Transfer Pricing Cross-Border Dispute Resolution
Tax Business Breakfast

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Agenda

• What is a cross-border transfer pricing (TP) case?
• Mutual Agreement Procedure (MAP) under Double Tax Treaties
• EC Arbitration Convention and its procedure
• Advance Pricing Agreements (APAs)
What is a cross-border transfer pricing (TP) case?
Cross-border TP cases: When double taxation arises?

Example

<table>
<thead>
<tr>
<th>Country</th>
<th>Taxable income</th>
<th>Tax rate</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (producer)</td>
<td>100</td>
<td>30%</td>
<td>30</td>
</tr>
<tr>
<td>B (distributor)</td>
<td>50</td>
<td>10%</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>150</td>
<td></td>
<td>35</td>
</tr>
</tbody>
</table>

Tax audit in country A

<table>
<thead>
<tr>
<th>Country</th>
<th>Taxable income</th>
<th>Tax rate</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (producer)</td>
<td>120</td>
<td>30%</td>
<td>36</td>
</tr>
<tr>
<td>B (distributor)</td>
<td>50</td>
<td>10%</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>170</td>
<td></td>
<td>41</td>
</tr>
</tbody>
</table>
Cross-border TP cases

Available double tax elimination procedures

- Arbitration Convention
- Double Tax Treaty
- EU Mutual Agreement Procedure + Arbitration Procedure
- Mutual Agreement Procedure
Cross-border TP cases

• What are EU Arbitration Convention (AC) and other Competent Authority Procedures for?
  • They provide taxpayers and tax administrations with tools (alternative to domestic litigation procedures) to settle international tax disputes potentially leading to double taxation.

• Why is it important?
  • Increased number/value of cross-border transactions + economic pressure to tax-optimise existing business
  • Increase in audit activity/skills of tax authorities + pressure to protect tax revenues
  • These factors are likely to lead to transfer pricing adjustments in one of the countries involved; this may lead to **double taxation**
Arbitration Convention (AC) & Its Procedure:
How does it work?
AC: Background

• Origin of the Arbitration Convention
  • European Commission's 1976 proposal for a directive to eliminate double taxation in the case of transfers of profits between associated enterprises in different Member States
  • White Paper of 1985 on the completion of the Internal Market

• Entry into force
    • Signed on 23 July 1990, initially in force from 1 January 1995 until 31 December 1999
  • In 2004, a Protocol signed on 25 May 1999 was ratified that provides for an automatic extension of the Convention by periods of five years
    • AC re-entered into force with retroactive effect from 1 January 2000
AC Procedure: How does it work?

• Notification of the action

• Submit claim to competent authority

  - Not well-founded = End of procedure
  - In case of dispute - Mutual Agreement Procedure (MAP)
  - Serious Penalty = End of procedure

• Solution to double taxation?

  - Yes = Double taxation eliminated
  - No = Matter referred to Advisory Commission

Three-year time limit

Two-year time limit
AC procedure: How does it work?

- Matter referred to Advisory Commission
  - Six-month time limit
- Advisory Commission delivers opinion
  - Six-month time limit
- Competent authority takes a decision eliminating double taxation

<table>
<thead>
<tr>
<th>Yes</th>
<th>Double taxation eliminated</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Advisory Commission’s opinion binding</td>
</tr>
</tbody>
</table>
AC: Bulgaria’s accession

• Bulgaria’s accession
  • In force for Bulgaria as of 1 July 2008
  • Applies to the following taxes:
    • Corporate Income Tax
    • Personal Income Tax
  • Unilateral Declaration on Article 8 of the Convention
    • The definition of “serious penalties”

“The term 'serious penalties' means penalties of every kind, imposed for actions constituting administrative or tax infringements, including infringements of procedural law concerning tax assessment and tax collection, as well as for crimes against the tax system. „Serious penalties“ imposed on the enterprise are also deemed to exist when penalties are imposed for offences committed against the tax system on an individual from that enterprise whose actions have influenced the amount of tax liabilities of the enterprise or the collection therewith.”
AC: Implementation

• EU Joint Transfer Pricing Forum (JTPF) Code of Conduct
  • In 2006 a Code of Conduct for the effective implementation of the AC was adopted
    • Non-binding political commitment
    • Reflecting the need of more detailed rules, e.g.:
      • Starting point of deadlines
      • Content of taxpayer’s notification for the case
      • Position paper and response under MAP
      • Proceedings during Advisory Commission procedure
  • In 2009 a Revised Code of Conduct was adopted:
    • Recommends the suspension of tax collection during the dispute resolution procedure
    • Indicates common rules of conduct for national tax authorities
• (JTPF) final report on improving the functioning of the Arbitration Convention (meeting on 12 March 2015)
  • Proposed amendments to the Code of Conduct
JTPF Developments:
Suggested Amendments to the Code of Conduct on the Arbitration Convention
JTPF Developments

Suggested Amendments to the Code of Conduct on the Arbitration Convention – draft

- JTPF’s comprehensive monitoring exercise on the practical functioning of the Arbitration Convention (AC) and the JTPF Code of Conduct (CoC) on AC
- Addressing important aspects by way of proposing amendments to the CoC

Aim:
- Improve the procedure of resolution of disputes by arbitration in a timely and resource effective manner
- Underline the commitment of all parties to the spirit of the AC to seek avoidance of double taxation, recommend to Member States (MS) to provide their Competent Authorities (CA) with sufficient resources in terms of personnel, funding, training

Expected timing: Mid 2015
JTPF analysis & draft recommendations

1. Application of the AC in specific cases

Issue:
- Application of AC in case of no actual tax payment

Recommendation:
- Cash payment is not required to apply AC, this allows for AC to be applicable in case of losses or group relief

Issue:
- Application of AC in case of changes in the status of the taxpayer (resulting in possible mergers, restructurings, being in liquidation or other changes)

Recommendation:
- Access to AC should be allowed
JTPF analysis & draft recommendations

2. Application of the AC dependent on MAP under DTCs (e.g. for PEs)

**Issue:**

- Missing three-year period submission deadline when the case depends on the result of a MAP under the Double Tax Convention

**Recommendation:**

- File separate request for MAP (to solve PE existence) and for AC (to solve allocation of income to PE)
- Two-year period (art. 7(1) AC) not to start before PE issue is solved.
JTPF analysis & draft recommendations

3. Access to the AC and remedies against denial of access

**Issue:**

- Denial of access to the AC by TAs arguing that the issue is not covered by AC

**Recommendation:**

- MS should consider providing domestic legal remedies for determining whether the denial of access to AC by their administrative bodies is justified
- CA receiving the application for AC should acknowledge receipt of the taxpayer’s request for MAP and inform the other CA within one month
- The two CA should reach a mutual understanding on whether they consider the minimum information as submitted
- The two CA should reach a common position on whether the denial of access to the AC is justified
JTPF analysis & draft recommendations

4. Informing enterprises of their rights under the AC

Issue:

• Taxpayers are not always aware of possibility of AC application (not only domestic rights)

Recommendation:

• A tax administration making the adjustment is encouraged to inform the taxpayer about applicability of AC and its time limits at the time of first notification.
5. Independence of Competent Authority from audit function

**Issue:**

- Level of autonomy of the CA from the audit function

**Recommendation:**

- CA should maintain a degree of autonomy and should ensure independence of its review, fair and appropriate application of the AC and not to seek to uphold all proposed audit adjustments.
JTPF analysis & draft recommendations

6. No waiver of rights for audit settlements or blocking MAP access through unilateral APAs

**Issue:**

- Audit settlements (or unilateral APAs) conditional on waiver of access to the AC

**Recommendation:**

- Enterprises and tax administrations should not include waiver of access to MAP in audit settlements and unilateral APAs as this would exclude the other Competent Authority from the final bilateral resolution
JTPF analysis & draft recommendations

7. Informing the other Competent Authority involved

**Recommendation:**

- The enterprise should submit the AC request to both CA
- If necessary translate it into a common working language, where allowed do it electronically

8. Implications of MAP results for other years

**Recommendation:**

- Combining new MAP requests with an ongoing agreement procedure
- Application of the outcome of prior MAP results to new request where applicable
JTPF analysis & draft recommendations

9. The Three-year period – determination of the starting point

**Issue:**

- The term „first notification” which initiates the three-year period for AC submission is interpreted differently by MS

**Recommendation:**

- The date of the first assessment notice or equivalent which results or is likely to result in double taxation due to a transfer pricing adjustment
- An Annex will be added to the Code of Conduct on the AC determining country-by-country the starting point for the three-year period (Annex 2 to the report)
10. Guidance on position papers

**Issue:**

- Lack of clarity on content and timing of position papers

**Recommendation:**

- Within the latest of 4 months of either tax assessment or CA receiving minimum information, CA should send its view and full justification of the assessment along with selection of methodology, comparables and background information of the case

- The responding CA should within 6 months reply with its agreement or justified disagreement
JTPF analysis & draft recommendations

11. MAP outcome and domestic remedies

**Issue:**

- Contradiction of MAP results and parallel domestic court procedures

**Recommendation:**

- If MAP result not satisfactory the enterprise may withdraw its AC request
- If MAP result received when domestic remedies are still pending, implementation of MAP will be subject to its acceptance by the enterprise and withdrawal from domestic remedies
JTPF analysis & draft recommendations

12. Serious Penalties

**Issue:**

- MS have made unilateral declarations to the AC on what constitutes a „serious penalty“. Serious penalties may result in denial / suspension of the AC

**Recommendation:**

- Art. 8: denial of access to the AC due to imposition of serious penalties should take place only when serious penalties are applied in exceptional cases like fraud, wilful default and gross negligence
JTPF analysis & draft recommendations

13. Improving the „second stage” of the AC – advisory commission

**Issue:**

- Presence of CA as full member of the advisory commission with voting power rights is an obstacle for the efficient functioning of the commission

**Recommendation:**

- The chairman and the independent persons of standing to hold separate deliberations
- The enterprise to be informed of its right to make a statement before the advisory commission
JTPF analysis & draft recommendations
14. Tax collection and interest charges

Issue:
• Tax payment suspension and interest treatment inconsistent among MS (Annex 3 to the report)

Recommendation:
• MS are recommended to allow taxpayers to benefit from same treatment of tax collection under MAP/AC procedure as under domestic appeals or litigation procedure
• During MAP taxpayers should not be adversely affected during the time it takes to complete the MAP – asymmetry may still exist
Arbitration Convention and Mutual Agreement Procedure (DTT)
Comparison
Comparison between AC and MAP

<table>
<thead>
<tr>
<th>Item</th>
<th>AC</th>
<th>DTT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Legal source</td>
<td>EU Convention n.90/436 /EEC 23 July 1990</td>
<td>Bilateral Tax Treaties (following Art.25 of the OECD Model Conv.)</td>
</tr>
<tr>
<td>2. Scope</td>
<td>Adjustments made by one contracting EU Member State to profits of associated enterprises within EU contracting member States</td>
<td>Actions of one or both Contracting States the taxpayer considers resulting in taxation not in accordance with the Treaty</td>
</tr>
<tr>
<td>3. Parties</td>
<td>EU Member States</td>
<td>Parties to relevant DTT</td>
</tr>
</tbody>
</table>
## Comparison between AC and MAP

| Item                        | AC                                                                                           | DTT                                                                                           |
|-----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4. Who can apply?           | Any enterprise resident in the EU (or having a PE therein) the profits of which have been or are likely to be included in those of a related enterprise resident in the EU | Any “person” resident in one of the two Contracting States, considering that measures taken by one or both the Contracting States violate the Treaty’s provisions |
| 5. To whom to apply?        | Competent Authorities                                                                         Competent Authorities                                                                         |
| 6. When to apply?           | Three years from the date of the notification of the first action that implies or **may imply** a double taxation | May vary from Treaty to Treaty; OECD Model: **three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention** |
Comparison between AC and MAP

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<tr>
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</thead>
<tbody>
<tr>
<td>7. Is elimination of double taxation certain?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>8. What is the deadline for elimination of the double taxation</td>
<td>2 years + 12 months</td>
<td>No deadline</td>
</tr>
<tr>
<td>9. Is the procedure alternative to domestic litigation?</td>
<td>The case may be presented irrespective from the remedies of the domestic Law (i.e. a litigation may also be started).</td>
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</tr>
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## Comparison between AC and MAP

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<th>DTT</th>
</tr>
</thead>
<tbody>
<tr>
<td>10. Are final court decisions an obstacle to the agreement?</td>
<td>Most likely yes: if CAs cannot deviate from Tax Courts’ decisions, then settlement is not mandatory.</td>
<td>No specific provisions in the OECD Model</td>
</tr>
<tr>
<td>11. What happens if CAs do not reach agreement?</td>
<td>CAs must appoint an advisory commission, made of both CA’s representatives and independent persons. The commission must release an opinion within 6 months. CAs have another 6 months to settle the case on their own or to adhere to the solution presented by the commission.</td>
<td>No provisions in the Model Convention. Some DTTs include arbitration clauses. However, in most cases arbitration is voluntary, not obligatory.</td>
</tr>
</tbody>
</table>
## Comparison between AC and MAP

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<thead>
<tr>
<th>Item</th>
<th>AC</th>
<th>DTT</th>
</tr>
</thead>
<tbody>
<tr>
<td>12. Can the elimination be achieved even in those cases where domestic time limits for adjustments of assessments and tax refunds expire?</td>
<td>Yes</td>
<td>In principle yes (pursuant to the OECD Model), yet some of the Treaties do not exclude domestic time limits.</td>
</tr>
</tbody>
</table>
Advanced Pricing Agreements (APAs)
Advance Pricing Agreements (APAs)

- An **APA** is an agreement between two (or more) tax authorities, deciding on the allocation of profits between two or more associated enterprises.

- An APA is the only document which offers a **mean of securing the approval of tax authorities** on the transfer pricing policies and methodologies selected by the taxpayer.

- An APA produces **effects only for the future**.

- Applied to a (group of) intra-group transaction(s)

- An APA process takes a long time to complete and can be **costly**.
Unilateral vs Bilateral / Multilateral APAs

- **Unilateral APA**
  - Between a taxpayer and one tax administration (cf. ruling)
  - Only unilateral elimination of tax risk (TP, goodwill, PE, etc.)
  - No avoidance of international double taxation

- **Bilateral or multilateral APA**
  - Between the competent authorities (CAs) of two or more tax administrations
  - Bi-or multilateral legal certainty and elimination of (double) income taxation risks
### APAs – filing fees and terms across Europe

<table>
<thead>
<tr>
<th>Country</th>
<th>APA filing fee</th>
<th>APA term of agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>EUR 1,500 - EUR 20,000 (for unilateral APA procedures)</td>
<td>Not specified</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>EUR 365</td>
<td>3 years</td>
</tr>
<tr>
<td>Germany</td>
<td>EUR 20,000</td>
<td>3 - 5 years</td>
</tr>
<tr>
<td>Greece</td>
<td>EUR 5,000</td>
<td>4 years</td>
</tr>
<tr>
<td>Hungary</td>
<td>EUR 1,750 - EUR 24,700 (for domestic APA procedures)</td>
<td>3 - 5 years</td>
</tr>
<tr>
<td></td>
<td>EUR 10,600 - EUR 28,200 (for bilateral APA procedures)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>EUR 17,500 - EUR 35,300 (for multilateral APA procedures)</td>
<td></td>
</tr>
<tr>
<td>Latvia</td>
<td>EUR 7,114</td>
<td>3 years</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>EUR 3,000 - EUR 10,000</td>
<td>5 years</td>
</tr>
<tr>
<td>Poland</td>
<td>EUR 1,250 - EUR 12,500 (for domestic unilateral APA procedures)</td>
<td>5 years</td>
</tr>
<tr>
<td></td>
<td>EUR 5,000 - EUR 25,000 (for Foreign unilateral APA procedures)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>EUR 12,500 - EUR 50,000 (for Foreign bilateral / multilateral APA procedures)</td>
<td></td>
</tr>
<tr>
<td>Portugal</td>
<td>EUR 3,150 - EUR 35,000</td>
<td>3 years</td>
</tr>
<tr>
<td>Romania</td>
<td>EUR 10,000 - EUR 20,000</td>
<td>5 years</td>
</tr>
<tr>
<td>Slovakia</td>
<td>EUR 4,000 - EUR 30,000 (for unilateral APA procedures)</td>
<td>5 years</td>
</tr>
<tr>
<td></td>
<td>EUR 5,000 - EUR 30,000 (for bilateral APA procedures)</td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>EUR 15,000</td>
<td>3 - 5 years</td>
</tr>
<tr>
<td>Belgium</td>
<td></td>
<td>5 years</td>
</tr>
<tr>
<td>Denmark</td>
<td></td>
<td>No fixed terms</td>
</tr>
<tr>
<td>France</td>
<td></td>
<td>3 - 5 years</td>
</tr>
<tr>
<td>Lithuania</td>
<td></td>
<td>1 - 5 years</td>
</tr>
<tr>
<td>Netherlands</td>
<td>No fee</td>
<td>5 years</td>
</tr>
<tr>
<td>Spain</td>
<td></td>
<td>6 years</td>
</tr>
<tr>
<td>Switzerland</td>
<td></td>
<td>3 - 7 years</td>
</tr>
<tr>
<td>Ukraine</td>
<td></td>
<td>3 years</td>
</tr>
<tr>
<td>United Kingdom</td>
<td></td>
<td>3 - 5 years</td>
</tr>
</tbody>
</table>

Unilateral / Multilateral APAs – Example of the process (1/2)
**Unilateral / Multilateral APAs – Example of the process (2/2)**

1. **Pre-Filing Meeting**
   - Informal meeting between tax administration and taxpayer for assessment of eligibility for APA prior to submission of a formal APA proposal
   - Key points of discussion:
     - Background of APA request
     - Records of tax returns (e.g. taxpayer’s OM (PLI) compared to the arm’s length price)
     - Eligibility for bilateral APA (e.g. existence of tax treaty, whether the relevant tax treaty is applicable for the covered transaction)
     - Scope of covered transactions and applicants

2. **Application**
   - Documents required for APA application:
     - Financial statements, tax returns, a copy of contracts for international transactions, and relevant documents
     - Transfer pricing documentation detailing TPM, financial statements of comparable companies, financial adjustments, segmented financial statements by transaction item, the arm’s length range, conditions and assumptions for ALP calculation

3. **Evaluation & MAP**
   - Evaluation of the proposed TPM
   - Request for additional supporting documents, or change/modification of the proposed TPM
   - MAP with relevant foreign competent authorities
   - Suspension of MAP:
     - Where agreements are not reached between two tax authorities within 3 years from the receipt of APA requests
     - Where the CAs decide to end the MAP process

4. **APA Approval**
   - Upon agreement, the applicant is notified by CAs

5. **Annual Report**
   - Annual updates attesting that the conditions of the APA have been kept

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IRS 2015-11, Statistical Report on APAs

• **APAs executed by industry** – 2014: manufacturing (48% - majority: computer and electronic products), wholesale/retail (22% - majority: durable goods);

• **Covered transactions** – 2013: sale of tangible goods (36%), provision of services (40%);

• **Sources of comparables**: RoyaltyStat, RoyaltySource, ktMINE, LoanConnector, Bloomberg, Recap.

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<table>
<thead>
<tr>
<th>No. of APAs filed during the period 1991 – 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Period</strong></td>
</tr>
<tr>
<td>Filed 1991 – 1999</td>
</tr>
<tr>
<td>Filed 2000 – 2013</td>
</tr>
<tr>
<td>Filed in 2014</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>No. of APAs executed during the period 1991 – 2014</th>
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