Joint and simultaneous tax audits: unexplored options for impending double taxation

Large business taxpayers and tax authorities, who have historically taken different and opposing views, finally seem to agree on a core issue: that more (and more complex) cross-border tax disputes are occurring and will continue to occur — and that something needs to be done to stem their flow. Joint and simultaneous tax audits, while not a complete, multilateral solution, may provide some taxpayers with an avenue of relief. And with their use set to grow as a result of developments in the European Union (EU) and individual jurisdictions elsewhere, taxpayers may want to learn more about their aims and operation.

Today, the large business taxpayer community — typically multinational companies (MNCs) — stands on the verge of another set of fundamental changes to how they calculate, pay and report taxes. These changes are complex, and the road to implementation has already proved to be rocky. Should things continue as expected, the number of tax disputes is likely to grow at pace.

These changes — centering on BEPS 2.0 Pillar One and Pillar Two[1] (and a plethora of national-level anti-avoidance laws, many of which seek to mimic the pillars' effects) — are unlike the first set of BEPS changes launched in 2015. They are more complex, certainly. But importantly, they are also not accompanied by any new or novel tool, program or process via which disputes might be prevented in the first place or resolved when they do occur. There will likely be a Pillar Two Multilateral Convention (MLC). But its efficacy is as yet unknown, and companies should ensure they understand all available options — including Advance Pricing Agreements (APAs), the use of administrative guidance (difficult, when jurisdictions are certain to implement the pillars differently) and the Mutual Agreement Procedure (MAP). Other multilateral solutions — such as a more innovative use of the Organisation for Economic Cooperation and Development's (OECD) International Compliance Assurance Programme (ICAP) or some other multilateral risk assessment approaches have not yet been floated. Proactive education is therefore key.

Instead of being feared and avoided, joint and simultaneous tax audits may provide a useful way forward. They are not a complete solution to every case of potential double taxation, but they are a way forward for some taxpayers and some situations.

Concerns from a controversy perspective

Almost a decade after the 2015 BEPS 1 Actions, much of the detail around the impending Pillars is now known. But without doubt, each of the measures will be implemented different by the almost 150 member jurisdictions of the Inclusive Framework[2] (IF), the coordinating body of the project. In many cases, the measures will be implemented in different financial years. In other cases, they may not be implemented at all. This does not bode well for tax disputes.

The most concrete changes agreed so far center upon the 15% Global Minimum Tax under Pillar Two and Amount B under Pillar One. Amount B is intended to simplify and streamline the application of the arm's-length principle to in-country baseline marketing and distribution activities, with a particular focus on the

[1] The so-called Global Minimum Tax.

[2] https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/beps/inclusive-framework-on-beps-composition.pdf

needs of low-capacity jurisdictions[3]. Its mechanics, potential lack of global consistency, and complex guidance provided so far by both OECD and tax authorities are of worry to taxpayers and their advisors, especially when it comes to the potential for new controversies.

Outside of these two measures, other major changes are possible but may not reach final consensus. That statement, of course, describes Amount A of Pillar One, a proposed new taxing right for market jurisdictions with respect to a defined portion of the residual profits of the largest MNCs operating in their markets. If Amount A fails to be implemented, global tax chaos[4] may well result, as set out below.

Not a new problem

Simply put, there is likely to be more double taxation and more tax disputes ahead, but the avenues for relief are already crowded and difficult to navigate.

This is not the first time that concerns about a lack of relief in response to newly created double taxation instance has unfolded, either. However late in the process it came, and whatever criticism it attracted, the original BEPS recommendations of 2015 included Action 14 on *More Effective Dispute Resolution Mechanisms*[5]. This action, which focused largely on MAP, is generally perceived as having been successful in meeting its objectives. But MAP remains a challenge for many companies, and whether it can shoulder the weight of what may turn out to be a significant rise of new disputes remains to be seen. This will be a challenge in lesser developed markets especially (due to a lack of programs, skills and treaty networks), and that's where joint (and simultaneous) tax audits may have a role to play. That's likely also why the OECD, EU and countries like the United States and even China have become far more active in supporting the growth of joint audits recently.

How big is the problem?

To demonstrate the potential quantum of double taxation ahead, let's pick up Amounts A and B of Pillar One and have a closer look, leaving Pillar Two, a likely source of future disputes to 50% of Global Vice Presidents of Tax[6], to one side.

"Amount B is intended to increase tax certainty, reduce compliance and administrative costs," noted a July 2023 OECD report.[7] But the same organization, just three months later, also says[8] that double taxation *will* result if the jurisdiction in which the counterparty is resident seeks to make a primary adjustment that is inconsistent with Amount B — something that is highly likely to occur in practice.

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[3] The scope of this has changed quite considerably since the birth of the project. See: https://www.oecd.org/tax/beps/statement-covered-jurisdiction-definition-inclusive-framework-commitment-amount-b.pdf

[4] A phrase first coined by Pascal Saint-Amans, past Director of the OECD's Centre for Tax Policy and Administration.

[5] https://www.oecd.org/en/topics/sub-issues/dispute-resolution-in-cross-border-taxation.html

[6] According to the 2023 EY Tax risk and controversy survey: www.ey.com/taxrisksurvey

[7] https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/cross-border-and-international-tax/pillar-one-amount-b-in-a-nutshell.pdf

[8] See https://www.oecd-ilibrary.org/taxation/pillar-one-amount-b_21ea168b-en

Some jurisdictions may provide relief from economic double taxation through unilateral corresponding adjustments, making use of provisions in their domestic laws. Most jurisdictions, however, would only be able to consider corresponding adjustments as part of a MAP or under arbitration – which, ironically, many of the low-capacity markets that Amount B was in large part developed for have never implemented. Moreover, *not* referring to Amount B in MAP will be a challenge and is also counter to the fact that Amount B is an Inclusive Framework-benchmarked measure, which seems to be in opposition to its objective of streamlining transfer pricing compliance.

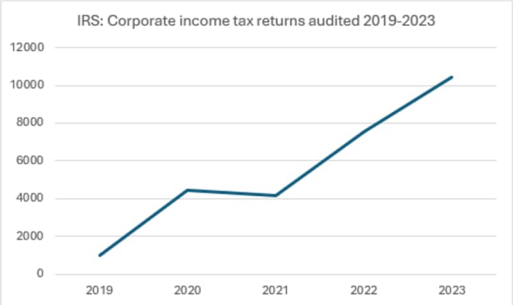
Finally, low-capacity jurisdictions are likely to have limited treaty networks and, therefore, limited competent authority resources. So the overall picture as it currently stands is not overly positive.

For Amount A, the text of a consensus-based MLC was recently published with the objective of helping the measure enter into force in 2025. But for that to occur, the MLC must be ratified by at least 30 jurisdictions[9], including the headquarters jurisdictions of at least 60% of MNCs currently expected to be within Amount A's scope[10]. In simple numerical terms, this cannot be met without the United States agreeing to implement Amount A.

With a broad range of factors already driving pessimism around its implementation, Amount A continues to experience long-felt headwinds in the United States and elsewhere. But the facts are now out, and the world expects the tax system to change. In fact, the EU has already earmarked part of the assumed Amount A revenues for the EU budget; any shortfall is going to have to be made up by EU Member States.

If implemented, Amount A would bring its own complications and its own disputes around accurately calculating market presence. But if it fails to reach a critical mass of MLC ratifications, the outcomes for business could be worse still: many countries are instead likely to adopt unilateral measures such as digital services taxes (DSTs), value-added tax (VAT) or goods and services tax (GST) solutions, as well as new nexus rules, increased economic substance requirements and amended permanent establishment rules. We could see actions among groupings of countries, too, further compounding the issue. This could include alternative multilateral approaches (such as one proposed by the United Nations) or even regional/sub-regional solutions. Again, it is hard to argue that anything except a rise in disputes will result.

Of course, Pillars One and Two would not be the only cause of world new disputes. Despite impending changes, the chart at right, continues to do business, and both hard data (see being which shows the growing number of business audits anecdotal conducted by the United States' IRS[11]) and disputes and evidence from companies suggest that audits, more complex litigation are all increasing in lock step with ever-tax legislation.



[9] See https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/cross-border-and-international-tax/multilateral-convention-amount-a-pillar-one-overview.pdf
[10] Which the OECD currently says is 76 companies.
[11] Source: IRS data books 2019-2023.

Finding solutions

Joint audits can be an effective tool in securing tax certainty and have been studied and used for several years, most notably in the European theater. It is probably fair to say, though, that they failed to gain traction when first pushed by the OECD, during the Global Financial Crisis of 2007-08, as both taxpayers and governments struggled to implement any new processes over and above core business operations and financial survival.

A 2019 report[12] by the OECD's Forum on Tax Administration (FTA) notes that several country pairings have been active in carrying out joint and simultaneous tax audits in recent years, confirming that Europe is a clear leader in their use. Among the 20 countries contributing to the report, almost 500 simultaneous audits have already occurred. But while such approaches were conducted in a generally coordinated manner, only a limited number has expanded to fully coordinated, jointly conducted audits. The OECD would like to see that number increase, in turn presenting new opportunities to stem the flow of MAP cases. There is no time like the present to start that process.

Broader definition of a joint audit

The 2019 FTA report delivered a new, relatively broad definition of joint audit, defining it as:

- Two or more tax administrations joining together to:
    - Examine an issue/transaction of one or more related taxable persons (both legal entities and individuals) with cross-border business activities, perhaps including cross-border transactions involving related affiliated companies organized in the participating jurisdictions, and in which the tax administrations have a common or complementary interest
    - Proceed in a pre-agreed and coordinated manner, guaranteeing a high level of integration in the process and including the presence of officials from the other tax administration
    - Engage with the taxpayer, enabling the taxpayer to share information with them jointly

[12] OECD: Joint Audit 2019 – Enhancing Tax Co-operation and Improving Tax Certainty. March 2019. https://www.oecd-ilibrary.org/taxation/joint-audit-2019-enhancing-tax-co-operation-and-improving-tax-certainty_17bfa30d-en#:~:text=Joint%20Audits%20are%20an%20essential,profit%20shifting%2C%20and%20minimise%20the

The OECD 2019 joint audit survey, upon which the FTA based its 2019 Joint Audit Report recommendations, found that the following technical issues may be particularly suitable for resolution within a joint tax audit:

- Transfer pricing issues
- Taxpayer residency or permanent establishment determinations
- The analysis of complex tax structures and entities operating in tax havens and aggressive tax planning schemes
- Complex business restructuring processes
- Split benefit agreements (including royalty payments)
- Cost allocation agreements
- Hybrid financial instruments
- Back-to-back loans
- Structured transactions
- Double-dip leases
- Service agreements and cost-sharing agreements
- Private equity funds
- Dealings with source issues
- Particular tax fraud in relation to VAT
- Criminal investigations

o Include Competent Authority representatives from each tax administration for the exchange of information The report clarifies that engaging in a joint audit does not imply that all involved must exercise the same audit powers or are conducting the audit jointly under one procedural umbrella or legal basis, but rather that the tax administrations are fully coordinating and have assigned the audit tasks among themselves, combining elements of simultaneous audits with the presence of tax officials in the other country/countries.

That all sounds like it would be a fit for some of the Pillar One and Two issues expected to arise in the coming years.

Importantly, the report also establishes that joint audits are a tool for the tax administrations that can be conducted cooperatively with the taxpayer but also non-cooperatively, against the will and without the involvement of (or even communication to) the taxpayer. Additionally, a taxpayer does not need to be invited (or commanded) to participate in a joint audit. Joint audits are also something a taxpayer may request. These are all important points for taxpayers.

Joint vs. simultaneous audit

The set of criteria for joint audits also applies to simultaneous tax audits; Article 8 of the OECD Convention on Mutual Administrative Assistance provides a legal foundation for conducting simultaneous tax examinations. It describes them as "an arrangement between two or more Parties to examine simultaneously, each in its own territory, the tax affairs of a person or persons in which they have a common or related interest, with a view to exchanging any relevant information which they so obtain."

The FTA report concludes that there is a significant benefit for tax administrations and taxpayers to take all available dispute prevention/resolution tools into account — including ICAP, joint or simultaneous audits, APAs and MAPs, and to manage them holistically to achieve dispute resolution at the earliest opportunity. The report therefore recommends ensuring that MAP Competent Authority is available if required to conclude a joint audit, as well as to initiate MAP procedures as early as possible in cases where resolution cannot be achieved at audit level. It can therefore be argued that even where a joint audit is ultimately unsuccessful in its primary aim, the work performed therein may still prove to be valuable.

Key costs, benefits

According to the FTA report, a benefit to joint audits is that they entail fact-finding involving the participating tax administrations and the taxpayer, thus limiting the risk of misunderstanding. This in turn allows for a more efficient, expedited resolution process, especially compared with separate audits or MAP. In contrast, though, joint audits may require more time and resources than a domestic audit settled at national level. This may include time to initiate and conduct the joint audit, potential costs for travel and accommodation, differing language skills, and the need to have international tax experts in the team who are familiar with the particularities of information exchange and audit cooperation.

Achieving a positive cost-benefit ratio will incentivize tax administrations to engage in joint audits. To that end, the report recommends developing further guidance to ensure that only appropriate cases are considered, namely those where there is a significant risk of double taxation (e.g., because the tax authority's MAP inventory indicates that comparable cases are already part of MAP pipeline). In addition, the report suggests that tax administrations set clear short, immediate and long-term objectives, and develop an evaluation framework that allows accurate assessment of whether such objectives are met.

Legal basis

The FTA report also studied the legal framework in which joint audits may be conducted. Although there are a relatively large number of international regulations that allow for joint audits, there are still several uncertainties regarding the rights and obligations of tax administrations, taxpayers and the interplay of local laws and regulations. To remedy these legal obstacles, the report suggested that the OECD carry out work to further address these uncertainties (e.g., by model legislation applicable to the presence of foreign officials abroad, and to streamline the conduct of joint audits).

Role of the taxpayer

The report recommended that the taxpayer be involved at an early stage during case selection and emphasizes the benefit of tax authorities cooperating closely with the taxpayer.

However, the precise involvement of the taxpayer will depend on the specific circumstances, and there will be differences between a joint audit in a cooperative and in a non-cooperative context, but even in the latter case, open engagement by tax administrations can sometimes result in a change in a taxpayers' behavior. Further, the report recommended close cooperation with the concerned taxpayer(s) by engaging and consulting on a regular basis, unless the facts and circumstances of the case suggest otherwise. According to the report, tax administrations should share results with the taxpayer before they finalize the audit, providing the taxpayer with the opportunity to identify possible misunderstandings, and to provide any missing documentation or other evidence.

The report concludes with a summary of the joint audit process and includes practical guidance and leading practices. Among other recommendations, it suggests determining a strategic approach to joint audits and implementing organizational measures accordingly, as well as integrating joint audits within the tax certainty agenda by managing different bilateral and multilateral dispute prevention and resolution tools and programs. A further recommendation made is to better measure the costs and benefits of joint audits as well as optimize their ratio, including through case selection and program evaluation.

The importance of countries possessing a solid legal framework, both domestically and internationally, and of strengthening the rules applicable to the presence of tax officials abroad is another key topic covered in the report, which further recommends that countries engage in training and joint audit pilots to gain higher levels of practical experience. Finally, the report encourages tax authorities to build on the experiences of others, and to consider the best practices and recommendations contained in the report.

Should taxpayers be wary of joint audits?

At first glance, entry into a tax audit with not only one but two (or potentially more) national tax administrations may seem like the opposite of a leading practice. But that arguably represents a knee-jerk reaction. Instead, the benefits — when well considered and measured — can be significant for the taxpayer. Documentation costs may be reduced, processes for joint fact-finding may be improved, communication may be more efficient, and management of tax issues can be closer to "real time" and thus more effective.

Tax authorities, meanwhile, would be exposed to higher levels of commercial understanding, while for the taxpayer, of course, two potential disputes can be resolved at once. That's not to say joint audits are for everyone, and any tax leader should ask themselves a series of questions to assess whether a joint audit is appropriate:

- Is the topic at hand truly suitable for joint audit consideration?
- Have we planned for all possible outcome scenarios, and are we confident that the desired outcome has a reasonable chance of occurring?
- Can we invest the increased time and resources, including potential travel, that a joint audit may necessitate?
- Are we confident that each tax authority is both committed to and knowledgeable in performing joint audits?
- Will both countries work from a common protocol document in which a comprehensive operating framework or process is set out?
- Do both countries have a legal basis that supports joint audits, and can legal certainty be a result?

- Are we concerned that a joint audit may lead to other out-of-scope issues being discussed or scrutinized?
- Are we confident that the processes suggested by each country are flexible enough to ensure that we have ample opportunity to argue our case?
- What impact will either a good or a bad outcome have on our relationship(s) with the tax administration(s)?
- What is the best-case outcome of a joint audit that could be expected? Could results from both countries be memorialized into a Bilateral APA, for example?
- Can we exit the joint audit at any stage, without penalty or fear of retribution?

Recent developments in joint audits

Joint audit developments in the European Union

On 22 March 2021, the Council of the European Union adopted new rules revising the Directive on administrative cooperation in the field of taxation (Council Directive 2011/16/EU or DAC) to extend the EU's tax transparency rules, introducing a reporting obligation for digital platforms located inside and outside the EU (DAC7[13]). Embedded in the same Directive, however — and potentially missed by many taxpayers — were several generic changes to the DAC not limited to digital platforms. These included a legal framework for the conduct of joint audits between two or more Member States. That framework entered into force as of 1 January 2024[14], and many Member States are known to have plans to make use of it. While some Member States requested relatively short implementation extensions (of three months, for example — exclusively around the digital reporting requirements and not the element addressing joint audits), the joint audit framework has now been adopted into the active tax legislation of all 27 Member States.

What will happen in terms of practical application of the joint audit framework among Member States is anyone's guess – but feedback from EY colleagues illustrates a broad spectrum of possible interest and possible actions – inter alia:

- Luxembourg made the framework part of its tax law on 1 June 2023 but reports that its tax authority has little or no prior experience of conducting joint audits.
- Poland was a later adopter, and DAC7 did not come into effect until 1 July 2024. Again, colleagues report that while the Polish tax authorities have been making steady progress in exchanging more and more information with other revenue authorities during the last few years, joint audits are a virtually unknown practice.
- Italy adopted the joint audit framework on 26 March 2023 but has been known to already have extensive joint audit experience with partners including Germany, the Netherlands, Poland, Spain, Slovakia, Slovenia and Sweden.
- In Spain, the joint audit framework took effect on 1 January 2024. Prior to this, joint tax audits were not regulated in Spain, but a system of "simultaneous controls" (as described in Article 12) existed. These controls, however, are not formal joint tax audits, but a mechanism in which two or more

[13] https://eur-lex.europa.eu/eli/dir/2021/514/oj
[14] The digital platform reporting obligations entered into force earlier, in January 2023.

Member States agree to carry out simultaneous tax audits, each one in parallel in its own territory. The objective is to exchange information obtained during these national tax audits between the administrations participating in the simultaneous controls procedure. As these simultaneous controls are costly, so far the National International Taxation Office of the Spanish Tax Administration has carefully selected the procedures in which it has decided to participate. Therefore, it is probably fair to expect Spain to demonstrate a high level of interest in trialing more joint audits.

- In the Czech Republic, the joint audit framework was also enacted into law on 1 January 2024. Prior to that point, simultaneous tax audits were possible but were not widely used, and EY colleagues estimate that no more than 10 cases per year typically occurred. In that vein, one might expect the Czech Republic to follow Spain in trialing joint audits in the near future.
- In France, new provisions to allow for joint audits were added to II-C of Section L.42 of the French Code of Fiscal Procedures and apply from 1 January 2024. Similar to the Czech Republic, prior to DAC7, Section L45 2 of the French Code of Fiscal Procedures (which entered into force on 1 January 2005), permitted simultaneous tax audits, but few, if any joint audits were conducted.
- Sweden was a further 1 January 2024 adopter; again, a very limited number of joint audits/multilateral controls procedures had been conducted prior to that point, but local colleagues now expect more joint audits with countries in relation to which Sweden has significant trade and/or strong relationships between competent authorities – including Denmark, Finland and Germany.
- Germany has for some time been one country that has made extensive use of joint tax audits. While not perceived as a very common procedure, administrative regulations on joint audits have been in place since 2017, and DAC7 was transposed into local law effective 1 January 2024. Interestingly, Germany is one of the few countries that seems to use joint audits outside of direct taxes and/or transfer pricing and counts VAT as a common topic for this type of procedure. A growing number of joint audits is further expected, with Germany continuing to work closely with partner tax authorities including the Netherlands, Austria and Italy.

What may be of surprise to some taxpayers is that China's State Taxation Administration is also known to be piloting a small number of joint audits. This fits with China's push to continuously upgrade its tax administration regime for taxpayers – which includes some regional Chinese authorities (including Beijing, Shanghai and Shenzhen) also actively implementing a pilot advance tax ruling system, with a goal to roll out to the entire nation in the near future.

United States' IRS may shift certain taxpayers toward joint tax audits

Joint audits are not a singularly European phenomenon, however. While they appear to remain a relatively rare creature in the United States, in April 2023 the US IRS issued internal guidance that implemented a rigorous new screening process under which taxpayers may be shifted from analyzing their related-party transactions through the APA process to alternative workstreams, including joint audits[15]. They further suggest that ICAP may also be worth looking at as an innovative way to address new sources of double taxation.

[15] See IRS, "Memorandum for Treaty and Transfer Pricing Operations Employees," LB&I-04-0423-0006 (25 April 2023). See also EY, "IRS Interim Guidance on Review and Acceptance of Advance Pricing Agreement Submissions Fundamentally Changes Early Stages of the Process," Tax Alert 2023-0800, May 3, 2023.

At a high level, it appears that the IRS wants to set APAs up for success and believes that encouraging taxpayers to consider joint audits or ICAP is one way to achieve that goal. But whether taxpayers will want to expose themselves to the potential for a joint audit is another question. Many taxpayers believe that audits often involve significant resources. In addition, the IRS appears to have limited experience with joint audits, which could result in taxpayers participating in the learning process at a very challenging point in time.

Finally, at the multilateral level, the OECD transfer pricing guidelines[16] also indicate that coordinated tax audits (i.e., simultaneous tax audits, as opposed to 100% "joint" audits) in transfer pricing cases could be more efficient[17].

Final thoughts

The OECD, EU and countries like the United States are increasingly indicating that joint or simultaneous tax audits may have a more substantial role to play in the coming years.

Their usefulness thus far, however, has been hampered by limited utilization, with a relatively small number of jurisdictions participating, and with little consistency of approach across them.

But imminent and complex new cross-border tax rules present a concrete opportunity to revitalize this important activity. Companies, too, can do their part to bring the right cases to those tax authorities who have demonstrated openness and capability in this area.

Although things do seem to be moving in the right direction, even significant forward steps such as DAC7 remain vague about taxpayers' rights — including, for example, the right for their views and positions to be better understood before information is exchanged between tax administrations. Taking these rights further into consideration would assist in increasing taxpayers' confidence and trust in such collaborative procedures to the benefit of all stakeholders. And the only way to get from A to B is via practical experience.

So, with careful consideration of the risks and opportunities, coupled with close examination of which tax authorities will truly be the most capable, we encourage taxpayers to consider whether this novel approach to dispute resolution can play a role as we enter such a difficult new period of global tax change.

[16] https://www.oecd.org/en/publications/2022/01/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_57104b3a.html

[17] OECD, "2022 Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations," at para. 4.79

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