

ALDER&SOUND

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Tier 1 Tax Firm in Finland in 2018 & 2017 | The Finnish Transfer Pricing Firm of the Year in 2017, 2015 & 2011 | The European Tax Technology Firm of the Year in 2017

Transfer Pricing: Dispute resolution workshop

Aalto BIZ / 32E29000 European and International Tax Law

Thursday, January 31, 2019 | Petteri Rapo

Guest Speaker

Petteri Rapo, Managing Partner | Alder & Sound



- ▶ Master of Science (Business Law, Finance) | Aalto University, School of Business (former HSE).
- ▶ Joined A&S in 2011, previous work experience from accounting and financial administration. Acting Managing Partner (CEO) since 2016.
- ▶ Professional experience from working with multinational corporations from a range of industries, including construction, consumer goods, chemicals, food products, engineering, mining and software.
- ▶ Specialized in demanding transfer pricing engagements, intra-group financing, intangible assets and tax considerations related to operating in BRICS and other developing regions.

Alder & Sound – Your trusted partner in international business

Founded in 2010 by experienced professionals, A&S is today one of the leading independent Finnish professional service providers

We are committed to serving as a trusted partner and advisor through integrated provision of legal, tax, transfer pricing, financial advisory and data & analytics services.

We highlight pragmatic approach and provide our clients with flexible, comprehensive and cost-effective solutions by utilizing our innovative tools and methodologies.

We believe in true 'one-stop-shop' experience. From start to finish, we provide turnkey solutions that maximize the benefit and value creation while minimizing the administrative burden.



Independent Finnish service provider with a global cooperation network.



Legal, tax, transfer pricing, financial advisory and data & analytics services.



Multidisciplinary professionals with extensive practical experience.



Clientele consisting of large multinational enterprises & smaller domestic companies.



- ▶ The Tier 1 Finnish Tax Firm in 2018 & 2017
- ▶ The Finnish Transfer Pricing Firm of the Year in 2017, 2015 & 2011
- ▶ The European Tax Technology Firm of the Year in 2017

▶ **Client retention rate since 2010: 96.7%**

Agenda | January 31, 2019

Transfer Pricing: Dispute resolution workshop

1. Introduction: National and international regulatory framework
2. OECD Transfer Pricing (TP) Guidelines
3. International dispute resolution in transfer pricing
 - a) Mutual Agreement Procedure (MAP)
 - b) EU Dispute Resolution Directive

International tax law

Division of taxing power between sovereign states in case of cross-border business activities is carried out based on international tax rules



International tax rules apply, when:

- a) The **source country** of certain income item and the **country of residence** for the receiver of such income are not the same
- b) The **location** of certain item of property is different from the **residence** country of its owner

≠ supranational law

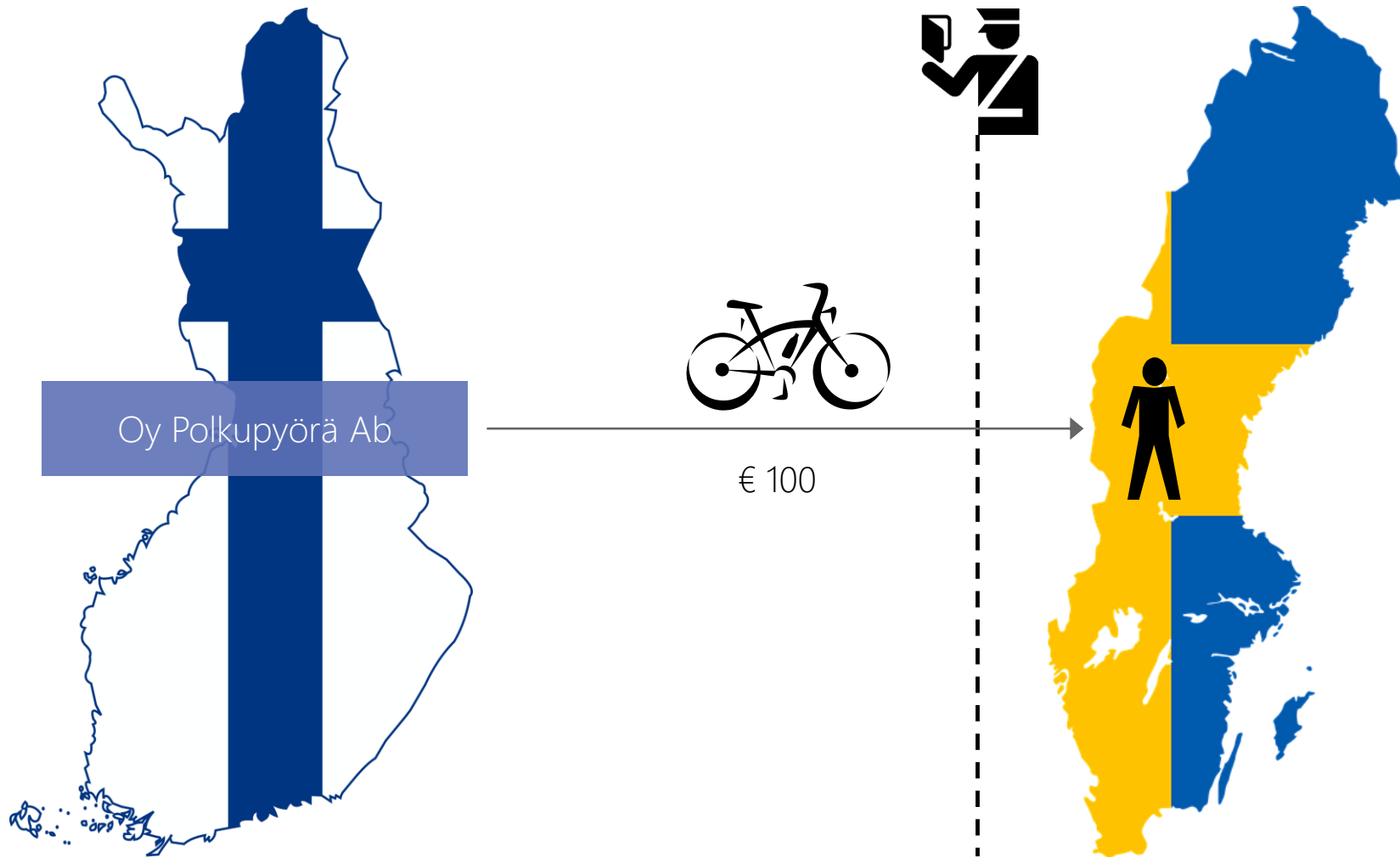
→ national legislation

→ tax treaties

→ EU tax law

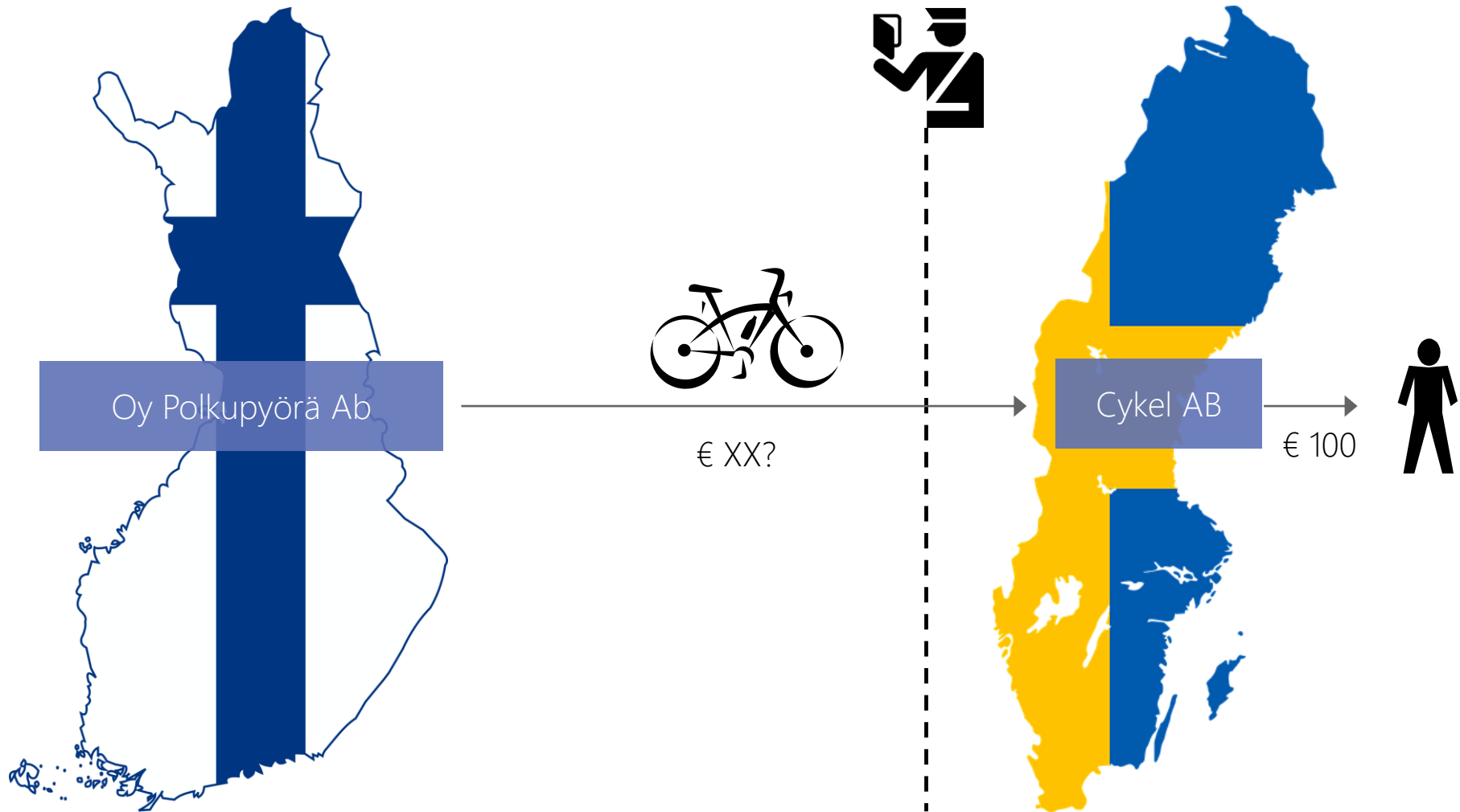
Domestic transactions vs. cross-border transactions

Cross-border business transactions create the need for division of taxing powers between the sovereign states involved



Domestic transactions vs. cross-border transactions | Transfer pricing

Cross-border business transactions create the need for division of taxing powers between the sovereign states involved



National and international regulatory framework

The regulatory framework for transfer pricing consists of both national and international guidelines and legislation

► OECD:

- Model Tax Convention on Income and on Capital (Art. 9: Associated enterprises & Art. 25: Mutual agreement procedure)
- Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

► UN:

- Model Double Taxation Convention between Developed and Developing Countries (Art. 9: Associated enterprises & Art. 25: MAP)
- Practical Manual on Transfer Pricing for Developing Countries

► EU: Joint Transfer Pricing Forum (JTPF)

- Code of conduct for the effective implementation of the Arbitration Convention
- Code of conduct on transfer pricing documentation for associated enterprises in the EU
- Guidelines for Advance Pricing Agreements (APAs) in the EU
- Guidelines on low-value-adding intra-group services
- Potential approaches to non-EU triangular cases
- Report on Small and Medium Enterprises (SMEs) and Transfer Pricing
- Report on Cost Contribution Arrangements on Services not creating Intangible Property (IP)
- Report on Secondary Adjustments
- Report on Transfer Pricing Risk Management
- Report on Compensating Adjustments

+ tax & other
inter-
governmental
treaties

+ domestic legislation

(Finland: VML 14 a-c §,
31 § & 32.4 §)

Question:

What is
the relationship between
international guidelines,
intergovernmental treaties and
national legislation?

OECD Transfer Pricing (TP) Guidelines

OECD Transfer Pricing Guidelines

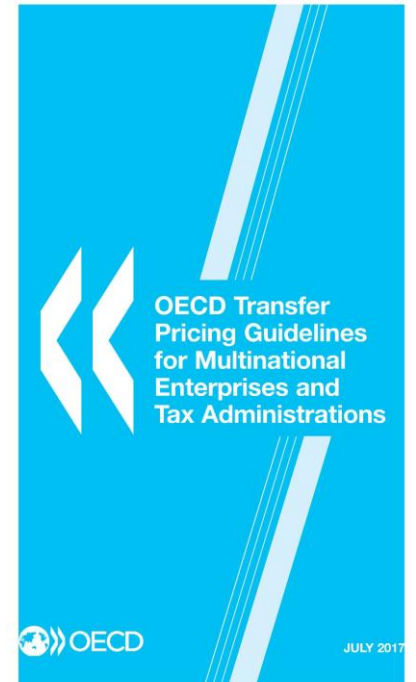
The OECD Transfer Pricing Guidelines provide guidance on the application of the arm's length principle

- The mission of the Organisation for Economic Co-operation and Development (OECD) is *to promote policies that will improve the economic and social well-being of people around the world.*
 - One of the key focus areas in the work of OECD is international taxation and transfer pricing.
 - The OECD Transfer Pricing Guidelines provide guidance on the application of the **arm's length principle**.
- The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (**OECD TP Guidelines**) aim to ensure transparency with respect to taxation of cross-border business transactions:
 - **The national governments** need to ensure that the taxable profits of multinational enterprises (MNEs) are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein.
 - **The taxpayers** need clear guidance on the proper application of the arm's length principle, certainty over the tax treatment of their cross-border activities and protection from potential double taxation resulting from non-aligned interpretation of the arm's length principle between two separate operating countries of a MNE.

OECD Transfer Pricing Guidelines (cont'd)

The OECD Transfer Pricing Guidelines provide guidance on the application of the arm's length principle

- ▶ The OECD TP Guidelines were approved by the OECD Council in their original version in 1995.
 - Basis of the original version in existing national TP legislations, especially in United States and Australia.
 - The Guidelines were subsequently updated in 1996, 1997 and 2010. The latest version was published in July 2017, reflecting a number of agreed revisions based on the outcome of the OECD/G20's 2015 Base Erosion and Profit Shifting (BEPS) project.
- ▶ The OECD TP Guidelines are maintained by the Committee on Fiscal Affairs (CFA) and its Working Party nr 6 (WP6) which is focused on taxation of MNEs.
 - WP6 produces discussion drafts on new or revised provisions to which public comments are requested from all interested parties and which are reviewed in public consultations held in Paris.
 - Based on the discussion drafts and the comments received from the public, the final versions of the provisions are approved by the OECD Council (consensus required)



OECD Transfer Pricing Guidelines (cont'd)

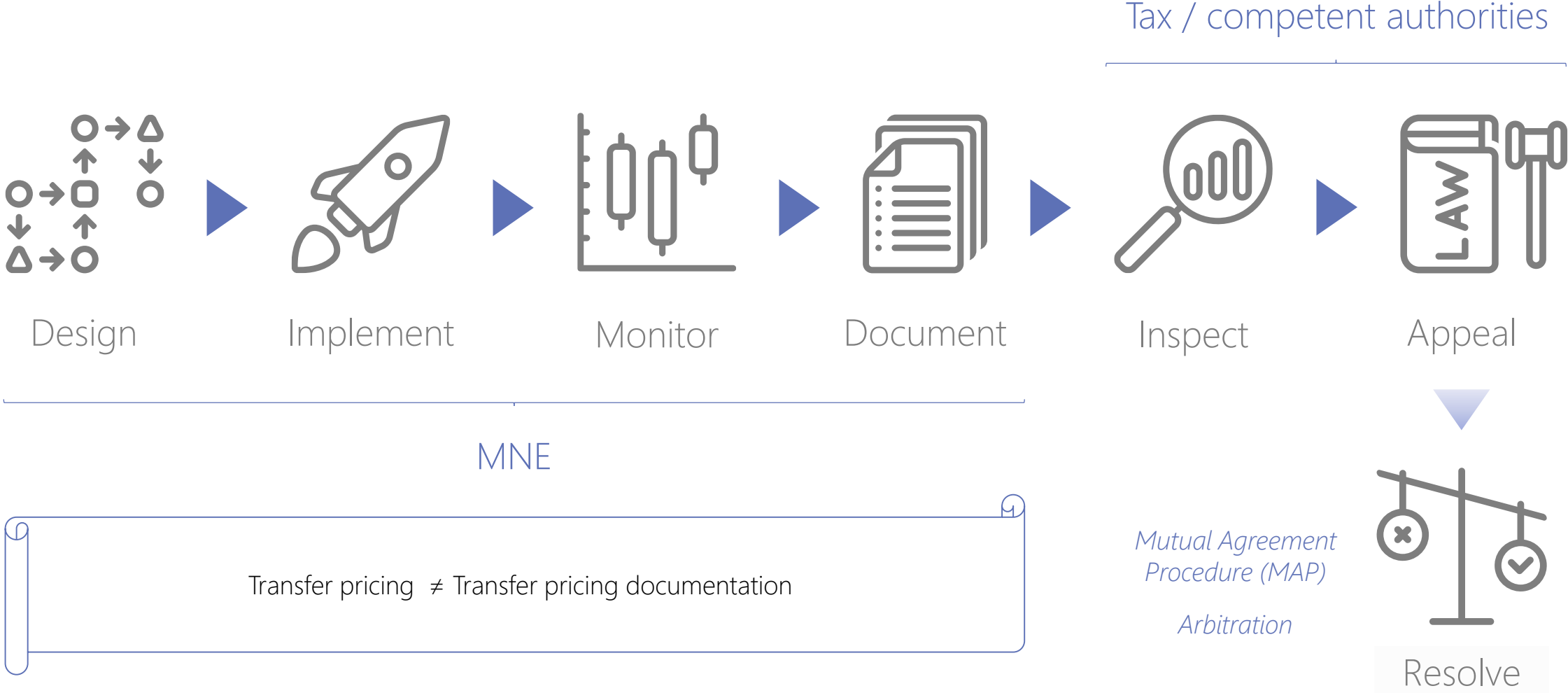
The OECD Transfer Pricing Guidelines provide guidance on the application of the arm's length principle

- ▶ OECD Transfer Pricing Guidelines are not supranational law
 - The relationship with national legislation and also the interpretation and emphasis of specific guidance varies
 - Risk for non-aligned application of arm's length principle in separate operating countries of a MNE
 - No common global tribunal for transfer pricing matters
 - In Europe, ECJ may direct the correct application of arm's length principle through creation of case law
 - MAP and arbitration processes are aimed only for eliminating the double taxation resulting from non-aligned application

International dispute resolution in transfer pricing

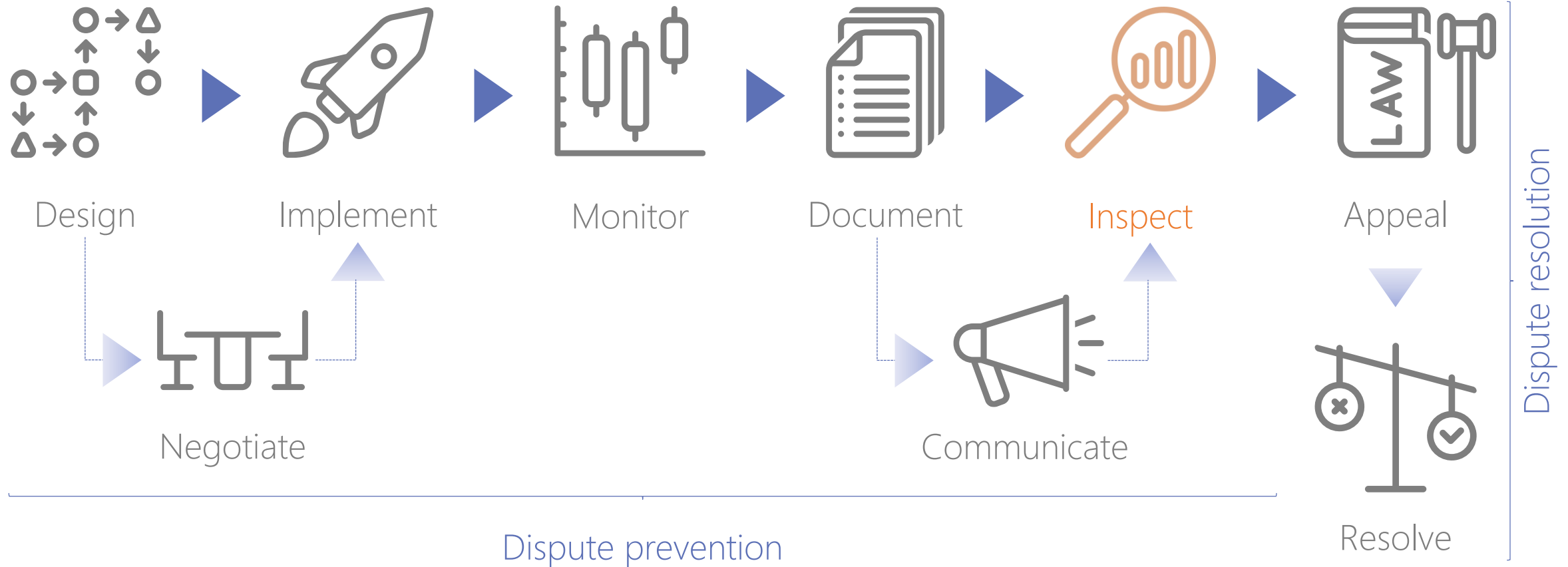
Overview of the typical transfer pricing process (in theory)

The different steps of the typical transfer pricing process aim at ensuring appropriate division of taxing power between sovereign states



Overview of the typical transfer pricing process (in reality)

The different steps of the typical transfer pricing process aim at effective dispute prevention in order to avoid dispute resolution



Question:

What is
the most difficult aspect
of international dispute resolution?

Dispute resolution Overview

The cross-border nature of transfer pricing dictates the need for efficient international dispute procedures



1) National appeal process (+ECJ)

2a) Mutual Agreement Procedure (MAP)

2b) Arbitration

3) *Advance negotiation*

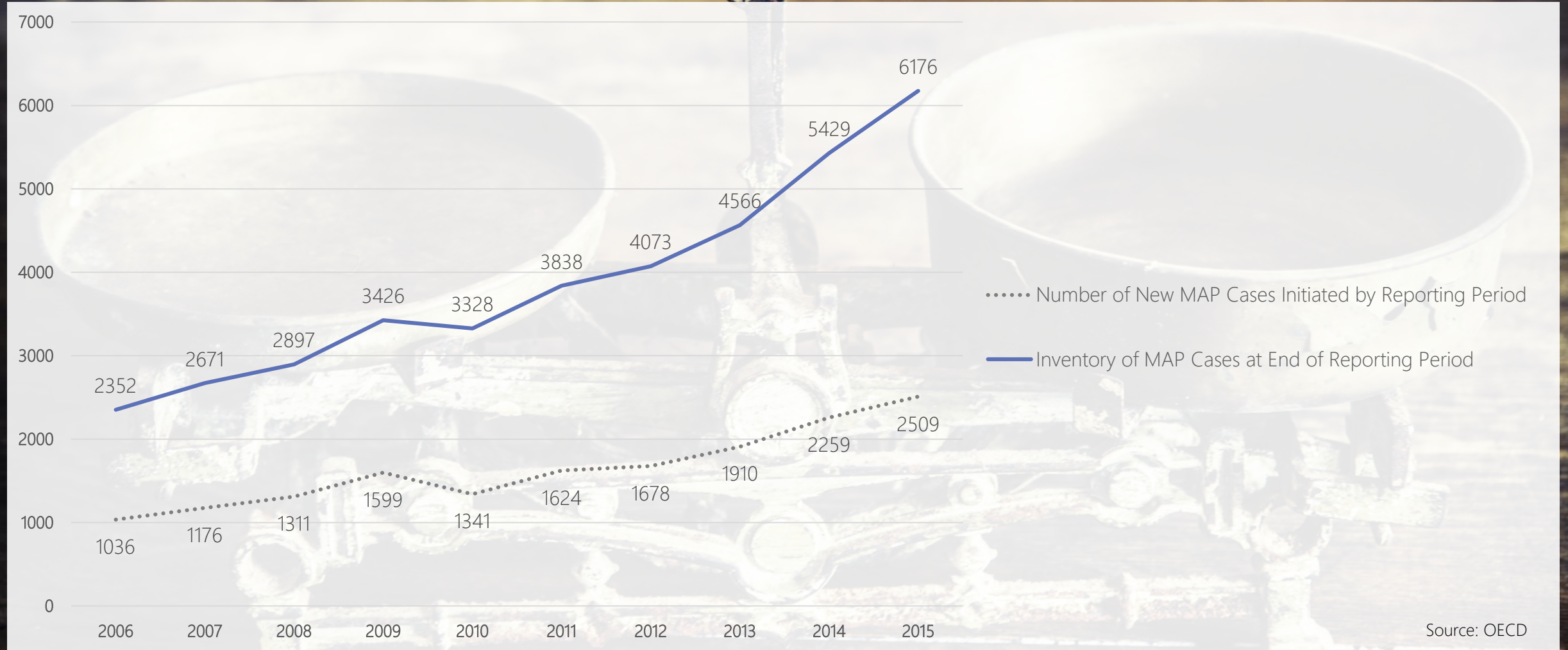
Mutual Agreement Procedure (MAP)

MAP allows the Competent Authorities of the Contracting States to interact with the intent to resolve international tax disputes

- ▶ **Mutual Agreement Procedure** (*MAP*) allows the Competent Authorities or designated representatives of the Competent Authorities from the governments of the Contracting States/Parties to interact with the intent to resolve international tax disputes.
- ▶ MAP is suitable for both dispute prevention and dispute resolution:
 - **Dispute prevention:** bilateral or multilateral advance agreements (*Advance Pricing Agreement, APA*)
 - **Dispute resolution:** elimination of double taxation
- ▶ MAP is based on corresponding Articles in the bilateral or multilateral tax treaties (Article 25 of the OECD Model Tax Convention).
- ▶ In order to mitigate international double taxation, there are ongoing initiatives to make the intergovernmental dispute resolution more efficient through mutual agreement procedure:
 - **OECD:** Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (*OECD Multilateral Instrument; MLI*)
 - **EU:** Dispute Resolution Directive

MAP (Mutual Agreement Procedure) statistics

OECD member countries / 2006-2015

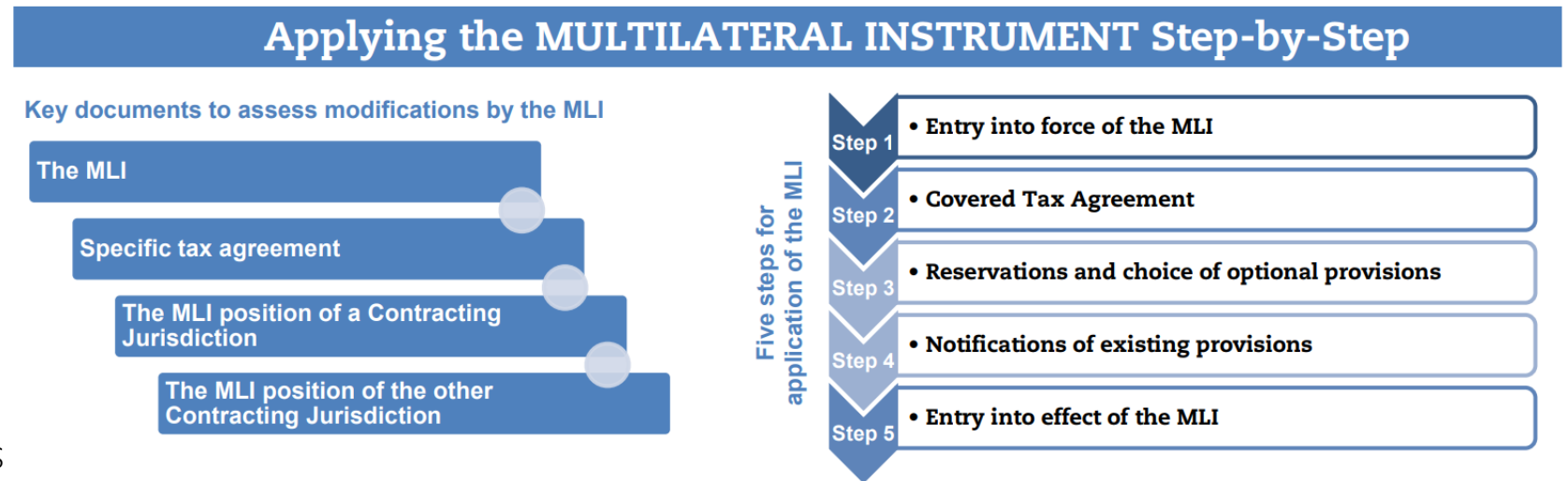


OECD Multilateral Instrument (MLI)

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

- The MLI is intended to offer concrete solutions for governments to close the gaps in existing international tax rules by transposing results from the OECD/G20 BEPS Project into bilateral tax treaties worldwide.
- The MLI modifies the application of thousands of bilateral tax treaties concluded to eliminate double taxation. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms.
- MLI applies in intergovernmental relations once both parties have signed the agreement and certain transition period has passed

- ➔ Majority of modifications are expected to become effective in the course of 2019,
- ➔ Applying the MLI into practice involves five (5) steps
- ➔ MLI does not override national legislation or create taxing powers



OECD MLI | Finnish positions

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

- ▶ The minimum standards do not significantly alterate the current practices followed by Finland in international tax matters. Finland has made reservations for all other Articles of the MLI.
- ▶ The most significant change relates to mandatory binding arbitration which may be applied in situations where the MAP process does not result in resolution of double taxation:
 - Finland made certain reservations on the arbitration Article of the MLI; application of the Article requires corresponding selection by the other Contracting Party
 - Does not alter the situation between EU Member States (Arbitration Convention / Dispute Resolution Directive)

OECD MLI | Practical application

MLI Matching Database makes projections on how the MLI modifies a specific tax treaty by matching information from Signatories' Positions

MLI Matching Database
beta © OECD 2017



Select jurisdictions:	<u>Finland</u>	<u>Russia</u>
	Finland	Russia
Signature MLI	07/06/2017	07/06/2017
Ratification MLI		
Status of List	Provisional	Provisional

[Read the Disclaimer](#)

Article 2 Covered Tax Agreement		The agreement would be a 'Covered Tax Agreement'.
Article 6 Purpose of a Covered Tax Agreement		The preamble language would be replaced by the text described in Article 6(1). Article 6(3) would not apply.
Article 7 Prevention of Treaty Abuse		Article 7(1) would apply and supersede the provisions of the agreement to the extent of incompatibility. Article 7(4) would not apply. The Simplified Limitation on Benefits Provision would not apply.
MAP	Article 16 Mutual Agreement Procedure	A.24(1)1st would be replaced by the first sentence of Article 16(1). The second sentence of Article 16(1) would not apply. The first sentence of Article 16(2) would not apply. The second sentence of Article 16(2) would not apply. The first sentence of Article 16(3) would not apply. The second sentence of Article 16(3) would not apply.
Article 35 Entry into Effect MLI		For the purposes of the application by Finland, the reference to 'taxable periods beginning on or after 1 January of the next year beginning on or after the expiration of a period' would apply. Article 35(4) would not apply.

EU Dispute Resolution Directive

EU Dispute Resolution Directive replaces the current Arbitration Convention and covers a wide range of tax disputes among the Member States

- ▶ EU Dispute Resolution Directive (“Directive”) replaces the current Arbitration Convention and covers a wide range of tax disputes among the Member States causing international double taxation (incl. transfer pricing and permanent establishments).
 - Contains provisions on the appeal process, mutual agreement procedure (MAP) and mandatory binding arbitration procedure
 - EU Member States must give the Directive priority over the signed tax treaties if found to be in contradiction.
 - ECJ shall issue rulings on the correct application of the Directive if necessary.
- ▶ The national implementation of the Directive **by June 30th, 2019**; applies to appeals that have been submitted after July 1, 2018 and covering tax years that have started on or after January 1, 2018.

EU Dispute Resolution Directive vs. national appeal process

EU Dispute Resolution Directive replaces the current Arbitration Convention and covers a wide range of tax disputes among the Member States

- If the taxpayer is simultaneously engaged in the national appeal process, the deadlines for processing the appeal and conducting the mutual agreement procedure under the Directive are observed only after the national process has been ended or halted
 - In certain situations, an enforceable ruling resulting from the national appeal process may restrain the access to the dispute resolution under the Directive
 - The potential restraints for application of the Directive depend on the national legislation:
 - Situations which characterise double non-taxation or cases of tax fraud, wilful default or gross-negligence are excluded from the scope of the Directive
 - ECJ shall issue rulings on the correct application of the Directive if necessary.

Future outlook for dispute prevention & resolution in transfer pricing

The existing interest combined with expanding reporting requirements are expected to lead to significant increase in the amount of TP disputes

- ▶ Increasing interest towards transfer pricing practices of MNEs by supranational organizations, local tax authorities and media
- ▶ Expanding requirements for mandatory reporting, documentation and disclosure
 - Increasing administrative burden for MNEs
 - Big data & utilization of quantitative screening in risk assessments
- ▶ Increasing amount of transfer pricing disputes
- ▶ Shifting focus towards proactive approach
 - “Culture of compliance”
 - Ex ante vs. ex post
 - Real-time (horizontal) monitoring
 - Advance pricing agreements (APAs)
- ▶ The future of tax & transfer pricing audits? The future of transfer pricing?

Homework assignment

Background information – A Group

A Group is engaged in manufacturing and distribution of construction materials

- ▶ Headquartered in Helsinki, Finland, A Group is engaged in manufacturing and distribution of construction materials.
- ▶ A Group Oy is the group parent entity. The company performs a variety of head office functions ranging from shareholder type activities to activities carried out for the benefit of individual Group companies; such categories include management, finance and control, HR, communication, IT and legal affairs.
- ▶ The Group has manufacturing operations in Finland (A Oy), Sweden (A Sweden AB), Lithuania (A Lithuania UAB) and Poland (A Poland Sp. z o.o.), with representative offices in 13 countries.
- ▶ Historically, the Group has grown both organically and through acquisitions. The majority of the Group's products are sold within the European Union, accounting for 80 % of the total net sales annually.
- ▶ On January 2, 2018, the Large Taxpayers' Office (LTO), part of the Finnish Tax Administration, initiated a transfer pricing audit concerning FY 2014-2016.

Background information – The dispute

On January 15, 2019, the LTO issued tax assessment decisions based on a re-assessment of A Group's business model during a tax audit

- On January 15, 2019, the LTO issued a tax audit report and related tax assessment decisions, according to which A Oy would have to pay EUR 14.1 million in additional taxes and EUR 9.1 million in penalty charges and interest for the period of 2014-2016, based on a re-assessment of A Group's business model during a tax audit.
 - In the audit report, the LTO claims that during the time period in question, the taxable income of A Oy has not been in line with the functions performed, the R&D contributions made, the relevant risks carried and the intangible assets owned by the company, especially in comparison to other manufacturing entities.
 - Consequently, the LTO has also disregarded the transfer pricing methods applied and comparable information utilized by the company and assessed the taxable income through Transactional Profit Split Method by determining arm's length routine return levels for manufacturing and distribution activities and then by allocating the residual profits based on accumulated R&D expenditures incurred by different A Group entities.
 - During the audit process, A Group has consistently denied the claims made by the LTO and maintains the view that its transfer pricing processes and intra-group transaction pricing principles have been in full compliance with all relevant laws and regulations in all its operating countries.
- A copy of the tax audit report is provided as a separate document. -----

Questions:

- 1) What are the three (3) key arguments presented by the LTO in the tax audit report supporting the re-assessment of A Group's business model?
- 2) What would be your / your group's three (3) key counter arguments (factual & legal) for opposing the re-assessment of A Group's business model made by the LTO?
- 3) Based on your current understanding & knowledge, what would be the next steps in the dispute process?
- 4) Based on your / your group's opinion about the case at hand, what chances do you see for A Group to successfully argue against the tax assessment presented by the LTO (on a scale 0-100)?

Homework assignment – BoD presentation

The homework assignment should be submitted on MyCourses (before the book exam, i.e. latest on February 19, 2019)

- After receiving the tax audit report, the BoD of A Group has called in you / your group to assess the situation and prepare a brief presentation (Powerpoint) illustrating your plan and main arguments for effective dispute resolution.
- **The presentation (max. 5 content slides + cover & potential appendices) should address the following topics:**
 - 1) **Summary of key arguments and potential supporting evidence** for opposing the re-assessment of A Group's business model made by the LTO
 - 2) **Illustration of the expected phases / next steps** in the dispute resolution process (both domestic & international dispute resolution)
 - 3) **Your professional opinion of the most likely outcome** for the dispute (including reasoning for the presented opinion)
- The homework assignment (i.e. BoD presentation) should be submitted on MyCourses (assignments box) before the book exam, i.e. latest on February 19, 2019.
- The grading will be based on correctness, thoroughness and practical applicability of answers provided.



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