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# The Role of the Competent Authority

International Tax – Transfer Pricing Branch

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# 1. Executive summary

## 1.1. Introduction

This document provides an overview of the increasing importance of the role of the Irish *competent authority* in resolving international tax disputes and ensuring the correct allocation of taxable profits to Ireland. This document also highlights changes made, or for consideration, to strengthen Revenue's competent authority function.

## 1.2. The competent authority function

Transfer pricing is one of the most significant tax issues being considered at a global level by governments, tax administrations and international bodies such as the Organisation for Economic Co-operation and Development ("OECD") and EU. It is also a major issue for Multinational Enterprises (MNE's) and is an important factor in decisions made by enterprises in respect of FDI projects.

The competent authority function seeks to resolve international transfer pricing disputes through negotiations with tax authorities of treaty partner jurisdictions. Due to the Base Erosion and Profit Shifting (BEPS) project, it is envisaged that there will be an increase in the number of mutual agreement procedures ("MAP's") and requests for advance pricing agreements ("APA's"). Therefore, it is increasingly important that Revenue has a strong, well-resourced competent authority team to resolve cases effectively. When deciding on where to establish/ expand operations, MNE's place increasing emphasis on the jurisdiction having a strong, experienced and well-resourced competent authority function.

## 1.3. Mutual agreement procedures ("MAP's") and advance pricing agreements ("APA's")

Revenue's role in negotiating MAP's and APA's is critical as it demonstrates Ireland's commitment to resolving international tax disputes in an open and transparent manner. Due to the potential significant impact on the Irish tax base from MAP adjustments, a robust examination of each case is essential to ensure the correct allocation of profits between Ireland and our treaty partners.

In an effort to obtain certainty with respect to their transfer pricing arrangements, MNE's are increasingly seeking the certainty of an APA. At present, Revenue accepts bilateral APA requests on an *ad hoc* basis, typically in situations where a treaty partner has agreed to enter into a bilateral APA negotiation. Formalising the procedures with respect to bilateral APA's would demonstrate that Ireland is committed to implementing an APA programme in accordance with international best practice.

## 1.4. Arbitration

Business and other stakeholders have pushed for mandatory binding MAP arbitration as a way to reduce uncertainty and double taxation. A significant number of countries (including Ireland) have indicated their willingness to seek to implement mandatory, binding arbitration.

In order to ensure that Ireland's position is represented as effectively as possible at arbitration, it is timely to consider selecting a new panel of individuals to represent Ireland in arbitration.

## 1.5. Key considerations / Actions

The items listed below set out Revenue's key aims and objectives with respect to the competent authority function:

In the context of MAP negotiations, ensure the correct allocation of profits to Ireland.

Continue to ensure that Revenue has a sufficiently resourced and experienced competent authority team to deal with the inventory of MAP and APA cases.

Scope and evaluate the introduction of a formal bilateral APA programme.

Ireland to work with the interested group of countries with respect to the introduction of mandatory binding arbitration.

## 2. Dispute resolution

### 2.1. Introduction

In a globalised economy, international double taxation may result where two countries seek to tax the same transactions or activities. Whilst tax treaties directly resolve most such cases, international double taxation may remain where two countries disagree on the interpretation or application of a treaty provision.

The OECD and the EU have focused for a number of years on improving *mutual agreement procedures* in an effort to speed up the resolution of disputes and to try and ensure that double taxation does not arise.

### 2.2. Dispute resolution through tax treaties

Countries enter into double tax treaties in order to set out the taxing rights of each jurisdiction in an effort to avoid disputes and double taxation. As disputes still arise, most tax treaties will contain an Article similar to Article 25 *Mutual Agreement Procedure* of the OECD Model Tax Convention to provide a mechanism for the tax authorities to resolve disputes. As a result, when Ireland enters into a tax treaty with another jurisdiction, it has a legal obligation to provide a competent authority function to resolve disputes that may arise under the treaty. Article 25 provides that competent authorities “*shall endeavour...to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of double taxation*”. Although the competent authorities try to reach an agreement and avoid double taxation, this is not always possible.

Where the competent authorities fail to reach an agreement, a resolution may be found through arbitration. Arbitration is a mechanism aimed at resolving conflicts by involving an independent third party expert who reviews all of the facts and makes a final independent decision.<sup>1</sup> However, not all tax treaties contain an arbitration clause and where such clauses are included they may not mandate binding arbitration. This means there may be no requirement to go to binding arbitration and disputes can go unresolved, resulting in double taxation.

### 2.3. OECD efforts to improve dispute resolution

In order to reduce the instances of double taxation, the OECD continues to develop ways to improve the operation of MAP's. Improvements to MAP's made to date include:

- The publication of MEMAP (Manual for Effective Mutual Agreement Procedures), which contains a number of *best practices* to improve the functioning of MAP's;
- The inclusion of an arbitration clause in the MAP Article of the OECD Model Tax Convention;
- The publication of country profiles on the OECD website, which give contact details of competent authorities and information on a country's transfer pricing rules; and

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<sup>1</sup> A more detailed discussion on arbitration is included in Section 6.

- The publication of statistics relating to MAP caseloads of all OECD member countries and of OECD partner economies.

At present there are two forums specifically established within the OECD with a clear mandate to improve the effectiveness of MAP's. These are the Forum on Tax Administration (FTA) *MAP Forum* and a specific dispute resolution *focus group*, established under Working Party 1 of the Committee of Fiscal Affairs, to address Action 14 of the BEPS action plan.

The MAP Forum is a subgroup of *competent authorities* from FTA countries. The objective of the Forum is to collectively improve the effectiveness of MAP's in order to meet the needs of both governments and taxpayers.

The objective of Action 14 of the BEPS plan is to develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases (e.g. where a serious penalty has been applied).

Action 14 includes a three-pronged approach:

- Firstly, a political commitment to support the elimination of double taxation;
- Secondly, measures to remove obstacles to an effective and efficient mutual agreement procedure that results in timely resolution of disputes (the minimum standard); and
- Thirdly, a monitoring mechanism to ensure proper implementation of the minimum standard.

Key elements of the Action 14 minimum standard are that cases should be resolved within an average timeframe of two years; countries should enhance their relationships with other competent authorities by being active members of the FTA MAP Forum; and countries should ensure that adequate resources are provided to the MAP function.

The improvement of dispute resolution procedures under Action 14 is seen as a key outcome from BEPS for MNE's. Reducing the time taken to resolve cases and more certainty regarding the avoidance of double taxation are key objectives of MNE's. As discussed in more detail in Section 6, MNE's are in favour of mandatory binding arbitration as a mechanism to reduce the time taken to resolve cases and avoid double taxation. However, it has not been possible to get consensus on this issue and it will now not form a part of the Action 14 recommendations. This increases the pressure on the OECD and tax authorities to deliver on the other aspects of Action 14.

Ireland's position is to support mandatory binding arbitration and this may be achieved through co-operation with other countries that have a similar view. This will be a positive outcome for MNE's.

## 2.4. EU work on improving dispute resolution

The EU Joint Transfer Pricing Forum ("JTPF") assists and advises the European Commission on transfer pricing tax matters. The work of the JTPF is divided into two main areas—

- monitoring and improving the functioning of the EU Arbitration Convention and

- addressing other transfer pricing matters identified by the JTPF for inclusion in its work plan.

Over the past two years, the JTPF has focused on improving the *Code of Conduct for the Effective Implementation of the EU Arbitration Convention*. A revised Code of Conduct was finalised in March 2015.

The items included in the JTPF's work plan are agreed by the European Commission and Member States with the goal of improving transfer pricing in the EU. By providing reports and guidance agreed by all Member States, the JTPF helps to resolve transfer pricing disputes that arise between Member States. Over the past number of years, the JTPF has issued several reports and formal guidance aimed at improving transfer pricing in the EU.

## 3. The role of the competent authority

### 3.1. Introduction

The purpose of this section is to provide an overview of the role of the competent authority. A *competent authority* is a term used in tax treaties to identify the position, person, or body to whom issues can be addressed to ensure a good faith application of a double taxation convention<sup>2</sup> and who will endeavour to resolve such issues in accordance with the applicable tax convention. In Ireland, Revenue is the competent authority. A taxpayer can request competent authority assistance to resolve a dispute arising under a double taxation convention. This document is focused on the role of the competent authority in resolving transfer pricing disputes which arise under Article 7 and Article 9 of the OECD Model Tax Convention.

Assistance by a competent authority is generally provided under the Mutual Agreement Procedure (MAP) article contained in a tax convention. In addition to the MAP procedures available through double taxation conventions, the EU Arbitration Convention establishes a procedure to resolve transfer pricing disputes where double taxation occurs between enterprises of different Member States.

### 3.2. Importance of the competent authority

Transfer pricing is one of the most significant tax issues being considered at a global level by governments, international bodies such as the OECD and EU, and tax administrations. It is also a major issue for MNE's and is an important factor in decisions made by such companies in respect of FDI projects.

One consequence of the current international focus on BEPS – and of the OECD Anti-BEPS Action Plan – is that there is likely to be a significant increase in the number of disputed profit adjustments for MNE's leading to an increased risk of double taxation.<sup>3</sup> In a Q1 2015 survey of over 550 global tax professionals, 79% agreed or strongly agreed that double taxation would arise from some of the BEPS changes.<sup>4</sup>

It is increasingly important that competent authority functions are sufficiently resourced to cope with the growing number of cases. Revenue needs to ensure that the number of open cases and the time taken to conclude cases does not increase significantly and damage Ireland's reputation as a location to do business.

The table below gives a broad indication, subject to organisational differences, of the transfer pricing resources in other jurisdictions which are approximately similar in size to Ireland. The table shows how, in eight of the thirteen jurisdictions, there has been an increase in the number of transfer pricing specialists from 2012 to 2014. Some of the

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<sup>2</sup> Double taxation conventions are also referred to as double taxation agreements or tax treaties.

<sup>3</sup> The EU Arbitration Convention: Reinforcing the Procedure to Cope with an Expected Flood of Double Taxation Disputes – International Transfer Pricing Journal Volume 21, 2014

<sup>4</sup> OECD's Base Erosion and Profit Shifting (BEPS) initiative - Full results of second annual multinational survey – Deloitte, May 2015



countries have indicated that they intend to further expand their transfer pricing teams in the coming years.<sup>5</sup>

**Table 1 – Indication of number of transfer pricing employees in jurisdictions of a similar size to Ireland**

<sup>6</sup> Number of transfer pricing employees	2012	2014	Increase
Austria	30	30	0
Belgium	12	12	0
Czech Republic	33	36	3
Denmark	80	100	20
Estonia	6	6	0
Finland	37	43	6
Hungary	7	16	9
Israel	5	6	1
Norway	62	87	25
Portugal	50	50	0
Slovak Republic	9	52	43
Sweden	40	40	0
Switzerland	14	16	2

### 3.3. The Irish competent authority team

Until Q4 2013, the Irish competent authority function was undertaken by a single principal officer. The competent authority relied on the assistance of Revenue’s *Large Cases Division* to provide support on MAP and APA cases and on specialist economic support provided by the *Statistics and Economic Research* team.

In May 2014, the Department of Finance launched a BEPS consultation process and invited submissions from interested parties on how Ireland’s domestic tax system might best respond to international tax changes.<sup>7</sup> Several of the respondents to the consultation paper highlighted the need for Revenue to increase its expertise in transfer pricing and to devote additional resources to the competent authority function. The *Road Map for Ireland’s Tax Competitiveness*<sup>8</sup> committed to strengthening the capabilities of the transfer pricing competent authority— a commitment endorsed in Budget 2015.

In Q2 2015, the competent authority team includes a principal officer, three assistant principals and one administrative officer. By the end of 2015 it is expected that the competent authority team will comprise one principal officer, five assistant principals and three administrative officers. This will include two assistant principals hired externally with significant international tax and transfer pricing experience.

There are four main factors driving the requirement for additional resources in the competent authority team—

<sup>5</sup> The figures give an indication of the transfer pricing resources (both competent authority and audit function) available to the different tax authorities. Revenue’s Large Cases Division has a specialist transfer pricing audit team.

<sup>6</sup> 2014 global transfer pricing tax authority survey - Perspectives, interpretations and regulatory change – EY 2014

<sup>7</sup> Public Consultation Paper: OECD Base Erosion and Profit Shifting Project in an Irish Context – Department of Finance , May 2014

<sup>8</sup> Competing in a Changing World, A Road Map for Ireland’s Tax Competitiveness – Department of Finance, October 2014

- ensuring that the correct arm's length profits are attributed to Ireland in MAP negotiations;
- an increase in the number of MAP and APA cases being presented to the competent authority in recent years and a further anticipated increase as a result of BEPS;
- pressure from taxpayers and other interested parties to strengthen Ireland's competent authority function; and
- in line with recommended practice, the separation of the role of the competent authority from the transfer pricing audit function (performed by Large Cases Division).<sup>9</sup>

In order to achieve separation from Revenue's audit function, the Irish competent authority is being sufficiently staffed so that it is no longer necessary to rely on the assistance of Large Cases Division. This ensures that when Large Cases Division raises a transfer pricing audit assessment which is disputed by the taxpayer<sup>10</sup>, the competent authority can independently and objectively review the case.

It is increasingly important for Revenue to have an experienced and well-resourced competent authority team who have the experience and expertise to support Ireland's interests. As the number of global transfer pricing disputes increases, it will be vital that Revenue can demonstrate its commitment and ability to negotiate the correct arm's length allocation of profits to companies located in the State.

### 3.4. Conclusion

Where there is a dispute with a foreign tax authority, the competent authority function has a key role in ensuring that the profits allocated to Ireland are consistent with the arm's length principle. The competent authority function also has an important role in protecting Ireland's reputation as a location that does not support base erosion and profit shifting. Due to an increase in the complexity of international trade, there has been an increase in the number of disputes being referred to competent authorities. In addition, it is envisaged that the OECD's BEPS project will lead to a significant increase in transfer pricing disputes as well as placing more requirements on the competent authority function as a result of proposed changes under Action 14.

Over the past 18 months, the Irish competent authority function has expanded significantly. It is better equipped to cope with the expected increase in the number of cases arising from the BEPS project and this important Revenue function should continue to have sufficient resources.

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<sup>9</sup> Both the EU and OECD recommend that, in order to enhance objectivity, the competent authority should remain largely independent from the field team that perform audits.

<sup>10</sup> Not all disputed audit adjustments will result in a MAP claim. The taxpayer may opt to proceed with a domestic appeal rather than pursuing a MAP settlement, in which case the competent authority would not be involved.

## 4. Mutual agreement procedures (“MAP”)

### 4.1. Introduction

The MAP article in tax conventions allows the competent authorities from the governments of the contracting states to interact with the intent to resolve international tax disputes. These disputes involve cases of double taxation where the same profits have been taxed in two jurisdictions.

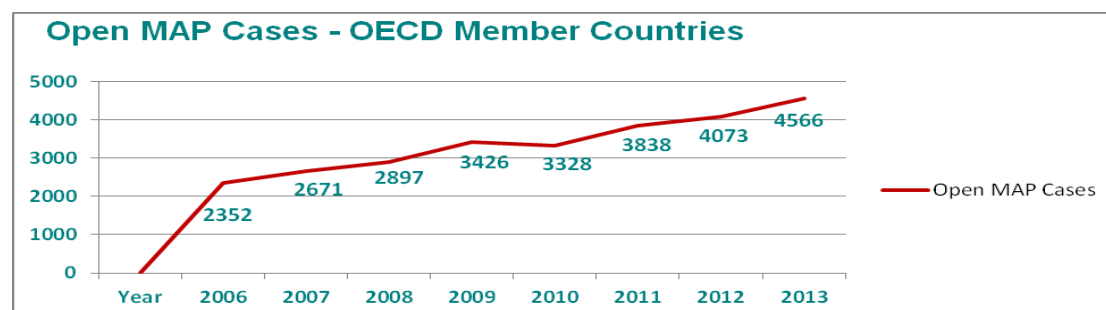
From a transfer pricing perspective, MAP’s arise as a result of an audit taking place in one country (Country A) which results in an adjustment to a company’s transfer price. This increases the profits subject to tax in Country A. However, the additional profit that is now being taxed in Country A was already taxed in the other country (Country B). Through MAP negotiations, the competent authorities of Country A and Country B will endeavour to agree the correct profit allocation between the companies in their respective jurisdictions in order to prevent or reduce double taxation. If the competent authorities agree that some or all of the upward adjustment to the profits proposed by the audit team in Country A is justified, Country B will allow a downward adjustment for the agreed amount to the profits of the company in its jurisdiction and will repay any tax already paid on this income. Ultimately the objective of the MAP process is to negotiate a position that is acceptable to both tax authorities and to seek to avoid double taxation for taxpayers.<sup>11</sup>

The situation described above will not always result in a MAP. The taxpayer in Country A may opt to proceed with an appeal through the domestic courts or may reach a settlement with the tax authority in Country A. In this situation, the taxpayer in Country B may approach the tax authority in its jurisdiction to seek double taxation relief by way of a downward adjustment of taxable profits. The tax authority in Country B must grant relief, but only to match so much of the Country A upward adjustment as was consistent with the OECD arm’s length principle.

### 4.2. OECD

The chart below shows the total number of open MAP cases in OECD member countries and demonstrates how the number of MAP cases has almost doubled from 2006 to 2013. The OECD’s BEPS initiative is proposing significant and far-reaching changes to the international transfer pricing environment. This is likely to result in a very significant increase in the number of transfer pricing adjustments and consequently the number of MAP cases being presented to competent authorities.

Figure 1 - Growth in the number of MAP cases 2006 - 2013



<sup>11</sup> The adjustment agreed by the competent authorities (on foot of the audit adjustment in Country A), arising from the MAP process, may prompt the tax auditors in Country B to review the appropriateness of aspects of the transfer pricing arrangements of the company in Country B.

### 4.3. Irish MAP cases

Negotiating MAP cases is the main function performed by the competent authority. Revenue's role is critical as it demonstrates, in an open and transparent manner, that Ireland does not facilitate base erosion and profit shifting. Revenue's competent authority has resolved 25 MAP cases in the period from 2010 to 2014.

MAP's involving Ireland have been initiated by tax authorities located in other treaty partner countries<sup>12</sup> who seek to attribute additional profits to their jurisdiction, thus reducing the profits subject to tax in Ireland<sup>13</sup>. Accordingly, it is important that Ireland has a strong competent authority team that can engage with other competent authorities to ensure that soundly-based transfer pricing positions can be agreed and that adjustments are consistent with the arm's length principle.

The table below shows the number of open MAP cases, additional cases initiated and cases closed by the Irish competent authority from 2012 to 2014. It is anticipated that the BEPS project will result in an increase in the number of MAP cases being submitted to competent authorities.

**Table 2 - Summary of Irish MAP cases 2012 – 2014 (to date)**

	2012	2013	2014
<b>Opening inventory of MAP cases</b>	26	26	24
<b>New MAP cases initiated</b>	6	7	7
<b>Cases resolved</b>	6	9	9
<b>Closing inventory of MAP cases</b>	26	24	22

MAP cases typically take a number of years to reach conclusion. During the period of the MAP, the competent authority has to carry out a detailed review of the case in order to form a view as to the correct treatment/ pricing of the transaction. In order to do this, the competent authority has to review large quantities of information generated by the taxpayer and the audit team/ competent authority from the other jurisdiction. The competent authority may also conduct interviews with personnel from the domestic and foreign taxpayer entities and may perform an independent economic analysis of the transaction. In order to reach a final conclusion, there will typically be several rounds of negotiation between the two competent authorities.

### 4.4. Conclusion

Adjustments proposed under MAP's can be significant and a robust negotiation of MAP claims is important to ensure the correct allocation of profits to Ireland. It is envisaged that the OECD's BEPS project will result in an increase in the number of MAP claims in the coming years.

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<sup>12</sup> Revenue's Large Cases Division is currently undertaking a number of transfer pricing audits and it is likely that this will result in Large Cases Division making transfer pricing adjustments, potentially leading to double taxation and consequently the need for MAP negotiations.

<sup>13</sup> A transfer pricing audit adjustment by a treaty partner may indicate that there is an issue with the group's transfer pricing arrangements and may represent a risk factor to be considered by Large Cases Division when selecting Irish companies for a transfer pricing audit.

## 5. Advance pricing agreements (“APA”)

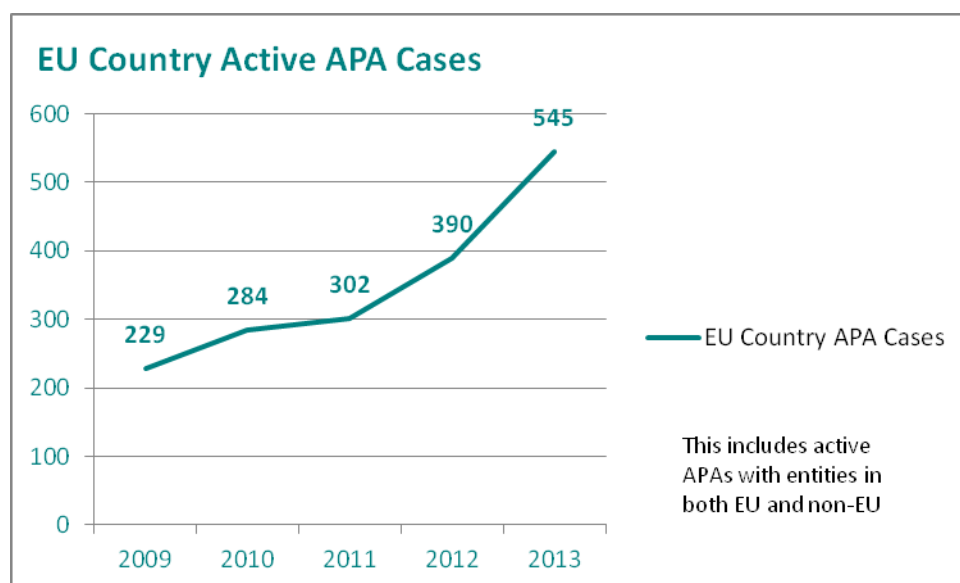
### 5.1. Introduction

APA’s are agreements between the tax administrations in two or more countries defining how *future* transactions between related taxpayers established in their respective jurisdictions will be taxed<sup>14</sup>. MNE’s are increasingly seeking certainty with respect to transfer pricing matters. This has resulted in an increased demand for advance pricing agreements with tax authorities relating to transfer pricing.

APA cases can have a significant impact on how profits should be allocated between the entities involved in the APA. For example, an APA may examine the allocation of the profits earned on a particular product over a five year period. In some cases, the amount of anticipated profit to be allocated could be hundreds of millions, or even billions, of Euro over the life of the product. As a result, obtaining the optimal result for Ireland in an APA negotiation can have a significant impact on the level of profits being reported and taxed in Ireland. Furthermore, a country’s willingness to enter into APA’s and a sufficiently experienced and well-resourced national team capable of successfully negotiating APA’s are increasingly important considerations for companies when deciding where to locate their operations.

The chart below shows the total number of active cases across the EU from 2009 to 2013 and clearly demonstrates the growth of the APA process during this period.

Figure 2 - Active APA Cases in EU Member States



### 5.2. Irish APA cases

While Ireland does not currently have a formal bilateral APA programme (see Section 5.3 for more details), Revenue will enter into bilateral APA’s with treaty partners in relation to cases which have been accepted by Ireland’s treaty partners and which are considered complex or likely to result in a MAP<sup>15</sup>. Revenue adheres to the OECD<sup>16</sup> and EU<sup>17</sup> guidance for all

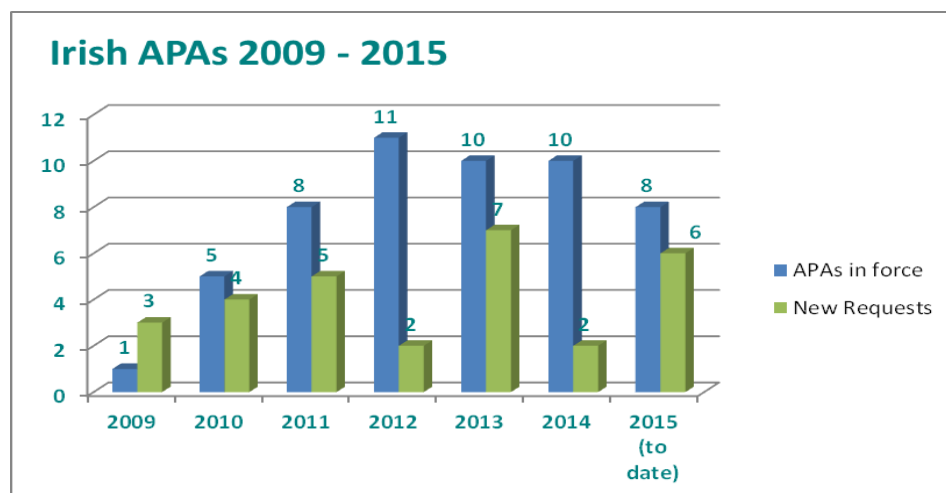
<sup>14</sup> APA’s typically apply for a period of three to five years.

<sup>15</sup> The criteria to qualify for an APA will be kept under review.

bilateral APA negotiations with treaty partners. Ireland will only enter into *bilateral* APA's, i.e. an APA involving Ireland will always involve two tax administrations, the other being a treaty partner.

This section shows the number of *in force* APA's negotiated by the Irish competent authority and the new APA requests received from 2009 to 2015.

Figure 3 - Irish APA's 2009 - 2015



Similarly to MAP's, the negotiation of an APA is a lengthy and time-consuming process— it can often take two years or more to successfully negotiate an APA. The amounts involved are often very significant and it is important to have a full understanding of all aspects of the case before negotiations begin. Before a final agreement can be reached, it is necessary to fully understand the impact of the APA for future years and, in particular, any budget or forecast information on which the APA is based. If the actual results differ materially from the forecasts, it may significantly impact the intercompany pricing and reduce the level of profits reported and taxed in Ireland compared to what was envisaged when the APA was agreed.

### 5.3. Formal APA programme

Currently more than 30 countries have a formal APA programme. These APA programmes provide clarity to taxpayers and tax authorities with respect to APA's by establishing the parameters within which an APA will be granted. This can be achieved by issuing administrative guidance and operating procedures with respect to the APA programme. Alternatively, a formal APA programme may be incorporated into legislation and the OECD has issued guidance to assist countries in drafting APA legislation. Whether an administrative or statutory approach is adopted, an APA programme requires the preparation of detailed guidance notes setting out how to apply for an APA; the review process undertaken by the tax authority before the taxpayer is formally accepted into the APA process; the information that the taxpayer must provide; and the criteria by reference to which the tax authority will assess each case<sup>18</sup>. APA programmes will also set out the process for monitoring compliance with the conditions of the APA as well as the procedures for revising, cancelling or renewing an APA.

<sup>16</sup> OECD Guidelines for Multinational Enterprises and Tax Administrations – July 2010 Chapter IV (F)

<sup>17</sup> Guidelines for Advance Pricing Agreements in the European Union - EU Joint Transfer Pricing Forum 2007

<sup>18</sup> Some countries charge a fee for access to the APA programme.

Ireland does not currently have a formal bilateral APA programme. At present, the Irish competent authority accepts requests for bilateral APA's on an *ad hoc* basis in situations where a treaty partner has agreed to enter into a bilateral APA negotiation. As Ireland does not have any procedures or guidance in place, bilateral APA negotiations will be governed by the approach adopted by the other competent authority. If a formal APA programme is introduced in Ireland, taxpayers will be required to consider Ireland's APA guidance as well as that of the counterparty jurisdiction. Ireland's APA guidance would likely adhere to the OECD and EU recommendations, as is the case with most countries, so the guidance of both jurisdictions should be broadly aligned.

The OECD publishes country transfer pricing profiles and Ireland is shown as having no APA regulations. This could be read by MNE's – incorrectly – as indicating that Revenue is not willing or able to enter into bilateral APA's. Formalising the procedures with respect to bilateral APA's would demonstrate that, where specified conditions are met, Ireland will agree to accept bilateral APA requests. When MNE's are making a decision where to locate new activities, one of the considerations is whether a jurisdiction has a formal APA programme. Furthermore, it would demonstrate to our treaty partners that we have an open and fair tax system and do not encourage base erosion and profit shifting. A likely outcome of formalising the APA process would be an increase in the number of enquiries regarding APA's.

One of the outcomes of Action 14 of the OECD's Anti-BEPS initiative is the best practice recommendation that countries should have a bilateral APA programme. While there are benefits associated with the implementation of a formal APA process, there are also disadvantages which need to be considered. The table below highlights some of the main advantages and disadvantages of an APA programme.

**Table 3 - The advantages and disadvantages of a formal APA programme**

Advantages	Disadvantages
Taxpayers benefit from the certainty concerning the agreed transfer pricing methodology. This enhances Ireland's reputation as a location for FDI.	An APA may initially place a strain on transfer pricing resources, requiring diversion of resources earmarked for other purposes (e.g. examination, advising, litigation, etc.).
The opportunity to discuss complex tax issues in a less confrontational atmosphere than in a transfer pricing examination can facilitate a free flow of information and agreement between all parties.	The resource implications for tax administrations of APA's may limit the number of requests that can be accepted. APA's therefore may mainly assist in resolving complex transfer pricing cases.
An APA may prevent costly and time-consuming examinations and litigation of major transfer pricing issues for taxpayers and tax administrations and reduce the exposure to interest payments and penalties.	APA's are not used by all taxpayers because the procedure can be expensive (in terms of professional fees) and time-consuming and taxpayers may not be able to afford it.
Once an APA has been agreed, fewer resources may be needed for subsequent examination of the taxpayer's return.	
A bilateral or multilateral APA, which agrees the tax treatment between a taxpayer and more than one tax administration, averts the risk of double taxation.	



## 5.4. Conclusion

MNE's increasingly wish to enter into APA's in order to provide certainty with respect to their transfer pricing arrangements and MNE's view a strong competent authority, capable of negotiating APA's in accordance with the arm's length principle, as an important factor when considering where to invest. It is envisaged that the BEPS project will lead to more transfer pricing uncertainty and, as a result, there is likely to be a further increase in the number of MNE's seeking to enter into APA's.

While there has been an increase in APA requests, Revenue does not have a formal bilateral APA programme. Arising from the increasing number of APA requests and pressure from the OECD and EU, it may now be appropriate for Ireland to consider implementing a formal bilateral APA programme. This would serve to enhance Ireland's standing as a fair and transparent tax jurisdiction. While there are benefits associated with formalising Ireland's approach to APA's, the disadvantages outlined above also need to be considered.



## 6. Arbitration

### 6.1. Introduction

Although most countries refer to the OECD Transfer Pricing Guidelines for assistance when establishing and interpreting their transfer pricing legislation, countries often have different approaches to specific transfer pricing issues. As a result, it is often difficult for competent authorities to reach a final agreement in transfer pricing MAP cases. As such, disputes can remain unresolved for many years and taxpayers suffer double taxation. Arbitration is a mechanism aimed at resolving conflicts by involving an independent third party expert who reviews all of the facts and makes a final independent decision. Arbitration can take many forms. Mandatory arbitration usually provides that if a resolution has not been reached after a set period of time, the case is automatically sent to arbitration. When an arbitration process is binding, the decision reached by the arbitration panel is final and is binding on all parties involved. Many international double taxation treaties (including four of Ireland's treaties) contain arbitration clauses.

### 6.2. EU Arbitration Convention

The EU Arbitration Convention establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State. Companies have the option to apply for relief under the MAP clause under the appropriate double taxation agreement or under the EU Arbitration Convention or both. Whilst most bilateral double taxation treaties include a provision for a corresponding downward adjustment of profits of the associated enterprise concerned, they do not generally impose a binding obligation on the contracting states to eliminate the double taxation.

The EU Arbitration Convention provides for the elimination of double taxation through a two phase approach.

#### **Phase 1 - Negotiation**

The first phase is similar to a MAP negotiation and both competent authorities seek to reach agreement through negotiation with the goal of eliminating double taxation. If agreement is reached between the Member States, there is no second phase (arbitration). The competent authorities have two years from the date that they have received all of the necessary information (*initiated*) in which to reach a conclusion under phase one. If the dispute is not resolved within the two-year time limit – and there is no agreement by the competent authorities and the taxpayer to extend phase one beyond the initial two-year period – phase two will commence and arbitration automatically applies, i.e. the arbitration process is mandatory.

#### **Phase 2 - Arbitration**

If agreement is not reached in phase one, phase two of the process commences and an advisory commission (arbitration panel) is established to review the case. Both competent authorities agree on the composition of the advisory commission. The decision of the advisory commission is binding on both tax authorities and the taxpayer.

The members of the advisory commission are drawn from an existing panel of *independent persons of standing*. [Each country is required to nominate five *independent persons of standing* to the panel of persons who are then eligible to become members of an advisory commission.]

The table below shows the total inventory of cases in phase one across all EU countries under the EU Arbitration Convention in 2012 and 2013.<sup>19</sup> These are cases where the taxpayer has submitted a claim for relief under the EU Arbitration Convention. The majority of cases are settled during phase one and never enter the arbitration process. While there are no formally published figures, it would appear that only five cases have gone to arbitration since the introduction of the EU Arbitration Convention.

**Table 4 - Total cases submitted under the EU Arbitration Convention - all Member States 2012 - 2013<sup>20</sup>**

	2012	2013
<b>Opening number of cases under the AC at 1 January</b>	780	851
<b>New cases initiated under the AC</b>	259	313
<b>Cases resolved</b>	191	181
<b>Closing number of cases under the AC at 31 December</b>	851	983

### 6.3. Ireland cases under the EU Arbitration Convention

Ireland has received a number of MAP requests under the EU Arbitration Convention. The table below shows the number of MAP cases currently under negotiation by Ireland which were submitted under the EU Arbitration Convention. To date, none of the cases submitted to Revenue under the EU Arbitration Convention have entered phase two and been subject to arbitration. However, as is shown in the table below, Ireland is currently negotiating a number of cases that were submitted under the EU Arbitration Convention and, accordingly, the Irish competent authority could become involved in an arbitration process if a case is unresolved within two years of it being initiated *and* there is no agreement by all involved to extend phase one beyond the two years allowed.

**Table 5 - Ireland's EU Arbitration Convention cases 2012 - 2013**

	2012	2013
<b>Opening number of cases under the AC</b>	13	10
<b>New cases initiated under the AC</b>	1	3
<b>Cases resolved at phase 1 - <i>negotiation</i></b>	4	6
<b>Closing number of cases under the AC</b>	10	7
<b>Cases that have entered phase 2 - <i>arbitration</i></b>	0	0

### 6.4. The impact of BEPS on arbitration

As mentioned above, the OECD's BEPS Action Plan is expected to result in an increase in the number of transfer pricing disputes leading to double taxation. Action 14 of the Action Plan is aimed at improving the mechanisms of dispute resolution. Business and other stakeholders have expressed the view that mandatory binding MAP arbitration would be the only effective way of ensuring that uncertainty and double taxation arising from BEPS is eliminated. There is also a perception that the *threat* of arbitration encourages tax authorities to process cases faster and to reach a conclusion.

As there has been strong opposition from some countries to the implementation of mandatory binding arbitration, it will not be universally introduced. Although consensus was

<sup>19</sup> Reliable information is not available for earlier years.

<sup>20</sup> As all Member States report the number of Arbitration Cases opened and closed in their jurisdictions, the figures shown in Table 4 are likely to include duplications and overstate the total number of Arbitration Convention cases.

not reached, a number of countries (including Ireland) have indicated their willingness to accept mandatory binding arbitration and may seek to implement this policy through a multilateral instrument.<sup>21</sup>

## 6.5. Conclusion

Arbitration is a powerful tool for dispute resolution. Mandatory binding arbitration gives taxpayers a guarantee that their case will be resolved within a set time period and also that they will not be subject to double taxation. As a result, taxpayers and other stakeholders are pushing for the introduction of mandatory binding arbitration. While Action 14 does not provide for mandatory binding arbitration as a minimum standard or best practice, Ireland's willingness to enter into a multilateral instrument with other countries in favour of mandatory binding arbitration will send a strong message that Ireland is committed to resolving international tax disputes.

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<sup>21</sup> A multilateral instrument is a mechanism to provide a single legal basis for multi-country rights and obligations, addressing a variety of issues. Countries that agree to sign a multilateral convention on mandatory binding arbitration would be providing for mandatory binding arbitration in the event of disagreement in their negotiations with other countries that have signed the convention in respect of that issue.