

Fiscal Risk Minimization Tools, Transfer Pricing Associated

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Abstract

Given the conditions of transparency amplification by introducing supplementary reports on the activity of sub holding companies, fiscal administrations grow to be more and more interested in the national budget income increase, therefore intensifying controls mainly in transfer pricing.

Documenting this research with the existing literature in the field, through the processing and interpretation of statistical data or data comparative analysis, we recommend the following, for companies transacting with sub holding companies: transfer pricing file preparation while respecting in-force legal regulations and the use of some instruments that should lead to fiscal risk minimization in transfer pricing. These instruments are the in-advance price agreement or the anticipated individualized fiscal solution.

If control authorities have settled measures, they have come to a dispute, or the companies consider double taxation, they may resort to the mutual agreement procedure or arbitration, to the fiscal appeal or a litigation proceed to the national courts of justice.

Key words: transfer pricing, advance pricing agreement (APA), anticipated individualized fiscal solution (AIFS), mutual agreement procedure, fiscal appeal.

J.E.L. classification: G3, H2, H3.

1. Introduction

While fiscal administrations have intensified controls in the field of transfer pricing, companies involved in transactions with sub holding companies must be more and more prepared to face fiscal inspection in this field, in order to avoid the eventual measures suggested by authorities, or disputes with these caused by lacunae in legislation, various interpretations in law, determined by the level of education and experience of the staff involved in the control process.

In this sense, in the year 2020, through the PFM Order no. 3281/2020, the informative statement 394 has been modified – concerning the delivery/service providing and acquisitions performed on the national territory by VAT registered taxpayers, by reporting, in the form, transactions with sub holding entities from the reporting period (PFMO 3281, 2020). The modified format of the statement comes in the aid of fiscal authorities to whom it is easier to identify taxpayers that develop transactions with sub holding parties and who might be selected for an eventual fiscal inspection.

Through the *Plan of Actions for the implementation of the National Reform Program 2020 (PNR)* and *Country Specific Recommendations 2020 (RST)*, the Romanian Government, in July 2020, has suggested a series of measures in transfer pricing matters in the responsibility of the National Fiscal Administration Authority (ANAF), presented below:

Table no. 1 Impact measures in the field of transfer pricing

Measure	Content and stages	Starting period (quarter/year)	Dead-end of implementation (quarter/year)	Performance indicators
1. Prevention and fight against fiscal evasion	The measure targets: -the initiation of fiscal inspections in agreement to BEPS plan (Base Erosion Profit Shifting) and ATAD directive; -the extension and improvement of electronic control techniques (by implementing a standard international audit file for all economic entities: SAF-T); -the development of an electronic system monitoring intra-community transactions (ESMICT).	I/2020	II/2022	-fiscal risk identified in the case of taxpayers, transfer pricing associated; -approved mutual agreement; -SAF-T implemented electronic system; -implemented electronic system monitoring intra-community transactions.
2. Increase in voluntary compliance in the field of transfer pricing	The measure aims to improve the fiscal inspection staff administrative and professional capacity and dealing with transfer pricing controls and intends to intensify the fiscal inspectors' training in transfer pricing matters, the public promotion of possibilities to issue advance pricing agreements and anticipated individualized fiscal solutions as well as scheduling meetings to assist taxpayers on transfer-pricing topics.	I/2020	IV/2021	- no. of fiscal inspectors trained in transfer pricing matters; - taxpayers are assisted on transfer pricing in a no of meetings.
3. Improving risk analysis in the field of transfer pricing	The measure consists of: - issuing some work procedures that should lead to the improvement of means in taxpayers' fiscal risk identification, associated to transfer pricing; - drawing a methodology to identify suspect transactions between sub holding entities and performing the control of transfer pricing documentation; - national wide identification of sub holding entities, the inventory of suspicious transactions in the field of transfer pricing and taxpayers' notification with a view to correcting fiscal statements.	I/2020	IV/2021	-supplementary amounts established as a result of fiscal inspections having as selection criteria transfer pricing risk analysis; -the total number of fiscal inspection actions having as topic transfer pricing;

Source: (The plan of actions for implementing PNR and RST 2020)

Within the context of prior presentations, in order to reduce the fiscal risk associated to transfer pricing, contributors may resort to types of actions, namely, proactive and reactive (Gheorghiu, 2020).

Section 2 of the paper presents **proactive instruments**, having the role to anticipate problems and changes, preparing the taxpayer for what might follow. We include in this category:

- Resorting to advance pricing agreement (APA);
- Resorting to the anticipated, individualized fiscal solution (AIFS);
- The identification of transactions with sub holding entities and help given to draw and update the transfer pricing file their corresponding documentation by drawing and updating the transfer pricing file.

In Section 3 of the paper we present **reactive instruments**, that turn up as a result of a fiscal inspection action, namely when measures were taken, or they have come to a dispute with control authorities, or the companies consider double taxation. In this category we include:

- Applying for the mutual agreement procedure and arbitration;
- Fiscal appeal;
- A litigation proceed in the national courts of justice;

Section 4 of the paper comes with the conclusions of this research, highlighting the idea of using APA or AIFS as fiscal risk covering instruments used by companies carrying out transactions with sub holding companies. Another conclusion of this research refers to applying for the mutual agreement procedure, respectively resorting to a fiscal appeal or ultimately, initiating a litigation in the national courts of justice, in situations in which control authorities have established measures or they have gone into a dispute with these, or the companies consider double taxation.

2. Theoretical background

Transfer pricing is about a set of laws and practices through which the States ensure themselves that the profit resulted from transactions between the parties of the same group with their goods, services, intellectual property rights, and assets is registered and deposited where locally obtained. This is a very important aspect, given the conditions in which transfer pricing may determine the group's profit increase in States with diminished fiscality or, on the contrary, they may reduce profit, where fiscality is increased.

According to law, transactions between sub-holding parties must be concluded at the **market price**, in other words, at the price a similar transaction between independent parties had been concluded, given comparable economic conditions. If the transaction price between sub-holding entities is not within the **market interval**, one may consider that the profit obtained by parties as transaction result is not correctly reflected, therefore affecting paid taxes and fees.

According to the **arm's length principle**, when established or imposed conditions for trading or financial relationships between two sub-holding entities are different from the ones existing between independent entities, any profit that would have been obtained by one of the parties while the respective conditions are lacking may be considered the profit of that entity and taxed accordingly.

In order to cut down on the fiscal risk associated to transfer pricing, companies may appeal to the in-advance price agreement (APA), and the anticipated individualized fiscal solution (AIFS). If measures are established or taxpayers go into dispute with the control authorities, the solution is the amicable settlement and arbitration, the fiscal appeal or a litigation proceed at the national courts of justice.

3. Research methodology

The conclusions of this study are based on the existing literature in the field, on the processing and data interpretation through data comparative analysis.

4. Proactive Instruments of Fiscal Risk Minimization, Transfer Pricing Associated

Further on, we will analyse, among proactive actions, APA and AIFS, in detail.

According to the study globally performed by Ernst and Young - *Transfer Pricing and International Tax Survey 2019* (Ernst and Young, 2019), within which more than 700 people in leading positions, in fiscal and transfer pricing, were interviewed, an increase in the interest of using advance pricing agreements is to be noticed, as an instrument to prevent some dissensions with fiscal authorities in transfer pricing matters. As the information presented below shows, 43% of the company representatives have mentioned they would use in future the in-advance price agreement.

Figure no. 1. Tendencies for using APA



Source: (Ernst and Young, 2019)

4.1. Advance Pricing Agreement (APA) is defined by Law no. 207/2015 on the Fiscal Procedure Code as being the administrative document issued by the National Fiscal Administration Authority (ANAF), with a view to solving a taxpayer's request about establishing conditions and means that are about to determine transfer pricing along a fix period, in the case of transactions performed with sub holding entities, the way they are defined in the Fiscal Code. The main APA characteristics are the following:

It is the document through which the taxpayer obtains the guarantee that fiscal authorities will accept the methodology to determine transfer pricing chosen by these;

- It is opposable to the fiscal authorities.

As in-force regulations stipulate, APA can be issued for any kind of transaction, as follows: funding within the group, procurement of goods, service-providing, sales (Tache, Luca, 2019). Taking into consideration the expenses with issuing APA, namely, 20.000 EUR for large taxpaying entities and 10.000 EUR for the rest of taxpayers and the fact that APA covers a unique intra-group transaction with a single sub holding party of the applicant, there is a need to perform a cost analysis in comparison to obtained benefits. It is recommended that transactions for which APA is requested should have coherence and have important values in order to justify the request opportunity.

ANAF Order no. 3735/2015, that approves on the issue and amendment of the in-advance price agreement, as well as the on content of the issue request and modification of the in-advance advance price agreement (ANAF Order no. 3735/2015) regulates the procedure of issuing APA.

APA is used to approve the methodology through which it establishes transfer pricing in the case of in-advance intra-group transactions on an initial period of up to 5 years, with the possibility of subsequent extension. Longer term agreements may be issued, given the situation of long-term agreements. Annually, the taxpayer that benefits from APA must prove the observance of the terms settled in the agreement by preparing and submitting an annual compliance agreement.

The agreement may be unilateral – concluded with the fiscal authority in Romania, mutual or multilateral – with the involvement of two or more fiscal authorities. By concluding a mutual or multilateral settlement, the risk to double tax or double non-tax is avoided.

The in-advance price agreement is favourable by the following:

- success in the protection of the eventual measures related to transfer pricing for transactions covered by APA;
- allows increased adaptability in setting the pay for the performed transactions within the group, such as: production and distribution transactions, service-providing, financial agreements etc.;

- the period in time in which it might be obtained is generally diminished (for unilateral APA to 12 months, respectively, for mutual or multilateral APA to 18 months), comparatively with the period that might need the transfer pricing analysis performed by the authorities as a result of some litigations;

- for transactions covered by APA the transfer pricing file is not necessary, and that would diminish the company’s efforts on a long term;

- it correctly determines the company’s fiscal liabilities, which implicitly leads to cost prevention in the case of a financial control in the field of transfer pricing.

On basis of OECD recommendations in EU, the in-advance price agreement may be applied on periods previous to the moment of application, given that certain conditions are respected, a procedure known under the name of roll-back APA. At present, in Romania, there is no possibility to use the same APA for periods prior to the one that represents the object of APA. In the near future, we expect a local legislation within the range of OECD recommendations.

The applying procedure and the documentation to be drawn by a taxpayer applying for the issue of the in-advance price agreement are provided in Law no. 207 of 2015 concerning the Fiscal Procedure Code. The issuing procedure is initiated by the taxpayer by submitting an application that may be preceded, if the taxpayer requires it, by a preliminary discussion with the fiscal authority.

The documentation to be submitted in order to obtain APA may comprise the following information:

- ✓ Organization structure of the group, describing in general the group activity;
- ✓ A methodology description that would implement and allow applying for transfer pricing (if the case) and the general presentation of transactions between the sub holding entities;
- ✓ The analysis of functions, risks and assets within the group;
- ✓ A detailed presentation of transactions to be covered by APA and of parties involved in transactions;
- ✓ A comparative analysis;
- ✓ An information presentation on external or internal comparable transactions;
- ✓ Critical assumptions that might affect the transaction’s transfer pricing;
- ✓ Authorities from abroad requested to participate in issuing the agreement;
- ✓ A description of proposed transfer pricing methodology;
- ✓ The period to be covered by agreement;
- ✓ The description of other relevant conditions for the taxpayer;
- ✓ Declaration on honour regarding the information correctness and that there is no fiscal, administrative or judicial procedure on for the transaction which is APA subject;

4.2. The Anticipated Individualized Fiscal Solution (AIFS) is defined by Law no. 207/2015 on the Fiscal Procedure Code as the administrative document issued by the central fiscal entity in order to solve a request of the company and which regulates future fiscal reports. AIFS is required in cases in which a taxpayer encounters difficulty in the interpretation of fiscal legislation, this representing a definite answer from the fiscal authorities, being opposable and mandatory. AIFS issuing procedure was regulated by ANAF Order no. 3736/2015 in order to approve the Procedure on issuing the anticipated individualized fiscal solution and the application for the issue of the anticipated individualized fiscal solution (ANAF Order no. 3736/2015).

The main AIFS characteristics are the following:

1. It targets a future state of facts, it is issued for every future factual fiscal report and for each fiscal liability. The fiscal treatment established by AIFS is applicable starting with the future operation whose regulation was requested.

2. It does not regulate a future fiscal report which is the object of other administrative documents, such as the fiscal inspection report.

3. The application form, attached to AIFS issuing documents, contains a documentation content request, respectively, “*information and data briefing requested within the application form for the issuing of a fiscal solution that makes the object or might lead to commercial, industrial and/or professional secret disclosure*”, and is meant to protect this information and data.

4. AIFS issuing application form might be rejected by the authorities in cases specified by ANAF Order no. 3736/2015, which also states the situation in which “*the case in discussion makes the object*

of Penal investigation, including facts of fiscal evasion and is related to the applicant taxpayer”.

5. AIFS project is sent to the taxpayer who may express his point of view within 60 working days.

6. There might exist the procedure of fiscal information exchange with the fiscal administrations of the States involved in a possible cross-border transaction, when the fiscal authorities find that the transaction which is AIFS subject might be an artificial cross-border transaction.

7. If the taxpayer does not agree with the issued AIFS, he might send, within 30 days' time “from the communication, a notification to the issuing fiscal authority”, AIFS not producing therefore any judicial effect.

8. Expenses established by ANAF for AIFS issuing are 5000 euro for large taxpaying entities and 3000 EUR for the other taxpaying categories.

5. Reactive Instruments for Fiscal Risk Minimization, Transfer Pricing Associated

The multinational companies' double taxation imposes reactive actions from the part of those involved. It comes up in cases in which control authorities from another state establish measures in relation to transfer pricing for transactions with non-resident sub-holding entities. Further on, we are going to present taxpayers' best-known - transfer pricing - reactive actions:

5.1. The Mutual Agreement Procedure – MAP is a resolution instrument used by taxpayers in double taxation caused by transfer pricing measures taken by the fiscal authorities. At present, the national legislation regulates two manners of developing the mutual agreement procedure:

- the mutual agreement procedure initiated on basis of conventions that avoid double taxation, concluded between Romania and other States;

- the mutual agreement procedure developed under the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC) - the Arbitration Convention, applicable only to the Member States of the European Union.

The procedure allows competent authorities from the States involved to communicate with one another and supposes a negotiation process. The taxpayer is the one that must draw the documentation needed for the initiation of a mutual agreement procedure (Gavriliu, Botez, 2019).

In practice, legislation uses the procedures of:

- The Fiscal Procedure Code;
- Conventions that would eliminate double taxation, concluded between Romania and other States;
- Directive lines on transfer pricing issued by the Organisation for Economic Cooperation and Development for multinational companies and fiscal administrations, with its amendments and subsequent completions;
- The Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (The Arbitration Convention);
- Revised Code of Conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (2009/C 322/01)
- Manual on Effective Implementation of the Mutual Agreement Procedure – MEMAP, issued by the Organisation for Economic Cooperation and Development.

Romania has adopted Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union. This directive was implemented in the national legislation through G.O. no.19/2019 for the amendment and completion of Law no. 207/2015 on the Fiscal Procedure Code.

The main advantages given by the mutual agreement procedure on the elimination of double taxation are:

- ✓ It can be initiated in parallel with the development of administrative and judicial fiscal procedures;
- ✓ It supposes cooperation between the fiscal authorities and taxpayers subject to the decision, being a process characterized by transparency and objectivity;
- ✓ Concluded agreements will be put into application, no matter the prescription period provided by the internal legislation of Contracting States;

✓ It represents a means of action used by the taxpayers who consider themselves wronged by the fiscal authority decision.

The procedure for the elimination of double taxation between Romanian sub holding entities, according to the Fiscal Procedure Code, supposes the following aspects:

1. The adjustment/estimation of one of the subs’ revenue or expense, performed by the competent fiscal authority for the administration of receivables due by the respective entity, it is opposable to the fiscal authority for the administration of the other’s sub holding entity receivables.

2. The adjustment or estimation decision is communicated to the other Romanian sub, as well as to the competent fiscal authority and is opposable to the fiscal authority only if the other Romanian sub holding party has performed the corrections that would lead to avoiding double taxation.

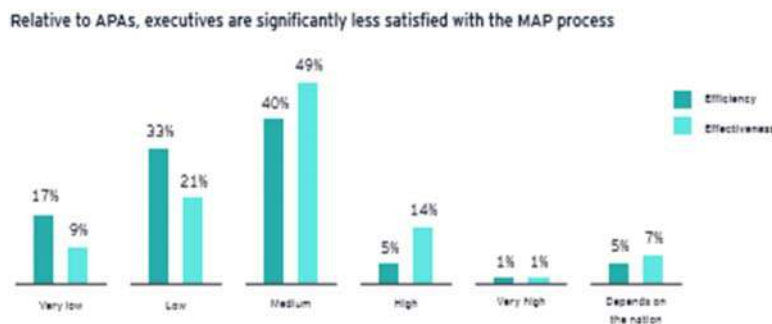
3. The other sub holding entity may correct the adjustment or estimation decision by submitting the tax return statement for the tax period when the respective transaction was carried out.

In the development of the mutual agreement procedure for the elimination/avoidance of double taxation on basis of (EU) 2017/1852 Council Directive on tax dispute resolution mechanisms in the European Union, the following steps are important to go through:

1. It is performed at a taxpayer’s request when affected by double taxation.
2. It is exclusively initiated by the taxpayer and not by the fiscal administrations generating the double taxation, withing three years from communicating the tax return statement.
3. The Romanian State may choose to solve the dispute unilaterally (1 – 1,5 years).
4. Member States in question are to reach an agreement for the elimination of double taxation, via mutual agreement, by identifying the right taxation level in both States (2-3 years).
5. If double taxation is not solved, the dispute is concluded by a consultative commission, namely by arbitration (3-4 years).

According to the study performed by Ernst and Young - *Transfer Pricing and International Tax Survey 2019* (EY, 2019), there is to be noted a respondents’ dissatisfaction, as well as that of fiscality and transfer pricing managers with regard to MAP (mutual agreement procedure), and the statistics is graphically presented below:

Figure no. 2. Degree of satisfaction evolution on the mutual agreement procedure



Sursa: (Ernst and Young, 2019)

5.2. The Fiscal Appeal is an administrative remedy at law and it does not remove the statute of limitations of the entity considering itself injured in rights by a fiscal administrative document. It is regulated by Law no. 207/2015 on the Fiscal Procedure Code.

The fiscal appeal shall be lodged within 45 days from communicating the fiscal administrative document. If the fiscal administrative document does not mention: the possibility to appeal, the appeal’s lodging term and the fiscal authority to lodge the appeal to, the lodging term is of 3 months from communicating the fiscal administrative document and the addressee is the fiscal authority who issued the administrative document subject to appeal.

Those responsible with analysing and solving the appeal are the fiscal inspection authorities who drew the fiscal administrative document subject to appeal, which must consider the information, documents and new arguments brought to the case.

Appeals are solved by competent authorities in matters of appeal.

According to law, any taxpayer lodging for an appeal has the right to withdraw complaint any time before it is being solved, without losing the right to lodge a new appeal while respecting the legal lodging terms.

According to the Fiscal Procedure Code, decisions issued in solving appeals, together with fiscal administrative documents they refer to, may be attacked, by the appellant or by people mentioned in the appeal solving procedure, to the competent administrative and fiscal court, given the law conditions.

5.3. A Litigation Proceed in the National Courts of Justice represents another means to solve disputes on transfer pricing and their specific double taxation.

In support of these statements we have data provided by Ernst and Young’s study - *Transfer Pricing and International Tax Survey 2019* (EY, 2019), who show “a more increased degree of satisfaction in the case of respondents” concerning the experience of domestic fiscal litigations in comparison to the mutual agreement procedure. According to the study, 21% of companies have filed to the court of justice during the last 3 years on transfer pricing. From these, 25% were satisfied with the litigation sentence, while 42% of respondents declared themselves dissatisfied with the result.

6. Conclusions

To conclude with, it is important that companies performing transactions with sub holding entities, potential beneficiaries of APA or AIFS, should perform an analysis of the type cost-benefit, while scaling expenses they have with their issuing vs fiscal risks they have in this case. About costs, both pecuniary ones, respectively, issuing tariffs, and the ones with the staff involved in preparing and providing information and data must be analysed. Given the conditions of a legislation continuously at change, if estimated costs are smaller than the estimated fiscal risk, then, we recommend the use of these instruments that cover fiscal risks to companies that perform transactions with sub holding entities.

As a result of fiscal inspections, when measures were established or disputes with control authorities have arisen, or the companies consider double taxation, companies may access the mutual agreement procedure and arbitration, they may resort to a fiscal appeal or ultimately to proceed with a litigation in the national courts of justice.

The mutual agreement procedure incorporation by internal regulations has the role to stimulate local taxpayers that would like to initiate an amicable settlement for the solving of double taxation caused by transfer pricing adjustments.

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