be justified by reference to the taxpayer's improved tax compliance and overall improvements to tax compliance risk management.

*2.3.4.1.5 Potential benefits of cooperative compliance programmes*[31]

56. It has been argued from the perspective of governments that cooperative compliance programmes could have the following benefits:

- **Improve tax compliance:** Cooperative compliance facilitates compliance by providing timely advice on tax issues. It affects the behaviour of a broad group of taxpayers for whom avoidance of tax disputes is a tangible benefit of the programme.
- **Secure revenue base:** As a result of improved tax compliance, in the longer-term the revenues paid voluntarily will increase. In the short term, settlement of legacy issues, which is a first step in establishing the new relationship, may deliver an immediate yield.
- **Improve compliance risk management:** As part of a risk-based compliance strategy, cooperative compliance assists the tax administration with allocating resources to focus on high risk taxpayers.
- **Save resources by reducing the scope of audits:** As a result of transparency and full disclosure, the tax administration may get a better understanding of current

27 T. Bingham (2007), The rule of law, Cambridge Law Journal, 66 (1), pp. 67-85, p. 69.
28 J. L. M. Gribnau and C. Peters (2003), Introduction, (in:) Legal Protection Against Discriminatory Tax Legislation. The Struggle for Equality in European Tax Law, H.L.M. Gribnau (ed.), p. 1.
29 Gribnau, H., (2013). Equality, Legal Certainty and Tax Legislation in the Netherlands. Fundamental Legal Principles as Checks on Legislative Power: A Case Study. Utrecht Law Review. 9(2), pp.52–74, p. 53.
30 OECD (2013), *Cooperative Compliance: A Framework: From Enhanced Relationship to Cooperative Compliance*, OECD Publishing, http//dx.doi.org/10.1787/9789264200852-en, p. 45-48.
31 See OECD (2014), *Measures of Tax Compliance Outcomes: A Practical Guide*, OECD Publishing, http//dx.doi.org/10.1787/9789264223233-en.

issues impacting the taxpayer, and therefore may be able to reduce the scope of audits.

- **Improve capabilities:** With cooperative compliance the tax administration may improve its commercial awareness, develop a better understanding of how MNEs' manage their business including their control systems which ensure that their accounts and returns are accurate.

57. It has been argued from the perspective of taxpayer businesses that cooperative compliance programmes could have the following benefits:

- **Avoid or minimise tax disputes:** Cooperative compliance provides a platform for discussing any tax issues with the tax administration and can substantially reduce the risk of dispute.
- **Better and easier tax risk management:** Tax issues are better integrated in the taxpayer's processes and are underpinned by a TCF.
- **Lower compliance costs:** The taxpayer is less exposed to administrative penalties, can file and settle tax returns quicker, and may require less assistance from tax intermediaries (such as, lawyers, accountants and tax professionals). Also, the number of disputes that involve extra costs should be lower.

- **Corporate social responsibility:** Taxpayers may benefit from reputational gains. Company's stakeholders will perceive the enterprise as more reliable and a good corporate citizen. Shareholders and institutional investors will have greater confidence in the returns from investments.
- **Better investment climate:** An improved relationship between large taxpayers and the tax administration will encourage FDI as MNEs can achieve certainty about the tax treatment of their investments.

#### *2.3.4.1.6 Developing countries taking the first steps towards cooperative compliance programmes*

58. Although to date cooperative compliance programmes have been mainly deployed in developed countries, a number of emerging and developing countries (e.g. Chile, Ghana, Malaysia, Nigeria, South Africa and Zambia) are exploring this concept.[32] For a description of Brazil's experience in taking the first steps towards a cooperative compliance programme, see Box 7.

32 See Cooperative Compliance Pilot Programmes by Global Tax Policy Center at the Institute for Austrian and International Tax Law, WU (Vienna University of Economics and Business).

***Box 7: Tax Compliance Incentive Programme (Pro-Conformity) – Brazil***

In 2018, the Secretariat of Brazilian Federal Revenue ("RFB") released a public consultation on a draft ordinance establishing the Tax Compliance Incentive Programme (Pro-Conformity). The proposal was inspired by good practices adopted by other national and international tax administrations, following a globally recognized model of favoring tax compliance practices. This draft ordinance has received several suggestions from different sectors in Brazil.

The RFB's objective is to create more favorable conditions for taxpayers who have a good relationship with the tax administration, facilitating the fulfilment of their obligations and providing them with efficient and agile service, when they demand it. The compliant taxpayer will have priority in his demands (for example: tax refund) and will be previously notified of his pending matters, for the purpose of self-regulation.

As a previous step to the implementation of the programme, the RFB will carry out the classification of taxpayers taking into account the following four criteria:

1. Registration status compatible with the company's activities;
2. Adherence to information provided to the RFB through declarations and bookkeeping;
3. Timeliness in the presentation of declarations and bookkeeping; and
4. Compliance in the payment of taxes due.

*2.3.4.1.7 Guidelines for setting up pilot studies in countries which wish to establish a cooperative compliance programme*

59. Countries which desire to establish a cooperative compliance programme may initially consider setting up a pilot study to test how such a programme can operate within their political, legal and administrative environment. Box 8 sets out some guidance which may assist them.

***Box 8: Methods to approach the implementation***

- A written agreement should be a sufficient basis for the necessary cooperation between the tax administration and the taxpayer during the pilot phase although some countries may already at this stage prefer to develop a legal framework. If it is successful, the need and case for legislative change can be considered later.
- The pilot should ideally involve taxpayers that are reasonably representative of the type of taxpayer that is likely to participate in a fully-fledged programme and which have shown by their past behaviour that they are willing to be transparent.
- Large business taxpayers in developing countries are often subsidiaries with the parent company located offshore. Therefore, it is important that the group as a whole is committed to participating in the pilot. Timely access to relevant data held in the foreign headquarters and to key decision makers should be an essential part of the disclosure that is expected from the taxpayer.

- Both the taxpayer and the tax administration should recognise the central importance of the TCF (see Box 6).
- Agreement on evaluation measures constitutes an important aspect of the pilot programme design. The pilots should be evaluated from the perspective of the tax administration, taxpayers and also the wider community. Among the possible measures of success could be: improved trust in the tax administration, greater speed of exchange of information, cordial interactions, and increased collection of taxes. Agreement on a set of indicators evaluating the programme requires certain data to be in place. Indicators, quantitative and qualitative, should be based on information that is accessible to tax administrations. It will be important to establish a baseline of current performance against which progress can be measured as the pilots unfold.

*Relationship managers*[33]

60. The appointment of a single point of contact or relationship manager between the tax administration and the taxpayer, who is responsible for the tax administration's overall relationship with the taxpayer could have the effect of preventing disputes arising.[34] This approach may be particularly helpful to large taxpayers and high-net-worth individuals.

61. Under such an approach, there is an on-going and transparent dialogue between the tax administration and the taxpayer. This may involve structured and planned discussions, such as a formal annual risk assessment, as well as ad hoc discussion of particular issues as they arise. The taxpayer is able to discuss with their relationship manager a proposed transaction or arrangement and an analysis of the tax consequences either at the annual review, or at a time when the taxpayer is seeking certainty of its tax treatment. The tax administration will then comment on those consequences. The relationship manager does not comment on those consequences independently of the tax administration. Any difference of opinion can be discussed, and therefore potentially resolved including, by a tax ruling, if possible and if required, before the taxpayer goes ahead with the transaction and/ or before the taxpayer is required to file its position for the relevant period. One of the aims of this approach is therefore to resolve any issues before a dispute arises.

62. The development of a relationship between a tax administration and the taxpayer fosters greater trust and transparency if the arrangements are approached in the right way. This relationship works to the benefit of both parties. Where the taxpayer and the tax administration reach an agreement on the tax treatment of a proposed transaction or arrangement, it will provide taxpayers with certainty of its tax treatment before they reach their filing position, therefore preventing a dispute from arising. However, where no such agreement is reached, the

33 This section discusses the relationship manager between the taxpayer and the tax administration whether or not that relationship manager is part of a cooperative compliance programme between the taxpayer and the tax administration, as described above in section 2.3.4.1.

34 This approach is taken, for example, in the United Kingdom, Belgium, Australia and Ireland.

taxpayer will obtain an understanding of the tax administration's position, including the likelihood that such a filing position will result in a dispute arising.

63. From the tax administration's perspective, the development of such a relationship with the taxpayer will result in it having a deeper understanding of the taxpayer's business model and operating environment and how these, and other commercial factors, impact upon the tax position of the taxpayer. This will inform an understanding of the particular needs of the taxpayer and how they behave, including by reference to their approach to tax compliance. This can be an effective way of avoiding disputes based on an understanding of the motivations for particular arrangements. It also allows a tax administration to identify tax risks at an early stage and therefore, potentially, allow resolution of any issues before they become a dispute.

64. For a description of the Client Relationship Manager Programme provided by the Tax Administration Jamaica, see Box 9 below.

***Box 9: Client Relationship Manager Programme - Tax Administration Jamaica***

*The Large Taxpayer Office*

Tax Administration Jamaica ("TAJ") opened the Large Taxpayer Office ("LTO") in April 2009. The LTO was established in keeping with a commitment of the Government of Jamaica to provide service of the highest quality, accessibility, convenience and responsiveness to the taxpayers or clients who contributed a significant portion of the country's revenue. The LTO enables tax administrators via their Client Relationship Managers ("CRMs") to interface with, and meet the needs of the clients in a more proactive and systematic manner in order to improve service delivery and foster greater compliance, and therefore may be effective in preventing disputes from arising.

*Clients*

The LTO facilitates taxpayers who have total sales or turnover of over $500 million Jamaican dollars or approximately $3.7 million USD (1 USD =135.72 Jamaican Dollars), or contribute tax revenues in excess of $50 million per annum for any of the following taxes, being Corporate Income Tax, Pay-As-You-Earn, General Consumption Tax and Stamp Duty.

These taxpayers comprise 3% of the tax paying population and contribute 80% of tax revenue. Typically, these clients are highly sophisticated in their operations and are usually involved in complex domestic and international commercial transactions.

*Client Relationship Management*

Client Relationship Management involves understanding the client**,** understanding the objectives of the TAJ, and continuously improving service quality. Where this is satisfactorily done, the outcome should be the maintenance of a nurturing environment where the clients feel that their needs are met.

The Client Relationship Management functions at the TAJ are carried out by CRMs acting under the supervision of the Director of Client Relationship Management ("Director").

*Role of the Director*

The Director of Client Relationship Management is responsible for planning, organizing, directing, coordinating and supervising the activities of the CRMs. Among the duties of the Director are the following:

- ensuring that all CRMs adopt and comply with the policies of the LTO;
- identifying training needs of the CRMs in tax laws and other relevant laws and practices;
- assisting the CRMs with meeting the needs of clients, in particular where there are complex tax issues involved;
- assisting the CRMs with conducting workshops and seminars targeting clients;
- establishing protocols between the CRMs and other units internal to TAJ, as well as other external stakeholders such as other government agencies and the various private sector bodies;
- conducting periodic reviews of strategies and protocols; and
- ensuring that CRMs have ongoing training.

*Role of the CRM*

The CRM is the main contact point between the client and TAJ, and provides personalized service to the client. This requires that the CRM should have a good understanding of the business environment and a working knowledge of the client's modus operandi.

Professionally, CRMs are required to possess at least a first degree in Accounting, ACCA level 2, or other equivalent professional qualifications from a recognized university. They are also required to have at least 4 years working experience and must display a knowledge of tax laws, and skills in communication of complex technical issues.

The duties and functions of the CRMs cover 2 broad areas, Managing the Interface between TAJ and the client, and Research and Dissemination of Information.

1. Managing the interface between TAJ and the client in order to prevent or minimize disputes and avoid misunderstandings. This function includes the following activities:

    - establishing and maintaining protocols for the relationship between TAJ and the client;
    - consulting on complex tax issues with in-house legal and technical staff in order to reach consensus on the response from TAJ to the client's concerns;
    - facilitating the flow of documents and payments between the client and TAJ;
    - facilitating the refund process as well as the timely issuance of documents such as the Tax Compliance Certificate;

- ensuring that accounts of clients are reconciled and updated and that clients receive timely updates on accounts;
- facilitating electronic transactions and direct bank payments;
- ensuring timely and professional responses to complaints, questions and requests of clients by keeping them informed on the progress of queries and the timeline for resolution of issues; and
- making courtesy calls on clients.

2. Conducting research and dissemination of information. This function includes the following activities:

- conducting ongoing research in order to appreciate the nature, characteristics and operations of the business of the assigned client;
- consulting with industry specialists to ensure full understanding of the complexities associated with the client's industry;
- conducting seminars and workshops aimed at informing clients about changes to domestic and international tax matters, as well as soliciting feedback from clients;
- liaising with legal and other technical staff members who assist with presentations at the various workshops and seminars; and
- tracking, maintaining and analyzing statistical data associated with the business of the assigned client.

### *2.3.5 International Compliance Assurance Programme*

65. The International Compliance Assurance Programme ("ICAP")[35] provides for a multilateral approach to early tax certainty for eligible multinational enterprise groups ("MNE groups"), which could have the effect of preventing disputes from arising between those MNE groups and the tax administrations.

66. ICAP is a voluntary programme for a multilateral co-operative risk assessment and assurance process. It was launched in January 2018 as a pilot programme with only eight participating countries and five MNE groups. Based on feedback received from the initial pilot programme, ICAP 2.0 (the second iteration of the programme) was announced in March 2019. As of September 2020, there were 19 participating countries. It is designed to be an efficient, effective and co-ordinated approach to provide MNE groups which are willing to engage actively, openly and in a fully transparent manner with increased tax certainty with respect to certain of their activities and transactions. ICAP does not provide an MNE group with the legal certainty of other approaches such as, for example, through an APA. It does, however, give comfort and assurance to the MNE group where the participating tax administrations undertaking the MNE group's risk assessment consider an issue covered represents no or a low tax risk. In this case, the participating tax administrations will each issue an assurance letter

35 https://www.oecd.org/tax/forum-on-tax-administration/international-compliance-assurance programme.htm.

setting out these findings, the form of which will vary by jurisdiction. Where an area is identified as requiring further attention, work conducted in ICAP can improve the efficiency of actions taken outside the programme, if needed.

67. As ICAP is still in its infancy, there is a limited track record to provide guidance to countries considering participation in the programme. Moreover, participation in ICAP is extremely resource intensive for both the tax administrations and the MNE groups.

### *2.3.6 Joint audits*

68. In 2010, the OECD Forum on Tax Administration introduced "joint audits" as a new form of coordinated action between and among tax administrations.[36] They are described as follows:

> *two or more countries joining together to form a single audit team to examine an issue(s) / transaction(s) of one or more related taxable persons (both legal entities and individuals) with cross-border business activities, perhaps including cross-border transactions involving related affiliated companies organized in the participating countries, and in which the countries have a common or complementary interest; where the taxpayer jointly makes presentations and shares information with the countries, and the team includes Competent Authority representatives from each country.*

69. Joint audits can be relevant when countries have a common or complementary interest in the fiscal affairs of one or more related taxpayers. Given the overall expense associated with joint audits, this is an approach that may be more appropriate for large and complex cases and from the perspective of developing countries, where they have the capacity to engage in these complex audits. They can also be most useful when a domestic audit does not allow the auditor to obtain a complete picture of a taxpayer's tax liability in relation to some portion of its operations or to a specific transaction. Transfer pricing audits are one example of audits where the information available in the jurisdiction does not always show the full picture.

70. Joint audits are distinguishable from the conduct of simultaneous tax examinations. A simultaneous tax examination is an arrangement by two or more countries to examine simultaneously and independently, each on its own territory, the tax affairs of a taxpayer in which they have a common or related interest with a view to exchanging any relevant information which they obtain.[37] Such examinations ensure high levels of efficiency regarding the exchange of information between tax administrations and enable a comprehensive review of all relevant business activities.[38] This may assist in averting double taxable and therefore preventing disputes from arising.

71. The term "joint audits" is not a legal term that is defined in international legislation. From a practical perspective, most of the joint audits seen so far are audits where two or more

36 Joint Audit report, available at https://www.oecd.org/tax/administration/45988932.pdf.
37 OECD Manual on the Implementation of Exchange of Information Provisions for Tax Purposes, Module 5, paragraph 5.
38 Ibid paragraph 6.

tax administrations work together and form a highly integrated team that interacts jointly with the taxpayer. If countries want to carry out a joint audit, they need to determine the legal framework on which they will co-operate.[39] The basis for co-operation can be found in bilateral and multilateral tax treaties and other instruments which provide for varying degrees of mutual assistance. Procedural aspects of the co-operation during the audit (e.g. relating to the physical presence and possible exercise of legal authority by officials of another country) are not covered in these instruments and are therefore governed by the domestic law of the participating countries. It is, however, possible for countries to conclude a working agreement that identifies legal issues and determines mitigation strategies. This could be done in the form of a Memorandum of Understanding.

72. Joint audits may provide tax certainty, and therefore could be effective in preventing disputes from arising between taxpayers and the tax administrations. This is because joint audits may result in quicker issue resolution, more streamlined fact finding and more effective compliance. Joint audits may also have the potential to shorten examination processes and reduce costs, both for tax administrations and taxpayers.

73. Additional benefits of joint audits include, reducing taxpayer burden of multiple countries conducting audits of similar interests and/or transactions, enhancing the awareness of tax officers of the opportunities available in dealing with international tax risks, assisting with gaining an understanding of the differences in legislation and procedures and if necessary accelerating the MAP by early involvement of the Competent Authority, where double taxation is involved and for all participating countries reaching a joint/mutual agreement on the audit results to avoid double taxation.

74. According to the 2019 Joint Audit report[40], joint audits may be beneficial as they assist with building capacity in international taxation matters, including on transfer pricing:

(a) less experienced tax administrations can gain a better understanding of the tools and approaches used in tax audits and case selection in more advanced jurisdictions, including the use of CbC reports and other risk assessment tools;

(b) they can gain from the experience of seasoned auditors in issue spotting, developing the case, through to taxpayer engagement and issue resolution; and

(c) joint audits also ensure that there is no information asymmetry as by definition the engagement is joint. This means that representatives of less experienced jurisdictions will not only interface with the local tax function of the taxpayer, but could be present at the tax examination at e.g. the headquarter location.

39 For a discussion of the legal framework for joint audits, see OECD (2019), *Joint Audit 2019 – Enhancing Tax Co-operation and Improving Tax Certainty: Forum on Tax Administration*, OECD Publishing, Paris, https://doi.org/10.1787/17bfa30d-en, Chapter 4.

40 OECD (2019), *Joint Audit 2019 – Enhancing Tax Co-operation and Improving Tax Certainty: Forum on Tax Administration*, OECD Publishing, Paris, https://doi.org/10.1787/17bfa30d-en.

### *2.3.7 Independent review of the statement of audit position*

75. An independent review of the statement of audit position ("independent review") is a procedure provided by a tax administration during an audit which could operate as a dispute avoidance mechanism. This would occur where the outcome of the independent review procedure conducted during the audit stage had the effect of preventing a dispute from formally arising, that is, the audit would not result in the tax administration issuing a reassessment for additional income tax payable by the taxpayer.

76. The overall objective of the independent review procedure is to allow eligible taxpayers who disagree with the statement of audit position to request a review of the technical merits of their case by an official of the tax administration who works independently and separately from the audit function, prior to the finalization of the tax administration's audit position. Following such a review, the independent review official will make recommendations, which may or may not be binding, to the taxpayer and the audit team on what the official considers is the better position on those issues. For a description of the independent review procedure provided by the Australian Taxation Office, see Box 10 below.

***Box 10: Independent review of the statement of audit position – Australian Taxation Office***

*Independent review procedure*

Under the independent review procedure, the independent review official will consider the facts, evidence and arguments that have been raised during the audit which are relevant to the issues of disagreement between the taxpayer and the tax administration as identified in the taxpayer's request and facilitate a case conference between the parties to clarify the issues in order to make recommendations on what the official considers is the better position on those issues.

A critical aspect of the independent review procedure is the case conference, which is an informal meeting attended by the taxpayer, the audit team and the independent review official. The purpose of the case conference is for the taxpayer and audit team to meet with the independent review official to discuss and clarify the factual and legal issues of disagreement raised at the audit for the benefit of the review. Although the independent review official will facilitate the case conference, the official will not provide any observations, recommendations or preliminary conclusions during the case conference.

*Outcome of independent review procedure*

The outcome of the independent review procedure will be in the form of recommendations containing the reasons for the conclusions made by the independent review official to the taxpayer and the audit team on what the official considers is the better position of the issues of disagreement raised in the statement of audit position. In Australia, as the independent

reviewer's recommendations are binding, the audit team will complete the audit in line with the recommendations.

If the independent review official agrees with the statement of audit position, the auditors will complete the audit in line with the recommendations which will result in the tax administration issuing a reassessment for additional income tax payable by the taxpayer. Although the independent review procedure will not prevent a dispute from formally arising, the official's recommendations will provide the taxpayer greater clarity and understanding of the initial positions taken in the audit.

In contrast, if the independent review official does not agree with the statement of audit position, the matter will be escalated to the Chief Tax Counsel if it relates to the interpretation of a critical question of law which has broader strategic or policy implications. The Chief Tax Counsel would be the final arbiter of the best view in the circumstances. If the Chief Tax Counsel agrees with the independent reviewer's recommendations, the auditor's initial positions will be altered in line with the independent review. In these circumstances, the outcome of the independent review procedure will prevent a dispute from formally arising.

However, if the Chief Tax Counsel does not agree with the independent reviewer's recommendations, the outcome of the independent review procedure will not prevent a dispute from formally arising but it will provide the taxpayer with greater clarity and understanding of the auditor's initial positions.

77. Countries interested in establishing an independent review procedure in their tax administration should consider creating a division that works independently and separately from the audit function. Further, as such a division would be dedicated to facilitating the early resolution of factual and legal issues of disagreements between the taxpayer and the tax administration during the audit stage it should be staffed with officials having an appropriate level of expertise in substantive tax matters that will allow them to fully and competently perform a review of the initial audit positions.

78. When a tax administration desires to provide such a dispute avoidance mechanism for its taxpayers, it must take into account its financial and human resources, which are often limited. As such, a division dedicated to the resolution of factual and legal disagreements between taxpayers and the tax administration during the audit stage to prevent disputes arising by providing a service like an independent review may have a small number of employees. In such cases, the tax administration may need to limit the number and nature of cases eligible for an independent review. For example, it may be more efficient to provide access to the independent review procedure only for audits of large taxpayers, with an annual turnover in excess of an established amount.

### *2.3.8 Mediation during tax audit*

*Mediation*

79. Mediation is a form of process-related assistance that involves the use of a mediator or facilitator to assist two parties resolve their potential dispute. This mediation process can be conducted during the audit stage to assist the taxpayer and the tax administration case officers to identify the issues of disagreement and options for resolution, and to evaluate those options in an attempt to reach an agreement.

80. This section discusses two different types of mediation processes which can be conducted during the audit stage which primarily depend on who acts as a mediator. "In-house facilitation" (discussed in section 2.3.9.2) involves an impartial official of the tax administration acting as a facilitator, whilst the mediator in "independent mediation" (discussed in section 2.3.9.3) is an independent body.

*In-house facilitation for individuals and small businesses*

81. "In-house facilitation" is a voluntary mediation process generally provided by a tax administration during the audit stage to individuals or small businesses with less complex issues of disagreement with the tax administration.[41] As this mediation process is provided during the audit stage, where the outcome of the mediation results in the resolution of the issues of disagreement between the taxpayer and the tax administration, it will have the effect of preventing a dispute from formally arising.

82. The in-house facilitation process involves an impartial official of the tax administration who is professionally trained in facilitative mediation and has no prior knowledge or involvement in the case, acting as a facilitator to assist the taxpayer and the tax administration case officers to identify the issues of disagreement and options for resolution, and to evaluate the options in an attempt to reach a resolution.

83. The in-house facilitation process can be requested by either, the taxpayer, their representatives or the tax administration case officers. In some countries (e.g. in the United Kingdom), the tax administration has a discretion as to whether to accept such a request. Where the request is accepted, the facilitator will contact the parties to provide them with an outline of the process, including what is expected of them. For the in-house facilitation process to be effective as a dispute avoidance mechanism, the taxpayer should prepare for the facilitation day including, by ensuring that all relevant persons will be participating or directly accessible and that they are authorized to discuss and resolve the issues of disagreement.

84. On the day of facilitation, the facilitator will commence by outlining the meeting structure and the mutual expectations of the parties. The facilitator will invite the parties to

41 This mediation process can be provided at any stage from audit up to and including the litigation stage. Where it is provided after the conclusion of the audit which results in the tax administration issuing a reassessment for additional income tax payable by the taxpayer, it is similar to the dispute resolution mechanism described as Administrative Mediation discussed in section 3.4.2 of Chapter 3.

present their view of the facts and issues of the case before assisting them to identify the issues of disagreement, the options for resolution, and to evaluate the options in an attempt to reach a resolution. The role of the facilitator is not to establish facts, give advice or decide which party is right or wrong, but to guide the discussion with a view to resolving the issues of disagreement, or at least make progress towards such a resolution.

85. An important aspect of this process is that any information that is shared during the process, including any admission by, or new evidence obtained from a participant, is confidential between the participants, the facilitator and any other people specifically involved in the process, such as lawyers or expert advisors. Such information is only to be used for this process, unless authority is provided by the disclosing party, or disclosure is required by law.

86. For the in-house facilitation process to be effective, it is imperative that the parties participate in good faith, are respectful of the other participants and the facilitator, are open and transparent in providing information relevant to the case, and are willing to negotiate and attempt to resolve all aspects of their disagreement.

87. Where the outcome of the in-house facilitation process during the audit stage does not result in the resolution of the issues of disagreement between the taxpayer and the tax administration, the parties will have obtained the benefit of a greater understanding of their issues of disagreement with a clearer path of the dispute going forward. In contrast, where the outcome of the in-house facilitation process during the audit stage results in the resolution of the issues of disagreement between the taxpayer and the tax administration, it will have the effect of preventing a dispute from formally arising.

*Independent mediation*

88. Independent mediation during tax audits could be effective as a dispute avoidance mechanism as it may eliminate or minimize the possibility of the audit resulting in the tax administration issuing a reassessment for additional income tax payable by the taxpayer.

89. The main difference between in-house facilitation or administrative mediation and independent mediation is that the mediator in an independent mediation is an independent body and not an impartial official of the tax administration. For a description of the main features of the independent mediation procedure in Mexico, see Box 11 below.

***Box 11: Main features of independent mediation procedure in Mexico***

*Independent mediation*

Independent mediation will consider the findings of a tax audit before that audit has been formally determined. The mediation may cover issues of interpretation of legislation and/ or a review of the findings of fact and associated evidence.

*Independent mediator*

The mediator is an independent body and has knowledge and expertise in tax matters. In Mexico, PRODECON[42] acts as an independent mediator. It is an independent public body which according to the law is recognized as an expert in tax matters with the necessary knowledge to conduct the procedure effectively, therefore creating an optimal environment for the parties to reach an agreement.

Further, if no agreement is reached, the parties understand that PRODECON will not be part of any future litigation. This engenders trust in the parties to have an exhaustive negotiation during the mediation process.

*Taxpayer's mediation request and tax administration's response*

A taxpayer dissatisfied with the tax administration's audit position may file a mediation request with the independent mediator.[43] In the request, the taxpayer may submit some or all of the issues discussed as part of the audit. In relation to the submitted issues, the taxpayer will provide reasons for their dissent including their interpretation of the facts, omissions, tax provisions and/or evidence involved in the audit.

Once the taxpayer's mediation request is filed, the independent mediator will give notice to the tax administration of the request and request a response within 20 working days.

*Suspension of time limits*

With the filing of the mediation request, all time deadlines (statutes of limitations) relating to the audit are suspended. This allows the tax administration time to carefully consider the arguments and evidence provided by the taxpayer. Notwithstanding, the mediator must ensure that the mediation procedure is agile and expeditious.

*Process of mediation*

The mediation procedure is effective as it is mandatory for the officials of the tax administration who are conducting the audit to attend the mediation.

The mediation procedure is flexible to deal with a range of circumstances as it is subject to few regulations. Assuming the good faith of the parties in trying to find a consensual solution, the mediator may order, any action which may contribute to the parties reaching an agreement.

The mediation procedure is confidential and does not set any sort of precedent. The parties know that their proposals, offers and positions will be safeguarded by the mediator and will not be public knowledge. This engenders trust in the parties to give-in to some of their claims in an attempt to reach an agreement.

*Outcome of mediation*

The tax administration may or may not accept the taxpayer's proposed terms, or propose alternative terms.

Where the tax administration agrees to the taxpayer's proposed terms, the mediator will prepare and explain the clauses of the proposed agreement before sending these to the parties for their observations or suggestions. Where the parties agree to the proposed agreement, they will be contacted to sign the agreement.

However, where the tax administration does not agree to the taxpayer's proposed terms but proposes alternative terms, the taxpayer will be notified of these and requested to provide their approval or disapproval.

Where the taxpayer is notified of the tax administration's proposed alternative terms, the taxpayer may modify their original proposal by presenting a counter offer, or to achieve consensus with the tax administration.

The mediator may contact the tax administration and the taxpayer to clarify any specific issue in the conflict or to discuss any issue in more depth (e.g. complex transfer-pricing conflicts). These meetings could be an opportunity for a negotiation led by the mediator.

Where the tax administration and the taxpayer do not reach an agreement on some of the tax administration's observations, the tax administration may issue a reassessment for the tax payable related to those issues, which the taxpayer retains the right to challenge. Further, the tax administration must provide reasons for not accepting the taxpayer's proposed terms. Where this occurs, the mediator will the close the mediation procedure and the suspended deadlines will be lifted allowing the tax administration to continue the audit and issue the reassessment for tax payable by the taxpayer.

Where the tax administration and the taxpayer reach an agreement, the agreed outcome will need to be in accordance with the relevant law and in line with any guidelines dictating how the tax administration should reach settlements with taxpayers.

*Legal consequences of the Agreement*

Once the parties sign the agreement, the agreed tax outcomes in relation to the stated issues will come into effect. The agreement will provide the parties legal certainty and closure in relation to those issues.

42 In Mexico the protection of the taxpayers' rights is entrusted to PRODECON, a public organism created by the Federal Congress which though it is part of the Federal Administration, it is not dependant from the tax collection body. It has an autonomous budget which allows it to carry out actions without any pressure. This organism, known as the *tax ombudsman* started operating in 2011. Since 2014 when the mediation procedure was enacted by the Federal Congress, it can act as a mediator between the tax administration and the taxpayer in conflicts that arise during an audit.

43 The taxpayer has the right to file a mediation request, but the tax administration does not have such a right.