

Emerging conversations Global Industrial Products Tax Alert

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Tax Alert*

*Emergence of New
Examination Approach -
Joint Audits*

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Emergence of New Examination Approach – Joint Audits

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Industrial Products companies with multinational operations should consider the pros and cons of engaging in a joint audit, taking into account the potential risks and cost-saving rewards with respect to all taxing jurisdictions involved.

Collaboration among revenue authorities around the globe has been noticeably increasing. Many countries have been engaging in traditional information exchange under recent and long-standing tax treaties and agreements, as well as other collaborative activities such as bilateral advance pricing agreements, competent authority agreements. In addition, multilateral tax information exchange programs, such as the Joint International Tax Shelter Information Centre (JITSIC) are common. Countries have also been engaging in simultaneous tax audits, where two or more countries examine simultaneously, each in its own territory, the tax affairs of a taxpayer where there is a common or related interest, with a view to exchanging the information they obtain.

This collaboration has continued to evolve into more sophisticated methods and strategies. One of the fastest emerging trends with respect to audit techniques is the pursuit of “joint audits” where a taxpayer is subject to a coordinated audit using a single audit team comprised of representatives from two or more jurisdictions. Joint audits stand in contrast to a more typical situation where the same taxpayer is subject to separate audits with respect to the same transaction or items of income or deduction by two or more countries. Joint audits are the next step to even greater cooperation between taxing authorities – a new era of coordinated action.

What prompted the emergence of this newest audit mechanism?

The joint audit concept arose from the Organisation for Economic Co-operation and Development (OECD) Forum on Tax Administration (FTA), established in 2002, which is comprised of tax commissioners from over 30 participating countries. The FTA is aimed at developing international best practices with respect to issues involving tax administration and is currently led by US Internal Revenue Service (IRS) Commissioner Doug Shulman. The joint audit project was carried out by representatives from 13 OECD countries (Australia, Canada,

Denmark, France, Japan, Korea, Mexico, Netherlands, South Africa, Spain, Turkey, the UK, and the US). The group was prompted to do so because tax administrators expressed a desire to enhance collaboration and coordination to achieve a reduction in tax avoidance, enhanced confidence in the tax systems, as well as the development of strategies and capabilities. The resulting reports, referred to as the “Joint Audit Report” and the “Joint Audit Participants Guide” were released in September 2010.

What are the main objectives of a joint audit?

The Joint Audit Report describes the participating taxing authorities’ overarching view that structured cooperation in a joint audit may “substantially enhance the impact of individual revenue body’s programs and their capability,” as well as “effectively reduce international tax evasion and avoidance across frontiers.” The Report also describes a multitude of specific objectives. One of the most significant is the reduction of administrative burden both in terms of saving time as well as taxpayer resources. The reasoning is that businesses will not face the burden of two exam teams conducting two audits which they must address separately.

Another objective noted in the Report is that countries involved should reach agreement on the audit results so as to reduce the risk of double taxation.

The Report states that if necessary to avoid double taxation, the joint audit may accelerate the mutual agreement procedures (MAP) by involving the Competent Authority from each jurisdiction at issue early during the joint exam process. This objective has been recognized by government officials, taxpayers, and practitioners as favourable for both taxpayers and the tax authorities because it could allow the parties involved to focus on the issue, understand the facts in a more expeditious manner, and thereby allow for quicker resolution of any disagreements.



*Joint audits – a new era of
greater collaboration between tax
authorities*

What issues are amenable for joint audits?

Although generally there is no limitation regarding the specific types of issue that may be the subject of a joint audit, the Joint Audit Report provides a list of issues that may be best suited or particularly amenable to being examined under a joint audit. These include, but are not limited to:

- transfer pricing issues
- cost allocation agreements
- service agreements
- cost sharing agreements

In addition, back-to-back loans, double dip leases, and split benefit agreements such as royalty arrangements are included. Hybrid financing instruments are specifically listed; however, it appears that not all hybrid transactions are susceptible to a joint audit. The Report states that a “mismatch” of different results based on the application of the different countries’ law would by itself generally not be a reason for an audit.

The Joint Audit Report also lists complex business restructuring processes, complex tax structures, as well as entities operating in tax haven jurisdictions as amenable to a joint audit. In addition to more fundamental issues such as taxpayer residency or permanent establishment determinations, the presence of private equity funds as well as “structured transactions” are also listed. The latter is defined as a series of related transactions that could have been conducted as one but were intentionally broken down. The Joint Audit Report lists collateralized debt obligations, asset backed securities, complex assurance contracts, and special purpose entities as examples.



No limitation on the types of issues which may be the subject of a joint audit

How does the joint audit process compare to a more traditional audit?

- Unlike traditional audits, participating countries must consider the legal frameworks in which their tax auditors must act such as bilateral and multilateral treaties that incorporate mutual assistance provisions.
- The joint audit process, described in the Joint Audit Participant's Guide, involves similar steps to a traditional domestic audit but adds the extra effort of doing so in a collaborative manner. Each participating country will be jointly responsible for organizing and managing the audit and will jointly request data and information from the taxpayer within their respective legal frameworks. In the final stages, a final audit report is produced showing liabilities or refunds from all participating countries.
- The Joint Audit Report's recommendation is that joint audits should be carried out with taxpayers that are willing participants in the audit. However, the Joint Audit Participant's Guide infers that in contrast to a more traditional type audit, either a taxpayer may request a proposal for a joint audit to a participating country, or the participating country may suggest joint audit cases.
- According to the Guide, a joint audit should be completed within 12-18 months of the start date, which may be quicker or longer than a traditional audit, depending upon the specific taxpayer. However, taking into account the potential time to resolve a double taxation dispute using the competent authority process, this expected duration may be far less than a traditional audit.



Tax authorities are already working together to pursue joint audits

Which countries are already working together?

In January 2011, the US IRS announced it will pursue joint audits with the Australian Tax Office (ATO) – its first joint audit partner. In a public statement, IRS and ATO officials stated that the pursuit of joint audits between their jurisdictions should help the development of a process that will serve as a prototype for joint audits between other countries. In June 2011, IRS and ATO officials confirmed that

joint audits of two large businesses are underway and that more will follow. IRS officials have additionally stated that they are pursuing joint audits with other tax authorities including the UK and the Netherlands.

What proactive measures should Industrial Products companies consider?

Multinational Industrial Products companies should look for situations where they are addressing foreign and domestic tax audits on the same transaction or income/deduction items, keeping in mind the non-exhaustive issue list noted above. In these situations, they should consider the benefits of voluntarily requesting a joint audit. For example, a joint audit may be helpful where the transaction is subject to differing tax rules in each jurisdiction with respect to the exam, such as transfer pricing disputes. It may also be beneficial to gain resolution on issues of potential double taxation if competent authority representatives from the specific

jurisdictions will be involved from the onset of the joint audit. Their involvement could yield significant time and resource savings while achieving greater certainty earlier in the process.

However, a joint audit can have potential disadvantages such as requiring more burdensome document production given that one of its objectives is to collect the most evidence possible to justify the requested tax consequences. Another area of concern is the involvement of other countries that lack a seat at the table, for example, where a non-treaty country is involved in some way in the transaction in which three countries are at issue. Consequently, the evaluation of the pros and cons of utilizing the joint audit process may be challenging and should be performed thoroughly, considering the potential risks and rewards with respect to all taxing jurisdictions involved.

PwC's Tax Controversy and Dispute Resolution (TCDR) Global Network

provides a full range of tax controversy and dispute resolution services relating to corporate tax audits and disputes arising anywhere in the world. The TCDR network includes former government officials and can deliver real-time, local country guidance and expertise, coupled with the local country connections that enable an in-depth understanding of local processes and procedures. The TCDR team is perfectly suited to help analyze the advantages and disadvantages of a joint audit both from a domestic and foreign tax perspective. The TCDR team can also assist with drafting the joint audit proposal submitted to a participating country, as well as support the implementation of a joint audit from start to finish, creating tremendous value for our clients by taking a comprehensive approach to the joint audit process.

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Adding value – a comprehensive approach to joint audit

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