MANUAL ON THE IMPLEMENTATION OF EXCHANGE OF INFORMATION PROVISIONS FOR TAX PURPOSES

UNCLASSIFIED

MODULE 9 ON JOINT AUDITS: THE FORUM ON TAX ADMINISTRATION JOINT AUDITS PARTICIPANTS GUIDE

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MODULE ON JOINT AUDITS : THE FTA JOINT AUDITS PARTICIPANTS GUIDE

1. Introduction[1]

1. There has been an unprecedented increase in the mobility of taxpayers and cross-border economic activity. Multinational corporations operate globally; their operations and financial affairs are complex and cross many tax jurisdictions. This environment makes it extremely difficult for any single tax jurisdiction to fully engage with taxpayers operating on a global level.

2. Exercising powers in an international context is considerably more circumscribed for tax administrations than for internationally operating companies, because the direct powers of a tax administration are generally limited by its national borders. Cooperation between tax administrations is required for several reasons. Firstly, it enhances the effectiveness of procedures. Secondly, it helps to ensure that the correct amounts of tax are raised on international business transactions. Thirdly, it serves to prevent and to rectify tax evasion and tax fraud.

3. As a consequence of the globalization of business transactions and a desire to optimize compliance with international and national fiscal rules and regulations, tax administrations aim to intensify, to streamline, and to optimize their exchange of information and to enhance international co-operation. The forms of cooperation between tax administrations may vary from the traditional exchange of information to rendering assistance by tax officers to conducting **tax audits jointly**.

4. In addition to the advantages for tax administrations, joint audits should benefit taxpayers by reducing a taxpayer's expenditures of its administrative resources and time in responding to multiple audits with common factual issues.

5. This guide provides a good practice for the joint audit procedures and the roles of each participant involved, and countries can seek for flexible application of these procedures depending on the circumstance of the case.

6. The chapters are outlined as follows:

   1. Introduction

   2. Preparation

[1] Se also The Report on Joint Audits
http://www.oecd.org/document/2/0,3343,en_2649_37427_46020546_1_1_1_1,00.html
was commissioned by the Forum on Tax Administration (FTA) in October 2009. The report reflects the wealth of experiences held by the thirteen countries on the OECD Study Team: Australia, Canada, Denmark, France, Japan, Korea, Mexico, Netherlands, South Africa, Spain, Turkey, the United Kingdom and the United States. In the past, many of these countries have successfully pursued cooperative activities: simultaneous examinations, bilateral advanced pricing agreements, mutual assistance agreements, etc. The joint audit has the potential to take this cooperation to a new level. Country experiences with other cooperative activities suggest that a joint audit could achieve efficient and effective results if proper planning occurs and processes are well-defined. To that end, the Study Team has prepared a practical, how-to Guide that provides a roadmap for conducting a joint audit process. The joint audit outlined in the Guide is intended not only to boost international tax compliance but also to reduce the administrative burden of conducting audits in multiple jurisdictions.

3. Case Selection

4. Planning Meeting

5. Joint Audit Process

6. Final Stages of Joint Audit

1.1 Definition

7. A joint audit (JA) means an arrangement whereby Participating Countries agree to conduct a coordinated audit of one or more related taxable persons (both legal entities and individuals) where the audit focus has a common or complementary interest and/or transaction. A JA shall include at least two or more Participating Countries.

8. The JA is a fully-coordinated audit from start to finish that is utilized for all compliance activities that can be accommodated through the competent authority process as outlined in the income tax treaties between the Participating Countries and the legal framework that guides the limits of collaboration between the participating parties.

9. The term 'joint audit' as such is not a *legal* term. In tax matters the term "joint audit" has been used *in practice* to express the idea that two or more tax administrations work together. If countries want to carry out a joint audit, it is necessary to determine the legal framework based on which they could co-operate. The basis for co-operation can be found in a network of bilateral and multilateral tax treaties in which mutual assistance is incorporated. The currently available frameworks for conducting tax audits cooperatively are described in chapter 2 of the Joint Audit Report.

10. A ***joint audit*** can be described as two or more countries joining together to form a single audit team to examine an issue(s) / transaction(s) of a company or individual with cross-border business activities, perhaps including cross-border transactions involving related affiliated companies organized in the participating countries, where the taxpayer jointly makes presentations and shares information with the countries, and the team includes Competent Authority representatives from each country who are involved to resolve potential differences/stalemates.

1.2 When to consider a joint audit

11. A JA should be considered when:

- there is an added value compared to the procedures of exchange of information;
- the countries have a common or complementary interest in the fiscal affairs of one or more related taxpayers, and
- in order to obtain a complete picture of a taxpayer's tax liability in reference to some portion of its operations or to a specific transaction, where a domestic audit is not sufficient.

1.3 Objectives

12. The main objectives of joint audits are:

- to reduce taxpayer burden of multiple countries conducting audits of similar interests and/or transactions;

- to improve the case-selection of tax audits by mutual risk identification and analyses;

- to provide as much evidence as possible that the correct and complete income, expense and tax are reported in accordance with national legislation, through efficient and effective administrative cooperation;

- to enhance the awareness of tax officers of the opportunities available in dealing with international tax risks;

- to gain understanding of the differences in legislation and procedures and if necessary to accelerate the Mutual Agreement procedure by early involvement of the Competent Authority, where double taxation is involved;

- to recognise and learn from the different audit methodologies in participating countries;

- to harness the particular strengths and expertise of team members (for example, valuation experts, economists or industry experts) from different administrations for the benefit of the joint audit;

- to identify and improve further areas of collaboration; and

- for all participating countries to reach a joint/mutual agreement on the audit results to avoid double taxation, as applicable.

1.4 Organizing and Managing

13. In conducting a JA, two or more Participating Countries are jointly responsible for organizing and managing the joint audit. The advantages of such joint initiatives are numerous, with the most important being:

- sharing the workload (audit plan, processes, and final reports);

- solving "practical" problems (e.g. urgent translation) more easily; and

- conducting a well-prepared consistent audit, thus enabling better results.

2 Participants of a Joint Audit

2.1 JA participants and their qualifications

14. Each participating country will appoint **one** Joint Audit Coordinator (JAC) to be the country point of contact for coordinating joint audits between Participating Countries.

15. The JAC of each country will assign a JA Team Leader to lead the joint audit process with the auditors. This Team Leader will ensure appropriate consideration of relevant Treaty provisions, including the powers and restrictions applicable to the Competent Authority relating to exchange of information (EOI) and, where relevant, MAP. In particular, the Team Leader will be alert to the legal aspects of confidentiality of taxpayer information and to whom any protective restrictions are applicable.

16. In summary, the JA Team from each participating country will consist of the following members:

1. Joint Audit Coordinator (JAC)
2. Joint Audit Team Leader (JA Team Leader)
3. Auditor(s) – participating country examiners

17. The JAC, the JA Team Leader, and the auditors involved in each participating country should have the proper technical qualifications, practical experience, and expertise in the matter upon which the joint audit is based. For example, in the case of a transfer pricing joint audit, the entire Team should be experienced in the field of transfer pricing. The JA auditors should be prepared to work within an international group of tax auditors. Language skills are not the primary requirement for the participants in the joint audit, as translation can be provided for if needed. It is most important to have tax audit experience, especially experience in the specific field targeted by the joint audit.

2.2 Skills required of the JAC and JA Team Leader

18. In general, the JAC of the initiating participating country will take the **initial** lead and be responsible for the overall management and coordination of the joint audit. This means, in practice, that the JAC ensures that everyone participating in the JA process periodically receives audit status updates (audit progress, minutes of meetings, etc). In addition to tax law and treaty expertise, the JAC should also possess excellent project management, time management, and communication skills, as these are key qualities of an effective JAC.

19. The JA Team Leader shall have similar technical qualifications as the auditors participating in the joint audit. Additionally, he/she must have sufficient project management and good communication skills to lead the auditors and coordinate with the JAC.

2.3 Authority of the JAC and JA Team Leader

20. Sufficient competent authority power will be delegated to the JAC and, if necessary, other members of the team to communicate (i.e. exchange information) under the legal framework of a joint audit.

3 Case Selection

3.1 Domestic Case selection

21. Basic selection of cases for a potential JA takes place within each participating country during the normal domestic audit process. However, countries intending to conduct a joint audit may coordinate with each other at any point during the process of selecting an appropriate case. Participating Countries will typically have tools and risk management programs for case selection. These programs use a wide range of internal and external information regarding taxpayers in order to establish the domestic audit plan.

22. The following indicators may be taken into consideration when selecting potential JA cases.

- Information available in two or more jurisdictions provides a better basis for risk analysis than independent risk analysis.
- Two or more jurisdictions are auditing similar or related transactions of their respective taxpayers.

- Two or more jurisdictions have difficulty understanding similar or related transactions of a multi-national enterprise that uses complex structured transactions and multiple entities with unnecessary complexity.

- A multinational wants greater certainty and an enhanced relationship with tax administrations on a global basis.

- A taxpayer has a non-compliance history.

- There are transactions in low tax/no tax jurisdictions.

- There are risks connected to specific business sectors (industry).

- A taxpayer shifts profits from one country to another by use of aggressive transfer pricing methods.

- Substance of a transaction is not consistent with the transaction's legal form.

- There are cross-border transactions reflected in loans, accounts payable/receivables, inventory, etc.

- Two or more jurisdictions agree that a joint audit would expedite factual development and issue resolution.

- There are losses in withholding taxes in connection with cross-border transactions.

- There is no activity for many years followed by a sudden start of business operations.

- There is fraudulent behaviour of the owners or managers of the company.

- There are indications that companies do not record all profits or turnovers realized in other Participating Countries.

3.2 How to Initiate a Joint Audit

23. Each country should designate an official (i.e., the JAC) to coordinate its JA activities. The JAC is the first contact point for JA activities. The selection of a potential JA case may be initiated within any participating country. When a participating country, during their internal risk assessment and/or examination of a domestic audit, identifies a need to further examine issues with complex or questionable cross-border transactions (e.g., involving tax evasion or fraud, withholding taxes, transfer pricing issues, use of low tax/no tax jurisdictions, etc), an **informal** (draft) JA proposal should be completed and provided to the JAC.

24. The JAC will then appoint a prospective JA Team Leader and conduct a risk assessment with the JA Team Leader and auditors to determine whether a JA will improve issue development and resolution. If it is determined that a joint audit would be an effective resolution, a **formal** JA proposal will be prepared for submission to the JAC of another participating country.

25. In general, the internal procedures in each participating country for proposing and initiating a case for a JA should be made as clear and simple as possible, in order to avoid delays.

26. Annex 2 provides a template for a JA proposal.

3.3 JAC Case Selection meeting

27. The **formal** JA proposal will be presented and discussed by the Initiating JAC. There may be preliminary discussions about the JA proposal with each participating country.

28. A case selection meeting will be convened by the Initiating JAC with the JAC(s) of other Participating Countries to determine if there is shared interest in conducting a JA based on the formal proposal. An agenda for this meeting will be prepared by the Initiating JAC. Consideration of whether a JA is in their best interest includes whether similar years are undergoing risk assessment or are under audit, whether both countries share concerns with specific cross-border transaction(s), and whether other logistical & resource challenges may be overcome (language; personnel availability; travel budget availability; etc).

29. If the JACs decide to conduct a joint audit, each JAC will jointly coordinate and be responsible for commencing the examination as soon as possible to insure timely issue development and resolution. A date will be scheduled for the JA Planning Meeting.

4 Joint Audit Planning Meeting

4.1 How to prepare for the JA Planning meeting

30. The JAC of the Initiating Country will initiate the JA planning meeting with the JAC of the participating country. Location of the JA planning meeting will be determined and agreed upon at the Case Selection meeting. The invitation should include the draft agenda and draft audit plan to be discussed. Prior to the planning meeting, it is important that all the information related to the specific transaction of the taxpayers has been collected, to the maximum extent possible. It is also necessary that a thorough review of each jurisdiction's legal framework be completed and discussed with all participating countries. All legal impediments must be recognized and addressed during the meeting.

31. The preliminary information collection should include the following:

- collection and review of relevant internal and external information available on the taxpayers targeted by the proposed joint audit: fiscal history, compliance information, previous audits, registration history, ownership, structure, review of tax returns and financial statements, information from other sources (internet, newspapers etc.), previous cases and correspondence, sector and branch information;

- identification of the relevant tax problems and risk areas; and

- identification of any criminal activity and/or ongoing investigations.

32. It is important to have a clear picture on the corporate structure of the taxpayer. Each participating country should prepare a brief presentation for the planning meeting based on the information gathered about its own taxpayers. This information should be communicated to the participating JAC before the planning meeting.

4.2 Purpose of the JA Planning meeting

33. The purpose of the JA planning meeting is to discuss and develop the JA plan by exchanging further information on the taxpayers in order to get a global picture of the case and to discuss the overall

approach and strategy of the proposed JA. The planning meeting is very important for the smooth operation of the joint audit. The draft agenda of the meeting should include at least the following topics: sharing relevant information during the pre-audit phase in each participating country, discussion and agreement on the audit process, and agreement on the JA plan.

34. The initiating JAC is responsible for preparing the minutes of the planning meeting. It is advisable to complete the meeting minutes as soon as possible after the meeting.

35. It is advised that each participating country prepare meeting minutes. This allows a cross-check against the official minutes of the meeting. Since there are cultural differences and tax differences in methods and procedures in each participating country, it is necessary to clarify and conclude in writing all discussions agreed upon at the planning meeting.

36. If the initial case selection meeting included discussions of the audit plan and an agreement was reached, a planning meeting may not be necessary.

4.3 Joint Audit plan

37. It is imperative to discuss and agree on the JA audit plan at the planning meeting. The JACs will consider the taxpayer's input when completing the JA plan in order to ensure an efficient joint audit is conducted.

38. The audit plan should include, at a minimum, the following information:

- JA Objectives (e.g. identification of any specific hoped-for results of the JA beyond ensuring compliance of the subject taxpayer(s) with their tax obligations[2]);
- audit areas and audit information to be jointly collected from the taxpayer and exchanged;
- scope of the audit (tax periods, taxpayers, transactions, etc);
- timeline of the audit steps, due dates, and anticipated final report;
- agreement on the communication and exchange of information during the JA;
- responsibilities and tasks of each JA participant;
- contact information of all JA Team members; and
- identification of an agreed-upon escalation procedure for unforeseen circumstances.

4.3.1 The time schedule of the JA

39. During the planning meeting, the participants will agree on the time schedule for the JA, which includes, when possible, joint information requests, joint communication guidelines, status meeting guidelines, audit conclusion, and final meetings. Since one general purpose of the JA is to reduce taxpayer burden in a timely manner, it is anticipated that a joint audit should be completed within 12-18 months of the start date. However, this suggested time span could be exceeded due to the taxpayer or the participating country.

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2 See Section 1.3 Objectives.

4.3.2 Communication matters

40. It is important that the JA Teams from each participating country work jointly to keep the audit process moving effectively and efficiently. Taxpayers should be able to communicate jointly with the JA Teams to reduce time and duplication. It should be agreed in the planning meeting (and recorded in the minutes) that a schedule for regular check-ins be established at the beginning of the planning, that communication is important in all stages of the JA process, especially in reference to:

- audit status;
- taxpayer meetings (re: audit plan, procedures, requests, progress, etc.);
- discovery of new taxpayer information; and
- information needed from a participating country.

41. The JACs of each participating country should be aware of the JA progress at all times. This can be accomplished by email, status reports, facsimile, phone, etc as prepared and provided by each JA Team Leader to the JAC.

4.4 Agreement of the JA Plan

42. The JA plan will be considered 'agreed' upon when it is signed and dated by each JAC and its Competent Authority. The JA plan must be signed in order for the joint audit to begin.

5 The Joint Audit Process

5.1 Introduction

43. The JA Teams may begin the JA based on the JA audit plan. The location of the joint audit will be flexible based on the circumstances surrounding the taxpayer's situation. The costs associated with conducting a joint audit will be borne by each participating country. An orientation regarding the JA process may be conducted by any/all Participating Countries, as deemed necessary, to familiarize the JA Teams on steps of the JA process.

44. The success of the JA relies on a good audit plan and communication between the JA Teams of the Participating Countries and the affiliated taxpayers. It is important that auditors should always keep their JAC informed about the progress of the audit and contact the JAC immediately if any problems occur.

5.2 Audit structure

45. It is necessary that the JA Teams follow all the proper steps in the audit process. In general, the steps to follow during the auditing process can be defined as follows:

1) risk assessment;

2) audit planning;

3) audit performance; and

4) conclusion.

5.2.1 Risk Assessment

46. The preliminary risk assessment done by the auditors before the start of the domestic audit has a significant influence on the audit process. Comprehensive and correct preliminary work is of great assistance in setting up the audit plan and carrying out audit actions.

47. Usually auditors collect all available information about targeted taxpayers from different internal and external sources, including results from risk analyses, before the planning meeting. In the planning meeting, the JA Team(s) should evaluate and update the gathered information taking into account the information obtained from each other.

5.2.2 Planning

48. Based on the agreed-upon JA plan, the JA Team members will ensure that all essential areas, transactions, and taxes are identified and that the audit is carried out in a timely and efficient manner. The audit plan must be sufficiently flexible to allow for changes during the audit process resulting from the information forwarded by other Participating Countries or from the taxpayer.

5.2.3 Audit Performance

49. In this stage, the JA Team jointly requests and gathers audit information. It is vital to remember when performing the JA, that the audit shall be carried out according to the domestic legislation applicable within each participating country. The JA Team(s) must choose audit techniques that enable them to collect all necessary information in the fastest and most efficient way to achieve the audit objectives. It should be noted that although different audit techniques are utilized by Participating Countries, the JA Teams from all Participating Countries should make their best effort to agree on an audit technique sufficient to meet the audit objectives.

50. In today's auditing environment, the use of computer equipment is common practice. When using computer-assisted audit tools, it is recommended that in order to optimize their effective and efficient use, the Participating Countries should agree upon a common approach at the beginning of the joint audit. Furthermore, when possible, the JA Teams should utilize the most cost-efficient methods of communication in performing a JA.

5.2.3.1 Communication during the audit

51. The efficient flow of information is vital for a successful joint audit. The JA Teams should keep the taxpayer periodically informed of the audit status. Meetings with the taxpayer should be scheduled as deemed necessary. Depending on domestic law of the participating country and the circumstances of the case, taxpayer's acceptance in the various steps may be the key elements for conducting and concluding the JA.

52. It is good practice for the initiating JAC to maintain regular contact with the participating JAC(s) to ensure that the JA Teams are progressing well and the time schedule is respected. Throughout the JA, the JA Teams should have continuous contact with each other. Information may be exchanged, in accordance with Treaty provisions, through a variety of means (e-mail, phone, face-to-face, etc) as agreed at the planning meeting. It is advisable to strive for "dialogue" between participating auditors in order to exchange information more efficiently and to prevent misunderstandings. This can be achieved by delegating the JA Team Leader the power to act as the Competent Authority, giving him/her the opportunity to exchange information efficiently.

5.2.3.2 Audit Progress Reports

53. The JA Team Leader should request periodic interim audit progress reports (e.g., monthly) from the auditors of the Participating Countries about the actions taken and information collected. These status reports and their frequency should be agreed upon in the planning meeting and included in the JA plan.

5.2.3.3 Escalation Procedure for unforeseen circumstances or potential divergences from the JA Plan

54. Audit practice experience indicates that differences and difficulties may arise during a JA. It is advisable for each participating country to agree to an Escalation Procedure to allow for bringing in Senior Officials should the need arise. This procedure should be determined and agreed-upon during the planning process.

6 The Final Stages of the Joint Audit

6.1. Introduction

55. The final stages of a JA are the production of the final audit reports, the final meeting with the taxpayer, and the JA Agreement. The final meeting with the taxpayer is after the JA Teams from the Participating Countries have met, discussed, and finalized their prospective audit reports.

6.2 When to consider concluding a JA

56. The decision to conclude a JA, including discontinuing the JA, is determined jointly by the JACs of the Participating Countries.

6.3 Final meeting of JA Teams

57. The preparatory process for the final meeting is similar to the process for the planning meeting, but the main points for discussion are the conclusion of the JA and the drafting of the final audit report(s).

58. Each JA Team will discuss the JA and its audit report. The JACs will reach a concurrence to finalize the JA with a final meeting with the taxpayer to present the audit reports.

6.4 Final Audit report(s)

59. The final audit report(s) will be presented by each participating country to the taxpayer in a Closing Meeting with the taxpayer. The audit report(s) will inform the taxpayer of any tax liabilities/refunds due as a result of the joint audit. Each transaction reviewed will be explained in detail by stating the issue, audit procedures, tax law, and conclusion.

60. It is recommended that the final reports be drafted as the JA progresses, utilizing the information obtained throughout the audit. This will significantly reduce the pressure and time during the final stages of the audit.

6.5 Final Closing Meeting with the Taxpayer

61. The final Closing Meeting with the taxpayer will provide an overview and analysis of the joint audit. The objective of the meeting is to:

- review and analyze if the audit objectives as outlined in the audit were met;
- evaluate whether the time schedule was respected;

- evaluate administrative cooperation (quality, timing of information exchanged);
- measure project management and coordination;
- review the final audit report(s) of the JA Teams; and
- conclude the JA Agreement.

6.6 Final Joint Audit Agreement

62. A Joint Audit Agreement or other memorialisation, such as an exchange of letters between the Participating Countries, will be prepared. The JA Agreement, or other appropriate memorialisation, e.g., "exchange of letters", as is typically done in MAP cases, will be signed and dated by the Competent Authority of each participating country. This signed agreement (or exchange of letters) concludes the JA process.

ANNEX 1 STEPS OF A JOINT AUDIT

The preparation process:

- assess potential audit considerations
- determine JA Team

The case selection process:

- identify potential joint audit by participating country
- submit an informal JA proposal to the JAC for review and revision
- initiating JAC presents formal JA proposal to other JACs in a formal case selection meeting
- initiating JAC sends invitation for the planning meeting to the JAC(s) of the other participating country
- each JAC gathers taxpayer information and prepares for the planning meeting

The planning meeting:

- draft agenda and draft audit plan prepared by initiating JAC
- review and revise the joint audit plan
- obtain signatures on JA plan prior to beginning audit

The auditing process:

- joint information requests and examination
- joint meetings with taxpayer
- exchange of information as deemed relevant and necessary
- status updates as mandated in audit plan

The final stages of the JA

- preparation for the final meetings
- preparation of final audit report by each participating country
- draft/final of the JA Agreement prepared by the initiating JAC (or exchange of memorializing letters by the JACs)
- obtain signatures as required

ANNEX 2 JOINT AUDIT PROPOSAL

A written JA proposal must be submitted by a participating country to its JAC in order to initiate internal discussions for a potential joint audit. The JA proposal is not bound to a format.[3] It should however contain enough information for the JAC to initiate preliminary discussions with the other JAC regarding the case selection and the benefit of conducting a joint audit. A JA proposal should contain, at a minimum, the following information:

Proposal for a Joint Audit

Taxpayer Name and Address:

Taxpayer Identification #:

Taxpayer's business sector and activities:

Reason for joint audit selection: (include risk analysis)

Audit plan: (audit period, transaction, time schedule, tasks, etc.)

Other Participating Country (country, name and address of related taxpayers)

Previous exchange of information, if any: (reference numbers, date)

Any other relevant information:

[3] The general format for the sample Proposal for a Joint Audit below is based on a similar sample template in the European Commission's Multilateral Guide for Auditors.